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CHURCH ALLIANCE

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June 26, 2018

Mr. Brett Redfearn
Director, Division of Trading and Markets
U.S. Securities and Exchange Commission
100 F Street NW
Washington, DC 20549

RE: Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants

Dear Director Redfearn:

We are pleased to submit this letter, on behalf of the Church Alliance, regarding the possible revision of regulations promulgated by the Securities and Exchange Commission (“SEC”) on business conduct standards for security-based swap dealers and major security-based swap participants (collectively, “SBS Entities”).¹ This letter is in follow up to recent discussions held at the SEC regarding business conduct standards and, in particular, the process by which a church plan is deemed to be a “Special Entity” for the purposes of the regulations. As discussed in more detail below, we urge the SEC to consider harmonizing its regulations with those of the Commodity Futures Trading Commission (“CFTC”), which allow church plans to “opt-in” to Special Entity status.

The Church Alliance and Church Plans

The Church Alliance is a coalition of thirty-eight (38) denominational benefit programs that provide pension and health benefits to more than one million clergy, lay workers, and their family members. These benefit programs are defined as “employee benefit plans” and “church plans” under Sections 3(3) and 3(33) of the Employee Retirement Income Security Act of 1974 (ERISA), respectively, and therefore, come within the definition of a “Special Entity” under Section 764(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which enacted a new Section 15F of the Securities Exchange Act of 1934 (Exchange Act) to govern the registration and regulation of SBS Entities.

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

¹ SEC Release No. 34-77617, Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants.

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).² A church benefits board is also (i) typically an organization described in Code Section 501(c)(3), (ii) an organization described in Code Section 414(e)(3)(A), which describes organizations that are permitted to administer or fund church plans, and (iii) exempt from treatment as an investment company pursuant to Section 3(c)(14) of the Investment Company Act of 1940. 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, some have authorized the use of certain derivatives. The authorized derivatives include futures, forwards, swaps, security-based swaps, structured notes, and options. Accordingly, the denominational benefits boards represented through the Church Alliance have an interest in the regulation of the security-based swap market.

CFTC and SEC Special Entity Rules

In 2012, the CFTC issued a final rule on Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties.³ The CFTC’s final rule contained the following within the definition of a Special Entity:

*Under the new prong in § 23.401(c)(6), any employee benefit plan defined in Section 3 of ERISA, not otherwise defined as a Special Entity, **may elect to be defined as a Special Entity** by notifying its swap dealer or major swap participant of its election prior to entering into a swap with the particular swap dealer or major swap participant. Therefore, for example, under § 23.401(c)(6), **any church plan defined in Section 3(33) of ERISA, including any plan described in Section 3(33)(C)(i), such as a church benefit board, could elect to be defined as a Special Entity.***

In 2016, the SEC released its final rule on business conduct standards.⁴ The SEC’s rule took a different approach to defining a Special Entity:

*Specifically, Rule 15Fh-2(d)(4), as adopted, defines a special entity to **include** “[a]ny employee benefit plan defined in Section 3 of [ERISA] and not otherwise defined as a special entity, **unless such employee benefit plan elects not to be a special entity** by notifying a security-based swap dealer or major security-based swap participant of its election prior to entering into a security-based swap with the particular security-based swap dealer or major security-based swap participant.”*

² Section 414(e)(3)(A) of the Internal Revenue Code of 1986, as amended (Code), is identical to ERISA section 3(33)(C)(i), and church pension boards are sometimes referred to as Section 414(e)(3)(A) organizations or “principal purpose organizations.”

³ 77 FR 9734 (Feb. 17, 2012).

⁴ 81 FR 29960 (May 13, 2016).

It is important to note that, unlike the CFTC rules that provide for an opt-in feature, the SEC rules provide for an opt-out feature. Acknowledging the deviation from the CFTC rule, the SEC made a utilitarian argument. The SEC determined that the opt-out model “afford[ed] the maximum protections to the broadest categories of special entities, while still allowing them the flexibility to elect not to be special entities when they do not wish to avail themselves of those protections.”

Church Alliance Views

The Church Alliance previously submitted comment letters to the CFTC and the SEC regarding the proposed rules on business conduct standards in 2011. Additionally, in October 2011, the Church Alliance provided a supplemental memorandum addressing issues and feedback raised by the CFTC. When addressing the possible definition for Special Entity in the CFTC’s proposed rule, the Church Alliance noted its concern that potential counterparties would be confused and possibly refuse to deal with church plans altogether.

As noted in the supplemental memorandum, the opt-in approach for Special Entity status mitigated these concerns; the Church Alliance suggested possible revisions to the rule to include such an election. However, the issue was revived when the SEC finalized a rule that contained an opt-out approach.

In the years since the rules were finalized, experience has demonstrated that church plans most often choose not to be special entities. Church plans have found that they have the internal resources necessary to transact with counterparties; special protections tend not to be necessary and, in certain instances, would become burdensome. Given that most church plans do not opt in, the SEC’s rules are incongruous with industry practice. In effect, the SEC places an additional burden on these plans.

Thus, the Church Alliance requests that the SEC review the actual costs associated with having inconsistent rules and consider revising the 2016 rule to adopt an opt-in approach to Special Entity status in harmony with the CFTC rules.

Conclusion

The Church Alliance appreciates the opportunity to comment on the business conduct standards put forth by the CFTC and SEC. We welcome the opportunity to discuss our recommendation in detail with the SEC at your convenience. Please feel free to contact me if you have any questions or wish to discuss this matter further.

Sincerely,



Karishma Shah Page
Partner, K&L Gates LLP
On Behalf of the Church Alliance