COMMODITY FUTURES TRADING COMMISSION
2033 K STREET, N.W., WASHINGTON, D.C. 20581

DIVISION OF
TRADING AND MARKETS

85-9

NO ACTION POSITION FOR A DIRECTED
Trustee Under Rule 4.5

July 16, 1985

Dear Mr. :

This is in response to your letter dated June 10, 1985, by which you requested on behalf of "the Bank" the relief from regulation as a commodity pool operator ("CPO") available under Rule 4.5 1/ in connection with "the Bank's" operation of "the Trust".

From the representations you previously made to us by your letter dated February 7, 1985, we understand the facts concerning "the Trust" in general to be as follows:

> "The Bank" is trustee to more than $85 billion in assets of pension, profit-sharing and other employee benefit trusts. . . . More than $9.6 billion of the assets to which "the Bank" is trustee are maintained in "the General Trust," a collective or commingled investment trust . . . under which "the Bank" as trustee and fiduciary may hold, administer, invest and reinvest the assets of participating employee benefit trusts and government plans and units (each a "Plan"), pursuant to separate agreements with the participating plan sponsors and government entities. Assets within "the General Trust" are segregated into several investment portfolios, each managed by "the Bank." "The Trust" is one of the commingled investment programs managed by "the Bank" within "the General Trust."
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> "The Trust" is managed to replicate the performance of the Standard and Poor's 500 Index using stock index futures and money market instruments. It was established and is maintained as a vehicle for temporary investment of funds earmarked for long-term equity investment. "The Trust" . . . has since its

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1/ 50 Fed. Reg. 15868 (April 23, 1985).

> inception been available only to Plans whose agreements permit participation in "the General Trust." "The Trust" is a service used by a relatively small number of our "General Trust" participants. Since its inception it has had a total of four participants and at present has four. 2/
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> . . . .
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> Because its objective is to provide a temporary means to mirror the investment experience of a broadly diversified equities portfolio, "the Trust" invests in long futures contracts in domestically traded, broad based stock indices. The face value of these contracts approximates the amount of "the General Trust" assets committed to "the Trust." Essentially all "Trust" assets are maintained in money market instruments. "The Trust" deposits United States Treasury obligations as initial futures margin. . . .
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> Plans may participate in "the Trust" by transferring funds to "the Trust" with the approval of "the Bank".

2/ In making Rule 4.5 effective upon its publication in the Federal Register on April 23, 1985, the Commission stated:

> [We recognize] that, pending the completion of the §4.5 rulemaking proceeding, there may have been uncertainty on the part of persons affected thereby as to whether, and under what criteria, they would be eligible to claim the relief from regulation as a CPO available under the final rule. In light of that uncertainty, those persons may be engaging in activities for which they now would be eligible for regulatory relief under §4.5 as adopted without having sought (and received) a "not a pool" or a "no-action" letter from Commission staff. In light of such uncertainty, and subject to continued compliance with all of the other provisions of §4.5, the Commission has determined that it will not take any enforcement action solely for failure to register as a CPO against any such person who files a notice of eligibility as specified in §4.5(c) within 60 days from the date hereof. 50 Fed. Reg. 15868, 15871.

In this regard, we note that "the Bank" has filed the subject request for relief under Rule 4.5 (and also a notice of eligibility, as discussed below) within such 60 day period.

> The value of each "Trust" unit is calculated as of the close of each business day on which there is trading on the exchanges in the futures contracts held by "the Trust." A Plan acquiring "Trust" units bears the investment experience of its pro rata share of "the Trust" between the time of acquisition and any redemption, including proportional deduction of any maintenance margins, brokerage commissions, taxes, fees and other related expenses as well as "the Bank's" daily management fee at an annualized rate of one-quarter of one percent of "the Trust's" market value.

Rule 4.5 makes an exclusion from the definition of the term "commodity pool operator" available to certain otherwise regulated persons -- e.g., a State-regulated bank such as "the Bank" -- with respect to their operation of certain qualifying entities -- e.g., the assets of any trust account for which the bank is acting as a fiduciary and for which it is vested with investment authority. Rules 4.5(a)(3) and 4.5(b)(3), respectively. To claim the exclusion, the otherwise regulated person must file a notice of eligibility with the Commission, which notice must contain certain identifying information and representations on the manner in which the qualifying entity will be operated. Rules 4.5(c)(1) and (c)(2)(i) through (v), respectively.

Preliminarily, we note that by your June 10, 1985 letter you also filed on behalf of "the Bank" a notice of eligibility under Rule 4.5 in connection with its operation of "the Trust" with respect to those trust account assets for which "the Bank" is a discretionary trustee at all times -- e.g., for which "the Bank" serves as an investment manager while those assets are held in trust by "the Bank" both outside and inside of "the Trust." Inasmuch as the notice of eligibility is effective upon filing, no response to that notice is required. Rule 4.5(d). 3/ Accordingly, and as

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3/ We do note, however, that the notice contains the identifying information and specified representations required by Rule 4.5(c).

With respect to Rule 4.5(c)(2)(ii), the notice represents that "the Bank" will not enter into commodity futures contracts for which the aggregate initial margin exceeds 5 per cent of the fair market value of "the Trust's" assets. In this regard, your letter explains:

> "The Trust" policy does not provide for options transactions, however, should "the Trust" policy change, such policy will comply with the provisions of Rule 4.5(c)(2)(ii) with respect to the percentage of

(Footnote continued)

you have requested, our response to your letter focuses solely on the operation of "the Trust" in those circumstances where "the Bank" is a discretionary trustee over certain trust account assets only while they are in "the Trust."

With respect to the operation of "the Trust" under those circumstances, your letter contains all of the identifying information and, subject to one exception, the specified representations on operating criteria required by Rule 4.5(c). That exception pertains to the requirement in Rule 4.5(c)(2)(i) that a qualifying entity will use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of Rule 1.3(z)(1). 4/ This is because where "the Bank" is a discretionary trustee over certain trust account assets only while they are in "the Trust," it is unable to directly substantiate that their use of "the Trust" will come within Rule 1.3(z)(1) -- i.e., that upon their withdrawal from "the Trust" those assets will be used to purchase securities a substantial majority of the time. 5/

In support of your request, your June 10, 1985 letter makes the following representations:

> "The Bank". . . agrees . . . to make or to receive and record from the appropriate investment manager of assets committed to "the Trust" a representation that the futures contracts purchased through "the Trust" will be used solely for "bona fide hedging" purposes

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(Footnote continued)

> "the Trust's" assets committed to options premiums.

Your letter also represents that "the Bank" will amend "the Trust" description in conformance with Rule 4.5(c)(2)(ii).

4/ Rule 4.5(c)(2)(i) also provides an alternate representation with respect to certain long contracts. With respect to both sets of circumstances under which "the Trust" may be offered your letter represents:

> "The Trust" policy provides solely for hedging, however, should "the Trust" policy change, such policy will comply with the hedging alternative set forth in Rule §4.5(c)(2)(i).

In this regard, your letter further represents that "the Bank" will amend its "Trust" description and its promotional literature to indicate that "the Trust" is to be used for hedging purposes.

5/ See 50 Fed. Reg. 15868 at 15876-77 for the Commission's discussion of this "completion" component of Rule 1.3(z)(1) with respect to the use of such "long hedge" strategies as "the Trust" employs.

> within the meaning and intent of Rule 1.3(z)(1) and a representation as to completion of the hedges such that at least 75% of transactions purchasing units of "the Trust" will result in the purchase of stock.
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> "The Bank" will also obtain from the investment manager . . . identification of the specific hedging strategy used, and will request notice if the strategy is no longer being followed. The Trustee of "the Trust" will allow a participating Plan, as defined in the February 7, 1985 letter, to acquire units only when it is impractical for the Plan to purchase common stocks immediately. 6/

Based upon the foregoing, this Division will not recommend that the Commission take any enforcement action against "the Bank", or any principal or employee thereof, for failure to register as a CPO in connection with its operation of "the Trust" in those circumstances where "the Bank" is a discretionary trustee over certain trust account assets only while they are in "the Trust."

This position is based upon the representations that have been made to us, as stated above. Any different, changed, or omitted facts or conditions might require us to reach different conclusions. In this connection, we request that you notify us immediately in the event the operations and activities of either "the Bank" or "the Trust" change in any way from that as represented to us.

Very truly yours,

Andrea M. Corcoran
Director

6/ By your letter you provide five separate reasons for such "delay." We note that these reasons -- and the facts and the representations quoted above -- are similar to those previously provided to us by another financial depository institution who sought and received a position similar to that requested herein. See Division of Trading and Markets Interpretative Letter No. 85-5, Comm. Fut. L. Rep. (CCH) ¶22,506 (February 28, 1985).

We further note that it appears that "the Bank" would be able to indirectly substantiate that the use of "the Trust" came within Rule 1.3(z)(1) by obtaining "completion" representations from "the Trust" participants. This is because in light of the specified reasons for which "the Trust" may be used, and the representations users must make, it appears that a substantial majority of a participant's "the Trust" transactions would be completed.