COMMODITY FUTURES TRADING COMMISSION
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94-62

DIVISION OF
TRADING AND MARKETS

June 1, 1994

Re: Request for CPO Registration No-Action Position

Dear :

This is in response to your letter dated March 11, 1994, to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by your correspondence dated March 31, 1994, and by telephone conversations with Division staff. You request, on behalf of "X", a registered futures commission merchant ("FCM"), relief from commodity pool operator ("CPO") registration requirements in connection with the retirement plan (the "Plan") maintained by "X" on behalf of its employees.

Based upon the representations contained in your letter, as supplemented, we understand that the facts are as follows. The Plan is a defined contribution plan administered by "X" for the benefit of its employees.[1/] The Plan is subject to Title I of the Employee Retirement Income Security Act of 1974 ("ERISA") and is qualified under section 401(k) of the Internal Revenue Code. The Plan was established by "X" as a vehicle for providing tax-deferred retirement income for the employees of "X". It was not created by "X" as means to raise funds for "X" to manage or to be the repository of financial products which "X" might create or sell to the Plan. "X" receives no fees or income from employee participation in the Plan.[2/]

The Plan is administered by (1) "X", which serves as the "named fiduciary" of the Plan within the meaning of Section

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1/ A defined contribution plan is a plan in which the benefit ultimately provided to the participants is dependent upon amounts contributed to their accounts and the earnings credited to such accounts.

2/ As an FCM, however, "X" does receive commissions on the trades that it clears on behalf of any commodity pool in which its employees may invest. See infra note 4.

402(a)(2) of ERISA, and (2) "A" and "B", who serve as the trustees ("Trustees") of the Plan (collectively, the named fiduciary and the Trustees may be referred to as the "Fiduciaries"), each of whom is subject to the fiduciary standards imposed under ERISA.[3/] Among other things, the Fiduciaries are under a duty to inform employee participants ("Participants") of their investment rights under the Plan and to provide periodic reports of Participant benefits. The Fiduciaries do not derive any economic benefit from increases in the amount of funds invested in the Plan, other than in their capacity as Plan participants, nor do they receive any compensation for their activities as Fiduciaries.

Under the Plan, Participants are provided with a choice of seven investment options, each of which has a specific investment strategy or objective. One of the investment options offered to Participants is investment in shares of the "Fund", a Bermuda investment company. The Fund invests all of its assets in "Y", a Bermuda general investment company which primarily trades and invests in commodity interest contracts. The Fund is the only investment option offered to Participants that invests in commodity interest contracts. "Y" also is the sole shareholder of "X". "Z", an affiliate of "X", is the CPO of the Fund and performs all managerial services relating to the operation of the Fund. The commodity trading advisor ("CTA") for the Fund is "W".

"X" does not promote investments by Participants in the Fund or in any of the Plan's investment options. Currently, approximately eighty of "X"'s one-hundred and thirty employees participate in the Plan. In its capacity as the Plan sponsor, "X" selects the investment options available to its employees but does not hold any trading authority over any employee funds invested under the various investment options. In particular, with respect to the Fund, "X" has no authority to hire or fire the Fund's CPO or CTA, nor does "X" have any control over the investment decisions of the Fund.[4/] The investment decisions of the Participants regarding the Plan's various investment options are entirely unsolicited and any promotion of any of the investment options is explicitly prohibited by ERISA.

3/ "A" is the president of "X", is registered as an associated person, and is listed as a principal of "X". "B" is the director of human resources for "X" and is not involved in the commodity interest activities of "X".

4/ "X" does, however, serve as one of the Fund's three FCMs. As such, it receives a commission on the trades it clears on behalf of the Fund.

With respect to the investment options offered, you represent that a Participant may elect to contribute no more than fifty percent of his or her total Plan contribution to investments in the Fund option. You also represent that a Participant's risk of loss from investment in the Fund is limited to the amount of his or her contribution to the Fund and any undistributed profits from his or her investment in the Fund.

As noted, the Plan is subject to the statutory purview of ERISA. ERISA imposes an extensive scheme of regulation upon the Plan. Under ERISA, persons who select investment alternatives and portfolio managers on behalf of the Plan act as fiduciaries and are required to make these selections with the skill, care and diligence of a prudent man and for the exclusive purpose of providing benefits to Participants. ERISA also contains extensive reporting and disclosure requirements. Pursuant to those requirements, the Fiduciaries must (1) file annual audited reports with the Department of Labor and the Internal Revenue Service; (2) make those reports available to Participants upon request; (3) provide Participants with summaries of those annual reports; (4) provide Participants with summary plan descriptions when entering the Plan and periodically thereafter; and (5) provide Participants with summaries of any material modifications to the Plan.

You represent that all Participants receive full disclosure with respect to all investment options offered by the Plan, including information relating to the risks of futures-related investments with respect to the Fund. In this regard, you state that the Fiduciaries will incorporate such portions of the material provided by the CPO as the Fiduciaries determine to be relevant under the standards of ERISA into the materials required to be provided to all Participants under ERISA. You also represent that any Participant who chooses to invest in the Fund will receive a full Rule 4.21 disclosure document from "X" (as provided to "X" by "Z", the CPO of the Fund) and that "X" has undertaken to obtain from each Participant who chooses to invest in the Fund the acknowledgement required by Rule 4.21(d) and retain such acknowledgement in accordance with Rule 4.23(a)(3).[5/] You further represent that "X" and the Trustees undertake to provide Participants all of the reports required by Rule 4.22 and received from the CPO of the Fund.

In addition, you state that the Fiduciaries are not subject to a statutory disqualification under Section 8a(2) or (3) of the

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5/ Commission rules referred to herein may be found at 17 C.F.R. Ch. I (1993).

Act.[6] You further ask that the Division note that "X", as a registered FCM, has met qualification requirements for registration as an FCM and is subject to the jurisdiction of the Commission. In addition, "A", as a principal of "X", also has met minimum fitness standards.

Based upon the foregoing, you have requested relief from CPO registration requirements on behalf of the Fiduciaries of the Plan. Rules 4.5(a)(4) excludes from the definition of "commodity pool operator" set forth in Section 1(a)(4) of the Commodity Exchange Act ("Act"),[7] the trustee or named fiduciary of any pension plan subject to Title I of ERISA provided that such trustee or named fiduciary files a notice of eligibility with the Commission representing that it will conduct its trading in commodity interests in accordance with certain requirements specified in Rule 4.5(c)(2). Because the Plan does not meet the operating criteria of Rule 4.5(c)(2), the Fiduciaries may not claim relief from CPO registration pursuant to Rule 4.5.[8]

Based upon your representations, the Division will not recommend that the Commission take any enforcement action for failure to register as a CPO against the Fiduciaries in connection with their operation of the Plan.[9] This position does not excuse "X" or the Trustees from compliance with any other applica-

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6/ 7 U.S.C. §§ 12a(2) and 12a(3) 1988.

7/ 7 U.S.C. § 1 (Supp. IV 1992).

8/ "X" does not meet the Rule 4.5 exemption criteria because the use by the Plan of commodity futures and options contracts will not be limited to bona fide hedging within the meaning of Rule 1.3(z)(1) and the aggregate initial margins and premiums required to establish such positions may exceed five percent of the liquidation value of the Plan's portfolio.

9/ The Division notes that it is not excusing, or in anyway limiting, the Commission's ability to proceed against "X" or the Trustees for any past violations of the Act or the Commission's regulations promulgated thereunder if the Commission determines that such action is appropriate. The relief granted herein is prospective only, effective as of the date of this letter.

You also request relief from Rules 4.21, 4.22 and 4.23. These rules, however, only apply to persons who are registered or are required to be registered as a CPO. Accordingly, in light of the relief from CPO registration granted herein, it is unnecessary for us to separately consider this request for relief.

ble requirements contained in the Act,[10/] or the Commission's regulations issued thereunder. For example, they remain subject to the antifraud provisions of Sections 4b and 4o of the Act[11/] and to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the regulations. Further, this opinion is applicable to "X" and the Trustees solely in their capacity as the Fiduciaries of the Plan.

The views expressed herein are based upon the representations that have been made to us. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. Therefore, we ask that you notify us immediately in the event that the activities of "X", the Trustees or the Plan change in any way from those as represented to us. Moreover, this opinion represents the views of the Division of Trading and Markets only. It does not necessarily reflect the views of the Commission or any other office or division of the Commission.

If you have questions concerning this correspondence, please contact me or Tina Paraskevas Shea, an attorney on my staff, at (202) 254-8955.

Very truly yours,

Susan C. Ervin
Chief Counsel

10/ 7 U.S.C. § 1 et seq. (1988 & Supp. IV 1992).

11/ 7 U.S.C. §§ 6b and 6o (1988).