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CHURCH ALLIANCE

Acting on Behalf of Church Benefits Programs

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April 6, 2011

COMMENT

By Hand Delivery

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

Re: Proposed Regulations Concerning the End User Exception to Mandatory Clearing of Swaps, RIN 3038—AD10

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) concerning the end user exception to mandatory clearing of swaps.[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 "financial entity" for purposes of these regulations.

The Church Alliance is a coalition of thirty-seven (37) denominational benefit programs that provide pensions and health benefits to more than one million clergy, lay workers, and their family members. These benefit programs constitute "employee benefit plans" and "church plans" as defined 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 "financial entity" under Section 723(a)(3) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which enacted a new Section 2(h) of the Commodity Exchange Act (CEA or Act) that will become effective in July 2011 to govern clear-

[1] 75 Fed. Reg. 80747 (December 23, 2010) (Proposing Release).

ing of swaps. 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).[3] A church benefits board is also (i) typically an organization described in Code Section 501(c)(3), (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 church plans and denominational benefits boards represented through the Church Alliance have an interest in the regulation of the swap market.

II. END USER EXCEPTION TO MANDATORY SWAP CLEARING

A. Proposed Regulation

New CEA Section 2(h)(7) provides an elective exception to the mandatory clearing requirement of new CEA Section 2(h)(1) if one party to a swap (i) is not a "financial entity"; (ii) uses swaps to hedge or mitigate commercial risk; and (iii) notifies the CFTC how it generally meets its financial obligations for non-cleared swaps. For purposes of that provision, a financial entity includes, among others, "an employee benefit plan as defined in paragraphs (3) and (32) of [ERISA]."[4] The CFTC has proposed to implement

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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 or other welfare 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] Section 414(e)(3)(A) of the Internal Revenue Code of 1986, as amended (Code), is identical to ERISA section 3(33)(C)(i), and church pension boards are also sometimes referred to as Section 414(e)(3)(A) organizations.

[4] New CEA Section 2(h)(7)(C)(i)(VII).

this provision by revising its Regulation 39.6. Proposed Regulation 39.6(a) would provide that the exception to mandatory clearing of swaps is available if one party to the swap "is not a 'financial entity' as defined in Section 2(h)(7)(C)(i) of the Act, is using the swap to hedge or mitigate commercial risk as defined in § 39.6(c), and provides . . . the information specified in § 39.6(b)." One of the pieces of information to be provided is "[w]hether the electing counterparty is a 'financial entity' as defined in section 2(h)(7)(C)(i) of the Act."[5]

Understandably, the CFTC has focused its attention in proposed Regulation 39.6 on the types of companies one might readily think of when considering the so-called "commercial end user exemption," such as those companies that manufacture or produce goods and services. There is scant discussion of the financial entities that are *not* eligible for the clearing exception, such as the employee benefit plans referred to above.[6] The Church Alliance respectfully requests that the CFTC clarify Regulation 39.6 so that church plans are included within the definition of the term financial entity for purposes of the regulation and, therefore, subject generally to the requirement for mandatory clearing of swaps.

The Church Alliance notes that the phrase "employee benefit plan . . . as defined in paragraphs (3) and (32) of section 3 of [ERISA]" appears in the major swap participant definition,[7] and similar phraseology may be found in the definition of the term "Special Entity."[8] The term Special Entity is relevant for purposes of determining what business conduct standards would have to be followed by swap dealers and major swap participants who deal with or advise such an entity about swaps, and the term is defined to include, among others, "any employee benefit plan, as defined in Section 3 of [ERISA]."[9] As noted by the CFTC in the preamble of the *Federal Register* release announcing the proposed business conduct standards, because Dodd-Frank, in defining a Special Entity,

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[5] Proposed Regulation 39.6(b)(2).

[6] *See* 75 Fed. Reg. 80747, at 80748 & n.7, 80750.

[7] Dodd-Frank Section 721(a)(16), which added a new Section 1a(33) to the CEA. The CFTC has proposed to further define the term major swap participant, and the Church Alliance has filed a separate comment letter on that rulemaking. 75 Fed. Reg. 80173 (December 21, 2010).

[8] New CEA Section 4s(h)(2)(C)(iii) and (iv), added by Dodd-Frank Section 731. The CFTC has proposed to implement the business conduct standards authorized by that statutory provision in a separate rulemaking for which the Church Alliance also has filed a separate comment letter. 75 Fed. Reg. 80637 (December 22, 2010).

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

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.[10]

Nevertheless, the CFTC also noted when proposing the business conduct standards that several letters were submitted during the pre-proposal stage that raised issues concerning possible ambiguities in the statutory definition of Special Entity and, therefore, the CFTC specifically requested comment regarding whether the phrase "employee benefit plans, as defined in Section 3 of ERISA," should be clarified in any way.[11] The Church Alliance believes that the provision in Regulation 39.6 that treats employee benefit plans as financial entities, so that they are therefore ineligible for the exception from mandatory clearing of swaps, also needs to be clarified to specifically reference church plans. The clarification takes on added importance in the mandatory clearing context, because the Proposing Release contains no similar employee benefit plan discussion to that contained in the release announcing the proposed business conduct standards for swap dealers and major swap participants and discussed above.

B. Clarifications to Proposal

1. Treatment of Church Plans

The Church Alliance recommends that the CFTC revise proposed Regulation 39.6 by: (1) redesignating the proposed paragraph (a) as paragraph (a)(1); and (2) adding a paragraph (a)(2) stating, "For purposes of this section, a financial entity as defined in Section 2(h)(7)(C)(i) of the Act includes 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 financial entity for purposes of Regulation 39.6 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."[12]

Such a revision to the proposed definition will make clear what Congress intended to provide in Dodd-Frank, that church plans should be subject to the mandatory clearing requirement for swaps. A requirement for swaps to be cleared through central counterparties is one of the ways that Dodd-Frank intends to reduce systemic risk, a goal that the Church Alliance supports. The Church Alliance submits that, as a matter of policy,

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[10] 75 Fed. Reg. 80637, at 80649 &n.89.

[11] 75 Fed. Reg. 80637, at 80649.

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

church plans should treated consistently with ERISA-covered plans and governmental plans with respect to the mandatory clearing requirement and other aspects of Dodd-Frank and the regulations thereunder.

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)[13] so that the definition of the term financial entity in Regulation 39.6 includes a paragraph encompassing a plan defined as a church plan. 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 financial entity for purposes of new CEA Section 2(h)(7) and CFTC Regulation 39.6 includes church benefits boards that hold the assets of church plans, so that such organizations will also be subject to the mandatory clearing requirement for swaps. When the CFTC proposed business conduct standards for swap dealers and major swap participants, it 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 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?"[14]

The CFTC should adopt a definition of the term financial entity in Regulation 39.6 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. Appropriate language for this purpose could be added to the text of the new paragraph (a)(2) of Regulation 39.6 recommended by the Church Alliance and discussed above. Such a definition would be reflective of the close and unique relationship be-

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[13] 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.

[14] 75 Fed. Reg. 80637, at 80649.

tween church benefits boards and their constituent church plans, a relationship recognized in both ERISA and the Code.

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,[15] 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 financial entity status for purposes of new CEA Section 2(h)(7) and CFTC Regulation 39.6, 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.[16] 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.[17] Further, the investment company exemption provided in Section 3(c)(14) of the Investment Company Act of 1940 to church benefits boards as well as to church plans, supports treating a

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[15] 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).

[16] Department of Labor regulations provide that, except where the underlying entity is an investment company registered under the Investment Company Act of 1940, when an employee benefit plan acquires or holds an interest in (i) a group trust exempt from taxation under Code Section 501(a) pursuant to the principles of Rev. Rul. 81–100, 1981–1 C.B. 326, as modified by Rev. Rul. 2011-1, 2011-2 I.R.B. 251, or (ii) a common or collective trust fund of a bank, plan assets include the plan's investment and an undivided interest in each of the underlying assets of the collective investment entity. 29 C.F.R. § 2510.3-101(h)(1)(i) and (ii).

[17] 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).

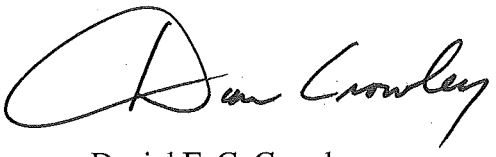
church benefits board similarly to a church plan, and both as financial entities under Dodd-Frank Section 723.

III. CONCLUSION

The Church Alliance appreciates the opportunity to comment upon the proposed regulations that would implement the end user exception to mandatory clearing of swaps. We believe that the definition of the term "financial entity" in these regulations should refer specifically to church plans and should include church benefits boards.

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,



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On Behalf of the Church Alliance