T+M 86-8

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

DIVISION OF
TRADING AND MARKETS

April 4, 1986

Re: Multiple-Employer Master Trust --
Requests for CPO and CTA "No-Action" Positions

Dear :

This is in response to your letter dated February 3, 1986, wherein you requested that the Division not recommend that the Commission take any enforcement action against "X&Y Inc.," Mr. "X" and Mr. "Y" for failure to register as a commodity pool operator ("CPO") or as a commodity trading advisor ("CTA") in connection with the proposed use of financial futures contracts 1/ by the "X&Y Inc." Joint Master Trust as described below. 2/

Based upon the representations made in your letter, we understand the facts to be as follows:

> "X&Y Inc." [is] a registered investment adviser under the Investment Advisers Act of 1940 (the "Advisers Act") and the investment manager (as defined in the Employee Retirement Income Security Act of 1974 ("ERISA")) for the "X&Y Inc." Joint Master Trust (the "Trust").
>
> The Trust is a qualified group pension trust formed for the collective investment of assets of qualified pension and profit sharing plans (the "Plans"). The Trust is organized under the laws of the State of Washington pursuant to an Agreement and Declaration of

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1/ In a telephone conversation held with Division staff on February 26, 1986, you explained that for purposes of this request the term "financial futures contracts" includes futures contracts based on debt securities and on stock indices.

2/ You also requested such a "no-action" position with respect to the Trust itself. Inasmuch as the Trust appears to be the "pool" that a CPO would operate or a CTA would advise, it has been unnecessary for us to consider that request.

Trust (the "Trust Agreement") entered into among the Plans, "X&Y Inc." as Investment Manager, Mr. "X" and Mr. "Y" as Trustees, and Rainier National Bank as Custodian. The Trust was formed to allow the participating Plans, each of which is a pension plan that is subject to the reporting, disclosure, administration and enforcement provisions of Title I of ERISA, to commingle all or portions of their respective assets for investment in order to obtain the benefits of various economies of scale. Under the terms of the Trust Agreement, each of the Plans adopts and incorporates the Trust Agreement by reference as part of its qualified plan under Section 401(a) of the Internal Revenue Code of 1954 (the "Code"). The Trust Agreement authorizes "X&Y Inc." to manage, acquire, control or otherwise dispose of the assets of the Trust and, as the Investment Manager, "X&Y Inc." has assumed the investment management authority and the associated fiduciary duties with respect to those assets.

Currently, the Trust has assets of approximately $260 million. The assets of the Trust are invested in four investment funds according to the investment criteria of the Plans: (1) an investment company fund, which includes equity mutual funds and money market mutual funds; (2) an equity fund, which includes equity mutual funds and money market mutual funds, as well as a portfolio of stocks and money market securities; (3) a bond fund, which includes treasury bonds and money market securities; and (4) a money market fund, which includes high quality debt securities with maturities of one year or less.

"X&Y Inc." intends to use only financial futures (and has no intention of using commodity options) solely for bona fide hedging purposes within the meaning and intent of Rule 1.3(z)(1), 17 CFR §1.3(z)(1) (1985).

"X&Y Inc.," the Trust and the Trustees have given notice of their desire to claim the exclusion from the definition of CPO pursuant to Rule 4.5, 50 Fed. Reg. 15868 (April 23, 1985), in conformity with the requirements of paragraph (c) of that Rule and, for purposes of the exclusion and this request, the staff

should assume that the Trust will be operated in the manner specified in paragraph (c) of Rule 4.5. 3/

Mr. "X" and Mr. "Y" as the Trustees of the Trust

Although you recognize that the activities of the Trust could constitute the operation of a commodity pool, you assert that the rule 4.5 exclusion from the definition of the term "commodity pool operator" should be available to the Trustees. In this regard, the Division notes that the relevant provision of the rule is found in paragraph (a)(4), which essentially provides that "a trustee or named fiduciary of a pension plan that is subject to Title I of [ERISA]" is eligible for exclusion from the definition of the term "CPO" with respect to the operation of a qualifying entity specified in paragraph (b) -- i.e., a pension plan subject to Title I of ERISA and operated pursuant to the criteria specified in paragraph (c). However, the Trust itself does not fall within the express definition of a "qualifying entity" under rule 4.5(b)(4) for which a notice of eligibility may be filed.

As we have indicated in previous interpretative letters concerning rule 4.5(a)(4), 4/ where the assets of multiple pension plans are commingled under a separate trading vehicle, one looks to that separate trading vehicle for the purposes of the "qualifying entity" definition. Accordingly, a determination of whether relief is available or not under rule 4.5 must be based upon an evaluation of the structure and trading activities in commodity interests of the trading vehicle as a single entity. Such an evaluation would consider, among other things, the characteristics of each pension plan under the trading vehicle and the purposes for which the trading vehicle was formed.

3/ Commission records confirm that the Trustees filed such (intended) notice of eligibility on September 24, 1985.

We note that the structure of the Trust appears to be similar to that of a registered "series" investment company, a qualifying entity under rule 4.5(b)(1). In this regard, the Commission has stated that it intends to interpret rule 4.5 such that, among other things, each portfolio of the investment company that intends to trade commodity interests must separately meet the operating criteria of rule 4.5(c). See 50 Fed. Reg. 15868 at 15872. We believe that, in light of the similarity in structures, each investment fund of the Trust that intends to trade commodity interests similarly must separately meet the operating criteria of rule 4.5(c).

4/ Division of Trading and Markets Interpretative Letters 85-13, Comm. Fut. L. Rep. (CCH) ¶22,734 (August 2, 1985), 85-15, Comm. Fut. L. Rep. (CCH)

(Footnote continued)

Those previous interpretative letters addressed the application of rule 4.5 to a trading vehicle comprised of single-employer pension plans where (1) each such plan individually was excluded from the "pool" definition by rule 4.5(a)(4)(i), (ii) or (iii), 5/ and (2) the trading vehicle had been created for the administrative convenience of the employer. 6/ On those facts, each of those letters concluded that neither the filing of a notice of eligibility nor any other action would be necessary to claim the exclusion from the "pool" definition available under rule 4.5(a)(4).

The instant request presents a question of first impression, then. Unlike the facts presented in the previous letters, those of the instant request pertain to a trading vehicle comprised of multiple-employer pension plans where each such plan individually would be a "qualifying entity" under rule 4.5(b) for which a notice of eligibility must be filed. Moreover, there is no evidence that the trading vehicle was created for the administrative convenience of the various employers sponsoring those plans. In light of this, the Division believes that the Trust would not be a "qualifying entity" for the purposes of rule 4.5(b) and that Messrs. "X" and "Y" would not be able to claim an exclusion from the CPO definition under rule 4.5(a) with respect to their operation of the Trust.

The Division further believes, however, that under the facts presented certain relief from CPO regulation is merited. 7/ Since each pension plan participating in the Trust is required to adopt and incorporate the Trust Agreement as a part of the plan, Messrs. "X" and "Y," the trustees of the Trust, also would be the trustees or named fiduciaries of each individual

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(Footnote continued)

¶22,736 (August 15, 1985) and 86-5A to be reprinted in Comm. Fut. L. Rep. (CCH) (November 6, 1985).

5/ If a pension plan is excluded from the "pool" definition by rule 4.5(a)(4)(i), (ii) or (iii), no action needs to be taken to claim relief from CPO regulation. (If there is no "pool," there is no CPO.)

6/ As the Division noted in Interpretative Letter 85-15, supra, n.4, at p. 31,081:

> [This letter] does not address the case where a financial depository institution (or other such persons as a private brokerage firm or investment advisory company) were to initiate formation of a master trust (or other commingled trading vehicle) in order to obtain customers for its business. [Emphasis added.]

7/ In this regard, we note that the Commission has directed the Division to interpret rule 4.5 as may be necessary and appropriate to fulfill the purposes of the rule. See 50 Fed. Reg. 15868 at 15870.

plan. 8/ Moreover, Messrs. "X" and "Y" have represented to the Commission that they intend to operate the Trust in compliance with the criteria of rule 4.5(c).

Accordingly, the Division will not recommend that the Commission take any enforcement action against the Trustees for failure to register as a CPO in connection with their operation of the Trust. 9/

You also have requested a "no-action" position in the event the Trustees fail to register as a CTA in connection with their operation of the Trust. In light of the nature of the responsibilities of those persons as described above -- i.e., essentially only the selection of the Trust's investment managers, we do not believe that their activities would require them to register as a CTA. See 49 Fed. Reg. 4778 at 4780 (February 8, 1984), wherein the Commission explained that rule 4.20(a), 17 C.F.R. §4.20(a) (1985), which establishes certain organizational requirements for CPOs, is intended to clarify the responsibility of CPOs for the activities and investment policies of their pools. The Commission further explained:

> [F]requently, Commission staff is called upon by members of the public to offer guidance on determining who, in fact, would be the CPO of a particular pool. In providing such guidance, the staff typically looks at such factors as who will be acting in the manner contemplated by the statutory definition of the term "commodity pool operator" -- e.g., who will be promoting the pool by soliciting, accepting or receiving from others, property for the purposes of commodity interest trading -- and who will have the authority to hire (and to fire) the pool's CTA and to select (and to change) the pool's FCM.

Thus, the Commission has stated that because the choosing of a pool's CTA is consistent with the functions of a CPO, no separate registration as a CTA by the CPO is required.

"X&Y Inc." as the Investment Adviser to the Trust

8/ Specifically, in a telephone conversation held with Division staff on February 26, 1986, you represented that as a result of this requirement Messrs. "X" and "Y" are deemed to be named as trustees of each individual plan in the "plan documents" and, accordingly, as trustees of that plan for ERISA purposes.

9/ This "no-action" position supersedes, then, the notice of eligiblity.

We agree with your assertion that the activities of "X&Y Inc." in its capacity as the investment adviser to the Trust do not appear to bring "X&Y Inc." within the definition of the term "commodity pool operator" as set forth in section 2(a)(1)(A) of the Commodity Exchange Act (the "Act"), 7 U.S.C. §2 (1982). This is because, as you have noted, the activities of "X&Y Inc." as investment adviser to the Trust are analogous to the investment activities of an investment adviser to an investment company. In this regard, the Commission previously has concluded that: 10/

> The Commission does not believe that the activities in which such persons [investment advisers and certain others] typically engage are, without more, the activities in which a CPO typically engages. Rather, the Commission believes that such persons are outside the CPO definition and, therefore, that relief from regulation as a CPO is not necessary in order to exclude such persons from the CPO definition. [Footnotes omitted.]

Accordingly, and as you have requested, the Division will not recommend that the Commission take any enforcement action against "X&Y Inc." if it fails to register as a CPO in connection with serving as an investment adviser to the Trust.

Finally, you contend that "X&Y Inc." should not be required to register as a CTA because, under the facts presented, "X&Y Inc." appears to fall within the spirit, if not the letter, of rule 4.14(a)(5), 17 C.F.R. §4.14(a)(5) (1985). That rule provides that a person is not required to register as a CTA if --

> it is exempt from registration as a commodity pool operator and the person's trading advice is directed solely to, and for the sole use of, the pool or pools for which it is so exempt.

Although you recognize that rule 4.14(a)(5) applies solely to persons who are exempt from registration as a CPO and does not expressly apply to persons who are excluded from the definition of CPO by rule 4.5, you assert that the activities of "X&Y Inc." with respect to the Trust are analogous to the activities described in a recent Division "no-action" position concerning CTA registration. 11/ There, the Division stated that it would not recommend that the Commission take any enforcement action for failure to register as a

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10/ 50 Fed. Reg. 15868 at 15871 (April 23, 1985).

11/ Division of Trading and Markets Interpretative Letter 85-21 (November 8, 1985), 2 Comm. Fut. L. Rep. (CCH) ¶22,795.

CTA against a person registered as an investment adviser in the event that person provided commodity interest trading advice to only one rule 4.5 qualifying entity -- i.e., a registered investment company -- that it had helped to form and for which a notice of eligibility had been filed with the Commission. As the Division explained: 12/

> Nonetheless, rule 4.14(a)(5) does reflect a general Commission intent to eliminate any unnecessary costs and burdens of regulation. Consistent with that intent, the Division believes that adoption of a no-action position with respect to a person's CTA registration would be appropriate under other circumstances not specified in rule 4.14(a) where the costs and burdens of CTA registration would appear to outweigh any regulatory benefit -- e.g., in the instant situation. Furthermore, adoption of such a position in this situation would be consistent with the general policy of rule 4.5, which essentially reflects a Congressional and Commission intent to avoid, where appropriate, unnecessary and duplicative CPO regulation for certain "otherwise regulated" persons.

In support of the instant request you have represented that "X&Y Inc." was formed to provide investment advice to the Trust and that although "X&Y Inc." has other clients, the Trust is the only client that "X&Y Inc." would currently advise to use commodity options or futures contracts of any kind. 13/ Moreover, we note that the sole principals of "X&Y Inc.," Messrs. "X" and "Y," individually are trustees or named fiduciaries of both the Trust and each underlying plan and, thus, are persons who are "otherwise regulated" persons under rule 4.5(a)(4). 14/ In light of the foregoing, we agree that the facts of this case and the prior "no-action" case are similar.

Accordingly, based upon the foregoing, the Division will not recommend that the Commission take any enforcement action against "X&Y Inc." if it fails to register as a CTA in connection with providing advice on commodity interest trading to the Trust. Like the position we took in the prior case, however, this position is subject to compliance with the following two conditions: (1) upon the request of a duly-authorized Commission representative, "X&Y Inc." must provide access to the books and records it keeps and maintains in connection with directing the commodity interest

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12/ Id. at pp. 31,333-34.

13/ This representation was made by you in a letter dated February 13, 1986.

14/ For the reasons provided above, however, the Trust would not be a "qualifying entity" under rule 4.5(b)(4).

trading of the Trust; 15/ and (2) "X&Y Inc." must agree to comply with whatever rule the Commission may adopt to exempt from registration as a CTA -- or to require registration as a CTA -- persons who are registered as an investment adviser and who provide advice on commodity interest trading to persons or entities who have claimed exclusion from the CPO definition pursuant to rule 4.5.

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The positions we have taken herein are based upon the representations you have made to us and are strictly limited to those representations. For example, in the event the Trust is not operated in compliance with the criteria of rule 4.5(c) or if "X&Y Inc." provides advice on commodity interest trading to one or more other persons, the "no-action" positions we have taken with respect to the need for Messrs. "Y" and "X" to register as a CPO and for "X&Y Inc." to register as a CTA would no longer obtain.

We note that this letter does not excuse Messrs. "Y" and "X", "X&Y Inc." and the Trust from compliance with any other applicable requirements contained in the Act or in the Commission's regulations thereunder. For example, they each would remain subject to the anti-fraud provisions of section 4o of the Act, 7 U.S.C. §6o (1982), and to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the regulations, 17 C.F.R. Parts 15, 18 and 19 (1985).

This letter is based upon the representations made to us and is subject to compliance with the conditions stated above. Any different, changed or omitted facts might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event that the activities of "X&Y Inc.," Messrs. "Y" and "X" or the Trust change in any way from that as represented to us.

If you have further questions on this matter, please do not hesitate to contact Barbara R. Stern, Assistant Chief Counsel, or Robert H. Rosenfeld, Division staff attorney, at (202) 254-8955.

Very truly yours,

Andrea M. Corcoran
Director

15/ We expect that those books and records would be in the nature of those required of registered CTAs by Rule 4.32, 17 C.F.R. §4.32 (1985).