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U.S. COMMODITY FUTURES TRADING COMMISSION

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COMMODITY FUTURES
TRADING COMMISSION
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DIVISION OF
TRADING & MARKETS

March 7, 1997

Re: Section 4m(1) -- Request for Relief from Registration as a Commodity Pool Operator; Rule 4.7 -- Request to Treat the Diversified Income Subaccount as a Rule 4.7 Exempt Pool and Waiver of the Ten Percent Restriction

Dear :

This is in response to your letter dated November 26, 1996, to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by your letter dated January 10, 1997 and telephone conversations with Division staff. By your correspondence, you request certain relief on behalf of "V", a mutual life insurance company, in connection with the offering of a variable annuity contract (the "Contract") to certain employees of "W", a privately-held corporation engaged in business consulting for Fortune 500-type companies.

Specifically, you request that the Contract's Diversified Income Subaccount not be deemed to be a commodity "pool" under Rule 4.10(d)(1).^{1/} In the event that the Division is unwilling to treat the Diversified Income Subaccount as outside the definition of "pool" under Rule 4.10(d)(1), you request that the Division take a no-action position with respect to "V" for failure to register as a commodity pool operator ("CPO") under Section 4m(1) of the Commodity Exchange Act (the "Act").^{2/} You further request that "X" be allowed to claim relief on behalf of the Diversified Income Subaccount from certain requirements pursuant to Rule 4.7 and that "X" and the CPO of any Rule 4.7 exempt commodity pool in which the Diversified Income Subaccount invests be exempt from complying with Rule 4.7(a)(1)(ii)(B)(2)(xi) (the "Ten Percent Restriction")

^{1/} As is explained below, the Diversified Income Subaccount is part of a separate account offered by "V". However, because it will not be operated pursuant to the provisions of Rule 4.5(c), an exclusion from the CPO definition pursuant to Rule 4.5 is not available to "V". Commission rules referred to herein are found at 17 C.F.R. Ch. I (1996).

^{2/} The Act is found at 7 U.S.C. §§ 1 et seq. (1994).

notwithstanding the presence of non-qualified eligible participant ("QEP") investors in the Diversified Income Subaccount.

Based upon the representations contained in your correspondence, we understand the pertinent facts to be as follows. "X", a wholly-owned subsidiary of "W", has been a registered CPO since 1988. "A", a "W" employee and registered associated person of "X", is the president of "X". "A" also is "W's" Director of Investment Programs, with responsibility for seeking, structuring and implementing investment opportunities for both "W" management group members and "W's" Master Retirement Trust.

"X", consistent with its mission to structure and implement investment opportunities for certain employees, as discussed below, initiated discussions with "V" with regard to the Contract. The Contract is a flexible purchase payment individually allocated group variable annuity. It is proposed to be offered pursuant to Regulation D of the Securities Act of 1933 by "Y", a registered broker/dealer and a wholly-owned subsidiary of "V", a financial services holding company wholly-owned by "V".

The Contract will be offered exclusively to certain management group members and key employees ("Eligible Employees") of "W", all of whom are accredited investors as defined in Regulation D and experienced professionals in the consulting business or in administrative, financial, accounting, legal or operational activities related thereto. Specifically, the Eligible Employees are: (1) shareholders of "W", *i.e.*, management group members, who are directors, principals, and a limited number of high-level administrators and client service support personnel of "W", *i.e.*, administrative shareholders who hold high-level positions in the administrative, financial, accounting, legal or operational departments of "W" and whose positions are comparable to those held by the chief financial officer, general counsel and other senior executive positions in other large corporations; and (2) certain retired directors of "W". Each Eligible Employee will receive, before investing, a private offering memorandum containing information deemed material by "V" and "X" to a decision to invest in the Contract. Each Eligible Employee will also consent to being treated as a QEP.

An Eligible Employee investing in the Contract may allocate his investment to one or more of the subaccounts that comprise a separate account of "V" designated the "Variable Annuity Account IX" (the "Separate Account"). The Separate Account will be comprised initially of three different subaccounts: (1) the Diversified Income Subaccount; (2) the High Yield Subaccount; and (3) the Money Market Subaccount. Each of the three subaccounts has its own investment objective and unit values. The Diversified Income Subaccount will invest only in limited liability vehicles, some of which will be commodity pools. The High Yield Subaccount

and the Money Market Subaccount: (1) will be prohibited from investing directly in commodity interests or in vehicles qualifying as commodity pools; and (2) will not be permitted to share in profits or losses attributable to investments in the Diversified Income Subaccount.

With respect to your request that the Diversified Income Subaccount not be deemed to be a commodity pool, we note that the Division has previously found a trading vehicle not to be a commodity pool where the investors in the vehicle were family members, close personal friends, or long-time business associates.^{3/} Although you state that the Eligible Employees are in many respects in a position similar to that of the club members, family members and friends referred to in certain prior Division correspondence, as of January 18, 1996, over 550 persons qualified as Eligible Employees, and no minimum number of years' employment is required as a condition of becoming an Eligible Employee. In addition, there is no relationship in the circumstances presented in your letter among the operator, "V", and the participants (the Eligible Employees). Accordingly, we believe the Contract is more in the nature of an employment-based investment vehicle rather than a joint business venture of the participants. In Interpretive Letter No. 96-2, as you note, the Division granted relief with respect to specialized pension-related products where another entity registered as a CPO and a commodity trading advisor had substantial decision-making authority. However, in that case the pension-related product at issue was non-contributory, funded solely by the employer, unlike the Contract proposed herein.^{4/} Your request that the Diversified Income Subaccount and Separate Account be treated as outside the definition of "pool" under Rule 4.10(d)(1) is, accordingly, denied.

Alternatively, you have requested that "V" be granted relief from registration as a CPO with respect to the Diversified Income Subaccount. In support of this request, you represent that "X" has been responsible for the design of the investment components of the Contract, while "V" has been responsible for the design of the insurance features of the Contract, such as the transfer and withdrawal provisions, the annuity options and the death benefit. Consistent with these roles, the portion of the private offering memorandum relating to the investments comprising the Separate Account is being prepared by "X", while the portion relating to the annuity features of the Contract is being prepared primarily by

^{3/} See, e.g., CFTC Interpretive Letter No. 95-35, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,376 (November 23, 1994).

^{4/} CFTC Interpretive Letter No. 96-2, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,604 (December 11, 1995).

"V". "X" will be appointed Investment Manager of the Separate Account and will be responsible for the investment-related aspects of the Contract. Pursuant to its responsibilities under state insurance laws, "V" will act as the issuer of the Contract, as custodian of the assets of the Separate Account and will be responsible for the valuation of the assets of the Separate Account. "V" will be ultimately responsible for the preparation and distribution of the Separate Account's annual reports and maintenance of books and records. It intends to delegate these responsibilities to "X" through an administrative services contract.

With regard to the offering of the Contract, "X" will initially inform the Eligible Employees that the Contract is available. Because the participation of a life insurance company is required in connection with an offering of an annuity contract product, "Y", a registered broker-dealer subsidiary of "V", will provide the offering document to those Eligible Employees expressing an interest in the Contract. We also note your representation, stated above, that "X" initiated Contract discussions with "V".

The Division considers several factors in determining whether relief from CPO registration is appropriate. In the case of "V", we believe the following factors support granting CPO registration relief to "V": (1) participation in the Contract will be limited to Eligible Employees, all of whom possess extensive business and finance education and experience; (2) "V", as a mutual life insurance company, is subject to regulation under state insurance law, and "Y", a registered broker-dealer, is subject to regulation under the federal securities laws; (3) the Diversified Income Subaccount will not invest directly in commodity interests but will only invest through other funds or investment partnerships; and (4) "X", a wholly-owned subsidiary of the employer of the Eligible Employees and a registered CPO, will act as Investment Manager and will be delegated responsibility for the preparation and distribution of annual reports and of books and records.

Based upon your representations, the Division believes your request for relief from CPO registration requirements for "V" has merit. Accordingly, subject to the conditions set forth below, the Division will not recommend that the Commission take any enforcement action for failure to register as a CPO against "V" in connection with the proposed offering and operation of the Contract. This relief is subject to the following conditions: (1) "X" continues to be registered with the Commission as a CPO and to act as the Investment Manager for the Diversified Income Subaccount; (2) each Eligible Employee receives, before investing, an offering memo which describes possible investments that may be made by the Diversified Income Subaccount and the material risks of such investments; (3) each Eligible Employee consents to being

treated as a QEP; and (4) "V" and "X" will comply with the requirements of the Act and the Commission's rules except to the extent exempted therefrom, as provided below.

With respect to your request that "X" be allowed to claim relief pursuant to Rule 4.7 for the Diversified Income Subaccount and that the Division exempt "X" and the CPO of any Rule 4.7 exempt pool in which the Diversified Income Subaccount invests from the Ten Percent Restriction, notwithstanding the participation of non-QEP investors in the Contract, we note that the Division has previously granted similar relief in connection with other pooled investments made available to "W" Eligible Employees.^{5/} Here, as in those cases, you represent that the Eligible Employees possess extensive business and finance education and experience. In addition, you represent that each Eligible Employee participating in the Contract will consent to being treated as a QEP.

In light of the foregoing, it appears that granting the requested relief would not be contrary to the public interest or the purposes of Rule 4.7. Accordingly, subject to the conditions set forth above, pursuant to the authority delegated by Rule 140.93(a)(1), the Division will not recommend that the Commission take any enforcement action based solely upon failure to comply with Rule 4.7 against: (1) "X" if "X" claims relief pursuant to Rule 4.7(a), notwithstanding investment in the Diversified Income Subaccount by non-QEP Eligible Employees, and treats the Eligible Employees as QEPs; and (2) "X" or the CPO of any Rule 4.7 exempt commodity pool in which the Diversified Income Subaccount invests, if the Diversified Income Subaccount invests more than ten percent of the fair market value of its assets in Rule 4.7 exempt pools.

This letter does not excuse "V" or "X" from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, they remain subject to the antifraud provisions of Section 40 of the Act, to the reporting requirements for traders set forth in Parts

^{5/} See CFTC Interpretive Letter No. 96-61, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,779 (August 6, 1996) (allowing "X" to claim relief under Rule 4.7 in connection with its operation of the "Z" Fund notwithstanding the investment therein by certain non-QEP Eligible Employees); CFTC Interpretive Letter No. 94-72, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,161 (May 6, 1994) (granting "X" and the CPOs of commodity pools in which certain "X"-operated funds invest a waiver from the Ten Percent Restriction on investments in Rule 4.7 exempt pools); CFTC Interpretive Letter No. 94-11, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,992 (December 17, 1993) (granting "X" relief from certain requirements of Rule 4.21, 4.22 and 4.23(a)(10) and (a)(11) in connection with the operation of several funds).

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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. In this connection, we request that you notify us immediately in the event that the operations or activities of "X", "V" or the Separate Account, including the composition of its investors, 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 any other office or division of the Commission.

If you have any questions concerning this correspondence, please contact me or Teresa Dondlinger Trissell, an attorney on my staff, at (202) 418-5447.

Very truly yours,

Susan C. Ervin
Chief Counsel