AMERICAN BENEFITS COUNCIL

September 8, 2010

David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Dear Mr. Stawick and Ms. Murphy:

I am writing on behalf of the American Benefits Council (the "Council") to express the views of major employee benefit plans across the country with respect to a critical set of issues arising under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). More specifically, pursuant to requests for public comments from both the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC"),[1] this letter addresses certain business conduct standards that may be applied with respect to swaps involving employee benefit plans.

The Council is a public policy organization principally representing Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

Swaps play a critical role with respect to our members' pension plans. Pension plans use swaps to manage risk, such as interest rate, currency, and equity risk, and to thereby reduce the volatility of the plan funding obligations imposed on the companies maintaining the plans. If swaps were to become materially less available to pension plans, funding volatility would increase substantially, forcing companies in the aggregate to reserve billions of additional dollars to satisfy possible funding obligations. Those greater reserves would have an enormous effect on the capital that would be available to businesses to create and retain jobs and for other activities that promote economic growth. In addition, increasing asset volatility can jeopardize the security of plan benefits and undermine employers' commitment to provide new benefits, both of which adversely affect participants.

[1] See, e.g., CFTC Release: PR 5856-10 (July 21, 2010) (topic III); Speech by Chairwoman Mary Schapiro (July 27, 2010).

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Accordingly, the issues addressed in this letter are of great importance to our members, to the pension plan system more generally, and to the economy. We look forward to working with you to ensure that the new rules strengthen plans, as intended, so that workers' retirement security is enhanced. It is critical that the new rules not be interpreted in such a way as to undermine such security.

Specifically, I am writing today with respect to new section 4s(h)(5) of the Commodity Exchange Act ("CEA") (as added by section 731 of the Dodd-Frank Act), which sets forth certain business conduct standards that the CFTC may impose on swap dealers and major swap participants ("MSPs") that offer to enter into or enter into a swap with a "special entity". That section provides:

> **(5) SPECIAL REQUIREMENTS FOR SWAP DEALERS AS COUNTERPARTIES TO SPECIAL ENTITIES.—**
>
> **(A) Any swap dealer or major swap participant that offers to enter or enters into a swap with a Special Entity shall—**
>
> **(i) comply with any duty established by the Commission for a swap dealer or major swap participant, with respect to a counterparty that is an eligible contract participant within the meaning of subclause (I) or (II) of clause (vii) of section 1a(18) of this Act, that requires the swap dealer or major swap participant to have a reasonable basis to believe that the counterparty that is a Special Entity has an independent representative that—**
>
> **(I) has sufficient knowledge to evaluate the transaction and risks;**
> **(II) is not subject to a statutory disqualification;**
> **(III) is independent of the swap dealer or major swap participant;**
> **(IV) undertakes a duty to act in the best interests of the counterparty it represents;**
> **(V) makes appropriate disclosures;**
> **(VI) will provide written representations to the Special Entity regarding fair pricing and the appropriateness of the transaction; and**
> **(VII) in the case of employee benefit plans subject to the Employee Retirement Income Security act [sic] of 1974, is a fiduciary as defined in section 3 of that Act (29 U.S.C. 1002); and**
>
> **(ii) before the initiation of the transaction, disclose to the Special Entity in writing the capacity in which the swap dealer is acting; and**
>
> **(B) the Commission may establish such other standards and requirements as the Commission may determine are appropriate in the public interest, for the protection of investors, or otherwise in the furtherance of the purposes of this Act.**

A parallel provision with respect to security-based swaps is contained in section 15F(h)(5) of the Securities Exchange Act of 1934 (as added by section 764 of the Dodd-Frank Act)[2]. Our comments below apply equally to the CEA and the Securities Exchange Act.

Generally, a "special entity" is defined to mean a Federal agency, a State or local governmental entity, an employee benefit plan, a governmental plan, or an endowment. We are writing today with respect to employee benefit plans, including governmental plans. However, the statutory analysis is very different for plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA") and plans not explicitly subject to ERISA, such as governmental plans. Accordingly, we divide our discussion into two parts: ERISA plans and non-ERISA plans.

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[2] Section 15F(h)(5) provides as follows:

> (5) SPECIAL REQUIREMENTS FOR SECURITY-BASED SWAP DEALERS AS COUNTERPARTIES TO SPECIAL ENTITIES.—
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> (A) IN GENERAL.—Any security-based swap dealer or major security-based swap participant that offers to or enters into a security-based swap with a special entity shall—
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> (i) comply with any duty established by the Commission for a security-based swap dealer or major security-based swap participant, with respect to a counterparty that is an eligible contract participant within the meaning of subclause (I) or (II) of clause (vii) of section 1a(18) of the Commodity Exchange Act, that requires the security-based swap dealer or major security-based swap participant to have a reasonable basis to believe that the counterparty that is a special entity has an independent representative that—
>
> (I) has sufficient knowledge to evaluate the transaction and risks;
>
> (II) is not subject to a statutory disqualification;
>
> (III) is independent of the security-based swap dealer or major security-based swap participant;
>
> (IV) undertakes a duty to act in the best interests of the counterparty it represents;
>
> (V) makes appropriate disclosures;
>
> (VI) will provide written representations to the special entity regarding fair pricing and the appropriateness of the transaction; and
>
> (VII) in the case of employee benefit plans subject to the Employee Retirement Income Security Act of 1974, is a fiduciary as defined in section 3 of that Act (29 U.S.C. 1002); and
>
> (ii) before the initiation of the transaction, disclose to the special entity in writing the capacity in which the security-based swap dealer is acting.
>
> (B) COMMISSION AUTHORITY.—The Commission may establish such other standards and requirements under this paragraph as the Commission may determine are appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act.

ERISA PLANS

I. How does clause (i) of new section 4s(h)(5)(A) apply with respect to ERISA plans?

By its terms, clause (i) of section 4s(h)(5)(A) quoted above only applies where the swap dealer or MSP's counterparty is "an eligible contract participant within the meaning of subclause (I) or (II) of clause (vii) of section 1a(18)". Thus, clause (i) only applies where such counterparty is:

> (vii) (I) A governmental entity (including the United States, a State, or a foreign government) or political subdivision of a governmental entity; [or]
>
> (II) A multinational or supranational government entity.

As written, clause (i) is initially limited to the above types of entities (referred to here as "governmental entities"). However, subclause (VII) refers to "employee benefit plans subject to the Employee Retirement Income Security act [sic] of 1974", and viewed in isolation imposes a rule on such plans. This sets up a potential inconsistency in the statute. Clause (i) only applies to governmental entities (which are not subject to ERISA), but subclause (VII) of clause (i) refers to plans subject to ERISA. The only way to reconcile this inconsistency is as follows. Clause (i) is generally limited to situations where the counterparty is a governmental entity. However, by reason of subclause (VII), ERISA plans are made subject to clause (i), but only with respect to the requirements of subclause (VII). Thus, where the counterparty is an ERISA plan, clause (i) requires that the swap dealer or MSP must have a reasonable basis to believe that the ERISA plan has a fiduciary as defined in ERISA.

This interpretation makes sense both from a technical perspective and from a congressional intent perspective. From a technical perspective, there is no statutory basis to apply any part of clause (i) to ERISA plans other than subclause (VII).

From a congressional intent perspective, this also makes sense. In order to function as a fiduciary under ERISA, a representative must satisfy, among other things, requirements that are similar to those set forth in subclauses (I)-(VI). There was accordingly no reason for Congress to apply overlapping rules to a fiduciary that is already highly regulated under ERISA.

Specifically, consider each of the requirements in section 4s(h)(5)(A)(i)(I)-(VI):

> **"(I) has sufficient knowledge to evaluate the transaction and risks".** See ERISA section 404(a)(1)(B), which requires ERISA fiduciaries to discharge their duties "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".

"(II) is not subject to statutory disqualification". Unless a representative satisfies ERISA's standards, such representative cannot legally be an ERISA fiduciary.

"(III) is independent of the swap dealer or major swap participant". See ERISA section 406(b), which prohibits a fiduciary from acting on behalf of a plan if it has conflicted loyalties, which would be the case if the plan's fiduciary were not independent of the opposing party to a swap.

"(IV) undertakes a duty to act in the best interests of the counterparty it represents". See ERISA section 404(a)(1) which provides in relevant part that a fiduciary must "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries [of the plan]".

"(V) makes appropriate disclosures". It is clear under ERISA that fiduciary duties include the duty to make all appropriate disclosures to the plan. *See, e.g.*, *Eddy v. Colonial Life Ins. Co. of Am.*, 919 F.2d 747 (D.C. Cir. 1990) (stating that "[t]he duty to disclose material information is the core of a fiduciary's responsibility").

"(VI) will provide written representations to the Special Entity regarding fair pricing and the appropriateness of the transaction". Again, it is clear under ERISA that a fiduciary advising regarding a transaction must evaluate both the price and appropriateness of the transaction. *See, e.g.*, *California Ironworkers Field Pension Trust v. Loomis Sayles & Co.*, 259 F.3d 1036 (9th Cir. 2001) ("When applying the prudence rule, the primary question is whether the fiduciaries, 'at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment.'") (quoting Donovan v. Mazzola, 716 F.2d 1226, 1232 (9th Cir. 1983)).

This analysis leads to a very logical result. Where a governmental entity is the counterparty, the swap dealer or MSP must have a reasonable basis to believe that the representative meets subclauses (I)-(VI). Since those subclauses relate to issues already addressed by ERISA with respect to ERISA fiduciaries, only subclause (VII) applies where an ERISA plan is the counterparty.

Thus, in the case of ERISA plans, compliance with clause (i) of section 4s(h)(5)(A) is very straightforward and logical. The swap dealer or MSP need only have a reasonable basis to believe that the plan's representative is "independent" (a requirement included in the language prior to subclause (I)) and is an ERISA fiduciary.

II. What is meant by the reference to a special entity having an "independent" representative?

The "independence" issue is clear. The representative advising the plan with respect to the swap must be independent of the swap dealer or MSP; there is no requirement that the representative be independent of the plan. This was squarely confirmed by a colloquy between Senators Blanche Lincoln (D-AR) and Tom Harkin (D-IA) on July 15, 2010 (Fed. Reg. S5903):

> Mrs. LINCOLN….Our intention in imposing the independent representative requirement was to ensure that there was always someone independent of the swap dealer or the security-based swap dealer reviewing and approving swap or security-based swap transactions. However, we did not intend to require that the special entity hire an investment manager independent of the special entity. Is that your understanding, Senator HARKIN?
>
> Mr. HARKIN. Yes, that is correct. We certainly understand that many special entities have internal managers that may meet the independent representative requirement….

Any other conclusion here would be inconsistent with Congressional intent—Congress certainly did not intend to cause plans across the country to dismantle efficient internal investment teams. Moreover, there is no policy reason to require representatives to be independent of the special entity. On the contrary, the objective is to ensure that the special entity is not relying on the swap dealer or MSP with respect to the swap.

In order for the swap dealer or MSP to have a reasonable belief that a plan's representative is independent of the swap dealer or MSP, the swap dealer or MSP must have a reasonable basis to believe that the representative is not controlled by, or under common control with, the dealer or MSP that is the plan's counterparty.

III. What does a swap dealer or MSP need to do in order to have a "reasonable basis" to believe that the specified requirements are satisfied?

It is critical that swap dealers and MSPs have a clear, simple, and administrable means of demonstrating the requisite "reasonable basis" required under clause (i) of section 4s(h)(5)(A). In many cases, a plan will enter into multiple swaps during a year with the same swap dealer or MSP. Swap dealers and MSPs need to have an efficient means of satisfying the reasonable belief requirement that does not entail costly and subjective due diligence with respect to every swap. Otherwise, plans' ability to use swaps would be materially affected, plans' costs would rise, and funding volatility could reach dangerous levels.

We would suggest the following safe harbor. If a swap dealer or MSP receives a written representation from the plan or its representative that (1) states that the plan's representative is independent of the swap dealer or MSP and is an ERISA fiduciary, and (2) states that the plan or its representative shall notify the swap dealer or MSP if at any time the representation becomes inaccurate, then the swap dealer or MSP can rely on such written representation for purposes of satisfying the reasonable belief standard until the swap dealer or MSP receives a contrary representation from either party. If the swap dealer or MSP receives the written representation from the representative, reliance would only be permitted with respect to swaps involving that representative.

One other point is very important. It should be made clear that the safe harbor representations do not give rise to any additional contractual rights. For example, assume that due to changing economic conditions, a swap between a swap dealer and a plan has become very disadvantageous for the swap dealer. The swap dealer should not be able, for example, to void the swap—or make any other type of claim against any party —by asserting that one or more of the representations made by the plan or its representative under clause (i) were incorrect. In other words, these business conduct standards—which were meant to protect plans—should not be permitted to be a weapon that can be used against plans or their representatives. Correspondingly, the swap dealer or MSP should be permitted to rely on such representations and should not have any liability or be exposed to the possibility of having the swap voided by reason of the representation turning out to have been incorrect.

In analogous situations, regulators have permitted reliance on certifications. For example, under Rule 144A, under the Securities Act, a seller of securities is entitled to rely on a certification by an executive officer of the purchaser that the purchaser meets the conditions necessary to establish that the purchaser is a qualified institutional buyer ("QIB"). Rule 144A (d)(1)(iv). The Adopting Release for Rule 144A states that: "[u]nless circumstances exist giving a seller reason to question the veracity of the certification, the seller would not have a duty of inquiry to verify the certification." Another example is Regulation EE issued by the Federal Reserve, which provides that a person will qualify as a "financial institution" (for netting purposes) if it represents orally or in writing that it meets the appropriate test. 12 CFR 231.3.

Under the language of these regulations, if the certification is reasonably obtained, the recipient of the certification may treat its counterparty as a QIB/financial institution. A subsequent determination that the certification was wrong will not retroactively void the QIB/financial institution status of the counterparty.

IV. What is needed for the swap dealer or MSP to satisfy the requirement in clause (ii) of section 4s(h)(5)(A) that it disclose to the plan the capacity in which it is acting?

The swap dealer or MSP should be permitted to make a one-time disclosure to the plan or its representative regarding the capacity in which it is acting with respect to swaps with the plan. Of course, if in a future swap a swap dealer or MSP functions in a different capacity—i.e., not as a counterparty—the swap dealer or MSP would be obligated to make a separate representation regarding the capacity in which it is acting with respect to that future swap.

NON-ERISA PLANS

There are questions as to whether clause (i) of section 4s(h)(5)(A) applies to non-ERISA plans, such as governmental plans, and if so, which provisions of such clause apply and which may be satisfied by ERISA-like requirements in relevant state statutes/ordinances. We defer on that issue to the governmental plan community. However, as advisors and representatives of governmental plans, we are keenly interested in ensuring that, to the extent clause (i) applies to governmental plans, it applies in an administrable and appropriate fashion.

Some of the analysis provided above with respect to ERISA plans applies equally to non-ERISA plans, i.e.:

- The definition of "independent";
- The means of satisfying the reasonable basis requirement; and
- The means of satisfying the requirement that the swap dealer or MSP disclose the capacity in which it is acting.

However, additional issues may apply to non-ERISA plans by reason of the application of subclauses (I)-(VI). Those issues are addressed below.

I. What is needed for a swap dealer or MSP to have a reasonable basis to believe that a special entity's independent representative (a) has "sufficient knowledge to evaluate the transaction and risks", (b) "undertakes a duty to act in the best interests of the counterparty it represents", and (c) "makes appropriate disclosures"?

As discussed above, it is critical that swap dealers and MSPs not be required to do burdensome and unnecessary due diligence, such as, in this case, detailed investigations regarding whether a representative makes "appropriate" disclosures. A written representation described above from the plan or its representative should be sufficient if it states that the requirements in section 4s(h)(5)(A)(i) regarding the representative's knowledge, duties, and disclosure practices are satisfied[3]. A different rule would not only be extremely burdensome, but would also give swaps dealers and MSPs a potential tool to exercise inappropriate control over the opposing party in a swap. Swap dealers and MSPs could decide which representatives were knowledgeable, act in the best interests of their counterparty, and make appropriate disclosures. This would give swap dealers or MSPs inappropriate power over their counterparty's selection of a representative. It is critical that plans retain the ability to protect themselves.

II. What is needed for a swap dealer or MSP to have a reasonable basis to believe that the independent representative "will provide written representations to the special entity regarding fair pricing and the appropriateness of the transaction"?

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[3] Where the representative makes a representation, it should be permitted for the representative to do so in a way applicable to all of its plan clients—such as on its website—as opposed to on a plan by plan basis.

A written representation described above from the plan or its representative should be sufficient if the representation states that the representative is obligated, by law and/or contract, to review pricing and appropriateness with respect to any swap transaction in which the representative serves as such with respect to the plan. In this regard, it is critical to clarify one point. While it is very important that every swap be reviewed with respect to pricing and appropriateness (and that existing swaps be monitored appropriately), the CFTC and the SEC should not impose any requirement that the representative provide a separate opinion on pricing and appropriateness for each and every swap entered into by plans. That would be very costly and very disruptive. Where swaps are used to hedge risk, swap transactions can be entered into with some regularity. To require separate formal opinions regarding pricing and appropriateness would make it extremely difficult to execute swaps as needed to fit plans' investment objectives. In fact, such a requirement would drive up plan costs materially and cause plans to have to reduce their use of swaps, thereby hurting participants and exposing the company sponsoring the plan to far greater risks and funding volatility. Moreover, there is no reason for separate opinions for each swap. If the representative is contractually or legally obligated to review pricing and appropriateness, the law would only be adding time and expense by requiring a separate opinion letter regarding every swap.

We very much appreciate your consideration of our views.

Sincerely,

Lynn D Dudley

Lynn D. Dudley
Senior Vice President, Policy

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