K&L GATES

1940 Act – Section 3(c)(11)
Section 7

October 2, 2015

Mr. Douglas Scheidt
Associate Director and Chief Counsel
Division of Investment Management
United States Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Dear Mr. Scheidt:

We represent the North American Division of Seventh-Day Adventists (the "Adventists"). As described in greater detail below, we are writing on behalf of the Adventists to request that the staff provide its assurances that it will not recommend enforcement action to the U.S. Securities and Exchange Commission (the "Commission") under Section 7 of the Investment Company Act of 1940 (the "1940 Act") against certain bank collective trusts (each, a "BCT" or "bank collective trust") or any insurance company separate account in which a BCT invests ("Separate Account") if a Separate Account that relies on the exclusion from the definition of "investment company" contained in section 3(c)(11) of the 1940 Act continues to rely on that exclusion, notwithstanding the fact that certain BCTs holding church plan[1] assets in accordance with section 3(c)(11) invest a portion of their assets in such Separate Account.

Background

The North American Division of Seventh-Day Adventists is one of thirteen divisions of the General Conference of Seventh-Day Adventists world-wide, and is the organization that oversees all Seventh Day Adventist churches in the United States. The Adventists are a church that is exempt from taxation under Section 501 of the Internal Revenue Code of 1986, as amended (the "Code").[2]

As an adjunct to their religious and charitable activities, the Adventists maintain a plan providing defined contribution retirement income accounts (the "Plan") as described in

[1] As noted more fully below, these church plans would satisfy the requirements of Section 3(c)(14) of the 1940 Act and Section 403(b)(9) of the Internal Revenue Code of 1986, as amended (the "Code").

[2] 26 U.S.C.A. §501 (2013).

Section 403(b)(9) of the Code.[3] Under the terms of Section 403(b)(9) of the Code, a "retirement income account" is defined as a defined contribution program established or maintained by a church, or a convention or association of churches, including an organization described in section 414 (e)(3)(A), to provide benefits under section 403(b) for certain employees and their beneficiaries.[4] The Plan is maintained in accordance with Section 414(e)(3)(A) of the Code, and the Adventists are a church within the meaning of this section. As a result, the Plan is a "church plan" within the meaning of Section 414(e) of the Code.

The Plan is excluded from the definition of "investment company" contained in Section 3(a) of the 1940 Act pursuant to section 3(c)(14), which excludes certain church plans from the definition of "investment company". The Plan currently offers a variety of investment options to its participants, including a stable value investment option. The stable value investment option presently consists of a professionally managed account within the Plan consisting solely of Plan assets.

The Plan would like to move its stable value investments from the Plan account and invest them instead in a larger BCT fund maintained by an unaffiliated bank trustee that provides a similar investment strategy. The BCT is excluded from the definition of "investment company" contained in Section 3(a) of the 1940 Act pursuant to Section 3(c)(11) of the 1940 Act. Section 3(c)(11), as pertinent here, excludes "any collective trust fund maintained by a bank consisting solely of assets of one or more of such trusts, government plans, or church plans, companies or accounts that are excluded from the definition of an investment company under paragraph (14) of this subsection."

The Plan believes that investing in the BCT would benefit the Plan and its participants. In particular, the greater size of the bank collective trust would allow the Plan to increase its asset diversification. This increased diversification should allow the Plan to maximize its investment return while minimizing risk in a manner that is currently not available to the Plan account due to its smaller asset size as compared to the bank collective trust.[5] In addition, the Adventists believe that they will have access to a larger number of investment options than those currently available in the Plan account (up to six investment options as compared to two for the Plan account) and a greater number of manager options (for example, up to six fixed-income managers for the BCT compared to only one for the

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[3] 26 U.S.C.A. §403 (2013).

[4] Id.

[5] Historically, the bank collective trust that the Adventists are interested in investing in has had a blended yield before fees that ranges from .44 to 2.18% higher than the Plan account.

Plan account). These increased options would provide greater investment flexibility for the Plan, and would provide commensurate benefits to the Plan participants.

Currently, this BCT invests in one or more insurance company separate accounts.[6] These separate accounts also rely on the exclusion contained in Section 3(c)(11).[7] Investors in the BCT have no ability to direct or influence the selection of investments by the BCT, including the BCT's investment in a Separate Account. The BCT and the Separate Account do not currently hold any other church plan assets.

Section 3(c)(11) does not explicitly permit one 3(c)(11) entity to hold the assets of another 3(c)(11) entity. In the past, however, the staff has provided no-action assurances that permit a 3(c)(11) entity to have investors that are themselves 3(c)(11) entities.[8] These "Two-Tier Letters" essentially stand for the proposition that the lower-level 3(c)(11) entity can look-through, or collapse, the top-tier 3(c)(11) entity and count the investors in the top-tier 3(c)(11) entity as its own for purposes of determining whether the requirements of Section 3(c)(11) are met.

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[6] The BCT invests in a variety of investments at the discretion of the bank trustee in order to provide stable value returns. Participants in the Plan have individual investment discretion to choose among the investment options within the Plan. Investors in the BCT have no ability to direct or influence the selection of investments by the BCT. The trustee to the BCT charges the BCT a management fee for managing the assets of the BCT, including the allocation of assets to various investments, and the insurance company sponsoring the Separate Account receives a fee for the services provided through the Separate Account, which can include any stable value guarantees.

[7] The separate accounts will sell their interests to the bank collective trust and to other investors in offerings that are not required to be registered under the Securities Act of 1933 ("1933 Act") (*e.g.*, pursuant to an offering under Section 4(2) or Section 3(a)(2) of the 1933 Act, Regulation D under the 1933Act, or other exemption from the registration provisions of the 1933 Act).

[8] See Frank Russell Trust Co. (pub. avail. Sept. 2, 1982) (Permitting a collective trust whose assets consisted solely of Section 401 plan assets to invest in another collective trust or separate account, and allowing each of the top tier and bottom tier entities to rely on Section 3(c)(11); Equitable Life Assurance Society of the U.S. (pub. avail. Dec. 17, 1981)(3(c)(11) separate account investing in a 3(c)(11) separate account); Maccabees Life Insurance Co. (pub. avail. July 29, 1983) (permitting certain separate accounts to invest in certain bank collective trusts and allowing each to rely on 3(c)(11)); Nippon Life Insurance Co. of America (pub. avail. Nov. 2, 1992) (permitting separate account to invest in a separate account and allowing each to rely on 3(c)(11))(collectively the "Two-Tier Letters").

The insurance companies have expressed the concern that if they were to look through the bank collective trust and count the trust's assets as their own for purposes of section 3(c)(11), they would no longer be able to rely on the exclusion contained in that section. The provisions of Section 3(c)(11) applicable to insurance company separate accounts – in contrast to those applicable to bank collective trust funds – do not explicitly permit an insurance company separate account to hold assets attributable to a church plan. As a consequence, the insurance companies have raised a question as to whether the inclusion of Plan assets in the bank collective trust would prevent the separate account from continuing to be able to rely on the exclusion from the definition of "investment company" contained in Section 3(c)(11).

We believe that the inclusion of Plan assets in the bank collective trust should not be viewed as imperiling the separate account's ability to rely on the 3(c)(11) exclusion, and for the reasons set out below, we request the staff's no-action assurances.

Analysis

Section 3(c)(11) excludes insurance company separate accounts from the definition of "investment company" provided that the assets are derived solely from:

- contributions under pension or profit-sharing plans which meet the requirements of section 401 of [the Code] or the requirements for deduction of the employer's contribution under section 404(a)(2) of [the Code],

- contributions under governmental plans in connection with which interests, participations, or securities are exempted from the registration provisions of Section 5 of the Securities Act of 1933 ("1933 Act") by section 3(a)(2)(C) of the 1933 Act, and

- advances made by an insurance company in connection with the operation of such separate account.

Although Section 3(c)(11) of the 1940 Act does not explicitly address investments by church plans in the insurance company separate accounts, the staff has previously permitted church plans to invest in separate accounts without the separate account losing its excluded status under Section 3(c)(11).[9] In the Aetna letter, the staff agreed not to recommend enforcement action to the Commission if Aetna issued group annuity contracts to church sponsored pension and retirement plans as defined in Section 414(e) of the Code. The Staff

[9] See Aetna Life Insurance Company (pub. avail. April 19, 1984); Mutual of America Life (pub. avail. June 17, 1993) (the "Church Plan Letters").

noted that this position was based specifically on representations that the annuity contracts would be offered and sold solely to church plans which were the functional equivalent to plans qualified under Section 401 of the Code, and which did not involve the exercise of participant discretion. In addition, in the Mutual of America letter, the staff took a similar no-action position, basing its relief on the following representations:

1. the separate account will be used for no other purpose than to fund (i) the church-sponsored pension plans and (ii) plans meeting the requirements of Sections 401 or 404(a)(2) of the Code;

2. the company will limit its offer or sale of the contract to church-sponsored pension plans which are functionally equivalent to Section 401(a) plans and which do not involve the exercise of individual employee discretion, particularly with respect to choosing investment vehicles to fund the plans, allocating funds among subaccounts, or making withdrawals under the contract;

3. the contract will not be offered or sold in connection with retirement plans described in Sections 403(b) or 408 of the Code; and

4. no part of the corpus or income of the church-sponsored plans shall be used or diverted to any purpose other than for the exclusive benefit of the employers' employees or their beneficiaries prior to the satisfaction of all the plans' liabilities to such employees and beneficiaries.

Reading this line of letters together with the Two-Tier Letters, it appears that generally under the terms of these letters: (1) bank collective trusts may hold church plan assets and the trusts may rely on Section 3(c)(11) per the terms of that section, and (2) bank collective trusts are permitted to invest in the insurance company separate account without effecting either's status under Section 3(c)(11).[10] Legislation that amended Section 3(c)(11) in 2004 may have modified this analysis however.

Prior to 2004, Section 3(c)(11) permitted both bank collective funds and separate accounts to have identical types of investors: either Section 401 plan assets or government plan assets. As a result, a separate account that had 3(c)(11) collective trust investors could essentially "look-through" and disregard the collective trust and it would see assets that it

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[10] The proposed transactions might not meet the requirement set forth in Mutual of America that no contract will be offered or sold in connection with retirement plans described in Sections 403(b). For the reasons set forth infra, however, we believe that this requirement would be inapplicable with respect to sales of the insurance products indirectly to the Plans through the bank collective trusts.

was permitted to hold directly under Section 3(c)(11). The Church Plan Letters implicitly analogized church plans to 401(k) plans, and in doing so they effectively added church plans to the ambit of Section 3(c)(11).

In 2004, however, Congress amended Section 3(c)(11) to explicitly permit church plans to invest in Section 3(c)(11) collective trusts; no parallel change was made to the provisions of 3(c)(11) that apply to separate accounts. Under the amendments, the section is silent as to whether church plans can invest in separate accounts, although investments in bank collective trusts are expressly permitted.

Our client's concern – which has also been essentially raised by the insurance companies – is that Congress' amendment of Section 3(c)(11) to include church plans solely in bank collective trusts could be viewed as an implicit rescission of the Church Plan Letters with respect to the church plan's investments in separate accounts. If the 2004 amendments were deemed to implicitly rescind the Church Plan Letters, then the position of the Two-Tier letters also would not appear to permit insurance separate accounts to hold assets of the bank collective trusts that contain church plan assets.

There is no evidence that the explicit inclusion of church plans in Section 3(c)(11) was intended to limit prior SEC no-action relief, however. Although Section 3(c)(11) was not amended to add church plans universally throughout the section, there is no indication that this result was intentional, or that Congress intended to limit the ability of church plans to invest in vehicles described in that section. The legislative history of the amendments to Section 3(c)(11) notes that the revision was intended, in part, to provide "parallel treatment under the securities laws of the assets of church plans to the treatment afforded the assets of governmental plans, as described in Section 3(a)(2)(C) of the Securities Act of 1933."[11] In essence, there is no indication in the legislative history that this parallel treatment was intended to exclude or limit in any way the ability of separate accounts to hold church plan assets. In view of this lack of evidence of Congressional intent to limit the ability of separate accounts to hold church plan assets, we believe that it would be appropriate for the Staff to provide no-action assurances based on one of two alternate theories.

First, the staff could take notice of the Congressional intention to put church plans on equal footing with governmental plans, and read the Section as permitting both bank collective trusts and separate accounts to hold church plan assets. There does not appear to be any policy reason to discriminate between bank collective trusts and separate accounts by treating church plan assets as permitted for one, but prohibited for the other. Both collective trusts and separate accounts are permitted to hold governmental plan assets, and permitting

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[11] Amending the Securities Laws to Permit Church Pension Plans to be Invested in Collective Trusts, H.R. Rep. 248 108th Cong., 1st Sess. 2 (2003).

both to hold church plan assets would further congressional intention to afford "parallel treatment under the securities laws of the assets of church plans to the treatment afforded the assets of governmental plans."

Second, the Staff could look to its original analysis as outlined in the Church Plan letters. As noted above, the relief in the Church Plan Letters was essentially premised on the idea that church plans were analogous to 401(k) plans, and that as a result they should be treated similarly to 401(k) plans under Section 3(c)(11). Church plans today are similar to 401(k) plans to an even greater extent than when the Church Plan letters were originally issued.

Both 401(k) plans and Church Retirement Income Plans are defined contribution plans comprised of individual accounts in which: (i) there is separate accounting for each retirement income account's interest in the underlying plan assets, such that it is possible to determine the retirement income account's interest in the underlying assets and to distinguish that interest from other plan assets, (ii) investment performance is based on gains and losses on the individual account assets, and (iii) the assets held in the account cannot be used for, or diverted to, purposes other than for the exclusive benefit of plan participants or their beneficiaries.

Furthermore, since the original Church Plan Letters were issued, the IRS has taken steps to ensure greater similarities between 401(k) plans and church plans such that any distinction that might have previously existed between the two is largely meaningless. In fact, the IRS has acknowledged the significant similarities between 403(b) plans and 401(k) plans. The IRS proposed rules in 2004 that were designed to further conform the regulation of 403(b) plans to 401(k) plans. In the release proposing these rule changes, the IRS stated that "[a] major effect of the legal changes in section 403(b) has been to diminish the extent to which the rules governing section 403(b) plans differ from the rules governing other arrangements that include salary reduction contributions, *i.e.*, section 401(k) plans .... Thus, these regulations will reflect the increasing similarity among these arrangements."[12] The IRS reiterated this view when it adopted the rules noting: "the effect of the various amendments made to section 403(b) within the past 40 years has been to diminish the extent to which the rules governing section 403(b) plans differ from the rules governing other tax-favored employer-based retirement plans, including arrangements that include salary reduction

[12] Revised Regulations Concerning Section 403(b) Tax-Sheltered Annuity Contracts, 69 Fed. Reg. 67075 (November 17, 2004) (Rule proposal making certain modifications to 403(b) regulation.).

contributions, such as section 401(k) plans...."[13] As a result, the two types of plans are functionally equivalent.

We are aware that the 1993 Mutual Life of America letter (which is one of the Church Plan Letters) explicitly excludes 403(b) accounts from its purview. As a result, it appears that under this letter an insurance separate account could not hold assets of church plans organized under Section 403(b)(9). We believe, however, that this condition was intended to eliminate annuity plans that are qualified under 403(b)(1) of the Code from being included in an insurance product, and was not intended to encompass retirement income accounts provided by churches in accordance with Section 403(b)(9) of the Code. Congress recognized this distinction in 2012 when it amended Section 3(a)(2) of the Securities Act of 1933 to clarify that 403(b)(9) church plans are eligible to invest in exempt collective funds notwithstanding the exclusion of other types of 403(b) plan assets.[14] As a result, we believe that the exclusion of 403(b) plans from the no-action relief contained in the Mutual Life of America letter should be clarified as not applying to 403(b)(9) church plans. Other investors in the Separate Account will consist solely of those categories of investors that are eligible to invest in Section 3(c)(11) vehicles under the terms of Section 3(c)(11) or as a result of guidance provided by the Commission or the staff.

Finally, the relief under the Church Plan Letters was based in part on the understanding that the plan participants did not have discretion with respect to the investment in the insurance company separate accounts. Although Plan participants may have the option to initially allocate their account value amongst various investment options including the BCT, their investment discretion is limited to selecting these Plan investment options, and the bank trustee of the BCT has full and sole discretion on whether to invest in the insurance company separate accounts. As a result, the participants in the Plan do not have investment discretion to invest in the insurance company separate accounts, as was the case in the Church Plan Letters.

Conclusion

In light of the foregoing, the Adventists request that the staff provide its assurances that it will not recommend enforcement action to the Commission under Section 7 of the 1940 Act against certain BCTs or any Separate Account in which a BCT invests if a Separate Account that relies on the exclusion from the definition of "investment company" contained in section 3(c)(11) of the 1940 Act continues to rely on that exclusion, notwithstanding the

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[13] Revised Regulations Concerning Section 403(b) Tax-Sheltered Annuity Contracts, 72 FR 41129 (July 26, 2007).

[14] See Church Plan Clarification Act, PL 112-142 (July 9, 2012).

fact that certain BCTs holding church plan assets in accordance with section 3(c)(11) invest a portion of their assets in such Separate Account, as discussed in this letter.

We hope to discuss these matters with you further. Please contact Eric S. Purple at (202) 778-9220 or Donald Smith at (202) 778-9079 to discuss these matters further.

Very truly yours,

Eric S. Purple