CFTC Letter No. 01-73
June 21, 2001
No-Action
Division of Trading and Markets

Re: Section 4m(1) of the Act -- Request for Relief from CPO and CTA Registration for Two State-Regulated Insurance Companies and a State-Regulated Trust Company.

Dear :

This is in response to your letter dated August 23, 2000, to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by your letters dated December 19, 2000 and March 22, 2001 and by telephone conversations with Division staff. By your correspondence, you request certain relief on behalf of: (1) "O"; (2) "P"; and (3) "Q", a registered commodity pool operator ("CPO") and commodity trading advisor ("CTA"). You request confirmation that the Division will not recommend that the Commission commence any enforcement action against "O" or "P", based on failure to register as a commodity pool operator ("CPO") or commodity trading advisor ("CTA") pursuant to Section 4m(1) of the Commodity Exchange Act (the "Act")[1] in connection with the offer and sale of certain insurance products, the premiums for which may be invested in a fund that engages in commodity interest trading. You also request that any such "no-action" position be extended to cover the offer and sale in the future of other insurance products with substantially the same terms and that would be offered, sold and held by the same persons and that could involve investment in pools operated by registered CPOs other than "Q".

Based upon the representations contained in your correspondence, we understand the facts to be as follows.

The Parties

"P" (which you describe as the ___ oldest life insurance company in the United States) was organized under the laws of _____ and regulated by the Division of Insurance. "O" is a life insurance company organized under the laws of the State of _____ and regulated by that state's Department of Insurance. "O" is a direct, wholly-owned subsidiary of "P" and an indirect, wholly-owned subsidiary of "S". In your request you refer collectively to "P" and "O" as the "Companies."

"Q" is a wholly-owned subsidiary of "T", a bank holding company headquartered in ___. "Q" provides investment advisory and management services and technical support to the investment portfolios within the "Fund". The Fund was organized on ____ as a ____ business trust. Its trustee is "W" (the "Trustee").

Interests in various portfolios of the Fund will be held by separate accounts (or sub-accounts thereof) of the Companies.

The Products

Your request involves the offer and sale of "Life Certificates," which you define to include individual variable life insurance polices and interests in a trust (the "Trust")[2] holding group variable life insurance policies, and "Annuity Certificates," which you define to include individual variable annuity contracts as well as interests in the Trust holding a group variable annuity contract. You refer to the Life Certificates and the Annuity Certificates collectively as the "Products." You state that the Life Certificates and Annuity Certificates are primarily life insurance and annuity products designed for long-term financial planning and estate-planning needs and that combine the "insurance" attributes of a life insurance policy or an annuity contract with opportunities for a variable accumulated value based on investment of the premium or purchase price.

The Life Certificates provide death benefits, surrender values and other features traditionally associated with life insurance policies, and are intended to be used primarily as estate planning devices. The Companies anticipate that the owner of a Life Certificate will hold it until the death of the insured, at which point the beneficiary would receive a death benefit. Annuity Certificates are designed to help the owner accumulate assets for retirement or other financial goals on a tax-deferred basis, providing for an accumulated cash value and the right to a future stream of payments for a specified period or for the life of the annuitant. If the owner of an Annuity Certificate dies before the annuity payments begin, the beneficiary would receive the right to a death benefit.

Proceeds of the sale of the Products are allocated to separate accounts ("Separate Accounts") of the Companies. Each Separate Account will have interests in a single investment fund (such as the Fund) or it may be divided into several sub-accounts, each holding interests in a different fund (Separate Accounts and any sub-accounts are collectively referred to in your correspondence as "Accounts").[3] You identify the Fund as being the recipient of these proceeds from the Accounts into the Fund's various portfolios, but you allow that one or more other funds that qualify for exclusion from the definition of CPO under Rule 4.5,[4] or that do not engage in commodity interest trading, may be utilized for investment of the proceeds in the same way as the Fund. As noted above, "Q", which is registered as a CPO and as a CTA, manages the portfolios of the Fund.

The Life Certificates are "variable" because their value and in some cases their death benefits will increase or decrease depending on the investment experience of the Accounts. There is no fixed schedule for premium payments. The value of the Annuity Certificates is likewise variable and will increase or decrease depending upon the investment experience of the Accounts before the annuity payments begin.

Currently, the minimum initial premium payment under a Life Certificate or Annuity Certificate will be

$250,000 (unless the Companies consent to a lesser amount) and in no event will any subsequent premium payment of less than $100,000 be accepted. Only "qualified eligible persons " as defined in Rule 4.7 ("QEPs") may purchase Products.[5]

The Companies are responsible for design of the insurance features of the Products, such as transfer and withdrawal provisions and death benefit options.[6] "Q" will be responsible for design of the investment components of the Products and (indirectly through the Fund) for the management of the assets supporting the Products. The Companies are preparing the private placement memorandum relating to the life insurance and annuity features of the Products, and "Q" is preparing a separate private placement memorandum relating to the Fund. These separate memoranda will be bound together and provided to prospective purchasers of the Products in the same package. The Companies will be responsible for the preparation and distribution of the Separate Accounts' annual reports and for maintenance of books and records. The Companies will also distribute to holders of the Products quarterly and annual reports for the Fund prepared by "Q".

Portfolios

The purchaser of a Product may choose the Accounts in which his premium payment is invested from among those identified in the offering documents. Each Account, in turn, seeks to achieve its investment objective by investing substantially all of its assets in an underlying fund (a limited liability trading vehicle, as opposed to direct trading of the portfolio's asserts) with the same investment objective as the Account. The assets of each Account will be invested in a portfolio of the underlying fund. The purchaser of the Product will receive a private placement memorandum in the case of a private fund (such as the Fund) or a prospectus in the case of a registered mutual fund, together with the disclosure document for the Product and the subscription documents.[7]

The Fund

Initially the Fund will offer two investment portfolios: the "D" and the "E," each with distinct investment objectives and strategies (collectively, the "Portfolios"). Each of the Portfolios will be operated in accordance with Rule 4.7. and will invest in other investment funds, some of which will engage in commodity interest trading. Neither portfolio will directly trade commodity interests. "Q", a registered CPO and CTA, will manage the Portfolios. "X" and "Y" (both registered as CPOs and as CTAs) will act as sub-advisors, respectively, to the "D" and the "E". Neither of the Portfolios is expected to trade within the restrictions of Rule 4.5(c)(2), and, accordingly, the Accounts will not be able to rely upon Rule 4.5.

As noted elsewhere, the Companies retain authority to select the Fund or to substitute other funds for investment by the Accounts.

Requested Relief

You request that the Division confirm it will not recommend that the Commission commence any enforcement action against the Companies, based solely upon the failure of the Companies to register as CPOs or CTAs in connection with the offer and sale of the Products in the circumstances described in your correspondence. You further ask that any no-action position taken by the Division in this regard be extended to cover future offerings and sales by the Companies of variable life insurance policies or individual annuity contracts (including interests in trusts such as the Trust) that have substantially the same terms as the Products, and that also employ registered CPOs to manage the funds in which Accounts hold interests and to perform the other functions performed by "Q" in the facts outlined in your correspondence.

You acknowledge that because the Companies have been responsible for the promotion of the Products and establishment of the Separate Accounts, and because they have retained the authority to select the Fund or to substitute other investment funds for investment of the Accounts' assets, the Companies could be deemed to be CPOs of the Separate Accounts or of the Portfolios. You argue, however, that the Products' purchasers, under the circumstances contemplated, will receive all the protections of the Commission's rules. You point out that the Products will be marketed by registered representatives of SEC-registered broker-dealers, that the vehicles in which the assets underlying the Products will be invested will be managed by entities registered as CPOs and CTAs, and that the Companies will comply with the investor eligibility, disclosure and recordkeeping standards of Rule 4.7. Thus, you believe, the Companies should not be required to register with the Commission. We also note that the Companies are state-regulated insurance companies.

The Division considers a number of factors in determining whether relief from CPO and CTA registration is appropriate. In the case of the Companies, we believe that the following factors support granting CPO and CTA registration relief: (1) "Q", a registered CPO and CTA, (together with its sub-advisors, which are also registered as CPOs and CTAs) will act as investment manager in connection with the selection and replacement of commodity pools in which the Portfolios participate and the allocation of Portfolio assets to such commodity pools; (2) the Companies, as state-regulated life insurance companies, are subject to regulation under state insurance law and "Z" and "ZZ", as registered broker-dealers, are subject to regulation under the federal securities laws; (3) the Companies will design the insurance features of the proposed program and will not participate in the management of commodities-related investments; (4) the Portfolios will not invest directly in commodity interests but will only invest through limited liability trading vehicles; and (5) purchasers of the Products will be limited to persons meeting the QEP criteria of Rule 4.7.

In support of your request, you state that the Companies and "Q" represent that: (1) "Q" will continue to be registered as a CPO and CTA, and to act as investment manager for the Portfolios; (2) each qualified investor will receive, before investing, a private placement memorandum that describes possible investments that may be made by the Portfolios and the material risks of such investments; (3) each investor will be a QEP; and (4) the Companies and "Q" will comply with the requirements of the Act and the Commission's rules except to the extent that the Division may relieve them from compliance

therewith.

Conclusion

In light of the foregoing, it appears that granting the requested relief would not be contrary to the public interest or the purposes of the Act and Commission rules. Accordingly, the Division will not recommend that the Commission take any enforcement action under Section 4m(1) of the Act against the Companies based solely upon the failure of the Companies to register as CPOs or as CTAs in connection with the offer and sale of the Products, provided that any commodity pool selected by the Companies to function in the same fashion as the Fund will be operated by a registered CPO who will perform the same functions and provide the same services to purchasers of the Products that "Q" performs and supplies in operating the Fund.

This letter does not excuse the Companies 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,[8] 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. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. The Division requests that you notify it immediately in the event that the operations or activities of the Companies, the Accounts, "Q", the Fund or the Portfolios change in any respect from those as represented to us. Further, the no-action 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. Finally, the Division is expressing no opinion with respect to the application or effect of relevant tax, securities or insurance law provisions or requirements.

If you have any questions concerning this correspondence, please contact me or Christopher W. Cummings, an attorney on my staff, at (202) 418-5445.

Very truly yours

John C. Lawton
Acting Director

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[1] 7 U.S.C. § 6m(1) (1994). You ask for similar confirmation with respect to certain separate accounts of "O" or "P". However, since a separate account would not be a CPO, it has been unnecessary for the Division to separately consider this aspect of your request.

[2] The name of the Trust is "C" and its trustee is "V". You state that there is no relationship between "V" and "Q" or between "V" and "W" (the Trustee of the Fund).

[3] For the time being, the Fund is the only such investment fund, although you indicate that in the future other investment funds may be utilized.

[4] Commission rules referred to herein are found at 17 C.F.R. Ch. I (2001).

[5] SEC-registered broker-dealers that are members of the National Association of Securities Dealers, Inc. will serve as placement agents for the Products. The Products provide for a ten-day "free look" period within which they may be cancelled. Fees and expenses incurred by or allocable to a particular portfolio will be set forth in the private offering memorandum or registered fund prospectus provided to investors. Although the Companies will not receive any commission from the sale of interests in the Fund or any incentive compensation with respect to any portfolio, they will receive certain fees in connection with the respective life insurance or annuity features of the Certificates, which fees will be described in each Product's offering memorandum.

[6] We make no determination in this letter regarding the legality of the products and transactions you contemplate under applicable insurance laws and regulations. Nor should any position taken in this letter be deemed an attempt to pre-empt any such laws or regulations.

[7] Life Certificate and Annuity Certificate purchasers do not receive a direct ownership interest in the underlying fund.

[8] 7 U.S.C. § 6b and 6o (1994).