85-15

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

DIVISION OF
TRADING AND MARKETS

August 15, 1985

Re: Application of Commission Rule 4.5 to Master Trusts Comprised of Single Employer Pension Plans

Dear :

This is in response to your letter dated June 25, 1985, in which you seek our views concerning the application of Commission rule 4.5, 50 Fed. Reg. 15868, 15882 (April 23, 1985), to certain master trusts to which your client, "X", provides investment advice.

Rule 4.5 provides an exclusion from the definition of the term "commodity pool operator" ("CPO"). Specifically, the rule specifies the persons who are eligible for that relief, the qualifying entities for which they are so eligible and the criteria pursuant to which those qualifying entities are required to be operated. That relief is effective upon the filing of a notice of eligiblity with the Commission.

In particular, rule 4.5 provides:

> (a) Subject to compliance with the provisions of this section, the following persons, and any principal or employee thereof, shall be excluded from the definition of the term "commodity pool operator" with respect to the operation of a qualifying entity specified in paragraph (b) of this section:
>
> * * *
>
> (3) A bank, trust company or any other such financial depository institution subject to regulation by any State or the United States; and
>
> (4) A trustee or named fiduciary of a pension plan that is subject to Title I of the Employee Retirement Income Security Act of 1974; Provided, however, That for purposes of this §4.5 the following pension plans shall not be construed to be pools:
>
> (i) A noncontributory plan, whether defined benefit or defined contribution, covered under Title I of the Employee Retirement Income Security Act of 1974;

(ii) A contributory defined benefit plan covered under Title IV of the Employee Retirement Income Security Act of 1974; Provided, however, That with respect to any such plan to which an employee may voluntarily contribute, no portion of an employee's contribution is committed as margin or premiums for futures or options contracts; and

(iii) A plan defined as a governmental plan in Section 3(32) of Title I of the Employee Retirement Income Security Act of 1974.

(b) For the purposes of this section, the term "qualifying entity" means:

* * *

(3) With respect to any person specified in paragraph (a)(3), the assets of any trust, custodial account or other separate unit of investment for which it is acting as a fiduciary and for which it is vested with investment authority; and

(4) With respect to any person specified in paragraph (a)(4), and subject to the proviso thereof, a pension plan that is subject to Title I of the Employee Retirement Income Security Act of 1974;

Provided, however, That such entity will be operated in the manner specified. . . .

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

"X" is a Commodity Trading Advisor registered pursuant to the [Commodity Exchange Act ("Act")] and an Investment Adviser registered with the Securities and Exchange Commission pursuant to the Investment Advisers Act of 1940. "X" provides investment advice with respect to fixed income portfolios of a large number of institutional clients. . . . In connection with its management of [the] fixed income portfolios [of public employee benefit plans,] "X" from time to time utilizes the futures and options on futures markets to manage

portfolio risk and for other hedging and portfolio management purposes. 1/ Each of the portfolios which is managed by "X" limits the futures activities in such a manner so that they would fall within the criteria of rule 4.5. . . . Moreover, to the extent that each client of "X" might otherwise be deemed a "commodity pool" or "commodity pool operator" under the Act, they otherwise comply with all of the criteria set forth for exclusion under rule 4.5.

A number of "X"'s clients are pension plans which have been established by single employers which have multiple pension plans because of various arrangements with differing groups of employees or varying employee benefit planning considerations. Each of these pension plans is subject to Title I of the Employee Retirement Income Security Act of 1974. These pension plans, which may number in excess of 10 or 15, are administered pursuant to a single master trust with a single bank master trustee. Moreover, pursuant to the master trust agreement, and each of the constituent pension plan relevant documents, the master trustee is required to act on direction from an investment committee (or other similar named fiduciary) established pursuant to the individual pension plan document (and master trust agreement) with respect to the investment of plan assets, including the retention of Investment Adviser/CTAs such as "X". Finally, the master trust consists: (1) of individual pension plans which are all pension plans described in Sections 4.5(a)(4)(i) and (ii) of the Rule; or (2) plans which fall within Sections 4.5(a)(4)(i) and (ii) of the Rule, and other pension plans which would otherwise be entitled to the exclusion provided pursuant to the Rule.

Essentially, you seek our confirmation of the following positions set forth in your letter:

(1) The master trustee bank would <u>not be</u> "vested with investment authority" because the master trustee would have no authority to act with respect to the investment of plan assets or the retention of Investment

---

1/ We note, however, that for the purposes of this letter it has not been necessary for us to also offer our views -- and therefore this letter should not be deemed to imply any finding -- that those management purposes would come within the scope of "bona fide hedging transactions and positions" in rule 1.3(z)(1), 17 C.F.R. §1.3(z)(1) (1985).

> Adviser/CTAs except at the specific direction of another named fiduciary. Therefore, the bank trustee would not be the appropriate person to file a notice of exclusion pursuant to rule 4.5. . . .

Essentially, an eligible person as specified in rule 4.5 is one who otherwise would be viewed as the CPO of the qualifying entity -- i.e., the person who will be promoting the "pool" by soliciting, accepting or receiving assets from others for the purpose 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. 2/ Thus, the rule contemplates that an eligible person is that person who has the primary authority to, among other things, authorize and direct the investment of the assets of a qualifying entity, such as a trust account.

Accordingly, we believe that a bank, trust company or other financial depository institution subject to regulation by a State or the United States which is required to invest or otherwise manage the assets of individual pension plans (including the retention of investment advisers) under a single employer multiple pension plan master trust on direction from the trustee or named fiduciary of those plans (e.g., an investment committee established by those plans' documents) is not a person who is "vested with investment authority" for purposes of rule 4.5(b)(3). Rather, we believe that for those purposes it is the trustee or named fiduciary of those plans which directs the investment actions required of the master trustee who should be viewed as the person having such investment authority and, accordingly, would be the person eligible to file a notice of exclusion under rule 4.5 with respect to the master trust.

> (2) In circumstances where there is a single employer multiple pension plan master trust, wherein the master bank trustee is not "vested with investment authority," one looks to the character of the individual pension plans to determine the action required, or not required, under rule 4.5.

Where the assets of multiple pension plans are commingled under a master trust, it is the master trust that is the qualifying entity (i.e., the trading vehicle). Accordingly, a determination of whether action is required or not required under rule 4.5 must be based upon an evaluation of the structure and trading activities in commodity interests of the master trust as a single entity. Such an evaluation would include not only a consideration of the characteristics of each pension plan under the trust, but also an analysis of how the assets of all such plans are commingled and invested, the manner in which gains and losses from trading in commodity

---

2/ See 49 Fed. Reg. 4778, 4780 (Feb. 8, 1984).

interests are allocated to each plan and the purposes for which the master trust was formed.

This is because the Commission has made clear that even though a rule 4.5(a)(4) exclusion from the pool definition may be applicable to an individual pension plan, it does not necessarily follow that the rule 4.5(a)(4) exclusion will be available to a different entity (such as a master trust) which commingles such a pension plan's assets with the assets of other persons for trading in commodity interests. Specifically, the Commission has stated that the rule 4.5(a)(4) exclusion from the pool definition in rule 4.10(d) may not be applicable: 3/

> where the assets of any such pension plan [i.e., a plan described by rules 4.5(a)(4)(i)-(iii)] are commingled with the assets of any other person in trading commodity interests and gains and losses are not separately accounted for. For example, in the event that the assets of two or more such plans are commingled in a trust account or other type of investment vehicle which intends to trade in, among other things, commodity interests, the Commission, in appropriate cases where that vehicle was not subject to an effective exclusion under §4.5, would deem the operation of such vehicle as the operation of a commodity pool and such plans as its pool participants. In such event, with respect to such vehicle, compliance with the provisions of §4.5 -- or regulation as a CPO -- would be required. (Emphasis added.)

Thus, the Commission has expressed concern that a person who operates a trading vehicle which is not subject to an exclusion from the pool definition but who solicits or accepts investors' funds for the purpose of trading in commodity interests not evade regulatory requirements applicable to CPOs merely by including an otherwise excluded entity in its commingled trading vehicle.

> (3) Where. . . all of the underlying plans are excluded from the operation of the rule and the Act by virtue of Sections 4.5(a)(4)(i) and (ii) of the rule, no notice of exclusion should be required.

The concerns noted above are not raised where a single employer multiple pension plan master trust is composed solely of pension plans which are excluded from the pool definition by Commission rules 4.5(a)(4)(i) and

---

3/ 50 Fed. Reg. 15868, 15873.

(ii), gains and losses from trading commodity interests are allocated solely to those plans and there are no other indicia that would warrant characterization as a commodity pool. Under such circumstances, we believe that the rationale noted by the Commission for excluding certain individual pension plans in rules 4.5(a)(4)(i) and (ii) from the pool definition -- i.e., they do not involve the placement of investors' funds at risk in commodity interest trading 4/ -- similarly applies and that such a master trust itself generally would be excluded from the pool definition.

Accordingly, the trustee of such a master trust (or the trustee or named fiduciary of the plans comprising that trust) would not be required to file a notice of exclusion under rule 4.5 -- or to take any other action -- to claim the exclusion from the pool definition available under the rule.

> (4) Where such a master trust consists of various different types of plans, only some of which fall within the statutory exclusion expressed in Sections 4.5(a)(4)(i) and (ii) of the rule, a filing should be made on behalf of each pension plan which falls outside of Sections 4.5(a)(4)(i) and (ii) of the rule.

Consistent with our views as expressed above, however, we believe that where a single employer multiple pension plan master trust consists not only of plans which are excluded from the pool definition by rules 4.5(a)(4)(i) and (ii), but also of other pension plans which are not similarly excluded, the exclusion from the pool definition generally would not be available to the master trust of those plans trading commodity interests. 5/ In such a case, a notice of eligiblity must be filed with respect to the master trust to claim the relief available under rule 4.5.

4/ As noted by the Commission in 50 Fed. Reg. 15873:

> [A] non-contributory plan, i.e., one in which all contributions are solely made by an employer, can never be a commodity pool, because no funds are solicited from participants and only the employer bears the funding responsibility of the plan if there are losses. Similarly, defined benefit plans are not likely to be commodity pools, even if contributions are permitted, because such plans normally require the employer to cover losses and permit the employer to benefit from excess earnings not needed to fund the benefit.

5/ See n.2. This is so even if the other plans were operated pursuant to the requisite criteria.

In view of the necessity to provide you with clarification on the application of rule 4.5 under the circumstances you have described, and as you have requested, the Division will not recommend that the Commission take any enforcement action against those of "X"'s clients which have been operating qualifying entities for which a notice of eligibility is required to be filed to claim the relief available under rule 4.5 provided, and as you have represented, that such person files such notice with the Commission within fifteen days from the date of this letter.

This letter solely addresses the application of rule 4.5 to a "directed" master trustee bank of a single employer multiple pension plan master trust. In the event that a master trustee bank (or other person) operates the assets of a master trust in such a manner that assets from the master trust are commingled in another trading vehicle with the assets of other persons or entities and are traded in commodity interests, we believe that it would be appropriate to view that other trading vehicle as a separate trading vehicle for the purposes of determining the applicability of rule 4.5. As previously noted, that determination would depend upon the facts of each case.

Moreover, this letter solely addresses the application of rule 4.5 to a single employer multiple pension plan master trust which has been created for the administrative convenience of the employer. It does not address the case where a financial depository institution (or such other 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.

The opinions we have expressed above are based upon the representations that you have made to us and on our understanding of those representations as set forth above. Any different, changed or omitted facts or conditions might require us to reach a different conclusion.

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

Very truly yours,

Andrea M. Corcoran
Director