CHURCH ALLIANCE

Acting on Behalf of Church Benefits Programs

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COMMENT

February 22, 2011

By Hand Delivery

David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Proposed Regulations on Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, RIN 3038—AD25

Dear Mr. Stawick:

I. INTRODUCTION

We are pleased to submit this comment letter, on behalf of the Church Alliance, regarding the regulations proposed by the Commodity Futures Trading Commission (CFTC or Commission) on business conduct standards for swap dealers (SDs) and major swap participants (MSPs) with counterparties.[1] Our comments are directed toward clarifying that "church plans" and the pension boards that maintain them are included within the definition of the term "Special Entity" for purposes of these regulations, and requesting clarification as to when an SD is deemed to be acting as an advisor to a Special Entity.

The Church Alliance is a coalition of thirty-seven (37) denominational benefit programs that provides pensions and health benefits to more than one million clergy, lay workers, and their family members. These benefit programs are defined as "employee benefit plans" and "church plans" under Sections 3(3) and 3(33) of the Employee Retirement Income Security Act of 1974 (ERISA), respectively, and therefore come within the definition of a "Special Entity" under Sec

[1] 75 Fed. Reg. 80637 (December 22, 2010) (Proposing Release).

tion 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which enacted a new Section 4s of the Commodity Exchange Act (CEA) that will become effective in July to govern the registration and regulation of SDs and MSPs. A church plan is an employee benefit plan as defined in Section 3(3) of ERISA.[2] Under ERISA Section 3(33)(C)(i), a church plan includes a plan maintained by an organization, the principal purpose or function of which is the administration or funding of a plan or program to provide retirement or welfare benefits for employees of a church or a convention or association of churches, if the organization is controlled by, or associated with, a church or a convention or association of churches. Church benefits boards, like those represented by the Church Alliance, are organizations described in ERISA Section 3(33)(C)(i). A church benefits board is also (i) typically an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (Code), (ii) an organization described in Code Section 414(e)(3)(A), which describes organizations that are permitted to administer or fund church plans, and (iii) exempt from treatment as an investment company pursuant to Section 3(c)(14) of the Investment Company Act. Our references throughout this letter to church plans should accordingly also be read to include church benefits boards.

To fulfill obligations to their beneficiaries, church plans invest in a wide variety of asset classes, and as part of their investment and risk management policies, they have authorized the use of certain derivatives. The authorized derivatives include futures, forwards, and swaps. Accordingly, the denominational benefits boards represented through the Church Alliance have an interest in the regulation of the swap market.

II. DEFINITION OF SPECIAL ENTITY

A. Proposed Definition

New CEA Section 4s(h) authorizes the CFTC to adopt rules or regulations establishing general business conduct standards for SDs and MSPs. In addition, that section authorizes the CFTC to adopt rules or regulations mandating enhanced duties for SDs and MSPs when acting as advisors or counterparties to "Special Entities." The term Special Entity is defined to include, among others, "any employee benefit plan, as defined in Section 3 of [ERISA]."[3] As noted by the CFTC in the Proposing Release, because Dodd-Frank, in defining a Special Entity, refers to any employee benefit plan as defined in Section 3 of ERISA, the term includes employee benefit plans that are not subject to regulation under ERISA, such as church plans.[4]

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[2] ERISA Section 3(3) defines the term "employee benefit plan" to mean "an employee welfare benefit plan or an employee pension benefit plan or a plan which is both an employee welfare benefit plan and an employee pension benefit plan." An employee welfare benefit plan provides medical benefits to participants and beneficiaries and an employee pension benefit plan provides retirement income to employees. *See* ERISA Sections 3(1)(A) and 3(2)(A)(i), respectively.

[3] New CEA Section 4s(h)(2)(C)(iii).

[4] 75 Fed. Reg. 80637, at 80649 &n.89.

Nevertheless, the CFTC also noted several letters submitted during the pre-proposal stage that raised issues concerning possible ambiguities in the statutory definition of Special Entity. The CFTC did not propose to clarify the Special Entity definition in the Proposing Release and the definition of that term in proposed Regulation §23.401 simply repeats the statutory language.[5] The CFTC cited the range of issues surrounding the definition of Special Entity as a reason not to propose to clarify the definition but, instead, to request comment on the definition in general and on several specific issues, including:

> "• Should the definition 'employee benefit plans, as defined in Section 3 of ERISA' be clarified in any way?
>
> "• Should the definition 'employee benefit plans, as defined in Section 3 of ERISA' be limited to plans subject to regulation under ERISA?
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> "• Should the Commission 'look through' an entity to determine whether it is a Special Entity for the purposes of these rules? If so, why? If not, why not? If so, should the Commission clarify that master trusts, or similar entities, that hold assets of more than one pension plan from the same plan sponsor are within the definition of Special Entity?"[6]

B. Clarifications to Proposal

1. Treatment of Church Plans

In response to the specific questions posed by the CFTC, the Church Alliance recommends that the CFTC revise the proposed definition of Special Entity to include a separate paragraph stating, "A plan defined as a church plan in Section 3(33) of Title I of the Employee Retirement Income Security Act of 1974 with respect to which no election has been made under 26 U.S.C. 410(d)." This revision would make the definition of Special Entity in Regulation §23.401 consistent with CFTC Regulation 4.5, which excludes various employee benefit plans from being construed as commodity pools, and has separate paragraphs excluding, among others, "governmental plans" and "church plans."[7] Such a revision to the proposed definition will make clear what Congress intended to provide in Dodd-Frank, that church plans are Special Entities deserving of enhanced conduct by SDs and MSPs advising or entering into swaps with them.

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[5] Dodd-Frank Section 721(b) authorizes the CFTC to adopt a rule to define any term included in an amendment to the CEA made by Dodd-Frank Title VII, Subtitle A.

[6] 75 Fed. Reg. 80637, at 80649.

[7] *See* 17 C.F.R. § 4.5 (a)(4)(iii) and (v).

Accordingly, the answer to the second question cited above is clearly *no*, the definition "employee benefit plans, as defined in Section 3 of ERISA" should *not* be limited to plans subject to regulation under ERISA. Because new CEA Section 4s(h)(2)(C)(iii) uses the quoted language and the phrase "defined in" rather than the more limited "subject to," the plain meaning of the statute is that any employee benefit plan defined in ERISA, including a church plan, should be treated as a Special Entity. The Church Alliance submits that, as a matter of policy, church plans should not be treated differently than ERISA-covered plans and governmental plans when entering into swaps with SDs and MSPs that would not be traded on designated contract markets or swap execution facilities.[8]. During the CFTC open meeting on December 9, 2010, at which these proposals were presented, Commissioner Chilton noted that those pension plans subject to ERISA regulation are subject to several requirements, and he inquired of staff whether the CFTC's proposals were duplicative. The staff responded that they had been in contact with their counterparts at the Department of Labor (DOL), who did not express concern that the proposals would interfere with DOL's administration of ERISA, but this colloquy demonstrates that, if anything, additional duties are appropriate for SDs and MSPs dealing with plans *not* subject to regulation under ERISA, as compared to plans already subject to the regulation and protections afforded by ERISA.

Swaps have not previously been subject to regulation in the United States and, therefore, there is a lack of precedent for parties and their counsel to rely upon in deciding whether it is lawful to enter into particular transactions. Moreover, some of the relevant terms in Dodd-Frank are ambiguous and could be interpreted in multiple ways. Consequently, the CFTC should take this opportunity to exercise its authority under Dodd-Frank Section 721(b) so that the definition of the term Special Entity includes a paragraph stating "A plan defined as a church plan in Section 3(33) of Title I of the Employee Retirement Income Security Act of 1974 with respect to which no election has been made under 26 U.S.C. 410(d)." Such a clarification will help to assure that individuals who dedicate their lives to working for religious institutions are not disadvantaged in terms of the treatment of their pensions or health benefits compared to other workers.

2. Treatment of Church Benefits Boards

The CFTC further needs to clarify that the definition of a Special Entity includes church benefits boards that hold the assets of church plans, so that such organizations receive the protections afforded Special Entities with respect to swaps under the CEA and the implementing regulations. The CFTC also requested comment on the following specific issues:

> "• Should the Commission 'look through' an entity to determine whether it is a Special Entity for the purposes of these rules? If so, why? If not, why not? If so, should the Commission clarify that

[8] Proposed Regulation 23.450, pursuant to paragraph (g) thereof, would not apply to a swap that is initiated on a designated contract market or swap execution facility where the SD or MSP does not know the identity of the Special Entity.

> master trusts, or similar entities, that hold assets of more than one pension plan from the same plan sponsor are within the definition of Special Entity?"

The CFTC should adopt a definition of the term Special Entity that makes clear that it includes a church benefits board that holds the assets of one or more church plans, church endowments, and other church-related funds on a commingled basis. Such a definition would be reflective of the close and unique relationship between church benefits boards and their constituent church plans, a relationship recognized in both ERISA and the Code.

Dodd-Frank provides that commercial end users should be able to conduct swap transactions largely as they have been accustomed to. Church denominations have organized themselves so that church pension boards are typically the entities that handle investments for the denomination's benefit plans and for other church assets, including church endowments. The use of church benefits boards is more administratively efficient, and such boards have greater resources, investment skills and market clout than the individual churches and other denominationally affiliated organizations that contribute to the boards.

The functions of a church benefits board are similar to those of a tax-exempt trust that is commonly used as the funding vehicle for a qualified private sector pension plan. Church benefits boards may also be likened to a master trust that is established by several multiple-employer pension plans. The CFTC has previously provided relief to the trustees of such a master trust similar to the relief available to trustees of individual pension plans,[9] providing a precedent for the church benefits board context. The CFTC, by making clear that a church benefits board is to be treated like a church plan and given Special Entity status, will provide guidance to fulfill the purposes of the regulation, while at the same time not attempting to dictate or micromanage how the religious denominations of America have chosen to structure themselves.

We note also that the ERISA plan asset rules themselves often "look through" commingled investment vehicles and, in such cases, subject such commingled investment vehicles to the same ERISA requirements as apply to the underlying plans. In addition, the legislative history under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) and the Internal Revenue Service regulations under Code Section 403(b) expressly recognize the right and authority of church benefits boards to hold, on a commingled basis for investment purposes, the assets of Code Section 401(a) qualified plans, Code Section 403(b) plans, and other non-plan church-related assets.[10] Further, the investment company exemption provided in Section 3(c)(14) of the

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[9] CFTC Staff Letter 86-8, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) § 23,014 (April 4, 1986). Although that letter was issued almost 25 years ago, it has been cited favorably within the last year. *See* CFTC Staff Letter 10-06, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) § 31,557, at 64,025 & n.11 (March 29, 2010).

[10] TEFRA Conf. Rept. Pub. L. 97-248, 1982-2 C.B. 462, 524-5; Internal Revenue Service Pvt. Ltr. Rul. 200229050 (July 19, 2002); Internal Revenue Service Reg. Sec. 1.403(b)-9(a)(6).

Investment Company Act of 1940 to church benefit boards as well as to church plans, supports treating a church benefits board similarly to a church plan, and both as Special Entities under Dodd-Frank.

III. SWAP DEALER AS ADVISOR

A. Proposed Definition

Dodd-Frank provides that SDs that act as advisors to Special Entities are subject to a general antifraud prohibition, have a duty to act in the best interests of the Special Entity, and must make reasonable efforts to obtain information necessary to make a reasonable determination that any swap recommended is in the best interests of the Special Entity. The information that an SD must make reasonable efforts to obtain includes the financial and tax status, and the investment or financing objectives, of the Special Entity, as well as any other information that the CFTC may prescribe by rule or regulation.[11] The CFTC has proposed Regulation § 23.440 to establish requirements for SDs acting as advisors to special entities. For purposes of that section, the term "acts as an advisor to a Special Entity" would include where an SD recommends a swap or trading strategy that involves the use of swaps to a Special Entity. The term would not include an SD's provision of: (1) information to a Special Entity that is general transaction, financial, or market information; or (2) swap terms in response to a competitive bid request from the Special Entity. The CFTC's proposed definition does not address what it means to act as an advisor in connection with any other dealings between an SD and a Special Entity.[12]

B. Clarifications to Proposal

The Church Alliance believes that the CFTC should clarify whether providing certain required information makes an SD an advisor to a Special Entity. For example, the CFTC proposes to require that, at a reasonably sufficient time prior to entering into a high-risk complex bilateral swap with a Special Entity, an SD provide a scenario analysis designed in consultation with the Special Entity to allow the Special Entity to assess its potential exposure. The CFTC notes that the scenario analysis would apply when "high-risk complex bilateral swaps" are offered or recommended.[13] The CFTC should revise proposed Regulation 23.440(a) to make clear that an SD who provides the disclosures of material information required by proposed Regulation 23.431 for a high-risk complex bilateral swap that is offered, but not recommended, would not be considered to be an advisor to a Special Entity. We reiterate that, because swaps have not previously been subject to regulation in the United States and, therefore, there is a lack of precedent for parties and their counsel to rely upon in deciding whether particular transactions could be lawfully entered into, and because certain of the relevant terms in Dodd-Frank are ambiguous

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[11] New CEA Section 4s(h)(4).

[12] 75 Fed. Reg. 80637, at 80650.

[13] 75 Fed. Reg. 80637, at 80644.

and could be interpreted in multiple ways, the CFTC should take this opportunity to exercise its authority under Dodd-Frank Section 721(b) to provide as much guidance as possible regarding what it means for an SD to act as an advisor to a Special Entity. That will serve the interests of both parties in having a clear understanding of rights and obligations in connection with particular swap transactions.

IV. CONCLUSION

The Church Alliance appreciates the opportunity to comment upon the proposed regulations that would establish business conduct standards for SDs and MSPs. We believe that the definition of the term "Special Entity" in these regulations should refer specifically to church plans and should include church benefits boards. Further, the CFTC should provide additional guidance as to when an SD is deemed to be acting as an advisor to a Special Entity.

We would welcome the opportunity to discuss our recommendations for revisions to the proposals in greater detail with Commissioners and staff at your convenience. Please feel free to contact the undersigned at 202-778-9447 if you have any questions or wish to discuss this matter further.

Sincerely,

Daniel F. C. Crowley
Partner, K&L Gates
On Behalf of the Church Alliance