tabular presentation of fees and expenses from all sources, setting forth how the break-even point for the pool is calculated (''break-even analysis''). Where specific components of the break-even analysis are not available or are not subject to precise determination, good faith estimates should be made, based on reasonable assumptions properly disclosed. As noted above, the ''break-even point'' for the pool is required by Rule 4.24(d)(5) and 4.10(j) to be set forth as a separate item in the forepart of the Disclosure Document, immediately following the table of contents, and must be expressed both as a dollar amount and as a percentage of the minimum unit of initial investment. The break-even analysis provides an explanation, in tabular form, of how the break-even point is calculated, taking into account all fees, expenses and commissions applicable to the pool. Rule 4.10(j) requires that the break-even point be prepared in accordance with rules promulgated by a registered futures association pursuant to section 17(j) of the Act. As noted above, NFA has adopted (and the Commission has approved) an Interpretive Notice to accompany NFA Compliance Rule 2–13, setting forth how a break-even point must be calculated and the format in which such calculation must be disclosed.

The Commission is clarifying that the break-even point must represent the trading profit the pool must realize in the first year of an investor's participation in order for the investor to recoup his initial investment, and Rule 4.10(j) as adopted so states. Revision of the break-even point is required for ongoing pool offerings whenever the Disclosure Document is amended or updated. Of course, if the actual break-even point becomes materially different from that which appears in the Disclosure Document, amendment is required.

As proposed and as adopted, Rules 4.24(i) and 4.34(i) require disclosure of fees and expenses expected to be incurred in the current fiscal year, including estimated figures if actual amounts cannot be determined. The Commission believes that reliance solely upon the prior year's actual fees and expenses may be misleading, especially if the CPO has reason to anticipate changes in investment strategies or advisors or market conditions. With respect to fees and expenses borne entirely by the CPO or the CTA, disclosure should not be necessary unless the compensation paid by the pool or account to the CPO or CTA is increased as a result. Of course, disclosure is required if such fees and expenses are subsequently charged to the pool or account.

Where a fee or expense item is variable or otherwise difficult to determine (*e.g.*, in the case of a multi-advisor pool rapidly substituting and re-allocating among numerous advisors), the narrative discussion required by Rule 4.24(i) must indicate a range based upon the CPO's advisor selection criteria, investment objectives and other business practices. For purposes of the break-even analysis, however, a good faith estimate should be used, as discussed above, and the assumptions for such estimate disclosed. This situation illustrates the benefit of requiring both the break-even analysis and the narrative discussion.

The Commission believes that the revised fee and expense disclosure requirements better codify disclosures required under the former rules, that the break-even analysis makes such disclosures more understandable, and that the revised requirements will better assist readers of Disclosure Documents in understanding the nature and effect upon investment returns of costs incidental to the offering and operation of the pool or trading program.

6. Conflicts of Interest: Rules 4.24(j) for CPOs and 4.34(j) for CTAs; Related Party Transactions: Rule 4.24(k) for CPOs [166]

a. Conflicts of Interest—CPOs

Proposed Rule 4.24(j) called for a full description of any actual or potential conflicts on the part of: (a) The pool's CPO, trading manager (if any), CTAs allocated at least ten percent of the pool's initial margin and premiums, the operators of investee pools allocated at least ten percent of pool assets; (b) any principal of the foregoing; and (c) any person providing services to the pool or soliciting participants for the pool. Proposed Rule 4.24(j) specifically referred to arrangements whereby a person benefits from the pool's use of a particular FCM or IB (specifically including payment for order flow and soft dollar arrangements) [167] or from the investment of pool assets in investee pools or other investments. Former Rule 4.21(a)(3) required disclosure of conflicts involving the following persons or their principals: The CPO, the CTA, any FCM that will execute the pool's trades, and any IB through which the pool's trades will be introduced. The former rule specified that such description should include any arrangement whereby the CPO or the CTA might benefit directly or indirectly from maintenance of the pool's account with the FCM or introduction of the account by the IB. The proposed rule would have retained the requirement to disclose conflicts of interest on the part of the CPO and its principals but, subject to the requirement that all material information be disclosed, generally would have eliminated such disclosure with respect to CTAs allocated less than ten percent of the pool's futures margins and option premiums. Further, rather than limiting the disclosure of conflicts of interest to specified categories of registrants, such as FCMs and IBs, specifically identified in the former rule, the proposed rule would have encompassed conflicts of interest on the part of any person providing services to, or soliciting participants for, the pool. As noted in the Proposing Release, the purposes of conflict of interest disclosure are not confined to conflicts involving a Commission registrant.[168] Unregulated parties such as a CPO affiliate acting as counterparty to over-the-counter transactions with the pool may be equally relevant for such purposes. Finally, unlike former Rule 4.21(a)(3), proposed Rule 4.24(j) would have specifically referenced payment for order flow and soft-dollar arrangements as types of disclosable arrangements by which a person may benefit from maintenance of the pool's account with an FCM or the introduction of the pool's account by an IB. As with the former rule, disclosure of all material conflicts would continue to be required, whether

[166] Former Rules 4.21(a)(3) for CPOs and 4.31(a)(5) for CTAs addressed conflicts of interest. The Commission's former disclosure rules did not contain any specific requirements with respect to related party transactions.

[167] Payment for order flow is a practice whereby FCMs and IBs compensate CPOs (and CTAs) for directing customers to them. Soft dollar arrangements consist of arrangements whereby customer or pool funds are used to pay for research or other services that benefit the CPO (or CTA). Both practices have concerned regulators because, among other things, they are often inadequately disclosed. *See Market 2000, An Examination of Current Equity Market Developments: Study V, Best Execution* (Division of Market Regulation, SEC, January 1994). The SEC recently adopted Rule 11Ac1–3 and amendments to Rule 10b–10 (17 CFR 240.10b–10 (1994)) under the Securities Exchange Act of 1934 15 U.S.C. 78a *et seq.* to require enhanced disclosure on customer confirmations and account statements (and upon opening of new accounts) with respect to payment for order flow practices. Release No. 34–34902, 59 FR 55006 (November 2, 1994). At the same time, revisions to Rule 11Ac1–3 and further amendments to Rule 10b–10 were proposed. Release No. 34–34903, 59 FR 55014 (November 2, 1994). The effective date of Rule 11Ac1–3 and the amendments to Rule 10b–10 has been postponed to October 2, 1995 (Release No. 34–35473, 60 FR 14366, March 17, 1995).

[168] 59 FR 25351, 25365.