Joseph J. Nameth

Investment Advisers Act of 1940 -- Section 202(a)(11)

Jan 31, 1983

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

December 30, 1982

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Based on the facts presented in your letter, we cannot agree with you that Joseph J. Nameth would not be an "investment adviser" within the meaning of section 202(a)(11) of the Investment Advisers Act of 1940 ("Advisers Act") if he proceeds in the manner described by you. We believe that a person who, for compensation, engages in the business of investment management with the discretionary power to buy and sell securities is an investment adviser even if such business is operated through the medium of trusts. See, R. C. A. Syvret (pub. avail. September 17, 1980); Philip Eiseman (pub. avail. July 22, 1976); Brewer-Burner & Associates, Inc. (pub. avail. February 7, 1974). Mr. Nameth's fees for administering the trusts would constitute compensation for investment advice. It is not necessary that a person who provides investment advisory and other services to a client charge a separate fee for the investment advisory portion of the total services. Investment Advisers Act Release No. 770, August 13, 1981. Because Mr. Nameth would be compensated for administering the trusts, which would be buying and selling securities, it is immaterial whether interests in the trusts would be securities or whether Mr. Nameth would be paid for making statements to potential settlors before the creation of the trusts.

You have cited Selzer v. Bank of Bermuda, Ltd., 385 F. Supp. 415 (S.D.N.Y. 1974) ("Selzer") and In re Loring, 11 S.E.C. 885 (1942) ("Loring") for the proposition that the administration of trusts does not constitute investment advisory services. In our view, Loring held only that a person, most of whose business consisted of acting as a court-appointed fiduciary--and, as such, was required to give bond upon acceptance of each trust in an amount sufficient to protect the trust property and was discharged from his liability thereon only upon the filing of his accounts and the allowance thereof--was found by the Commission, pursuant to its authority under section 202 (a)(11)(F), not to be investment adviser within the intent of section 202(a)(11) of the Advisers Act. In Selzer, it was held that the Advisers Act was not applicable to a trustee of a private trust which was created to invest in securities. That holding was based, in part, on the mistaken impression by the court that it was the Commission's position that a trustee is not an investment adviser within the meaning of the Advisers Act. 385 F. Supp. 415, 420. Moreover, we do not agree with the holding of the court in Selzer.

In addition, we believe that the proposed arrangement, which involves the commingling of assets of the trusts in the name of your client, may result in the issuance of securities in an investment company if substantially the same advice is rendered to each trust or each discernible group of trusts. See, Brewer-Burner & Associates, Inc. (pub. avail. February 7, 1974). The commingled fund for "extra cash" of the various trusts would not, however, be an investment company so long as each trust is managed individually and any decision to invest any extra cash of a trust in the commingled fund is made by Mr. Nameth on the basis of his consideration and determination of what is appropriate for that trust. See, Piette and Associates, Ltd. (pub. avail. September 17, 1981). This position would be different if any of the moneys invested in the commingled fund would be placed with Mr. Nameth through the trusts specifically for investment in the commingled fund and not for his investment management generally. Id.

We understand that the Division of Corporation Finance will write you separately regarding your question under the Securities Act of 1933.

Stanley B. Judd
Deputy Chief Counsel

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September 23, 1982

Securities Act of 1933 §§ 2(1), 2(2), 2(3) and 2(4)
Securities Exchange Act of 1934 §§ 15(a)(1) and 3(a)(5)
Investment Advisers Act of 1940 §§ 202(a)(1) and 203(a)

Securities and Exchange Commission
Division of Corporation Finance
500 South Capitol Washington, D.C. 20549

Re: No-Action Letter

Gentlemen:

I represent a client, Joseph J. Nameth, who wishes to obtain an interpretive opinion and possibly a no-action letter from the SEC's Division of Corporation Finance. This request is made with respect to the facts set forth below. The principal issue involved is whether my client, if he engages in the acts described herein, will be considered to be selling "securities" as that term is defined in Section 2(1) of the Securities Act of 1933.

My client has had considerable experience in making all manner of investments for himself. He is not a registered investment adviser or a broker-dealer.

He wishes to become the trustee of a number of inter vivos revocable trusts which will be created by people who are acquainted with him and wish him to make investment decisions which will benefit the trust beneficiaries. In most instances the trust settlor will also be the trust beneficiary.

The trust instrument will contain the following provisions. It will be revocable at will by either the settlor or the trustee. The trustee will be given actual title to all property placed with and held by him in trust. The trust beneficiary will be the equitable or beneficial owner of the trust corpus as at common law.

From time to time the trust settlor may give additional property to the trustee to hold in trust and he may demand that the trustee return any or all elements of the trust estate to him or the trust beneficiary upon reasonable notice. The trustee will be given, in most cases, broad investment powers which will not be limited to conservative investments authorized by the Michigan Revised Probate Code, M.C.L.A. 555.201. The settlor will be able to elect specifically what types of investments the trustee will be permitted to invest in. Such areas of investment will include securities (as that term is defined in the federal securities laws), notes secured by first and second mortgages on residential and commercial real estate, collectibles (rare stamps, coins, antiques, oriental rugs, works of art), commodities (such as gold and silver bars) and any other type of property that the settlor may wish to name. Within those broad parameters the trustee will have absolute discretion as the settlor will specifically waive the "prudent man" rule regarding investment decisions.

The trustee will be responsible for preparing and filing tax returns on behalf of each trust. He must follow the settlor's instructions for distribution of trust income and assets. He must keep accurate books and records of all transactions made by him for each trust and make regular periodic reports of his activities as trustee and the assets of the trust. The bookkeeping methods employed will be in accordance with standard accounting principles for trusts as used by bank trust departments.

As stated earlier, the trustee will serve in a fidiciary capacity for more than one trust. He will not, however, improperly commingle the assets of the trust. Funds from several trusts, for example, will not be pooled in order to purchase one real estate mortgage, bond or collectible item.

It is anticipated, though, that the trustee will place funds from many trusts into one interest-bearing account, either at a bank or in a money market fund, from time to time in order to obtain a return on relatively small amounts of cash. In those instances the trustee will carefully note the contribution of each trust to the larger account and properly allocate interest earned to each trust. This "earmarking" will be identical to the procedures successfully employed by most law firms in managing their clients' trust accounts which hold retainers and from which fees are drawn as they are earned.

The trustee will be compensated for his work as trustee by receiving a small percentage, less than one percent, of the average value of each trust corpus over the course of a year. This fee will be payable by the settlor whether or not the trust assets earned any cash during the year or showed any kind of profit. The trustee will also be eligible to receive commissions from the purchase by him on behalf of each trust of certain types of investments, but not securities. In each instance where a settlor expresses an interest in having his money invested in the type of investment from which the trustee can earn a sales commission, the trust instrument will fully disclose the fact that the trustee may earn such a commission. No fee will be paid to the trustee at the time the trust document is executed as consideration for establishing the trust. The trustee will not be required to post any performance bonds.

No representation will be made to any settlor prior to or after executing a trust agreement regarding any promised or guaranteed rate of return on property given to the trustee by the settlor. The trustee will make no representations that the settlor will be protected from any loss or decline in value of the property delivered to or purchased by the trustee. The trustee will not be required to consult with any settlor or beneficiary prior to making any investment decision.

The trustee will be liable to the settlor for damages caused by deviations from the terms of the trust agreement. He will also be held to be duties and liabilities of common law trustees and fiduciaries as are found in the Michigan Revised Probate Code and at common law. He will be expected to adhere to the duty to invest, to obey, to avoid commingling and self dealing, the duty of loyalty, etc.

I am of the opinion that the trusts described here do not constitute "securities" as that term is defined in Section 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b(1). They could only be conceived to be securities under the category of "investment contract" which appears in Section 2(1). In the case of SEC v. W.J. Howey Co., 328 U.S. 293 (1946), the Supreme Court defined an "investment contract" as "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits soley from the efforts of the promoter or third party." Id. at 298-299.

As the property contained in each trust will be individually maintained and segregated from that of all other trusts, I do not believe that these trusts could be considered to be one, larger "common enterprise." The only time that assets from more than one trust would be combined in any way would be in the case of extra cash being deposited in a single interest-bearing account either at a bank or in a money market fund. However, the earmarking that the trustee would employ and the fungible nature of any cash held by a bank or fund, such that withdrawal of one trust's funds would have no effect on the security or interest earned by cash deposited from any other trust, vitiates any practical similarity between this form of investment and a "common enterprise" as envisioned by the authors of the Howey opinion.

Neither can it be said that the settlors will look solely to the efforts of others for profits. It is the settlors who will authorize the trustee to invest trust assets in specific areas. These areas may be amended, expanded or deleted upon demand by the settlors, independently of each other and without prior consent of the trustee. In this manner each settlor participates in making decisions which directly affect the investment activities of the trust he creates.

If the trusts described herein are not "securities" as that term is defined in 15 U.S.C. § 77b(1), then it follows that the trusts are not "persons" as that term is defined in 15 U.S.C. § 77b(2), that neither the trustee not the settlor is an "issuer" as that term is defined in 15 U.S.C. § 77b(4), and that the execution of a trust agreement by the settlor and trustee and the transfer of property to the trustee to own and administer in trust does not constitute a "sale" as that term is defined in 15 U.S.C. § 77b(3).

In my opinion the trusts described herein are indistinguishable from common law trusts which have existed without regard to the federal securities laws since the adoption of the Securities Act of 1933. The common law and codes such as the Michigan Revised Probate Code have successfully regulated trusts and trustees for decades, if not centuries. I also find it difficult to believe that Congress intended the federal securities laws to supplement or supplant the common law or state statutes regarding trusts.

I have been unable to discover any case law or published articles which discuss in any way the possible application of federal securities laws to private individual trusts or their exemption from the purview of the securities laws. I have read the transcripts of all Congressional committee meetings and floor debates that preceded the adoption of the Securities Act and I could find no mention of individual private trusts therein. I would therefore appreciate hearing the Commission's opinion on this issue.

I am also interested in learning whether the act of establishing and administering the trusts described herein will cause my client to be considered an "investment adviser" as that term is defined in § 202(a)(11) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-2(a)(11) and therefore violating § 203(a) of the Advisers Act, 15 U.S.C. § 80b-3.

Section 202(a)(11) of the Advisers Act generally defines an investment adviser as:

> *[A]ny person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.... 15 U.S.C. § 80b-2(a)(11).*

Even if the Commission believes the trusts described herein are securities, the question arises whether the compensation earned by the trustee is the same kind of "compensation" contemplated by the above-quoted section of the Advisers Act. I believe that it is not.

The trustee will be compensated in only two ways. He will earn annually a flat percentage of the average value of each trust corpus for that year. He will also receive a commission for each purchase of certain types of assets that the settlor may specifically authorize the trustee to deal in. These types of assets will not include securities. The status of the trustee as a commissioned sales agent for these types of assets will be fully disclosed in the trust agreement. The trustee will be authorized by the settlor in the trust agreement to receive these commissions. The trustee will receive no fee for establishing the trust nor will he charge a fee for consulting with a potential trust settlor prior to the execution of a trust agreement or for negotiating its terms with the settlor.

There is no nexus between the compensation earned by the trustee and any statements he may make to the settlor prior to the creation of the trust. Fees will only be derived from the administration of the trust, if one is subsequently established. This cannot be considered to be the exchange of money for advice regarding the value of or the advisability of investing in securities. I am convinced that the administration of the trusts themselves does not constitute the act of an investment adviser, as the trustee, as legal owner of the trust corpus, "advises" himself when he makes investment decisions for the trust. Selzer v. The Bank of Bermuda, Ltd., 385 F.Supp. 415 (S.D.N.Y. 1974), In re Loring, 11 S.E.C. 885 (1942).

I also question whether, despite the trusts possibly being considered "securities" by the Commission, the trustee could nonetheless be considered to be an unregistered "dealer" as that term is defined in the Securities Exchange Act of 1934. Section 3(a)(5) of the Exchange Act defines "dealer" as:

> *[A]ny person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business. 15 U.S.C. § 78c(a)(5).*

A common law trustee, who is charged with a duty to invest the trust corpus, is typically limited in his investing discretion to conservative securities. He does not, however, buy and sell securities in a manner consistent with that of the usual securities "dealer." The trustee does not make a profit on these transactions as does the "dealer."

The trustee, my client, will place orders to buy and sell securities, but through a stockbroker as a regular customer. Because trustees are the record owner of their trust's corpuses, my client will be buying and selling securities "for his own account." However, the trustee will not be buying and selling these securities as part of a regular business. By the terms of the trust agreement he will not be entitled to receive commissions on securities transactions. Because there is no profit earned by him as a result of purchases and sales of securities he may make as trustee for these trusts, I do not believe he could be considered to be conducting a "business" as a "dealer" does. If he is not considered to fit the definition of "dealer" found in § 3(a)(5) of the Exchange Act, 15 U.S.C. § 78c(d)(5), then he cannot be considered to be violating § 15(a)(1) of the Exchange Act, 15 U.S.C. § 78o(a)(1), i.e., operating as a dealer without being registered as such.

Let me repeat that I am unaware of any authorities that have either held or even hypothecated that trustees of private, individual common law trusts fall under the regulatory purview of any of the federal securities laws. Accordingly, any opinion by the Commission is this area would not only reassure me and my client, but would provide useful direction for the entire legal community.

Very truly yours,
Richard W. Ingalls, Jr.