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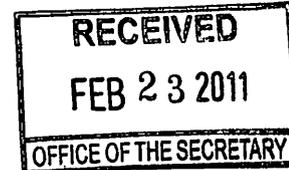
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# CHURCH ALLIANCE

Acting on Behalf of Church Benefits Programs

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February 22, 2011



## By Hand Delivery

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Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
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Elizabeth M. Murphy, Esq.  
Secretary  
Securities and Exchange Commission  
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**Re: Proposed Regulations on Further Definitions of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" – CFTC RIN 3038-AD06; SEC File Number S7-39-10**

Dear Mr. Stawick and Ms. Murphy:

## I. INTRODUCTION

On behalf of the Church Alliance, we are pleased to submit this comment letter regarding the regulations proposed by the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) (and collectively, Commissions) under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) to further define the terms "swap dealer," (SD) "security-based swap dealer," (SBSD) "major swap participant," (MSP) "major security-based swap participant," (MSBSP), and "eligible contract participant" (ECP).<sup>1</sup> Our comments are directed toward clarifying that: (1) "church

<sup>1</sup> 75 Fed. Reg. 80173 (December 21, 2010) (Joint Release).

plans” and their related church benefits boards are included within those entities, whose positions or contracts that are held for the primary purpose of hedging or mitigating any risk directly associated with plan operation, are *excluded* in determining whether the plans maintain a substantial position in swaps; and (2) church plans and certain related entities are not SDs or SBSBs.

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 are defined as “church plans” under Section 3 (33) of the Employee Retirement Income Security Act of 1974 (ERISA). A church plan is an employee benefit plan as defined in Section 3(3) of ERISA.<sup>2</sup> 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). A church benefits board is also (i) typically an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (Code), (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) and 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 denominational benefits boards represented through the Church Alliance have an interest in the regulation of the swap market.

## II. DODD-FRANK’S STATUTORY SCHEME

Dodd-Frank provides that the CFTC has jurisdiction over “swaps,” and the SEC has jurisdiction over “security-based swaps.” Dodd-Frank Sections 721 and 761 add to the Commodity Exchange Act (CEA) and the Securities Exchange Act of 1934 (Exchange Act) definitions of the terms SD, SBSB, MSP, and MSBSP. Dodd-Frank Section 712(d)(1) authorizes the CFTC and the SEC, in consultation with the Board of Governors of the Federal Reserve System, to further define the terms swap, security-based swap, security-based swap agreement, SD, SBSB, MSP, MSBSP, and ECP. Dodd-Frank Sections 721(b)(2) and 761(b)(2) provide additional au-

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<sup>2</sup> 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 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.

thority for the Commissions to further define these terms. The CFTC and SEC jointly published proposed regulations on December 21, 2010 that would further define the terms SD, SBSD, MSP, and MSBSP, and would amend the definition of the term ECP.

### III. DEFINITIONS OF MSP/MSBSP

#### A. Proposed Definitions

The Commissions have proposed to define the terms MSP and MSBSP in proposed Regulations 1.3(qqq) and 240.3a67-1, respectively. The first prong of these proposed definitions provides that, in determining whether a person maintains a “substantial position” in swaps or security-based swaps, “positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of Section 3 of [ERISA] for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan,” shall be excluded.<sup>3</sup> The proposed definitions track the statutory language essentially verbatim. The Commissions also request comment in the Joint Release on whether that exclusion should be available to different types of entities.<sup>4</sup>

#### B. Clarifications to Proposals

##### *1. Treatment of Church Plans*

The Church Alliance recommends that the Commissions revise the proposed definitions of MSP and MSBSP by replacing the phrase “paragraphs (3) and (32)” with the phrase “paragraphs (3), (32), and (33).” Because the term “church plans” is defined in paragraph (33) of Section 3 of ERISA, the recommended clarification should leave no doubt that, for purposes of excluding positions and contracts from the first test of the MSP/MSBSP definition, all employee benefit plans should be treated similarly, whether the plans are for workers in the private sector, government, or churches and church-affiliated denominational employers. The Church Alliance believes that Congress did not mean to discriminate against church plans in this regard, and this Congressional intent is evident by the fact that Congress used the phrase “as defined” rather than the narrower phrase “subject to” ERISA. Nevertheless, we are concerned that a regulatory body or a reviewing court could misinterpret Congressional intent if there is no specific reference to church plans in the regulatory text of the definitions and there is such a reference to governmental plans.<sup>5</sup>

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<sup>3</sup> Proposed CFTC Regulation 1.3(qqq)(1)(ii)(A) and SEC Regulation 240.3a67-1(a)(2)(i).

<sup>4</sup> 75 Fed. Reg. 80173, at 80201.

<sup>5</sup> If the Commissions for some reason determine that they do not want to make a specific reference to paragraph (33) of Section 3 of ERISA in the regulatory text, the Commissions should

We note that the CFTC has recognized this issue in the context of its separate rulemaking proposing business conduct standards for SDs and MSPs, which contains a definition of the term “Special Entity” for those purposes that also refers to any employee benefit plan defined in Section 3 of ERISA and any governmental plan as defined in the same section.<sup>6</sup> In the other rulemaking, the CFTC states, in the preamble of the *Federal Register* release announcing those proposals, that employee benefit plans defined in Section 3 cover more than plans that are “subject to” ERISA, and specifically refers to church plans.<sup>7</sup> The CFTC notes, however, that certain commenters in the pre-proposal stage found the authorizing provision in Dodd-Frank<sup>8</sup> to be ambiguous 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.<sup>9</sup> The Church Alliance believes that the employee benefit plans that are eligible for the exclusion in the first test of the MSP/MSBSP definitions also needs to be clarified to specifically reference church plans, as described above. The clarification takes on added importance in the MSP/MSBSP context, because the Joint Release contains no similar discussion to that contained in the release announcing the business conduct standards for SDs and MSPs.

The Church Alliance recommends that the requested clarification to the MSP/MSBSP definitions described above be included in the regulatory text of the definitions. This will enhance legal certainty and eliminate any need for persons relying on the exclusion of positions and contracts to scour the *Federal Register* to divine the intended meaning of the phrase “employee benefit plan.” Including the revised phraseology expressly within the regulatory text itself is especially important given the number of rulemakings necessary to implement Dodd-Frank and the length and complexity of the various *Federal Register* notices involved in that process.

The recommended revisions discussed above also would make the definitions of the terms MSP and MSBSP consistent with CFTC Regulation 4.5, which excludes various employee

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make clear, preferably in the regulatory text but at least in the preamble, that employee benefit plans defined in ERISA Section 3(3) include church plans.

<sup>6</sup> 75 Fed. Reg. 80637 (December 22, 2010). The Church Alliance will file a separate comment letter addressing that rulemaking.

<sup>7</sup> 75 Fed. Reg. 80637, at 80649 & n.89.

<sup>8</sup> Dodd-Frank Section 731 added a new CEA Section 4s to govern the registration and regulation of SDs and MSPs. The “Special Entity” definition is set forth in new CEA Section 4s(h)(2)(C), and employee benefit plans generally, and governmental plans specifically, are referred to in subparagraphs (iii) and (iv), respectively. *See also*, proposed CFTC Regulation 23.401, 75 Fed. Reg. 80637, at 80657.

<sup>9</sup> 75 Fed. Reg. 80637, at 80649.

benefit plans from being construed as commodity pools, and has separate paragraphs excluding, among others, “governmental plans” and “church plans.”<sup>10</sup>

Further, as the Commissions stated, “the appropriateness of these proposals [regarding definitions of swap entities] should be considered in light of the substantive requirements that will be applicable to dealers and major participants, including capital, margin and business conduct requirements.”<sup>11</sup> Any reasonable assessment of the proposed MSP/MSBSP definition in light of these other requirements clearly demonstrates that such requirements are inappropriate and unnecessary for church plans, as is the case for other employee benefit plans, and the proposed MSP/MSBSP definitions should be revised to ensure that result. The concomitant costs associated with registration and the other requirements applicable to MSPs/MSBSPs would be an undue and unnecessary burden for church plans, which would only serve to diminish the benefits available to beneficiaries of such plans. That would certainly not serve the interests of such beneficiaries or the public interest. In addition, the Church Alliance submits that, in the proposed business conduct standards for SDs and MSPs referred to above, church plans should be treated as Special Entities when dealing with or being advised by SDs and MSPs, which would afford church plans enhanced protections in those circumstances.<sup>12</sup> It would therefore be an anomalous result to classify church plans as MSPs or MSBSPs, and make them subject to substantial business conduct requirements, when church plans should be designated as Special Entities and thus entitled to be the *beneficiaries* of such extra protection.

One of the concerns that led to the enactment of the MSP/MSBSP provisions in Dodd-Frank is systemic risk. Church plans’ activities in swap and security-based swap transactions did not present systemic risk in the past and do not present such risk now. It is difficult to envision how they could ever present such risk, but if the Commissions have such concerns, the other two prongs of the MSP/MSBSP definitions, which address “substantial counterparty exposure” and “highly leveraged financial entities,” should be sufficient to cover any entity that presents true systemic risk.

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 Commissions should take this opportunity to exercise their authority under Dodd-Frank Sections 712(d)(1), 721(b)(2) and 761(b)(2) to clarify the definitions of MSP and MSBSP so that church plans and their related church benefits boards may exclude from the consideration as to whether they are

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<sup>10</sup> See 17 C.F.R. § 4.5 (a)(4)(iii) and (v).

<sup>11</sup> 75 Fed. Reg. 80173, at 80175 & n.8.

<sup>12</sup> The Church Alliance has asserted that position in its separate comment letter on the business conduct standards rulemaking.

maintaining a substantial position in swaps or security-based swaps, those positions and contracts that are maintained for the primary purpose of hedging or mitigating any risk directly associated with plan operations. 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 Commissions also need to clarify that church benefits boards that hold the assets of church plans are treated like church plans for purposes of the MSP/MSBSP definitions. The Commissions should include language in the regulatory text of the MSP/MSBSP definitions that makes it clear that the provision permitting exclusion of swap positions that constitute hedging or risk mitigation also applies to a church benefits board that holds the assets of multiple church plans, church endowments, and other church-related funds on a commingled basis. Such regulatory text would be reflective of the close and unique relationship between church benefits boards and their constituent church plans, a relationship recognized in both ERISA and the Code.

Dodd-Frank provides that commercial end users should be able to conduct swap transactions largely as they have been accustomed to. Church denominations have organized themselves so that church pension boards are typically the entities that handle investments for the denomination's benefit plans and for other church assets, including church endowments. The use of church benefits boards is more administratively efficient, and such boards have greater resources, investment skills and market clout than the individual churches and other denominationally affiliated organizations that contribute to the boards.

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 that is similar to the relief available to trustees of individual pension plans,<sup>13</sup> providing a precedent for the church benefits board context. The Commissions, by making clear that a church benefits board is to be treated like a church plan when defining the terms MSP and MSBSP, will provide guidance that is consistent with the purposes of the regulations, 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

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<sup>13</sup> 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).

same ERISA requirements as apply to the underlying plans. 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.<sup>14</sup> 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 church benefits board similarly to a church plan, for purposes of the exclusion of hedging and risk mitigation positions from the first test of the MSP/MSBSP definitions.

#### **IV. SD/SBSD DEFINITIONS**

##### **A. Proposed Definitions**

The Commissions propose to further define the terms SD and SBSB. Among other things, a person would be deemed to be an SD or SBSB if the person “[r]egularly enters into swaps [security-based swaps] with counterparties as an ordinary course of business for its own account.”<sup>15</sup> An exception to the definitions is provided for “a person that enters into swaps [security-based swaps] for such person’s own account, either individually or in a fiduciary capacity, but not as a part of regular business.”<sup>16</sup>

##### **B. Clarifications to Proposal**

###### *1. Adding a Hedging/Risk Mitigation Exception*

The SD/SBSB definitions should expressly state that the terms do not include any employee benefit plans, including church plans, with respect to any swap they enter into for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan. If hedging or risk mitigation activity could bring an employee benefit plan, including church plans, within the SD/SBSB definitions, they would be forced to reduce the use of swaps and security-based swaps for hedging and risk mitigation, rather than risk being required to comply with the onerous regulatory requirements for SDs and SBSBs. In the case of church plans, compliance with those requirements not only are costly in their own right, but are wholly incompatible with the demands of operating an employee benefit plan to secure maximum returns for beneficiaries. Discouraging hedging and risk mitigation is clearly contrary to Dodd-Frank’s in-

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<sup>14</sup> 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).

<sup>15</sup> Proposed CFTC Regulation 1.3(ppp)(1)(iii) and SEC Regulation 240.3a71-1(a)(3).

<sup>16</sup> Proposed CFTC Regulation 1.3(ppp)(2) and SEC Regulation 240.3a71-1(b).

tent, as well as the public interest and the interests of workers who depend upon pensions for retirement income.

## 2. "Regular Business" Exception

The "Exception" in proposed CFTC Regulation 1.3(ppp)(2) and SEC Regulation 240.3a71-1(b) that "[t]he term 'swap dealer' [*security based swap dealer*] does not include a person that enters into swaps [*security-based swaps*] for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business," should be clarified by inserting the words "swap dealing" and "security-based swap dealing," respectively, between the words "regular" and "business." Without this clarification, the exception's plain terms fail to exclude *on their face* the hedging and risk management activity of employee benefit plans. Church plans enter into swaps and security-based swaps for the purpose of hedging or mitigating risks directly associated with plan operations and as an integral part of their "regular business," *i.e.*, maximizing the pensions and health benefits available to their beneficiaries.

The clarification is necessary to better reflect the Commissions' intent in the plain terms of the regulatory definitions and to eliminate the legal risk of future indiscriminate application of the definitions. Failing to eliminate that risk will harm employee benefit plans, including church plans, as well as swap and security-based swap markets, because that legal risk would cause employee benefit plans to diminish their use of swaps and security-based swaps to avoid the extensive costs of compliance with the regulatory requirements applicable to SDs and SBSDs.

Further, as we discussed above in the context of the MSP/MSBSP definitions, the proposed business conduct standards for SDs and MSPs should be clarified to treat church plans as Special Entities when dealing with or being advised by SDs and MSPs, which would afford church plans enhanced protections in those circumstances. It would therefore be an anomalous result to classify church plans as SDs or SBSDs, and make them subject to substantial business conduct requirements, when church plans should be designated as Special Entities and thus entitled to be the *beneficiaries* of such extra protection.

## V. CONCLUSION

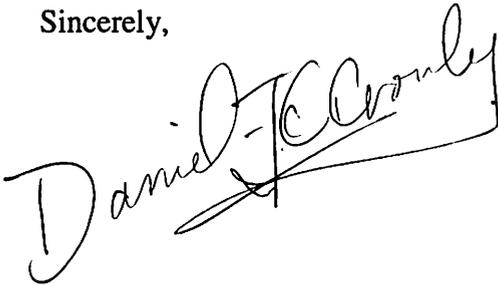
The Church Alliance appreciates the opportunity to comment upon the proposed regulations that would further define the terms SD, SBS, MSP, and MSBSP. We believe that the exclusion available in the MSP/MSBSP definitions for hedging and risk mitigation positions of employee benefit plans should refer specifically to church plans and should also refer to church benefits boards. Further, the Commissions should clarify the definitions of SD and SBS to make sure that the hedging and risk mitigation activities of employee benefit plans, including church plans, do not inadvertently sweep those plans into the definitions.

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

David A. Stawick  
Elizabeth M. Murphy  
February 22, 2011  
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contact the undersigned at 202-778-9447 if you have any questions or wish to discuss this matter further.

Sincerely,

A handwritten signature in black ink that reads "Daniel F. C. Crowley". The signature is written in a cursive style with a large initial "D" and a stylized "C" at the end.

**Daniel F. C. Crowley**  
**Partner, K&L Gates**  
**On Behalf of the Church Alliance**