

**CFTC Letter No. 97-94****November 21, 1997****Division of Trading & Markets**

Re: Section 4m(1) -- Request for relief from commodity pool operator ( CPO ) and commodity trading advisor ( CTA ) registration requirements for X as sponsor of an ERISA group trust and from CPO registration requirements for Y as trustee and custodian of such group trust

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Dear :

This is in response to your letter dated July 18, 1997, to the Division of Trading and Markets (the Division ) of the Commodity Futures Trading Commission (the Commission ), as supplemented by your letter dated August 8, 1997 and by telephone conversations with Division staff. By this correspondence, you request that the Division not recommend that the Commission take any enforcement action against X or Y in connection with the operation of the Group Trust if: (1) X does not register under Section 4m(1) of the Commodity Exchange Act (the Act<sup>1</sup>) as a CPO and CTA; and (2) Y does not register as a CPO.<sup>2</sup>

Based upon your representations, we understand the pertinent facts to be as follows. X , the sponsor of the Group Trust, is a S corporation and a state-regulated insurance company.<sup>3</sup> It is a registered investment adviser under the Investment Advisers Act of 1940 (the IAA<sup>4</sup>). The Group Trust was organized pursuant to an Agreement of Trust dated May 20, 1997 (the Trust Agreement ) by and between X as fund manager and Y as trustee.

The Group Trust was formed to provide its participating trusts with a guaranteed investment contract ( GIC ) having a fixed annual rate of return and fixed maturity. X guarantees principal, interest and book value benefit payments to the Group Trust s participating trusts.

Participation in the Group Trust is limited to trusts, each of which (a Participating Trust ) is part of a qualified employee pension or profit-sharing plan or governmental plan (collectively, Plans ) and each of which is (1) exempt under Section 501(a) of the Internal Revenue Code ( IRC ) from federal income taxation by reason of being qualified under Section 401(a) of the IRC or (2) is a governmental plan described in Sections 401(a)(24) and 818(a)(6) of the IRC.<sup>5</sup>

Pursuant to the terms of the Trust Agreement, each of the Plans of which a Participating Trust is a part must adopt and incorporate the Trust Agreement by reference and must adopt the Group Trust as part of such Plan. In addition, by adopting the Group Trust as part of a Plan, X must be designated as a named fiduciary (as such term is defined in the Employee Retirement Income Security Act of 1974 ( ERISA )) with respect to Plan assets invested in the Group Trust. You represent that each of the Plans is either a qualifying entity under Commission Rule 4.5(b) or is excluded from the definition of pool under Rule 4.5(a)(4)(i), (ii), or (iii).<sup>6</sup>

Further, pursuant to the terms of the Trust Agreement, the Group Trust will conduct its investment activities through an account at Y (the "Investment Fund"), which will be established by X as the fund manager of the Group Trust and will be comprised of all the property received by Y as the trustee of the Group Trust.<sup>7</sup> The Investment Fund will be divided into units of participation and a Participating Trust s beneficial interest in the Investment Fund will be expressed in terms of such units and fractions thereof. X will establish the investment objectives, guidelines and restrictions and has broad authority to manage, acquire, control and otherwise dispose of the assets of the Investment Fund. The ultimate management of the Group Trust s assets will thus be the exclusive responsibility of X . Accordingly, under the terms of the Trust Agreement, X must acknowledge that it is a fiduciary, as defined in ERISA, with respect to the Investment Fund and with respect to each Plan that has an interest in the Investment Fund.

X will diversify the Investment Fund s investments in domestic and foreign securities, collateralized mortgage obligations and securities private placements. X will use financial and currency commodity interests solely for bona fide hedging purposes within the meaning of Rule 1.3(z), and the Group Trust will be operated within the restrictions specified in Rule 4.5(c)(2). The minimum investment in the Group Trust is \$5,000,000 per Plan.

Y is a T trust company and as the trustee and custodian of the Group Trust, Y will be responsible for the valuation of the securities and other assets of the Group Trust and for the delivery and receipt of such securities and other assets. As trustee, Y will also be responsible for maintaining the accounting and financial records of the Group Trust and for preparing periodic reports. Y does not have any investment discretion with respect to the assets of the Group Trust s Investment Fund or any responsibilities for the formulation of the investment policies to be followed by the Group Trust. As trustee, Y exercises authority with respect to the Group Trust s assets only to the extent that it is directed to do so by X .

## I. X

### A. CPO Registration.

Rule 4.5(a)(4) provides an exclusion from the definition of the term commodity pool operator for

a trustee or a named fiduciary of a pension plan that is subject to Title I of ERISA with respect to the operation of a pension plan that is a qualifying entity as defined in Rule 4.5(b)(4). A notice of eligibility, containing specified representations concerning the manner in which the pension plan will be operated, must be filed with the Commission in order to claim the exclusion from the CPO definition made available by Rule 4.5(a)(4). Further, Rule 4.5(a)(4)(i)-(iii) excludes from the pool definition certain pension plans specified therein. Because the rule excludes these plans from the pool definition, no notice is required to be filed to claim CPO relief in connection with the operation of such plans.

As you note in your letter, the Group Trust does not fall within the express definition of a qualifying entity provided in Rule 4.5(b)(4) because it is not a pension plan but rather a group of pension and profit-sharing plans, including governmental pension plans. Further, X is not a trustee or a named fiduciary (as that term is defined in ERISA).<sup>8</sup> However, based upon your representations and consistent with our prior positions in this area,<sup>9</sup> the Division will not recommend that the Commission commence enforcement action against X based solely upon X's failure to register as a CPO in connection with its activities as sponsor and fiduciary of the Group Trust, provided that X complies in full with Rule 4.5.<sup>10</sup>

#### B. CTA Registration.

Rule 4.14(a)(8) provides an exemption from registration as a CTA for a person who is registered as an investment adviser where that person's commodity interest trading advice: (1) is directed solely to, and for the sole use of, entities which are excluded from the definition of the term pool under Rule 4.5 or are qualifying entities under Rule 4.5 for which a notice of eligibility has been filed; (2) is solely incidental to its business of providing securities advice to each such entity; (3) employs only such strategies as are consistent with eligibility status under Rule 4.5; and (4) is not otherwise holding itself out as a CTA. A notice of exemption, containing specified representations, must be filed with the Commission in order to claim the exemption from CTA registration made available by Rule 4.14(a)(8). As noted above, however, the Group Trust does not fall within the express definition of a qualifying entity under Rule 4.5. Moreover, it is not a trading vehicle excluded from the pool definition by Rule 4.5(b)(4)(i), (ii) or (iii). Accordingly, absent relief, X would be unable to avail itself of the exemption from CTA registration under Rule 4.14(a)(8).

However, based upon the representations made in your correspondence and, in particular, that X: (1) is a registered investment adviser; (2) has the exclusive responsibility for the ultimate management of the Group Trust's assets; and (3) will operate the Group Trust within the restrictions set forth in Rule 4.5(c)(2), the Division will not recommend that the Commission take any enforcement action against X based solely upon X's failure to register as a CTA in connection with providing commodity interest trading advice to the Group Trust, provided that, in addition to satisfying the condition stated above regarding relief from CPO registration, i.e., that X comply in

full with Rule 4.5, X : (1) does not otherwise hold itself out as a CTA; and (2) complies with the notice requirement of Rule 4.14(a)(8).<sup>11</sup>

## II. Y

Commission staff have generally determined the identity of the CPO of a pool by determining who holds the authority for promotion of the pool by soliciting, accepting or receiving from others property for the purpose of commodity interest trading and for hiring and firing of the pool's CTA and the pool's futures commission merchant (FCM).<sup>12</sup>

With respect to Y's activities as the trustee of the Group Trust, you represent that Y will be the custodian of the Group Trust's assets and will be responsible for maintaining the Group Trust's accounting and financial records as well as for preparing periodic reports. You further represent that Y will not: (1) solicit or initiate any contact with participants in the Group Trust other than with respect to administrative matters arising out of its custodial responsibilities;<sup>13</sup> (2) have any investment discretion with respect to the assets of the Group Trust's Investment Fund; (3) make any investment recommendations or review the investment decisions of X<sup>14</sup>; or (4) hire or fire or have any authority to hire or fire the Group Trust's fund managers or its FCMs. Rather, as noted above, all of these responsibilities will be discharged by X. Based upon the foregoing, the Division will not recommend that the Commission take any enforcement action against Y based solely upon Y's failure to register as a CPO under Section 4m(1) of the Act.

The positions taken in this letter do not excuse X or Y from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, each remains subject to the antifraud provisions of Sections 4b and 4o of the Act,<sup>15</sup> to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's rules and to all otherwise applicable provisions of Part 4.

This letter is based upon the representations made to us and is subject to compliance with the conditions set forth above. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event that the operations or activities of X, Y or the Group Trust change in any respect from those as represented to us. Further, the positions taken in this letter represent the views of this Division only and do not necessarily represent the views of the Commission or of any other office or division of the Commission.

If you have any questions concerning this correspondence, please contact me or Christopher W. Cummings, an attorney on my staff, at (202) 418-5450.

Very truly yours

Susan C. Ervin

Chief Counsel

<sup>1</sup> 7 U.S.C. § 6m(1) (1994).

<sup>2</sup> You represent that Y has authorized you to request relief on behalf of both X and Y .

<sup>3</sup> You state that X is the \_\_\_rd largest life insurance company in the United States based on its assets.

<sup>4</sup> 15 U.S.C. § 80b-1 et seq. (1994). Although X is not registered with the Commission in any capacity, it owns (through subsidiaries) a 30% interest in Z , which is listed as a principal of, and owns 99% of, each of S (a registered CTA) and W (a registered CPO and CTA). None of these other firms is involved in any way with the operation or advisement of the Group Trust or the Investment Fund, discussed below.

<sup>5</sup> It is intended that the Group Trust itself be a tax-exempt pooled fund arrangement pursuant to Section 501(a) of the IRC and that it qualify as a group trust under Internal Revenue Service rules.

<sup>6</sup> Commission rules referred to herein are found at 17 C.F.R. Ch. I (1997). In response to staff inquiries regarding a Trust Agreement provision permitting participation by collective trust funds that hold assets from various pension and/or profit sharing plans, you represent that in each case the trusts whose funds are held by such a collective trust fund will be qualifying entities under Rule 4.5(b) or excluded from the definition of pool under Rule 4.5(a)(4)(i), (ii), or (iii).

<sup>7</sup> This structure is intended to satisfy, among others, the custodianship requirements of ERISA.

<sup>8</sup> However, as you note, by adopting the Group Trust as part of a Plan, each participating Plan designates X as a named fiduciary with respect to those assets invested by such Plan in the Group Trust.

<sup>9</sup> See CFTC Interpretative Letter No. 94-53, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,116 (June 2, 1994) and CFTC Interpretative Letter No. 93-91, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,857 (September 7, 1993).

<sup>10</sup> Thus, if the Group Trust contains both plans which are covered by Rule 4.5(b)(4) and plans which are excluded from the pool definition by Rule 4.5(a)(4), X must file a notice of eligibility pursuant to Rule 4.5(c) with respect to the Group Trust and must operate the Group Trust pursuant to Rule 4.5(c)(2). If, however, prior to the commencement of trading commodity interests it is determined that the Group Trust contains only plans excluded from the pool definition by Rule 4.5(a)(4), X would not be subject to any filing or operational requirements under Rule 4.5.

<sup>11</sup> Alternatively, you sought a no-action position under Rule 4.6 with respect to X's failure to register as CTA. Rule 4.6 excludes from the CTA definition, inter alia, state-regulated insurance companies who provide commodity interest trading advice to Rule 4.5 trading vehicles in a manner solely incidental to their insurance company activities. In light of the registration no-action position we have taken above with respect to X's provision of commodity interest trading advice to the Group Trust, it has been unnecessary for us to separately consider this alternative request.

<sup>12</sup> See 49 Fed. Reg. 4778, 4780 (February 8, 1984)

<sup>13</sup> Further, you explain that if an employee of a Group Trust participant were to phone Y and ask for administrative information -- e.g., for the participant's account balance, Y would respond to that request. Y would refer non-administrative inquiries to X.

<sup>14</sup> You note, however, that assets of the Group Trust may be invested at the direction of X in overnight cash accounts established and administered by Y for the purpose of earning interest on the cash holdings of the Group Trust.

<sup>15</sup> 7 U.S.C. § 6b and 6c (1994).