

PUBLIC

JUL 22 1993

RESPONSE OF THE OFFICE OF
INSURANCE PRODUCTS
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. IP-6-93
CREF Real Estate Account

Your letters of June 26, 1991 and December 18, 1990, as supplemented by your letter of October 15, 1992 and discussions with the staff on October 16, 1992 and August 14, 1991, request assurance that we would not recommend enforcement action to the Commission against the College Retirement Equities Fund ("CREF") 1/ if CREF establishes a portfolio that invests primarily in real property (the "RE Account") without registering the portfolio under the Investment Company Act of 1940 (the "Investment Company Act"). 2/ As explained in your letters, the RE Account will be part of the CREF corporate entity and will be managed by CREF's Board of Trustees. You intend, however, to provide for the legal segregation of the assets held in the RE Account from the assets held in CREF's other portfolios. 3/

For a variety of reasons, you propose establishing the RE Account as an unregistered portfolio under CREF rather than as

1/ CREF is a nonprofit membership corporation subject to the Not-For-Profit Corporation Law of New York State. It was established by a special act of the New York State Legislature and was formed for the purpose of providing retirement benefits for the employees of certain nonprofit organizations. CREF is registered under the Investment Company Act as an open-end diversified management investment company.

2/ Your request to establish an unregistered real estate portfolio raised a number of fundamental concerns regarding investment company regulation which you addressed over a period of two years. As you offered new and additional arguments for your position, we attempted to incorporate these arguments in our continuing analysis of the issues over this period. Understandably, this has been a lengthy process.

3/ At our October 15, 1992 meeting, the staff expressed its concern that assets held in CREF's existing accounts may be subject to the claims of the RE Account's unsecured creditors. In response, you proposed amending CREF's Charter and Constitution to reflect the addition of the following sentence:

With respect to the establishment of a fund which invests primarily in real property or direct or indirect interests therein, including without limitation, income-producing real estate, participating and non-participating mortgage loans and real property sale-leaseback transactions (the "Real Estate Account"), the corporation may provide in the applicable agreements that income and both unrealized gains or losses from the Real Estate Account's assets will be credited to or charged against the Real Estate Account without regard to the income, gains and losses of the corporation's other funds.

part of the Teachers Insurance and Annuity Association of America ("TIAA") 4/ or as an independent legal entity. Among other things, you assert that establishing the RE Account as part of TIAA would significantly increase the level of mortality and expense risk charges participants in the RE Account must pay. You further explain that the alternative of creating a separate investment company would require the RE Account to have its own tax exempt status under the Internal Revenue Code, a procedure you assert is time consuming and very costly.

We are unable to assure you that we would not recommend enforcement action to the Commission if CREF proceeds as proposed. We are not persuaded by your arguments that a registered investment company, consistent with the Investment Company Act and the rules thereunder, may create a real estate investment portfolio. You have offered no precedent to support this argument nor considered whether it would be appropriate for any other registered investment company to establish an unregistered investment portfolio. In addition, your arguments concerning the administrative and financial costs of establishing the RE Account, either as a separate legal entity or as a separate account of TIAA, do not justify the relief you request.

We are also not convinced that CREF may insulate the RE Account from its investment company operations to the same extent insurance companies insulate their separate accounts under state law. The amendments you propose to CREF's Charter and Constitution do not provide us with enough assurance that CREF's existing accounts will not be chargeable with liabilities arising from the RE Account.

The Commission and the staff in the past have considered CREF's unique structure and history in connection with CREF's requests for relief from the Investment Company Act. In those situations, however, failure to grant the requested relief would have been inimical to CREF's established operations and the interests of contract owners. CREF's proposal to establish an unregistered real estate portfolio, in our view, does not present the same concerns.

Thomas E. Bisset

Thomas E. Bisset
Senior Attorney
Office of Insurance Products

4/ TIAA is a companion organization of CREF. Like CREF, TIAA offers fixed annuity contracts and insurance benefits to employees of certain nonprofit organizations.



ACT 1933 1934 1970

SECTION 3(a)

RULE _____

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
PUBLIC AVAILABILITY 07-22-93

July 22, 1993

Steven B. Boehm, Esq.
Sutherland, Asbill & Brennan
1275 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2404

Re: CREF Real Estate Account

Enclosed is our response to your letters of October 15, 1992, June 26, 1991 and December 18, 1990. By incorporating our answer into the enclosed photocopies of your letters, we avoid having to recite or summarize the facts involved.

In any future correspondence on this matter, please refer to our Reference No. IP-6-93.

Sincerely,

Wendell M. Faria
Deputy Chief
Office of Insurance Products

Enclosure

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PAUL J. MASON

DIRECT LINE: (202) 383-0147

October 15, 1992

BY MESSENGER

Clifford E. Kirsch, Esquire
Assistant Director
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

October 15, 1992

Re: College Retirement Equities Fund -- Proposed Real Estate Account

Dear Mr. Kirsch:

As we discussed, this letter provides some background as to the no-action letter request of the College Retirement Equities Fund concerning the addition of an investment portfolio that invests primarily in real property (the "RE Account" or "Account"). As you will recall, CREF is seeking to establish and operate the Account outside the definition of an investment company in Section 3 of the Investment Company Act of 1940 (the "1940 Act") and to not treat the Account as being part of its regulated investment company operations. As you know, there are practical reasons why a real estate fund cannot operate subject to the 1940 Act and to the best of our knowledge, there are no such funds that do.

On December 18, 1990, we initially submitted a no-action letter request on behalf of CREF in connection with its proposed implementation of the RE Account. In its letter of February 27, 1991, the Staff responded by outlining certain preliminary concerns and questions it had about the operation of the proposed Account. We, in turn, responded to the specific comments in that letter in a letter dated June 26, 1991.

On August 14, 1991, Charles Stamm and Peter Clapman of CREF, and Steve Boehm and I, met with you, Heidi Stam, Barry Miller and Tom Bisset to further discuss the proposed RE Account. At that time, it was acknowledged that the issues being raised were novel, and that even the indirect precedent in the area was not particularly relevant. We explained that CREF was choosing this unique approach (rather than, for example, utilizing a

Clifford E. Kirsch, Esquire
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Page 2

separate account of TIAA) to enable CREF to pursue its policy of providing benefits at the lowest cost possible. We pointed out that under the RE Account approach, CREF could provide this investment alternative with a level of aggregate fees that was lower than virtually anyone else's in the industry. It was explained further that if a TIAA separate account approach were utilized, TIAA would be required under New York insurance law to impose a mortality expense risk-type charge, which necessarily would be more costly to participants than CREF's current approach based on actual mortality experience, and does not involve additional mortality charges against assets during either the accumulation or the annuity phase. We also briefly explained that CREF carefully studied other possible structures and found each to be inappropriate for one material reason or another.

At our earlier meeting, the Staff expressed concern about the issue of the insulation that participants in CREF's investment company accounts would have vis-a-vis the RE Account even if it were not deemed part of CREF's investment company operation. You indicated that the Staff needed some level of assurance that insulation existed similar to that provided under separate account statutes. We indicated at that time that CREF believed that an opinion of counsel could be obtained from a major New York law firm to the effect that changes to certain of CREF's governing documents, appropriately worded, together with action by the New York State Insurance Department (the "Department"), would have that effect.

After some discussion, you indicated that if action were taken with respect to this issue by the Department, and such an opinion could be obtained, the Staff would be in a position to more favorably consider our request for relief.

Subsequent to that meeting, CREF commenced a dialogue with the Department concerning the proposed RE Account. Ultimately, officials of the Department approved amendments to CREF's charter and constitution that would provide for insulation between the Account and the rest of CREF's investment portfolios. CREF could implement the appropriate changes to those governing documents, but of course will not do so pending the outcome of this request for relief.

Following its discussions with the Department, CREF sought the opinion letter discussed at our August meeting. On October 5, 1992, that letter was issued by the New York City office of the law firm of Rogers & Wells. After reciting the relevant facts and other considerations, that letter concludes that:

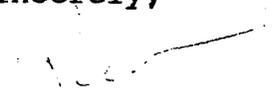
Clifford E. Kirsch, Esquire
October 15, 1992
Page 3

[O]nce the [charter and constitution] Amendments become effective, if (A) CREF files a statement of operations* for the Real Estate Account with the Insurance Department which is approved by the Insurance Department and is not inconsistent with the exclusive allocation of income, gains and losses on the Real Estate Account's assets to the Real Estate Account and (B) the contract with the participants in the Real Estate Account so provides, then (i) income, gains and losses from the Real Estate Account's assets will be credited to or charged against the Real Estate Account without regard to the income, gains and losses of CREF's other investment accounts and (ii) the assets in CREF's other investment accounts should not be liable for losses incurred by participants in the Real Estate Fund.

(* We would note that the Department, as part of the process of considering these amendments, went through the issues that are involved in connection with the statement of operations and was satisfied that CREF would meet the Department's standards.)

We believe that the foregoing developments are responsive to the concerns raised by the Staff on the "insulation" issue. We look forward to discussing this issue further at our meeting on Friday.

Sincerely,


Paul J. Mason

cc: Peter C. Clapman, Esq.
Steven B. Boehm, Esq.

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STEVEN B. BOEHM

DIRECT LINE: (202) 383-0176

October 16, 1992

October 16, 1992

BY MESSENGER

Clifford E. Kirsch, Esquire
Assistant Director
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: College Retirement Equities Fund ("CREF")

Dear Mr. Kirsch:

Pursuant to your request at our meeting this morning, enclosed is a copy of the opinion letter issued by the law firm of Rogers & Wells in connection with CREF's proposed Real Estate Account.

Please let us know if you require any additional information.

Sincerely,



Steven B. Boehm

Enclosure

cc: Peter C. Clapman, Esq.
Paul J. Mason, Esq.

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October 5, 1992

BY HAND

Peter C. Clapman, Esq.
Senior Vice President and
Chief Counsel, Investments
College Retirement Equities Fund
730 Third Avenue
New York, New York 10017

Re: College Retirement Equities Fund -
Real Estate Account

Dear Peter:

The College Retirement Equities Fund ("CREF") anticipates establishing and operating a new investment fund that would invest primarily in real property (the "Real Estate Account"). You have requested our advice concerning the allocation of income, gains and losses to the Real Estate Account. You have also requested our advice as to whether the assets in CREF's other investment accounts would be liable for losses incurred by participants in the Real Estate Account. Subject to the conditions described herein, it is our opinion that similar to the treatment accorded to separate accounts of New York life insurance companies (i) income, gains and losses from the Real Estate Account's assets will be credited to or charged against the Real Estate Account without regard to the income, gains and losses of CREF's other investment accounts and (ii) the assets in CREF's other investment accounts should not be liable for losses incurred by participants in the Real Estate Account.

CREF was incorporated in 1952 under a special enactment of the New York State Legislature. Chapter 124 of the Laws of New York of 1952 (the "CREF Act"). The CREF Act established the Charter (the "Charter") of CREF, and provided for the adoption of a Constitution (the "Constitution") and By-laws for the regulation

Rogers & Wells

Peter C. Clapman

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of the affairs of CREF. CREF is a Type B Corporation under the New York Not-For-Profit Corporation Law ("NPCL") and has elected pursuant to Section 103(a) of the NPCL to have the NPCL apply to it in all respects.

Under the CREF Act, as amended, CREF is subject to certain Articles and Sections (Articles 1, 3, 25 and 74, and Sections 1212, 1217, 1411 and 4230) of the New York Insurance Law (the "Insurance Law"), to the extent not inconsistent with the Charter, but is exempt from most provisions of the Insurance Law. Under the current statutory scheme, CREF is therefore not an "insurer" for most purposes of the Insurance Law. CREF is, however, authorized under Section 8 of its Charter and Article VI, Section 3 of its Constitution to establish funds with investment objectives and limitations as described in such funds' statements of operations filed with, and approved by, the Insurance Department.

CREF is registered with the Securities and Exchange Commission (the "SEC") as an open-end investment company under the Investment Company Act of 1940, as amended (the "1940 Act"), and operates as a series fund offering investment options including a Stock Account, a Bond Market Account, a Money Market Account, a Social Choice Account and a Global Equities Account (the "Existing Accounts"). Although the Existing Accounts are subject to the 1940 Act and applicable SEC regulations, we understand that it would be impracticable for CREF to offer its Real Estate Account as a part of this series fund because of valuation and redemption requirements under the 1940 Act. The Real Estate Account, however, would be subject to registration under the Securities Act of 1933 (requiring that the offering to participants be through a prospectus) and the reporting requirements of the Securities Exchange Act of 1934 (governing periodic financial reporting to account participants).

Currently, Section 8 of the Charter and Article VI, Section 3 of the Constitution permit CREF to establish funds with investment objectives and limitations as described in a statement of operations filed with, and approved by, the Insurance Department. CREF has proposed amendments (the "Amendments") to these Sections of the Charter and Constitution to the New York Insurance Department by addition of the following sentence:

With respect to the establishment of a fund which invests primarily in real property or direct or indirect interests therein, including without limitation, income-producing real estate, participating and non-participating mortgage loans and real property sale-leaseback transactions (the "Real Estate

Peter C. Clapman

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Account"), the corporation may provide in the applicable agreements that income and both realized and unrealized gains or losses from the Real Estate Account's assets will be credited to or charged against the Real Estate Account without regard to the income, gains and losses of the corporation's other funds.

Thus, under the Charter and Constitution if so amended, CREF would be expressly authorized to establish the Real Estate Account. However, the Real Estate Account can only be established after a statement of operations has been filed with, and approved by, the Insurance Department. The investment objectives and limitations for the Real Estate Account will be those set forth in such statement of operations. Moreover, if so provided in the agreements with participants relating to the Real Estate Account, the income, gains and losses from the Real Estate Account's assets are to be only credited to or charged against the Real Estate Account. The text of the proposed amendments requires that if the agreement with the participant so provides, losses from the Real Estate Account will be charged against the Real Estate Account and its assets. This prohibits such losses from the Real Estate Account from being used to reduce income from the Existing Accounts (such losses being charged to the Real Estate Account "without regard to the income, gains and losses of [CREF's] other funds."). Similarly, because losses arising from costs, expenses or liabilities relating to the Real Estate Account assets can only be charged against the Real Estate Account, such losses cannot be charged against the assets of the Existing Accounts.

Section 6 of the Charter makes Article 74, "Rehabilitation, Liquidation, Conservation and Dissolution of Insurers", as amended, applicable to CREF "to the extent...not inconsistent with the provisions of [the CREF Act]." The CREF Act constitutes the Charter. Therefore, the provisions of the proposed Charter amendment would supersede any inconsistent provision of Article 74 relating to the payment of liabilities of CREF. For example, the provisions of the proposed Charter amendment restricting the charges of losses from Real Estate Account assets to the Real Estate Account would supersede the provisions of Section 7435 relating to priority of distribution of claims from the estate of a life insurance company in a rehabilitation, liquidation, conservation or dissolution proceeding.

It is also clear that the Insurance Department understands that the proposed Amendments restrict Real Estate Account losses to the assets of the Real Estate Account. In your letter, dated September 13, 1991, to Mr. Terence Lennon requesting approval of the proposed Amendments, you clearly stated that the Real Estate Account was intended to "operate as a distinct vehicle

Rogers & Wells

Peter C. Clapman

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October 5, 1992

and not have any effect on the investment experience of other accounts within the CREF 'series' that operate under the 1940 Act" and that such amendment was designed to "expressly provide for the intended insulation of the Real Estate Account from the 'series' accounts." With this understanding, and after reviewing and discussing the proposed Amendments and their effects on the relationships between the various CREF accounts, the Insurance Department has found the proposed Amendments to be unobjectionable (the language typically used by the New York Insurance Department prior to its approval of CREF Charter and Constitution amendments).

Thus, once the Amendments become effective, if (A) CREF files a statement of operations for the Real Estate Account with the Insurance Department which is approved by the Insurance Department and is not inconsistent with the exclusive allocation of income, gains and losses on the Real Estate Account's assets to the Real Estate Account and (B) the contract with the participants in the Real Estate Account so provides, then (i) income, gains and losses from the Real Estate Account's assets will be credited to or charged against the Real Estate Account without regard to the income, gains and losses of CREF's other investment accounts and (ii) the assets in CREF's other investment accounts should not be liable for losses incurred by participants in the Real Estate Fund.

Sincerely,

Rogers & Wells

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STEVEN B. BOEHM
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June 26, 1991

Thomas E. Bisset, Esquire
Office of Insurance Products
and Legal Compliance
Division of Investment Management
Securities and Exchange Commission
Room 10183
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: College Retirement Equities Fund
Real Estate Account

Dear Mr. Bisset:

This letter responds to your letter of February 27, 1991, which set forth certain concerns and questions regarding the no-action letter request of the College Retirement Equities Fund ("CREF") concerning the addition of an investment portfolio that invests primarily in real property (the "RE Account" or "Account"). As you will recall, CREF is seeking to establish and operate the account outside the definition of an investment company in Section 3 of the Investment Company Act of 1940 (the "1940 Act") and to not treat the account as being part of its regulated investment company operations. By this letter, we also request the opportunity to meet with you and further discuss the issues you raised and our responses to them.

The items below correspond to your specific comments.

1. Relationship of RE Account to Other CREF Accounts.

As the Staff is aware, CREF is unique in a number of respects. It issues variable annuities, but it is a free-standing entity and not a separate account of an insurance company. In addition, since it is not an insurance company, it cannot create "separate accounts" within the meaning of New York insurance law. Also, it is not regulated by the New York Business Corporation Law, but rather is subject to that state's Not-For-Profit Corporation Law (the "NFPCL"). That law generally does not contemplate an investment-company type of operation like CREF's, nor the issuance of a number of classes or series of stock. (Indeed, that law is designed to regulate membership corporations, a common form of organization for nonprofit entities, and does not contemplate the issuance of any class of stock.)

Accordingly, there are no relevant "state law provisions that control CREF's ability to establish the RE Account as a separate series." CREF believes, however, that it can establish and operate the RE Account so that: (1) income and both realized and unrealized gains or losses from the RE Account's assets will be credited to or charged against the Account without regard to the income, gains and losses of the other CREF accounts; and (2) the other CREF accounts should be protected from claims asserted by creditors of the RE Account. CREF will seek to achieve this result as follows:

Thomas E. Bissett, Esquire
June 26, 1991
Page 3

First, CREF will seek to amend its charter to indicate that, from a corporate structural standpoint, the other CREF accounts will be insulated from the investment activities of, and any claims that might be raised against, the RE Account. To be effective, the charter amendment must be approved by the New York State Insurance Department. If and when the required approval is received, CREF will obtain an opinion of counsel to the effect that the charter amendment and action by the Insurance Department should have the effect of insulating the RE Account vis-a-vis the other CREF accounts to the same extent as separate accounts of an insurance company generally are insulated vis-a-vis the insurance company by statute.

2. Section 18(f) Issues. As discussed in the no-action letter request, CREF believes that, consistent with the approach taken by the Third Circuit in Prudential Ins. Co. v. Securities and Exchange Commission, 326 F.2d 383, 387 (3rd Cir. 1963), a non-investment company can be carved out of an investment company if the functional attributes of the structure do not subvert the policies and provisions of the 1940 Act. That approach necessarily requires that the RE Account not be considered part of CREF's investment company operation. Under that approach, then, CREF qua regulated investment company should not be viewed as issuing a class of stock representing interests in assets (i.e., the RE Account) that are not afforded the protections of the 1940 Act. Stated differently, the RE Account

would not be another class or series of an investment company, but would represent another part of CREF's business, just as an insurance company's general account would not be viewed as another series of any registered separate account the insurance company might maintain.

3. Comparison with Unregistered Real Estate Separate Accounts. Like interests in unregistered real estate separate accounts offered by life insurance companies ("Separate Accounts"), interests in the RE Account will be subject to registration under the Securities Act of 1933 (the "1933 Act"). Also, CREF, with respect to the RE Account, will be subject to the periodic reporting requirements of the Securities Exchange Act of 1934.

If the relief sought in the no-action letter is granted, the RE Account would not be subject to regulation under the 1940 Act. Likewise, Separate Accounts generally are not subject to those requirements of the 1940 Act.

Separate Accounts, as part of an insurance company, are subject to supervision and regulation by state insurance regulatory authorities. The RE Account, like the rest of CREF's operation, would be subject to regulation by the New York State Insurance Department, as well as by the insurance regulatory authorities of certain other states and jurisdictions.

The RE Account would also be subject to two layers of regulation affecting CREF which generally are not applicable to

Separate Accounts. First, its operation would have to be consistent with the requirements of the NFPCL. Second, it could not operate in a manner that was inconsistent with CREF's tax-exempt status under federal income tax law.

4. Disclosure Concerning Status of RE Account. CREF does not believe, as your comment suggests, that its status as a registered investment company with respect to its existing four accounts justifies a presumption that investors in the RE Account will be misled with respect to the applicability of the protections of the 1940 Act. Indeed, CREF is in virtually the same position in this regard as any unregistered real estate separate account of an insurance company that also offers interests in registered separate accounts.

CREF believes that the disclosure it intends to include in the registration statement covering interests in the RE Account will make clear that participants allocating amounts to the Account are not afforded the protections extended to the other CREF accounts under the 1940 Act. Specifically, CREF currently proposes to include a number of references in the prospectus to the fact that, unlike the other accounts, the RE Account is not subject to the 1940 Act. In addition, specific reference will be made to the fact that participants will have no voting rights with respect to interests in the Account. Given this disclosure, which the Staff will, of course, have an opportunity to review, CREF believes that the risk of a recipient

of the RE Account prospectus being misled as to its regulatory status is low. Obviously, CREF cannot guarantee that every participant will read the prospectus. The 1933 Act does not, however, impose that requirement on an issuer.

5. Feasibility of Separate Investment Company. The establishment of a CREF real estate account as a separate investment company was, in fact, considered by CREF before a determination to follow the proposed approach was made. However, the separate company approach raises two significant administrative and legal concerns which would make it impractical for CREF participants. First, and perhaps most significant, is the fact that a separate entity would have to have its own tax-exempt status recognized by the Internal Revenue Service. While CREF believes that it could ultimately obtain a tax exemption for such a separate real estate entity, the process can be, and often is, time consuming.

Second, CREF has a unique organizational history (i.e., it was formed by a special act of the New York State Legislature in 1952, prior to the existence of variable annuity regulation). The fact that there is now a long-standing body of state regulation governing issuers of variable annuities raises questions as to the appropriate form such a separate entity should take. Reliance on CREF's existing structure by simply adding a new real estate portfolio eliminates these concerns.

6. ERISA Fiduciary Issues. In our letter of December 18, 1990, we noted that the RE Account would be operating according to applicable standards and requirements of ERISA. We believe that discussion remains relevant. However, in connection with the development of more firm specifications for the Account, CREF recently has reevaluated the status of the Account under ERISA. It is now CREF's expectation that, at least during the early years following the establishment of the RE Account, it will satisfy the conditions of a so-called "real estate operating company" ("REOC") within the meaning of 29 C.F.R. §2510.3-101(e) of the Department of Labor's regulations defining "plan assets" for purposes of ERISA. To the extent (and for the time period) that the RE Account constitutes a REOC, it will not be considered to hold "plan assets," and therefore neither the RE Account nor the CREF Board of Trustees would be considered to be ERISA fiduciaries.

To the extent (and for such time as) the RE Account does not qualify as a REOC, however, it is CREF's expectation that the RE Account would be considered to hold "plan assets," so that:

- (a) the CREF Board of Trustees (if exercising discretionary management or control over the assets in the RE Account), and
- (b) any compensated investment adviser or manager of the RE Account

Thomas E. Bissett, Esquire
June 26, 1991
Page 8

would be considered to be plan fiduciaries of the ERISA plans investing in the Account.

As we discussed in the no-action letter request, persons who are plan fiduciaries are subject to the fiduciary duty provisions of ERISA, including the requirements that they act prudently and solely in the interest of plan participants and beneficiaries. Further, a fiduciary is prohibited from causing a plan to engage in transactions with parties in interest with respect to that plan in the absence of an applicable administrative or statutory exemption.

Even though the RE Account would not be subject to ERISA during such time as it constitutes a REOC, CREF would be willing to undertake that the RE Account will be operated by CREF (and any compensated investment adviser or manager of the RE Account) in a manner consistent with the general fiduciary standards set forth in Section 404(a)(1) (A), (B) and (C) of ERISA. In other words, the RE Account would be managed solely in the interest of the participants and beneficiaries of the Account, and -

(A) for the exclusive purpose of:

- (i) providing benefits to participants and their beneficiaries, and
- (ii) defraying reasonable expenses of administering the plans participating in the RE Account;

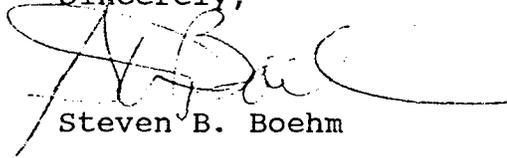
Thomas E. Bissett, Esquire
June 26, 1991
Page 9

- (B) with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; and
- (C) by diversifying the investments of the RE Account so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. ^{1/}

* * *

As mentioned earlier, we would appreciate the opportunity to meet with you and further discuss this matter. If you have any questions or require any additional information, please call the undersigned at (202) 383-0176.

Sincerely,



Steven B. Boehm

cc: Clifford Kirsch, Esquire
Peter C. Clapman, Esquire (TIAA-CREF)
Paul J. Mason, Esquire (SA&B)

^{1/} The "solely in the interest" and "exclusive purpose" standards would effectively preclude self-dealing, while the prudence and diversification standards would require professional fiduciary investment management for the RE Account. As to diversification, CREF would indicate to each potential investor in the RE Account that the Account is only one reasonable component of his or her pension plan's diversification strategy, and would suggest to institutions that no plan's assets should be invested wholly in the Account.



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December 18, 1990

1940 Act Section 3(a)

VIA MESSENGER

Heidi Stam, Esquire
Special Counsel
Office of Insurance Products
and Legal Compliance
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

RECEIVED
Division of Investment Management

DEC 18 1990

Office of Insurance Products
and Legal Compliance

Re: College Retirement Equities Fund --
Real Estate Account

Dear Ms. Stam:

We are writing on behalf of the College Retirement Equities Fund ("CREF") to request that the staff of the Division of Investment Management (the "Division") advise us that it will not recommend that the Securities and Exchange Commission ("Commission") take any enforcement action under the Investment Company Act of 1940 (the "Act") or the Securities Act of 1933 (the "1933 Act") if CREF establishes and operates an investment portfolio that invests primarily in real property (the "RE Account") in a manner, as described below, so as to place the RE Account outside the definition of an investment company in Section 3 of the Act, and does not treat the RE Account as part of its regulated investment company operations.

Background

CREF is a nonprofit membership corporation subject to the Not-For-Profit Corporation Law of New York State. It was established by a special act of the New York State Legislature which became effective on March 18, 1952, and was formed for the purpose of providing retirement benefits suited to the needs of faculty and other employees of nonprofit organizations that are exempt from federal taxation under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the "Code"), or are publicly supported, and are engaged primarily in education or research. CREF currently achieves its purpose by issuing variable annuity certificates (the "Certificates") ^{1/} that fund employer-sponsored pension plans and tax-deferred

^{1/} Currently, CREF issues two types of individual variable annuity certificates, Retirement Annuity Certificates ("RA Certificate") and Supplemental Retirement Annuity Certificates ("SRA Certificate"), and another type of individual certificate pursuant to a master group retirement annuity contract ("GRA Certificate"). The RA Certificate is designed for use in connection with retirement plans maintained pursuant to Section 401(a), 403(a), or 403(b) of the Code or tax-deferred annuity plans maintained pursuant to Section 403(b) of the Code. The SRA Certificate is used primarily in connection with tax-deferred annuity plans adopted pursuant to Section 403(b) of the Code. SRA Certificates are issued to individuals to permit them to contribute amounts toward retirement or other financial goals in addition to amounts accumulated under their institutions' basic retirement plan. GRA Certificates are issued pursuant to master group variable annuity contracts between CREF and U.S. Trust Company and are intended to be used in connection with retirement plans maintained pursuant to Section 401(a), 403(a), or 403(b) of the Code.

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annuity programs. The Certificates permit the accumulation of funds on their owners' (hereinafter "participants") behalf to be paid out as annuities at retirement or at some other future date. Under the Certificates, participants may, subject to the terms of the retirement plan or annuity program, allocate contributions made on their behalf to one or more of CREF's investment portfolios. CREF currently has four such portfolios: a Stock Account, a Money Market Account, a Bond Market Account, and a Social Choice Account (the "Accounts").

CREF is the companion organization of Teachers Insurance and Annuity Association of America ("TIAA"). TIAA was established in 1918 by the Carnegie Foundation for the Advancement of Teaching as a nonprofit corporation under the New York State Insurance Law, and offers fixed annuity contracts and insurance benefits suited to the needs of the types of institutions and employees served by CREF.

CREF is registered as an open-end diversified management investment company under the Act ^{2/} and the securities issued in connection with the Certificates are registered under the 1933 Act. ^{3/} In accordance with Section 18(f)(2) of the Act, CREF treats units of interest in each of

^{2/} File No. 811-4415.

^{3/} CREF currently maintains two effective registration statements under the 1933 Act: File No. 33-480 (RA and SRA Certificates) and File No. 33-20480 (GRA Certificates).

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the Accounts as a class or series of special securities having a preference over other classes or series in respect of assets specifically allocated to that Account and, in general, considers itself a "series company" as defined by Rule 18f-2 under the Act.

All services necessary for CREF's operations are provided internally at cost by salaried personnel through an expense reimbursement arrangement with TIAA. In this connection, CREF is registered as a broker-dealer under the Securities Exchange Act of 1934, and is a member of the National Association of Securities Dealers, Inc. ("NASD"), solely in connection with the distribution of the Certificates. It is also registered with the Commission as an investment adviser under the Investment Advisers Act of 1940 in connection with the management of its investment portfolios. ^{4/} CREF is also subject to supervision and regulation by the New York

^{4/} CREF, TIAA and certain newly formed wholly-controlled subsidiaries of TIAA filed an application with the Commission on September 7, 1990 (as amended on November 16, 1990) for an order pursuant to Section 17(d) of the Act and Rule 17d-1 thereunder approving a restructuring of CREF whereby CREF will "externalize" all services necessary for its operations. File No. 812-7588. A notice of that application was published in the Federal Register on November 28, 1990 (55 Fed. Reg. 49470). Those services will be provided at cost from the subsidiaries of TIAA, which consist of TIAA-CREF Investment Management, Inc. ("T-C Management"), and TIAA-CREF Individual & Institutional Services, Inc. ("T-C Services"). Both are non-profit entities. If the Commission issues the requested order, CREF will terminate its broker-dealer and investment adviser registration and its NASD membership.

State Superintendent of Insurance and by the insurance regulatory authorities of certain other states and jurisdictions.

In connection with its filing of registration statements under the Act and the 1933 Act on September 26, 1985, CREF simultaneously filed an application with the Commission requesting exemptions from certain provisions of the Act in order to permit it to continue its traditional methods of operation as a retirement vehicle (the "Application").^{5/} On August 22, 1989, the Commission issued an order (the "Order")^{6/} granting the relief requested, as modified consistent with the terms of a settlement agreement entered into on December 21, 1988, by CREF, TIAA and certain intervenors in a proceeding ordered by the Commission on the Application. Among other things, the Order granted relief to permit CREF to rely on certain conditional exemptions from the requirements of the Act generally available to life insurance company issuers of variable annuity contracts and granted certain other relief from the redeemability provisions of the Act.

As of November 30, 1990, there were approximately 1.1 million individuals accumulating retirement benefits under the Certificates or TIAA annuity contracts.^{7/} As of that

^{5/} File No. 812-6208.

^{6/} Inv. Co. Act Rel. No. 17116.

^{7/} Most individuals in the TIAA-CREF system allocate premiums to both TIAA and CREF annuities.

date, more than 4,400 institutions maintained retirement or tax-deferred annuity plans funded at least in part by TIAA-CREF. As of November 30, 1990, CREF had net assets of approximately \$37 billion (unaudited).

The RE Account

CREF intends to establish the RE Account as a new investment portfolio with the investment objectives of preserving and protecting its capital, providing for compounding of income as a result of reinvestment of cash flow from investments, and providing for increases over time in the amount of such income through appreciation in the value of its assets. CREF currently intends that the RE Account will attempt to achieve these objectives by investing primarily (at least 65%) in direct ownership interests in income-producing real estate (such as office buildings, shopping centers, agricultural land, hotels, apartment buildings or industrial properties) participating mortgage loans originated by the Account and real property sale-leaseback transactions negotiated on behalf of the Account. Examples of direct ownership interests in real estate include, but are not limited to, fee interests, general partnership interests, leaseholds and tenancies in common. Apart from a portion of the Account's assets (normally 5-10%) invested in short-term or intermediate-term debt instruments for liquidity purposes, the remainder of the Account's assets

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may be invested in other types of real estate investments, including primarily conventional, non-participating mortgage loans.

As with the Accounts, all services necessary for the operation of the RE Account will be provided at cost through an expense reimbursement arrangement with subsidiaries of TIAA. ^{8/}

Viewed separately, the RE Account will not be an investment company within the meaning of Section 3(a)(1) of the Act because it will not be, nor will it hold itself out as being, engaged primarily in the business of investing, reinvesting or trading in securities. ^{9/} In addition, the RE Account will not be an investment company within the meaning of Section 3(a)(3) of the Act because at no time will it invest more than 35% of its total assets in "investment securities" as defined in Section 3(a)(3). ^{10/} In this regard, the Division has in the past recognized that unregistered real estate

^{8/} CREF does not anticipate offering the RE Account until the externalization of services described above takes place. See supra note 4 and accompanying text.

^{9/} Section 3(a)(2) of the Act is inapplicable because the RE Account will not engage or propose to engage in the business of issuing "face amount certificates of the installment type" as that term is defined in Section 2(a)(15) of the Act.

^{10/} The RE Account may rely on Rule 3a-2 under the Act for a period of one year from the effective date of the Form S-1 registration statement relating to its securities. Rule 3a-2 generally provides a one year "start-up period" exemption from Sections 3(a)(1) and 3(a)(2) of the Act.

separate accounts of life insurance companies are not investment companies within the meaning of Sections 3(a)(1) or 3(a)(3) of the Act. ^{11/}

Although the RE Account will be part of the CREF corporate entity, it will, in many material respects, be operated in the same manner as are unregistered real estate separate accounts offered by a number of life insurance companies. ^{12/} The relationship between the RE Account and the Accounts will be comparable to that between different series (or subaccounts) of a registered management separate account in a series company form. Income and both realized and unrealized gains or losses from the RE Account's assets will be credited to or charged against the RE Account without regard to the income, gains and losses of the Accounts. In addition, as is generally the case with investors in unregistered real estate separate accounts of life insurers, participants in the RE Account would not have any voting rights. Nonetheless, CREF's Board of Trustees will be responsible for the management and administration of the RE Account. Because CREF is not a

^{11/} See, e.g., Pruco Life Ins. Co. Real Property Account, SEC No-Action Letter (avail. Sept. 18, 1986); N. N. Providence Variable Account, SEC No-Action Letter (avail. April 5, 1982).

^{12/} In this regard, the RE Account, like all other real estate accounts, will not be able to comply with many requirements of the Act such as those found in Sections 2(a)(4), 17, 18, 22(c) and 22(e) or Rules 2a-4 and 22c-1 thereunder. It will also not be able to avoid the activities prohibited to investment companies by Section 7 of the Act.

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life insurance company under the New York insurance laws, however, the RE Account could not be organized as a separate account under those laws and therefore is not a separate account within the meaning of Section 2(a)(37) of the Act or Rule 0-1(e) thereunder.

Interests in the RE Account will be registered under the 1933 Act on Form S-1 and the prospectus contained therein will contain the type of disclosure typically found in registration statements for real estate variable annuity contracts funded by real estate separate accounts of life insurance companies. In addition, CREF will file periodic reports pursuant to Section 15 of the Securities Exchange Act of 1934 in respect of the RE Account.

In addition, unlike registered investment companies, the RE Account will be operated in accordance with applicable standards and requirements promulgated pursuant to Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Most Certificates are issued in connection with a program for the purchase of annuity contracts described in Section 403(b) of the Code. Unless an applicable exception applies, Section 403(b) plans would be "pension plans" subject

to Title I of ERISA ^{13/} and the assets of the RE Account would be deemed to include "assets" of those ERISA plans. ^{14/}

ERISA attaches fiduciary status and responsibilities to persons that provide investment management or investment advice for a fee with respect to the "assets" of ERISA pension plans. In relevant part, Section 404(a)(1) requires plan fiduciaries ^{15/} to discharge their duties with respect to a plan solely in the interests of plan participants and beneficiaries and (A) for the exclusive purpose of providing benefits to participants and beneficiaries and defraying

^{13/} See ERISA § 3(2), 29 U.S.C. § 1002(2); 29 CFR § 2510.3-2. Section 403(b) plans are not subject to ERISA if, for example, they are not "established or maintained" by an employer (see 29 CFR § 2510.3-2(f)) or they are "governmental plans" (see ERISA §§ 3(32), 4(b)(1), 29 U.S.C. §§ 1002(32), 1004(b)(1)).

^{14/} In Advisory Opinion 78-8A (March 13, 1978), the Department of Labor ("DOL") opined that CREF Stock Account assets segregated to support variable annuity payments would be treated as "plan assets" for ERISA purposes. In 1986, the Department issued definitive regulations interpreting "plan assets." See 29 C.F.R. §2510.3-101. Those regulations provide that "plan assets" include, *inter alia*, a fractional undivided interest in each of the underlying assets of (1) any life insurance company separate account supporting a variable annuity contract issued to the plan (unless registered under the Act) and (2) any entity in which the plan has an equity interest unless certain exceptions apply, such as a publicly-offered security, an investment in an operating company or an interest in another entity where there is not significant participation by benefit plan investors.

^{15/} Section 3(21)(A) of ERISA defines a fiduciary as a person who, *e.g.*, (1) exercises discretionary authority or control over the management of the plan or its assets, or (2) renders investment advice (or has authority to render investment advice) for a fee with respect to plan assets.

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reasonable expenses of administering the plan; (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; and (C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. In addition, absent an exemption under Section 408, Section 406 of ERISA prohibits plan fiduciaries, e.g., from causing a plan to engage in specified transactions with parties in interest ^{16/} or from engaging in self dealing, acting with conflicting interests or receiving third-party consideration for their own account with respect to the plan. ^{17/}

^{16/} Section 3(14) of ERISA defines a "party in interest" very broadly. In general terms, a party in interest is analogous to an "interested person" under Section 2(a)(19) of the Act.

^{17/} DOL has issued a class exemption from certain of these prohibited transaction rules with respect to insurance company pooled separate accounts subject to certain conditions. See PTE 90-1 (formerly PTE 78-19), 55 Fed. Reg. 2891 (January 29, 1990). If the Division issues the no-action letter requested, CREF may seek prohibited transaction exemptions necessary or appropriate to the operation of the RE Account and comparable to those granted in similar cases by DOL (or to confirm that CREF may rely on PTE 90-1). ^{17/}

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Other Considerations

CREF has considered the option of establishing an unregistered real estate separate account of TIAA. CREF does not, however, believe that this alternative is as favorable to participants as the proposed RE Account.

A significant disadvantage is that the New York Insurance Regulations (Chapter III, Subchapter A, Part 50.7(a)(3)), would require that TIAA offer a so-called "nonforfeiture" benefit in the form of either "an option to receive the cash surrender value of the contract or an option to receive a paid-up annuity to commence at the maturity date." The regulation also requires that "if only the option to receive a paid-up annuity is available, the accumulated value of the contract in the separate account or accounts of the company at the time of default shall, at the option of the contractholder, be transferred to the general account of the company to provide a fixed dollar paid-up annuity." Consequently, TIAA would either have to use its general account assets to meet surrender and paid-up annuity requests or maintain a higher than desirable portion of the real estate separate account's assets in liquid securities. Although other for-profit life insurance companies offering real estate separate accounts apparently rely on both of these strategies, the expenses inherent in such practices is ultimately passed on

to participants in the form of lower investment returns or higher fees and charges.

For participants, the high mortality and expense risk fee that TIAA would have to charge makes the proposed RE Account much more advantageous than a TIAA separate account. Unlike CREF, which is unique in that it may (for each Account) pool the mortality experience of its annuitants and the expense experience attributable to participants (including annuitants) and pay the costs of this experience as they are incurred, ^{18/} TIAA must, under New York Insurance Law, ^{19/} guarantee annuity purchase rates.

A guarantee of such rates entails a guarantee that the rates will be as favorable to annuitants as those based on a specific mortality table identified in the certificate. Equally significant, it guarantees that expenses --other than investment portfolio expenses-- will not exceed the levels stated in the certificate. ^{20/} In order to accumulate

^{18/} See pages 33-36 of CREF's March 1, 1990 prospectus. File No. 33-480.

^{19/} This is true of state variable annuity contract and variable annuity separate account laws (and corresponding regulations) in a number jurisdictions (see, e.g., Pennsylvania Regulations, Title 31, §§ 85.36(a) & 85.36(b)).

^{20/} New York Insurance Regulation 50.6(a)(1) states, in relevant part:

Each variable annuity contract delivered or issued
for delivery in this state shall provide that
(continued...)

sufficient assets/reserves to support such guarantees, TIAA would, as do all variable annuity issuers other than CREF, have to charge a mortality and expense risk fee. Of necessity, this fee would be based on estimates of mortality that are conservative and, thus, less advantageous for participants than a procedure which relies on actual mortality experience in determining the amounts of annuity payments. In this connection, TIAA has estimated that it would have to charge a combined risk fee within the range of industry practice, currently between 0.75% and 1.25% of net assets per year.

The addition of a mortality and expense risk fee would dramatically increase the cost of a real estate variable annuity to participants when compared with that of a CREF certificate which would reflect the pooled mortality and expense experience as it occurs. Currently, CREF variable annuity participants pay approximately 0.35% of net assets per

^{20/} (...continued)

neither expenses actually incurred, other than taxes on the investment return, nor mortality actually experienced, shall adversely affect the dollar amount of variable annuity payments to any annuitant for whom variable annuity payments have commenced The method of computing the dollar amount of variable annuity payments shall be such that, if the annual rate of investment return of the separate account, as defined in Section 50.1(a)(7) hereinabove, were six and one half percent at all times from the issue of the contract, such amounts would not decrease.

year for all expenses during the accumulation period; ^{21/} no deduction or charge is made for mortality. CREF estimates that any real estate investment portfolio would require an investment management fee of approximately 0.65% of net assets per year. Therefore, a TIAA real estate separate account variable annuity could be expected to cost participants approximately 1.88% of net assets per year ^{22/} during the accumulation period as compared with 0.88% per year for a CREF real estate variable annuity. ^{23/}

Legal Arguments For Relief

CREF believes that it should be permitted to offer a real estate investment option to its participants at a level of expense consistent with its non-profit purpose and historical experience. TIAA cannot do this through a separate account. CREF believes, however, that it can and should be permitted to offer the RE Account at expense levels that participants and

^{21/} Of this figure, investment management expenses run approximately .12% of net assets per year.

^{22/} This figure is based on the assumption that a 1.00% deduction for mortality and expense risk would be made and that distribution and administrative expenses of a TIAA separate account product would be the same as they currently are for CREF Certificates.

^{23/} Even during the annuity period, the cost under a CREF product should be significantly lower, as the actual mortality experience of CREF annuitants during both 1988 and 1989 had an effect on returns to CREF annuitants equal to that of a .40% annual deduction.

institutions have come to expect from it. CREF's status as a registered investment company, however, raises questions about the applicability of the Act to the RE Account and any effect that the RE Account may have on CREF's compliance with the Act or the rules thereunder.

A number of legal issues arguably are raised by CREF's establishment of the RE Account: first, whether the RE Account is part of an investment company because it is part of the CREF corporate entity; second, whether CREF would meet the Section 3 definition of an investment company where one of its investment portfolios does not meet that definition, or whether CREF is properly registered under Section 8 of the Act where one of its portfolios is not "covered" by its Section 8 registration; and third, and most broadly, whether CREF's establishment of the RE Account makes it impossible to comply with the full range of substantive regulatory requirements imposed under the Act. In connection with the third issue, questions arise such as whether CREF would be in compliance with Section 18(f) of the Act because the securities it issues in connection with the RE Account are not, within the terms of Section 18(f)(2), excluded from the definition of a senior security.

Therefore, before it proceeds with establishment of the RE Account, CREF wishes to resolve any questions about the applicability of the Act to the RE Account and any effect the

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RE Account may have on CREF under the Act. As demonstrated below, the policy of the Act and the evolution of variable contract regulation thereunder are consistent with the no-action position requested.

We believe that the Act and rules thereunder do not prohibit a series company, as that term is defined in Rule 18f-2, from establishing an investment portfolio (and issuing a corresponding series of securities) that does not meet the Section 3 definition of an investment company and could not register as such under the Act. We also believe that if a series company established such a portfolio and issued a series or class of special securities having preference over other securities issued by the company with respect to the assets of that portfolio, then that portfolio should be treated as not being part of the registered series investment company for purposes of the Act. Likewise, in such a situation all the other portfolios should be treated as those of a series investment company and all the other classes of securities should be treated as those issued by an investment company.

The purposes fairly intended by the policy and provisions of the Act, as interpreted in court opinions with respect to variable annuities and as reflected by Commission and Division treatment of series companies, support the proposition that each portfolio of a series investment company should be treated as a separate investment company notwith-

standing that certain practical exceptions to such treatment are recognized. With regard to series companies, the Commission and the Division have generally applied the Act as if each portfolio were a separate investment company.^{24/} For example, Rule 18f-2 under the Act requires that a majority of the outstanding voting securities of a series must approve most shareholder actions for the actions to be effective as to that series. The fact that the Rule contains exceptions^{25/} evidences the Commission's understanding that the primary elements of the Rule were not doctrinaire formulations, but rather were pragmatic responses to the function rather than the form of the investment company.

The adaptation of form to suit function has a long history in the variable insurance products arena.^{26/} Section

^{24/} See Fleming, Regulation of Series Investment Companies Under the Investment Company Act of 1940, 44 Bus. Law. 1179, 1180 (1989).

^{25/} Paragraphs (e), (f), and (g) of Rule 18f-2 exempt shareholder selection of a company's independent public accountant, shareholder approval of a company's contract with a principal underwriter and shareholder election of directors, from the otherwise applicable requirement of a majority vote of each series. See also id. at 1191. These exceptions are based on the premise that the interests of all securityholders in a company will be the same with regard such matters. The exceptions would not have been necessary, however, if not for the practical difficulty of having more than one board of directors, independent accountant, or underwriter for a single corporation.

^{26/} One clear example of this is the use and adaptation of certain registration forms for registration of separate accounts
(continued...)

2(a)(8) of the Act defines a "company" to mean "a corporation, a partnership, an association, a joint-stock company, a trust, a fund, or any organized group of persons whether incorporated or not. . . ." The Third Circuit, after reviewing the legislative history of Section 2(a)(8), concluded that life insurance company separate accounts can come within the definition of an investment company notwithstanding that they are not legal entities under state law, and in fact are part of a larger legal entity that is excluded from the definition of an investment company. ^{27/} In essence, an investment company can

^{26/} (...continued)

under the Act and the registration of securities issued by such accounts. With two notable exceptions (Forms N-3 and N-4) these forms were not designed for separate accounts or variable annuity or variable life insurance contracts.

^{27/} Prudential Ins. Co. v. Securities and Exchange Commission, 326 F.2d 383, 387 (3d Cir. 1963), cert. denied, 377 U.S. 953 (1964). The court of appeals was quite specific on this point stating, in relevant part:

Furthermore, a study of the legislative history of the Act shows that Congress intentionally drafted the statutory definitions in general terms in order to control such situations regardless of the legal form or structure of the investment enterprise.

. . . .

In these circumstances we reject Prudential's argument that the broad statutory phrase "a trust, a fund, or any organized group of persons whether incorporated or not" refers only to recognizable business entities. . . . As we have previously seen, the Investment Fund is a completely segregated account, devoted to investing in securities. The cash for these investments is derived from payments

(continued...)

be carved out of a non-investment company. In this respect, the various investment portfolios or "Accounts" of CREF can be viewed as being no different in concept from insurance company separate accounts registered as investment companies, carved out of a non-investment insurance company, and we believe that had CREF begun its life as a single real estate portfolio and now proposed to add new portfolios investing in securities, the Commission would insist that these new portfolios be registered under the Act.

The obvious corollary to the functional definition of an investment company as articulated in Prudential is that a non-investment company can be carved out of an investment

^{27/} (...continued)

made by the purchaser of the variable annuity contract. Though the proceeds of the fund are held for the sole benefit of the annuitant, it is this fund, and no other entity in which he has an interest.

. . . .

Prudential also asserts that the specific exemption provided for the common trust funds of banks shows that regulation under the Act was imposed on an institutional rather than on a functional basis. It is pointed out that this exemption is provided in addition to the general exemption for banks. Prudential declares that such common trust funds are functionally indistinguishable from investment companies, but were excluded from the Act "because they were in fact part of the banking business and intended to be covered by the broad exemption for banks." We think that this specific exemption leads to the opposite conclusion.

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company if the functional attributes of the structure do not subvert the policies and provisions of the Act as these are applied to protect investors in investment companies and if certain practical aspects of routine Commission regulation (such as registration statements) can be facilitated. CREF submits that no aspect of the Act's (or the 1933 Act's) applicability to CREF or the Commission's regulation thereof would be adversely affected in any way by the existence or operation of the RE Account as described herein. ^{28/} CREF would continue to file or amend registration statements under the 1933 Act and to update its registration, vis-a-vis the Accounts, under the Act on Form N-3. ^{29/} In addition, CREF would file, and amend as necessary, a registration statement for the RE Account under the 1933 Act.

CREF maintains that the addition of the RE Account will not increase or diminish the protection and regulation

^{28/} In this regard, a potential conflict of interest could arise from the fact that CREF's Board of Trustees would be responsible for several investment company portfolios as well as a non-investment company portfolio. To avoid any possibility of "over-reaching" or undue influence by the RE Account or its investors or any other party with an interest or a relationship with the RE Account, CREF's Trustees will only be elected by participants in the Accounts in accordance with the Order.

^{29/} As one commentator recently pointed out "[T]he treatment of a series company as a single entity for purposes of filing a registration statement under Section 8 of the 1940 Act is one of the exceptions to the general rule that each portfolio of a series fund is regulated as a separate investment company under the 1940 Act." Fleming, supra, note 24, at 1183.

under the federal securities laws currently received by participants in the Accounts. Likewise, CREF maintains that participants in the proposed RE Account will receive the same degree of protection and regulation under the federal securities laws as do investors in any unregistered insurance company real estate separate account, interests in which are registered under the 1933 Act.^{30/} Moreover, the RE Account will be operated in accordance with applicable ERISA requirements.

The issues raised by CREF's proposed addition of the RE Account are novel and arise because, unlike other issuers of variable annuities, CREF is a stand-alone corporate entity and not a separate account of an insurance company. Granting the assurances sought here would recognize, as the Commission did in granting CREF extensive exemptive relief in 1989 to permit it to continue to operate as a pension funding vehicle,^{31/}

^{30/} In addition, it is our understanding that, pursuant to exemptions set forth in Section 3(a)(2) of the 1933 Act and exclusions from the definition of an investment company found in Section 3(c)(11) of the Act, interests in most real estate separate accounts of life insurance companies are not subject to the federal securities laws. We anticipate that a significant portion of the RE Account's assets will be derived from contributions under pension plans or under governmental plans of the type described in Sections 3(a)(2) or 3(c)(11). Therefore, participants who might otherwise not receive the protection of the federal securities laws if such assets were not commingled with "non-qualified" assets will, in the RE Account, benefit from the fact their interests will be registered under the 1933 Act.

^{31/} See supra note 6 and accompanying text.

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that CREF's unique history and structure create unprecedented compliance issues.

Accordingly, in light of the policy considerations outlined above, we believe that: (1) the RE Account should not be considered part of CREF's investment company operations nor should CREF be deemed to be operating in a manner that conflicts with the various substantive regulatory requirements of the Act solely because of the maintenance of the RE Account, and (2) neither CREF's status as an investment company within the meaning of Section 3 of the Act nor its registration under Section 8 of the Act should be affected by its maintenance of an investment portfolio which does not, itself, fall within the investment company definition. Thus, the establishment and maintenance of the proposed RE Account should not affect CREF's status as an investment company under the Act or cause the Commission to deem CREF not to be in compliance with any provision of the Act or the rules thereunder.

Conclusion

In view of the foregoing, we respectfully request that the Division advise us that it will not recommend that the Commission take enforcement action under the Act or the 1933 Act if CREF establishes and operates the RE Account in a manner, as described herein, so as to place it outside the definition of an investment company in Section 3 of the Act and

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does not treat it as part of its regulated investment company
operations.

* * * *

If you have any questions or require any additional
information, please call the undersigned at (202) 383-0176 or
David S. Goldstein at (202) 383-0606.

Very truly yours,



Steven B. Boehm

cc: Clifford Kirsch, Esq. (SEC)
Barry D. Miller, Esq. (SEC)
Peter C. Clapman, Esq. (TIAA-CREF)
Paul J. Mason, Esq. (SA&B)