



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and  
Intermediary Oversight

Gary Barnett  
Director

CFTC Letter No. 14-145  
Exemption  
November 12, 2014  
Division of Swap Dealer and Intermediary Oversight

**Re: Request for relief from commodity pool operator obligations under Commission regulations 4.22 and 4.24(s) with respect to an insurance-linked securitization vehicle**

Dear :

This is in response to your letter dated December 10, 2013 to the Division of Swap Dealer and Intermediary Oversight (the "Division") of the U.S. Commodity Futures Trading Commission (the "Commission" or the "CFTC"). You request on behalf of "A", a registered commodity pool operator, and the directors of "B" (the "Issuer") no-action relief from: (1) the financial statement requirements under Commission regulation 4.22; and (2) the disclosure requirements of Commission regulation 4.24(s) with respect to the Issuer.

### **Background**

Based upon the representations made in your letter and other telephone and email correspondence (altogether, the "Correspondence"), which includes the Offering Circular of the Issuer, dated "D" (the "Offering Circular"), the Offering Circular Supplement No. 1 to the Offering Circular (the "Offering Circular Supplement"), and the Pricing Supplement No. 1 for the "E" Notes to the Offering Circular, we understand the facts to be as follows.

You state that the Issuer entered into a transaction designed to transfer insurance risk relating to excess mortality from "C", acting for itself and certain of its affiliates (the "Protection Buyer"), to the investors in the insurance-linked notes offered by the Issuer (the "ILS Notes") through a Risk Transfer Agreement (the "RTA"). The RTA provides for quarterly payments from the Protection Buyer to the Issuer, which, together with the returns on the collateral owned by the Issuer, are used to fund interest payments on the ILS Notes, in exchange for contingent payments from the Issuer to the Protection Buyer related to the occurrence of certain excess mortality events "F" (the "Excess Mortality Events"). In order to fund its potential obligations under the RTA, the Issuer issues the ILS Notes, the proceeds of which are invested in a pool of high quality instruments, such as "AAA"-rated bonds issued by the European Bank for Reconstruction and Development (the "EBRD") and U.S. Treasury-only money market funds.

“A”

Page 2

These investments serve as collateral for the obligations of the Issuer under the RTA. You state that all potential payments from the Issuer to the Protection Buyer pursuant to the RTA are 100% prefunded and collateralized by the investment of the proceeds of the ILS Notes. In particular, you state that, currently, the Issuer has invested in \$ million of EBRD notes, issued on “G” and maturing on “H”. You state that these EBRD notes have a put provision whereby they can be cashed out at 100% of par value to pay off the ILS Notes at their maturity, or to fund a claim from the Protection Buyer due to the occurrence of the Excess Mortality Events.

You state that, because of the nature of the Issuer, it may meet the definition of a “commodity pool” under section 1a(10) of the Commodity Exchange Act (the “Act”), which would cause the commodity pool operator (a “CPO”) of the Issuer to register as such pursuant to section 4m of the Act and comply with Part 4 of the Commission’s regulations with respect to the Issuer. As a result, “A”, as the CPO of the Issuer, is registered as a CPO and must comply with Part 4 of the Commission’s regulations with respect to the Issuer, including, without limitation, compliance with Commission regulations 4.22 and 4.24(s), from which “A” is requesting relief.<sup>1</sup>

### **Requested Relief**

On behalf of “A” and the directors of the Issuer, you request no-action relief from the financial statement requirements under Commission regulation 4.22 and the disclosure requirements of Commission regulation 4.24(s) with respect to the Issuer.

### **Commission regulation 4.22**

In support of your relief request with respect to Commission regulation 4.22, you state that the financial statements required pursuant thereto would not provide relevant information for the investors of the Issuer. You state that this is because the Issuer is not an operating company, but rather a securitization vehicle with predefined assets and liabilities, the activities of which largely entail holding eligible investments, receiving quarterly payments from the Protection Buyer, and using such investments and payments, as applicable, to pay its obligations under the RTA or its investors in accordance with the terms of the ILS Notes. In particular, you state that there is no management of assets and liabilities over the lifetime of the Issuer. You state that the assets consist of high quality instruments, such as “AAA”-rated bonds issued by the EBRD, U.S. Treasury-only money market funds, and any amounts to be received under the RTA, and the liabilities consist of payments due under the RTA triggered by the occurrence of the Excess Mortality Events and payments due to the holders of the ILS Notes.<sup>2</sup> With respect to the

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<sup>1</sup> With respect to the CPO obligations relating to the Issuer, the directors of the Issuer have entered into a CPO delegation agreement dated “D” with the Issuer and “A” to delegate to “A” all CPO responsibilities under the Act, Commission regulations, and the rules of the National Futures Association that the directors may incur due to the issuance of the ILS Notes. You also state that the directors of the Issuer and “A” meet the requirements of the CPO delegation no-action relief provided in CFTC Staff Letter No. 14-126.

<sup>2</sup> You state that the following is a current summary of the assets and liabilities of the Issuer:

1. The Issuer’s only significant asset is \$ million of EBRD notes, issued on “G” and maturing on “H”.

liabilities of the Issuer, including the payments under the RTA to the Protection Buyer or payments to the holders of the ILS Notes, you state that the Issuer’s ability to meet them will not be subject to material liquidity or market value risk from the liquidation of any underlying collateral and that proceeds of the collateral should be available at such times and in such amounts as may be required to meet its liabilities. As a result, you state that such risks will not have a material effect on the pricing of the ILS Notes or pose a material risk to any payment due under the RTA or on the ILS Notes.<sup>3</sup>

The Offering Circular Supplement that you provided states that “A” will provide “Available Information”<sup>4</sup> and the “Rule 144A Information”<sup>5</sup>, each as defined in the Offering Circular Supplement, to current and prospective investors of the Issuer. The Offering Circular Supplement states that this information includes, among other things, the final execution copy of the RTA, the indenture, the management agreement, and the series supplement. The Offering Circular Supplement states that this information also includes notice of payments made to and by the Issuer pursuant to the RTA, the amount of such payments, and the increase or decrease in the

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2. The Issuer’s only significant liability is \$ million of “E” Notes, issued on “D” and maturing on “I”, with potential extensions through “J”.
  3. Under the RTA, the Issuer has a contingent liability of up to \$ million. If triggered, this liability would be offset, dollar-for-dollar, by a reduction in the Issuer’s liability to the holders of its “E” Notes.
  4. At the end of each calendar quarter, the Issuer receives a risk transfer payment from the Protection Buyer and an interest payment from the EBRD. The combined total is approximately \$ million, which is remitted to the holders of the Issuer’s “E” Notes within one or two business days.
  5. The Issuer’s operating and offering expenses are reimbursed by the Protection Buyer.

<sup>3</sup> Staff notes that the U.S. Securities and Exchange Commission (the “SEC”) recently adopted final rules to address certain money market fund risks. *See* SEC Release No. 33-9616. Staff is in the process of considering those rules and the risks sought to be addressed thereunder.

<sup>4</sup> “Available Information” as defined in the Offering Circular Supplement includes the following (each as defined in Offering Circular Supplement): the Indenture; the Series Supplement; the Mortality Calculation Agent Agreement; the Management Agreement; any Event Notice; any Event Report and Event Loss Report; notice of any Early Redemption Event or Optional Redemption; any Optional Extension Notice, including notice of any Partial Extension; any Optional Extension Discontinuation Notice; notice of any Issuer Payment or Principal Reduction, including the amounts thereof; notice of any RTC Payment or Principal Increase, including the amounts thereof; any EBRD Put Notice; any information relating to a downgrade of the EBRD (if any) that is made available to the Issuer; the nominal amount of the applicable EBRD Notes, the applicable securities identification number for the applicable EBRD Notes and the then-current issuer rating of the EBRD by Standard & Poor’s Credit Market Services Europe Limited; for any Money Market Fund shares constituting a Permitted Investment for such Class of Notes, the name and ratings of the relevant Money Market Fund and the market value of and accrued dividend for such Money Market Fund Shares, all of which will be made available on a monthly basis to the extent such information is available to the Issuer; notice of any Event of Default under the Indenture relating to such Class of Notes; notice of any Unwind Offer or related Tender Offer and the results thereof, including whether a Tender Offer Full Redemption Event has occurred; and any supplemental information the Risk Transfer Counterparty may, in its discretion, furnish to the Issuer for distribution to the Holders of such Class of Notes.

<sup>5</sup> Rule 144A Information is defined in the Offering Circular Supplement as “the information required to be delivered pursuant to Rule 144A(d)(4) under the Securities Act of 1933, as amended, (or any similar successor rule) to permit compliance with Rule 144A in connection with resales of the Notes of such Class.” You state that this consists of: a very brief statement of the nature of the business of the Issuer and the products and services it offers; and the Issuer’s most recent balance sheet and profit and loss and retained earnings statements, and similar financial statements for such part of the two preceding fiscal years as the Issuer has been in operation (the financial statements should be audited to the extent reasonably available).

principal held by the Issuer. Furthermore, the Offering Circular Supplement states that this information includes information relating to the EBRD notes, including the nominal amount and credit rating, and the U.S. Treasury-only money market funds, including the market value and accrued dividend.

#### Commission regulation 4.24(s)

In support of your request for relief with respect to Commission regulation 4.24(s), you state that the requirements of Commission regulation 4.24(s)(1)-(2) are not relevant, because the amount of “subscriptions” for purposes of Commission regulation 4.24(s) is known ahead of closing and disclosed in the offering prospectus supplement and/or pricing supplement received by all purchasers of the ILS Notes, because a predefined principal amount of the notes is to be issued. You also state that the requirements of Commission regulation 4.24(s)(3)-(5) are not relevant, because the RTA is entered into concurrently with the issuance of the ILS Notes.

#### **Regulatory Purpose**

Commission regulation 4.22 requires a registered CPO to distribute periodic account statements and an annual report to each pool participant and electronically submit a copy of the annual report and key financial balances from the annual report to the National Futures Association (“NFA”) with respect to each pool that it operates. The principal purpose of the financial reporting required by Commission regulation 4.22 is to ensure that pool participants receive accurate, fair, and timely information on the overall trading performance and financial condition of the pool.

Commission regulation 4.24(s) requires a registered CPO to disclose to each prospective participant in each pool that it operates or intends to operate pursuant to Commission regulation 4.21 and file with NFA pursuant to Commission regulation 4.26(d) various information relating to the inception of trading in a disclosure document. The principal purpose of the disclosure document, including the disclosures required by Commission regulation 4.24(s), is “to protect pool participants—particularly those who are unsophisticated in financial matters—by ensuring that they are informed about the material facts regarding the pool before they commit their funds.”<sup>6</sup>

#### **Relief Granted**

Based upon the representations made in the Correspondence, the Division believes that granting relief is neither contrary to the purposes of Commission regulations 4.22 and 4.24(s) nor to public interest. Accordingly, pursuant to the authority delegated by Commission regulations 140.93 and 4.12(a), the CPO of the Issuer is hereby granted relief from the following requirements, subject to satisfying the conditions for relief provided below:

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<sup>6</sup> 44 FR 1918, 1920 (January 8, 1979).

1. The financial statement requirements under Commission regulation 4.22 with respect to the Issuer. These requirements will be replaced by the disclosures required in the conditions for relief provided below.
2. The specific requirements of Commission regulation 4.24(s). The information required under that section is moot due to the structure of the transaction.

#### Conditions for Relief

1. There is no management of assets and liabilities over the lifetime of the Issuer.
2. The CPO of the Issuer must provide all of the following disclosures:
  - A. To the existing investors of the Issuer:
    - i. All of the following information on at least a monthly basis:<sup>7</sup>
      - a. All payments that have been made during the month prior pursuant to the RTA and all payments that have at least a reasonable possibility<sup>8</sup> of being payable pursuant to the RTA.<sup>9</sup>
      - b. Material performance information concerning the assets supporting the ILS Notes or the obligations under the RTA, including without limitation, any swaps held in the Issuer’s portfolio.
    - ii. Basic, material information concerning all of the following, to the extent an existing investor has not received such information, at the same time or before the information required in 2.A.i. above is first provided:
      - a. The terms and conditions of the RTA including the risks agreed to be borne by the Issuer pursuant thereto.
      - b. The structure of the securities and distributions thereon.
      - c. The nature and servicing of the assets supporting the ILS Notes and the obligations under the RTA including, without limitation, a

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<sup>7</sup> If this information is provided a monthly basis, it must be provided during the same time frame when the periodic account statements must be provided pursuant to Commission regulation 4.22(a) and (b).

<sup>8</sup> “Reasonable possibility” is defined in paragraph 3 (under “reasonably possible”) of Statement of Financial Accounting Standards No. 5 (“FAS No. 5”), which provides the level of assurance of an event that will trigger a disclosure event under paragraph 10 of FAS No. 5.

<sup>9</sup> This must include the remaining principal amount of eligible investments after all such payments, not including any anticipated discount in the case of zero coupon bonds or other assets purchased at a discount to par.

discussion of any swaps held in the Issuer’s portfolio, including the function of such swaps.

d. The Issuer’s counterparties.

B. To the prospective investors of the Issuer:

i. The most recent copy of the information required to be provided to the existing investors of the Issuer described in 2.A. above.

C. If the CPO of the Issuer knows or should know that the information required under 2.A. or 2.B. above is materially inaccurate or incomplete in any respect, the CPO of the Issuer must correct that defect and must distribute the correction consistent with Commission regulation 4.26(c).

3. The CPO of the Issuer must calculate net asset value with respect to the Issuer in the following manner:

A. Fixed income securities rated BB and higher should be treated as debt.

B. All other fixed income securities and equity tranches should be treated as equity.

The relief issued by this letter does not excuse the CPO of the Issuer from compliance with any other applicable requirements contained in the Act or in the Commission regulations issued thereunder. In particular, the Division notes that the CPO of the Issuer is still required to comply with Commission regulation 4.24(w), which requires the CPO of the Issuer to disclose all material information to pool participants, and Commission regulation 4.26(c), which requires the CPO of the Issuer to correct any material inaccuracy or incompleteness in its disclosures to pool participants and furnish such correction to pool participants. Further, this letter, and the relief contained herein, is based upon the representations made to the Division. Any different, changed or omitted material facts or circumstances might render this letter void. Finally, the Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the relief provided herein, in its discretion.

“A”

Page 7

Should you have any questions, please do not hesitate to contact Amanda Olear, Associate Director, at 202-418-5283, or Chang Jung, Special Counsel, at 202-418-5202.

Very truly yours,

Gary Barnett  
Director  
Division of Swap Dealer and  
Intermediary Oversight

cc: Regina Thoele, Compliance  
National Futures Association, Chicago