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Division of Swap Dealer and Intermediary Oversight

Gary Barnett
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CFTC Letter No. 14-152
No-Action
December 18, 2014
Division of Swap Dealer and Intermediary Oversight

Securities Industry and
Financial Markets Association
120 Broadway, 35th Floor
New York, NY 10271

RE: Request for Interpretative or No-Action Relief from Commodity Pool Operator Registration for Operators of Insurance-Linked Securities Issuers

Ladies and Gentlemen:

This is in response to your letter ("Correspondence"), dated August 18, 2014, to the Division of Swap Dealer and Intermediary Oversight ("Division") of the Commodity Futures Trading Commission ("Commission"), as well as ongoing discussions with Division staff, in which you requested interpretative or no-action relief from commodity pool operator ("CPO") registration for entities engaging in insurance-linked securities ("ILS") transactions.[1] Specifically, you note that "due to the expansion of the definition of 'commodity interest' to include swaps… certain vehicles participating in ILS transactions may constitute commodity pools under the [Commodity Exchange Act ("CEA")]."[2] Therefore, you are requesting relief from CPO registration similar to that available under Regulation 4.13(a)(3),[3] provided that the

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[1] The Correspondence requests relief from CPO registration on behalf of the issuers of insurance-linked securities ("ILS Issuer" or "Issuer"). However, based on the facts presented in the Correspondence, it appears that the ILS Issuers could be potential commodity pools in this context. Therefore, the relief granted herein is provided with respect to the operators of the ILS Issuers.

[2] Correspondence, p. 1. 7 U.S.C. 1 *et seq*. As explained further below, an ILS transaction uses a risk transfer contract that shifts defined insurance-related risks from an insurance company to investors, who purchase and hold bonds issued by the ILS Issuer, a special purpose vehicle formed by that insurance company. You have represented that such risk transfer contract may be in the form of ISDA-based swap agreements, reinsurance contracts, or other similar risk transfer contracts that could be considered swaps under the CEA.

[3] 17 CFR 4.13(a)(3).

entities engaging in ILS transactions and seeking such relief agree to specific alternative conditions outlined in the Correspondence and explained herein.

Background Information on ILS Transactions and Issuers

The Correspondence provides the following background information on what ILS transactions are and how they function:

> "ILS transactions were first developed in the 1990s as a means of bringing additional capital to support the insurance industry in the devastating wake of Hurricane Andrew, which forced several insurers into receivership. ILS transactions allow insurance companies ("Protection Buyers") to obtain collateralized protection against insurance-related risks from the capital markets, pursuant to a risk transfer contract with the ILS issuer, a special purpose vehicle formed by the insurance company. ILS transactions provide protection for losses resulting from events such as earthquake, hurricane, tornado, hailstorm, fire, flood and other property and casualty related events, extreme mortality, extreme disease, longevity and other risks that are typically covered by insurance. A Protection Buyer typically initiates an ILS transaction to secure risk protection from the capital markets relating to its exposure to one or more insurance-related risks.
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> In a typical ILS transaction, the Protection Buyer causes a special purpose vehicle to be created, to act as the Issuer. The Protection Buyer enters into a risk transfer contract with the Issuer pursuant to which the Protection Buyer obtains protection against specified and clearly defined trigger events to which the Protection Buyer has exposure and anticipates [having such exposure] for the life of the ILS transaction (typically one to five years). For example, an insurance company that has historically had exposure to California earthquakes and wants to purchase protection against a major event might look to obtain protection against a portion of that risk from the capital markets. In order to support its obligations under the risk transfer contract, the Issuer sells bonds, notes, certificates or other similar instruments ("Bonds") in an amount equal to its maximum exposure under the risk transfer contract. The Protection Buyer makes payments under the risk transfer contract sufficient to cover the expenses of the Issuer and to pay interest to the holders of the bonds ("Bondholders"). The Bondholder[s'] interest payments consist of that portion of the Protection Buyer's payment designated for that purpose, plus the earnings on the investment of the proceeds from the Bond issuance (net of any payments made by the Issuer to the Protection Buyer under the risk transfer contract).
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> All proceeds of the Bonds are deposited into a collateral account that serves as security for the Protection Buyer and the Bondholders. Upon the occurrence of a specified trigger event, the contractual payment amount is paid to the Protection Buyer from the collateral account. Coverage provided by the Issuer is 100% secured by liquid collateral. Coverage provided by the Issuer cannot exceed the collateralized amount.

> Other than passing through interest payments, there are no further ongoing obligations for additional payments or collateral to be exchanged under the risk transfer contract. When amounts are transferred from the collateral account [to the Protection Buyer] to cover a specified trigger event under a risk transfer contract, the aggregate principal amount of the Bonds is written down in the amount of such transfer. At maturity and upon satisfaction of the risk transfer contract obligations to the Protection Buyer, funds from the collateral account are used [for] repayment of the remaining principal balance of the Bonds. The Bonds are offered and sold only to Bondholders who are qualified institutional buyers that, with respect to U.S. persons, are also qualified purchasers. Qualified purchasers are 'qualified eligible persons' as defined in CFTC Rule 4.7(a).
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> The Bonds in ILS transactions are typically offered by means of an offering circular that includes a risk analysis report prepared by an independent company experienced in the statistical modeling of insurance risk. The modeling company uses standard models widely employed by insurers and reinsurers in their own portfolio risk evaluations. The output of these models is expressed as estimates of expected loss, probability of attachment (where the first loss would be triggered under the Bonds), and probability of exhaustion (where the Bond principal would be reduced to zero). The risk analysis forms much of the basis on which the Bonds are evaluated, rated and priced[, and] is the output of many computer generated simulations of the relevant events run against the modeling company's database of property valuations and a notional portfolio of insurance risk."[4]

Legal Necessity of Relief from CPO Registration

Section 1a(10) of the CEA, added by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,[5] defines a commodity pool as "any investment trust, syndicate or similar form of enterprise operated for the purpose of trading in commodity interests,"[6] and this definition is identical to its regulatory counterpart, which was proposed and adopted by the Commission in 1981.[7] From the time of the regulatory definition's initial adoption in 1981, the Commission has declined to constrain the phrase "operated for the purpose of trading" to the narrowest of possible interpretations. The reasons that the Commission articulated for rejecting a narrow understanding of the phrase were grounded in its dual concerns for customer and market protection. The Commission noted in the Preamble to the 1981 rule that commenters were concerned that the definition was overly broad.[8] One commenter suggested a brightline percentage test as a function of commodity interests to other portfolio holdings to determine whether a collective investment scheme should be considered a pool. The Commission declined to set a specific percentage as a threshold over which an entity would be considered a commodity

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[4] Correspondence, pp. 2-3.
[5] Pub. L. 111-203, 124 Stat. 1376 (2010).
[6] CEA Section 1a(10), 7 U.S.C. 1a(10).
[7] *See* 17 CFR 4.10(d).
[8] 46 Fed. Reg. 26004, 26005 (May 8, 1981).

pool due to concerns that an entity which would not exceed the set trading level could still be marketed as a commodity pool to participants, who should still be afforded the protections under Part 4 of the Commission's regulations.[9]

Several other commenters suggested that the definition should be narrowed to only those funds whose "principal purpose" was the trading of commodity interests. The Commission rejected that suggestion because it could "inappropriately exclude from the scope of Part 4 rules certain persons who are, in fact, operating commodity pools."[10] Thus, the Commission recognized that there may be entities whose primary business focus may be outside the commodity interest sphere, yet may still have a significant exposure to those markets, which may implicate the Commission's concerns regarding both customer and market protection. The rejection of the more narrow "principal purpose" language further operated as an additional indicator of the Commission's broader understanding of the phrase "operated for the purpose of."

The Commission recently affirmed and refined this interpretation in the preamble to the final rule entitled "Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations."[11] Explaining its amendments to Commission Regulations 4.5 and 4.13(a)(3) to include swaps in the trading thresholds, the Commission stated, "any swaps activities undertaken by a CPO would result in that entity being required to register because there would be no *de minimis* exclusion for such activity. As a result, one swap contract would be enough to trigger the registration requirement."[12] This statement is the Commission's most recent guidance with respect to the relationship between an entity's swaps activity and the requirement that its operator register with the Commission as a CPO.

The Correspondence describes a structure in which an insurance company, the Protection Buyer, creates a special purpose vehicle, the ILS Issuer, with which it engages in a risk transfer contract, in order to transfer to private investors the risk of specified insurance-related trigger events to which the Protection Buyer is exposed. In order to raise and maintain the capital necessary to provide the specified protection to the Protection Buyer, the ILS Issuer collects premiums from the Protection Buyer, solicits investors to purchase the Bonds issued by it,[13] and

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[9] *Id.*
[10] *Id.* at 26006. The Commission's conclusion that commodity pools are not limited to those funds whose primary purpose is trading commodity interests is consistent with the Dodd-Frank Act's recent amendments to the CEA in Section 4m(3). Section 4m(3) was amended to exempt certain commodity trading advisors ("CTAs") from registration provided that their business does not primarily consist of acting as a CTA, and that the CTA does not serve as a CTA to a commodity pool that is engaged primarily in trading commodity interests. CEA Section 4m(3), 7 U.S.C. 6m(3). By its inclusion of commodity pools that engage primarily in trading commodity interests as a factor to differentiate between those CTAs required to be registered from those not required to register, this statutory exemption for CTAs recognizes that there may be entities that are properly considered commodity pools that are not engaged primarily in trading commodity interests.
[11] 77 Fed. Reg. 11252 (Feb. 24, 2012).
[12] *Id.* at 11258.
[13] The Correspondence describes the Bonds an ILS Issuer issues as "bonds, notes, certificates or other similar instruments." Correspondence, p. 2.

manages the pooled assets,[14] which will be used to make interest and principal payments to the Bondholders and/or to pay the Protection Buyer when a specified trigger event occurs.

The Correspondence states that "due to the expansion of the definition of 'commodity interest' to include swaps, … certain vehicles participating in ILS transactions may constitute commodity pools under the CEA." To the extent that the risk transfer contract between the ILS Issuer and the Protection Buyer could be considered a swap, and because of the pooling of assets belonging to the Bondholders and Protection Buyer by the ILS Issuer, as described in the Correspondence, the ILS Issuer could fall within the definition of "commodity pool" in Section 1a(10) of the CEA. That interpretation is consistent with the historical interpretation of the commodity pool definition. Notwithstanding the fact that an ILS Issuer operated in the manner described above could be a commodity pool, the Correspondence requests that the Division grant operators of ILS Issuers relief from CPO registration, pursuant to the analysis and conditions outlined below.

Legal Analysis

The Division agrees that an ILS Issuer operated in the manner described above could be considered a commodity pool and, absent relief from the Division, entities operating the ILS Issuers may be required to register as CPOs. The Correspondence requests relief from CPO registration, provided that entities operating ILS Issuers and the ILS Issuers substantially meet the requirements for an exemption from CPO registration under Regulation 4.13(a)(3).

Regulation 4.13(a)(3) contains four prongs an entity must meet in order to rely on the exemption from CPO registration:

- Interests in the pool are exempt from registration under the Securities Act of 1933, and such interests are offered and sold without marketing to the public in the United States;

- The pool at all times meets a *de minimis* test pursuant to which either (x) the margins, premiums and required minimum security deposit for retail forex transactions does not exceed 5% of the liquidation value of the pool's assets after giving effect to unrealized profits or losses; or (y) the aggregate net notional value of the pool's commodity positions, determined at the time the most recent position was established, does not exceed 100 percent of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses;

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[14] The Correspondence represents that ILS Issuers are required to invest the collateral according to narrow contractual investment guidelines that permit investments only in high-grade, liquid securities or cash as the collateral, and that ILS Issuers are neither permitted to actively manage nor do they have discretion over such investments of the collateral. Correspondence, p. 5.

- The CPO reasonably believes at the time of investment that each investor in the pool meets one of certain enumerated tests relating to the financial sophistication of the investor (*e.g.*, accredited investor or qualified eligible person); and

- Participations in the pool are not marketed as or in a vehicle for trading in the commodity futures or commodity options markets.[15]

The Correspondence states that ILS Issuers offer their bonds in "private placements to institutional investors structured to rely on the resale exemption under SEC Rule 144A and Section 3(c)(7) for an exemption from the 1940 Act with respect to U.S. persons."[16] Pursuant to SEC Rule 144A,[17] bonds from the ILS Issuers are offered and sold only to "qualified institutional buyers that, with respect to U.S. persons, are also qualified purchasers."[18] Additionally, "even though sales outside of the U.S. could be made pursuant to SEC Regulation S, the transactions typically require that non-U.S. persons also meet the qualified institutional buyer standard under Rule 144A."[19] Therefore, bonds sold by the ILS Issuers are exempt from registration under the Securities Act of 1933,[20] are not offered or sold through marketing to the public in the United States, and will typically be sold only to sophisticated institutional investors meeting the qualified eligible purchaser standard, in compliance with Regulations 4.13(a)(3)(i) and (iii).[21] The Correspondence further represents that operators of ILS Issuers and the ILS Issuers will comply with the *de minimis* threshold established by Regulation 4.13(a)(3)(ii).[22] This representation is consistent with how the ILS Issuer will be operated and how coverage is provided to the Protection Buyer.[23]

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[15] As explained above, in 2012, the Commission added swaps to the transactions considered in the trading threshold calculations contained in Regulation 4.13(a)(3)(ii) by specifically referencing the term "commodity interest," which as defined in Regulation 1.3(yy) includes futures, options, and swaps. In order to consistently interpret the prongs of the exemption in Regulation 4.13(a)(3), Division staff similarly considers swaps added to the transactions listed in the marketing prong of that exemption, though the Commission has not yet explicitly amended Regulation 4.13(a)(3)(iv) to also include swaps.

[16] Correspondence, pp. 3-4.

[17] 17 CFR 230.144A.

[18] *Id.* at p. 3.

[19] *Id.* at 4.

[20] 15 U.S.C. 77a *et seq*.

[21] The Division recently addressed the JOBS Act of 2012, which eliminated the prohibition against general solicitation in the SEC's Regulation D and Rule 144A, and its impact on the Commission's exemptions for CPOs in Regulations 4.7 and 4.13(a)(3). *See* CFTC Staff Letter 14-116 (Sept. 9, 2014), *available at* www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-116.pdf.

[22] Correspondence, pp. 2 and 5.

[23] "All proceeds of the Bonds sold by the Issuer are deposited into a collateral account that serves as security for the Protection Buyer and the Bondholders. Upon the occurrence of a specified trigger event, the contractual payment amount is paid to the Protection Buyer from the collateral account. Coverage provided by the Issuer is 100% secured by liquid collateral. … When amounts are transferred from the collateral account to cover a specified trigger event under a risk transfer contract, the aggregate principal amount of the Bonds is written down in the amount of such transfer." Correspondence, p. 2. These facts are consistent with those of a mortgage credit risk transfer structure, whose operators recently received relief from CPO registration from the Division. *See* CFTC

The fourth prong of Regulation 4.13(a)(3) requires that investments in Bonds issued by the ILS Issuer not be marketed as or in a vehicle for trading in commodity futures, commodity options, or swaps markets. In the same 2012 final rule amending part 4 of the Commission's regulations referenced above, the Commission also outlined several factors to be considered in a facts and circumstances analysis of whether or not an investment vehicle has been marketed as a vehicle for trading in commodity interests.[24] Most of the seven factors are either irrelevant or inapplicable to the ILS risk transfer structure, with the exception of one: "Whether the futures/options/swap transactions engaged in by the fund or on behalf of the fund will directly or indirectly be its primary source of potential gains and losses."

Because the risk transfer contract between the Protection Buyer and the ILS Issuer is the mechanism for creating and transmitting the insurance-linked risk exposure from the Protection Buyer to the Bondholders, it is difficult to argue that the transaction is not literally the primary source of investment gains and losses to the Bondholders. Therefore, ILS transactions could involve the marketing of ILS Issuers and their Bonds as vehicles for investing in commodity interests in violation of the fourth prong of Regulation 4.13(a)(3). Consequently, the Correspondence proffers multiple conditions restricting the operations of ILS Issuers in order to obtain relief from CPO registration for entities operating ILS Issuers; such conditions, the Correspondence represents, are commonly used in ILS transactions to protect both the Bondholders and the Protection Buyers.[25] Among other things, entities operating ILS Issuers and seeking relief from CPO registration hereunder must: restrict the investment of collateral by the ILS Issuer to cash or cash equivalent, highly liquid assets; observe corporate formalities to ensure the separateness of the Protection Buyer and the ILS Issuers;[26] restrict the operations and activities of the ILS Issuer to only those necessary or appropriate for engaging in an ILS transaction; limit the ILS Issuer's investment in commodity interests to only the swap(s) necessary and appropriate to support one or more ILS transaction(s); and subject the collateral to legal security arrangements that protect the parties to the transaction in the event the ILS Issuer becomes insolvent, to the extent possible under applicable laws.

The detailed restrictions on the operations and activities of ILS Issuers, combined with the highly specific factual context of ILS transactions outlined above, lead the Division to believe that the risk transfer contract between the Protection Buyer and the ILS Issuer serves merely as a conduit to transmit the insurance-related risks of the Protection Buyer through the ILS Issuer and to the investors purchasing Bonds from the ILS Issuer. In this context, and when

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Staff Letter 14-111 (Aug. 25, 2014), *available at* www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-111.pdf.

[24] Although the factors were enumerated by the Commission in the context of its revisions to Regulation 4.5, the Division believes that such factors are useful in determining whether a CPO has violated the terms of the marketing restriction in Regulation 4.13(a)(3)(iv) because the limitations in both regulations are substantially similar in scope and intent.

[25] Correspondence, pp. 4-6.

[26] Such restriction is consistent with the requirements of Regulation 4.20. 17 CFR 4.20.

all of the other three substantive requirements of Regulation 4.13(a)(3) are met, the Division accepts the Correspondence's representations that the marketing efforts of an ILS Issuer are focused on the analysis and statistical modeling of insurance risks to and for which the Protection Buyer is actually exposed and is seeking coverage, rather than the risks and rewards of the underlying transaction transferring those risks.[27] In contrast, when a commodity interest transaction is used to create other investment exposures for investors, whether through the provision of leverage or the transmission of other risks, the Division would assume that the transaction itself must be marketed as part of the investment package in violation of the fourth prong, and thereby making exemptive relief under Regulation 4.13(a)(3) unavailable.[28] Based on the foregoing facts and analysis, and subject to the conditions outlined below, the Division believes granting relief that allows an entity operating an ILS Issuer to rely on Regulation 4.13(a)(3) for an exemption from CPO registration is appropriate.

Conditions of Relief

These conditions are intended to limit the relief provided by this letter to bona fide ILS transactions and to protect participants in an ILS transaction. For the reasons stated herein, the Division will not recommend that the Commission take an enforcement action against any entity characterized as the CPO of an ILS Issuer ("ILS CPO"), for failure to register as a CPO pursuant to CEA Section 4m(1),[29] provided that:

1. The ILS CPO meets the conditions for an exemption from CPO registration in Regulations 4.13(a)(3)(i), (ii), and (iii), with respect to an ILS Issuer.

2. The ILS CPO files a notice of eligibility for an exemption from CPO registration with the National Futures Association pursuant to Regulation 4.13(b) and meets the other terms of Regulation 4.13.

3. The ILS CPO operates the ILS Issuer in the following manner:

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[27] The Correspondence represents that U.S. broker-dealers registered with the Securities and Exchange Commission are typically the underwriters and solicitors for investment in ILS transactions, a process through which "material disclosure [is] made pursuant to an offering circular that is distributed to prospective Bondholders." Correspondence, pp. 3-4. As described above, such disclosure is focused on statistical modeling, risk analysis, and probabilities of the specified trigger event(s) actually occurring and requiring coverage by the ILS Issuer. This finding by the Division is also consistent with its findings in CFTC Staff Letter 14-111, in which the Division concluded that, in the described mortgage credit risk transfer structure, it was not actually the swap mechanism transferring the mortgage credit risk that was being marketed, but rather the quality and actual credit risk of the pool of mortgages underlying the transaction. *See* CFTC Staff Letter 14-111, pp. 9-10.

[28] The Correspondence represents that, "[t]he risk transfer contract is always used as a risk management tool and is not a mechani[sm] to transfer investment exposure." Correspondence, p. 5.

[29] 7 U.S.C. 6m(1).

a. There will be no active management of assets and liabilities over the lifetime of the ILS Issuer.[30]

b. The collateral ("Eligible Collateral") held by the ILS Issuer at all times shall:
   i. Be in the form of cash or cash-equivalent, "highly liquid" (as that term is defined in Regulation 1.25[31]) assets, limited to:
      1. Puttable debt issued by the International Bank for Reconstruction and Development (IBRD), the European Bank for Reconstruction and Development (EBRD), or Kreditanstalt fur Wiederaufbau (KfW);[32]
      2. Any U.S. or European Union regulated money market fund that invests solely in debt issued by the U.S. Treasury or U.S. sponsored agencies, or repurchase and reverse repurchase agreements collateralized by debt issued by the U.S. Treasury or U.S. sponsored agencies;
      3. Other assets that are highly liquid, pursuant to Regulation 1.25; and
      4. Any other eligible collateral approved by the Division or Commission from time to time; and
   ii. Either have a maturity date that is on or before the termination date of the risk transfer contract ("Agreement") or be convertible to cash by the issuer/obligor of the collateral upon demand by the ILS Issuer.

c. Upon becoming aware that the value of the collateral held by the ILS Issuer is less than the notional amount of the risk transfer contract ("Deficiency"), the ILS Issuer (a) shall promptly notify the Division of the same in writing and copies of such notice shall be provided to the Protection Buyer and the Bondholders pursuant to the notice procedures in the applicable transaction documentation, and

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[30] This condition is consistent with the facts as represented in the Correspondence: "There is no ability to sell or trade the risk transfer contract, and each risk transfer contract is related to a separate class or series of Bonds issued by the Issuer," and "The Issuer is not permitted to actively manage and has no discretion over the investments." Correspondence, p. 3.

[31] Regulation 1.25(b)(1) states: "*Liquidity*. Investments must be 'highly liquid' such that they have the ability to be converted into cash within one business day without material discount in value." 17 CFR 1.25(b)(1).

[32] With respect to this type of puttable debt, you have made the following representations: "In the case of medium term note investments (*i.e.*, IBRD, EBRD or KfW), the terms of the notes include a mandatory redemption or early repayment provision which requires the issuer to retire the note and repay the full principal upon notice. Such provision may, however, become effective starting six months to one year from the issue date. If an event trigger payment obligation is triggered under the risk transfer [contract] in the first year, the [ILS Issuer] is permitted to make a payment-in-kind to the [Protection Buyer] by transferring ownership of the medium term note investment in a principal amount sufficient to cover the payment obligation. The payment obligation under the [risk transfer contract] for such event is deemed to have been met upon transfer of such note to the [Protection Buyer]. These medium term notes are admitted assets for insurance regulators in most jurisdictions (*i.e.*, New York), and therefore, are as good as cash to hold on the [Protection Buyer's] balance sheets."

(b) shall neither issue any additional bonds nor enter into any commodity interest transactions for so long as such Deficiency exists. For purposes of the preceding sentence, an ILS Issuer shall become aware that a Deficiency exists (a) with respect to Eligible Collateral for which industry standard pricing sources are available, if a decline in the value of such collateral is determined to result in a Deficiency based on at least weekly monitoring of one or more such pricing sources (by the ILS Issuer or an agent on its behalf); and (b) with respect to Eligible Collateral for which industry standard pricing sources are not available, if the issuer of such collateral has other similar obligations for which standard pricing sources are available, then a decline in the value of such other similar obligations shall be utilized as a proxy for determining whether a Deficiency has occurred, and if the issuer of such collateral does not have other similar obligations for which industry standard pricing sources are available, then a Deficiency will be deemed to exist if such collateral is downgraded by an applicable rating agency or upon the occurrence of an event of default with respect to such collateral that is not cured within any applicable cure period.

d. The payment obligations of the ILS Issuer to the Protection Buyer and to the Bondholders must be secured by the Eligible Collateral, and the security arrangements must provide that obligations to the Protection Buyer under the Agreement will be satisfied from the Eligible Collateral prior to any proceeds of the Eligible Collateral being used to repay principal to the Bondholders.

e. The Eligible Collateral shall be maintained by the ILS Issuer so that it is available to be distributed in the form of cash or in kind to the Protection Buyer at the time a payment becomes due under the risk transfer contract.

f. The Eligible Collateral held by the ILS Issuer shall be subject to arrangements that protect the Protection Buyer in the event the ILS Issuer becomes subject to an insolvency proceeding, to the extent possible under the applicable law. This condition will be satisfied if the ILS Issuer satisfies the following criteria:

   i. The powers of the ILS Issuer shall be limited so that the ILS Issuer may not engage in business or activity other than as necessary or appropriate for serving as an ILS vehicle;
   ii. The ILS Issuer shall be restricted from incurring additional debt, except as may be necessary or appropriate for entering into additional ILS offerings in the case of a multi-use Issuer, in which case the obligation to repay such additional debt shall be secured solely by additional Eligible Collateral obtained in connection with such additional ILS offering;
   iii. The ILS Issuer shall be restricted from entering into any additional commodity interest transactions beyond the swap transaction necessary for the ILS offering, except that in the case of a multi-use Issuer, the ILS

Issuer may enter into additional swap transactions to the extent it is necessary or appropriate in order to enter into additional ILS offerings;

iv. The ILS Issuer shall be governed by a board of directors (or other similar body) comprised of individuals independent of the Protection Buyer;

v. Corporate formalities shall be observed between the ILS Issuer, on the one hand, and the Protection Buyer and affiliates of the Protection Buyer, on the other hand, such that each entity maintains its separate corporate status and identity;[33]

vi. As a condition to any agreement imposing obligations on the ILS Issuer, interest holders the Protection Buyer and any other potential creditors of the ILS Issuer shall be required to waive any right to file an involuntary bankruptcy petition for the ILS Issuer or otherwise initiate a solvency, liquidation, dissolution or other action having substantially similar effect with respect to the ILS Issuer; and

vii. The ILS Issuer shall be prohibited from filing a voluntary petition for bankruptcy and from engaging in a merger, asset sale (other than for collateral management purposes), consolidation, liquidation, dissolution or other action having substantially similar effect.

The relief provided by this letter shall remain effective until the effective date of any Commission action in consideration of the ILS transactions described herein.

This letter, and the positions taken herein, represent the views of this Division only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse the affected persons from compliance with any other applicable requirements contained in the CEA or in the Commission's regulations issued thereunder. Further, this letter, and the relief provided herein, is based upon the representations made to the Division. Any different, changed or omitted material facts or circumstances might render this letter void. In this regard, you must notify the Division immediately in the event the operations or activities of an ILS issuer or its operator change in any material respect from the representations above.

Should you have any questions, please do not hesitate to contact Amanda Olear, Associate Director, at 202-418-5283 or aolear@cftc.gov, or Elizabeth Groover, Special Counsel, at 202-418-5985 or egroover@cftc.gov.

Very truly yours,

[33] This condition is consistent with the requirements of Regulation 4.20.

Gary Barnett

cc: Regina Thoele, Compliance
National Futures Association, Chicago