CFTC Letter No. 02-89
May 16, 2002
Interpretation
Division of Trading and Markets

Re: Section 4m(1) of the Act -- Request for CPO and CTA Registration No-Action Position for a State-Regulated Insurance Company

Dear :

This is in response to your letter dated November 22, 2001, to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by your letters dated January 24, 2002 and March 22, 2002 and by telephone conversations with Division staff. By your correspondence, you request certain relief on behalf of "X", a state-regulated insurance company ("X").[1] Specifically, you request confirmation that the Division will not recommend that the Commission commence any enforcement action against "X", based solely upon "X's" failure to register under Section 4m(1) of the Commodity Exchange Act (the "Act")[2] as a commodity pool operator ("CPO") or as a commodity trading advisor ("CTA") in connection with the operation of an insurance company separate account (the "Separate Account") established to invest the proceeds of "X's" Private Placement Universal Life Product (the "Product"), or the operation of other separate accounts in connection with insurance products with substantially identical terms and features as the Product.

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

The Parties

"X" is a wholly-owned subsidiary of "Z". "Z", in turn, is a wholly-owned subsidiary of "U", and like "X", it is organized under the laws of the State of _____.

"Y" has been retained to act as investment advisor to a separate account of "X" (the "Separate Account") into which purchasers of the Product may allocate part of the cash value of the Product to be invested in investment vehicles that may trade commodity interests. "Y" is registered with the Commission as a CPO and as a CTA, and is a member of the National Futures Association. "Y" is not affiliated with "X" or with "Z".

The Product

The Product, designed exclusively by "X", is a life insurance contract that permits the purchaser to allocate the cash value accumulated in the policy into various investment options. The cash value varies

as a result of the performance of the investments, and income and loss therefrom are tax-deferred. "Y" is responsible for making investment decisions for the Separate Account, including any decision to invest in trading vehicles that may trade commodity interests.[3]

The Product will be sold exclusively by broker-dealers registered with the Securities and Exchange Commission ("SEC") through a private placement in accordance with Regulation D[4] of the Securities Act of 1933 (the "Securities Act").[5] All policy owners must be qualified eligible persons ("QEPs") as defined in Commission Rule 4.7,[6] and each will receive a private placement memorandum prepared by "X". The Product will provide for a "free look" period of not less than ten days, during which a policyholder may cancel the policy. Like a variable universal life insurance product, the Product will provide the policyholder with a death benefit, the ability to surrender the policy for cash, the right to move the cash value among various investment options and the opportunity to borrow from the cash value of the policy.

"X" will receive premiums from the policyholder and will extract its various up-front loads. The policyholder can allocate the remaining cash value to several different investment options, each of which is structured as an insurance company separate account pursuant to Section _____ of the _____ Insurance Code. One of these separate accounts (the Separate Account) will invest its assets in investment vehicles (limited partnerships or other limited liability vehicles), some of which ("Pools") will speculate in futures contracts and options on futures.[7] All of the Pools will be operated by registered CPOs. Although the Separate Account will not register under the Investment Company Act of 1940 (the "ICA"), it will be regulated pursuant to the _____ Insurance Regulations.[8]

Each policy owner who wishes to direct cash value of the policy into the Separate Account will receive (before making such an allocation) a private placement memorandum that includes a disclosure statement prepared by "X" and "Y" describing the Separate Account, the investment strategy for the Separate Account, the investment risks associated with the Separate Account (including the use of commodity interests and the associated risks), the fee structure and business background information.[9]

Each policyholder will receive annual reports as well as monthly reports from "X" showing the policyholder's beginning cash value in the Separate Account, as well as all transactions in the Separate Account throughout the year (including withdrawals for monthly insurance charges, withdrawals requested by the policyholder, and deposits made by the policyholder). "X" would be responsible for maintenance of books and records regarding the Separate Account, including financial statements.[10]

Analysis

You acknowledge that, absent relief, "X" would be required to register as a CPO in connection with operating the Separate Account in the manner you have described and any similar vehicles it may create in the future. You further acknowledge that although an exclusion from the definition of "pool" is

available for an insurance company separate account, that rule imposes certain trading restrictions which will not likely by observed by the Pools in which the Separate Account will invest assets, and accordingly, "X" will be unable to claim relief under Rule 4.5. You claim, however, that the Division's reasoning in Staff Letter 01-73 supports granting your request.[11] You further represent that none of "X's" officers or directors is subject to statutory disqualification under Sections 8(a)(2) or 8(a)(3) of the Act.[12]

The Division considers a number of factors in determining whether relief from CPO and CTA registration is appropriate. In the case of"X", we believe that the following factors support granting CPO and CTA registration relief: (1) "Y", a registered CTA (together with the Pool operators that "Y" selects, which will be registered as CPOs) will act as investment manager in connection with the selection and replacement of Pools in which the Separate Account participates and the allocation of Separate Account assets to such Pools; (2) "X", as a state-regulated life insurance company, is subject to regulation under state insurance law and the registered broker-dealers who will be selling the Product are subject to regulation under the federal securities laws; (3) "X" will design the insurance features of the proposed program and will not participate in the management of commodities-related investments (which will be the responsibility of "Y"; (4) the Separate Account will not invest directly in commodity interests but will only invest through limited liability trading vehicles; and (5) purchasers of the Product will be limited to persons meeting the QEP criteria of Rule 4.7.

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 "X" based solely upon the failure of "X" to register as a CPO or as a CTA in connection with the operation of the Separate Account or any substantially similar separate account organized by "X", provided that any commodity pool selected by "Y" (or by any advisor chosen to function in the same fashion as "Y") will be operated by a registered CPO, and provided further, that "Y" and any advisor chosen by "X" to function in the same fashion as "Y", will be, and will remain, registered CTAs.

The no-action position taken in this letter does not excuse "X" from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, "X" remains subject to all antifraud provisions of the Act[13] and the Commission's regulations, the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations, and to all otherwise applicable provisions of Part 4. Moreover, this letter is applicable to "X" solely in connection with the operation of the Separate Account and substantially similar separate accounts organized by "X" in the future.

This letter, and the no-action position taken herein, is based upon the representations that have been made to the Division. Any different, changed or omitted facts or circumstances might render the position taken herein void. You must notify the Division immediately in the event that the operations or activities

of "X", "Y" or the Separate Account or of any substantially similar separate account organized in reliance upon this letter change in any respect from those as represented to us. Further, the no-action position taken in this letter represents the views of this Division only and does 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] "X" is regulated by the _____ Department of Insurance.

[2] 7 U.S.C. §6m(1) (2000).

[3] "X" will not be actively involved in day-to-day investment management of the Separate Account, but will monitor "Y's" activities retrospectively on an ongoing basis and may take corrective measures to address any perceived deficiencies (including, but not limited to, replacement of "Y"). "Y" and "X" will negotiate the applicable advisory fee to be paid by the Separate Account prior to offering the Product for sale. "Y" will be solely responsible for valuation of separate account assets and will report that information to "X" as needed for calculation of policyholder benefits.

[4] 17 C.F.R.. §230.501, *et seq*. (2001).

[5] 15 U.S.C. §77a, *et seq*. (2000).

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

[7] You state that your request for relief applies to one of "X's" existing separate accounts, but you ask that any relief also apply to similarly structured separate accounts to be organized in the future, and which will have substantially identical disclosure, reporting and investor eligibility standards.

[8] You represent that the Separate Account and any future similarly structured separate accounts will not register under the ICA because they will be excluded from the definition of an "investment company" under either Section 3(c)(1) or Section 3(c)(7) of the ICA (and therefore not required to be registered as such).

[9] You acknowledge that this disclosure statement will not comply with the disclosure requirements of Part 4 of the Commission's rules, but you represent that, as required by Rule 4.7(b)(1), it will include all disclosures necessary to make the information contained therein, in the context in which it is furnished, not misleading. Information in the private placement memorandum regarding the Product and the basic structure of the Separate Account will be prepared solely by "X". Information regarding the investments of the Separate Account will be prepared solely by "Y" (subject to "X's" review only with respect to anti-fraud standards of clarity and materiality).

[10] To the extent necessary to meet its obligations, "X" will rely on information provided by "Y", who will be contractually obligated to provide such information.

[11] CFTC Staff Letter 01-73 [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,604 (June 21. 2001). Staff Letter 01-73 provided CPO and CTA registration relief for two affiliated state-regulated insurance companies that had designed insurance and annuity products for which the premiums would be invested through separate accounts in commodity pools (that would in turn invest in other commodity pools, all pools being operated by registered CPOs). Significant factors included selection of commodity pool investments exclusively by registered CPO/CTAs, registration of placement agents for the products with the SEC, non-participation by the insurance companies in managing commodity-related investments, the indirect nature of the commodity interest trading, and the restriction to QEPs of eligible purchasers of the products.

[12] 7 U.S.C. § 12a(2) or 12a(3) (2000).

[13] *See, e.g.*, 7 U.S.C. §§ 6b and 6o (2000).