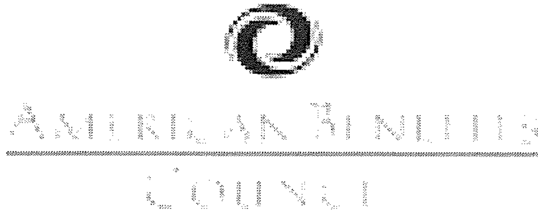

June 3, 2011

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

Re: RIN 3038-AD25 / Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties

Dear Mr. Stawick:

The American Benefits Council (the "Council") and the Committee on Investment of Employee Benefit Assets ("CIEBA") appreciate this opportunity to provide supplemental comments to the Commodity Futures Trading Commission (the "CFTC") regarding the proposed rules under the Wall Street Transparency and Accountability Act of 2010 (the "Act" or "WSTAA") relating to business conduct standards for swap dealers and major swap participants (the "Proposed Rules").

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.

CIEBA represents more than 100 of the country's largest corporate sponsored pension funds. Its members manage more than $1 trillion of defined benefit and defined contribution plan assets, on behalf of 15 million plan participants and beneficiaries. CIEBA members are the senior corporate financial officers who individually manage and administer ERISA-governed corporate retirement plan assets.

Among all the proposed regulations affecting the use of swaps by plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), the Proposed Rules give rise to the greatest concerns among plan sponsors. Our members continue to be concerned that, without some important changes, the Proposed Rules would, in many cases, threaten ERISA plans' ability to use swaps, which are an essential risk-mitigation tool.

As a threshold matter, we believe that it is important to stress the importance of the points raised in our February 22 comment letter. Each of the issues discussed therein is very important to the continued use of swaps by plans. For example, it is critical that the "Know Your Counterparty" rule, as discussed on pages 13-14 of that letter, not apply to ERISA plans for the reasons discussed in the letter. Rather than restate our earlier concerns, we wish in this letter primarily to address our three main concerns regarding the Proposed Rules in the context of a recent letter to the CFTC from the Department of Labor ("DOL") and to explain why that letter does not give us comfort.

The Council and CEIBA very much appreciate the time that both the CFTC and the DOL have devoted to this critical issue, as well as their openness to listen to our concerns. The DOL's letter is another indication that the agencies are willing to engage in a dialogue to ensure that the rules are structured correctly. Unfortunately, the DOL letter does not solve our three main concerns, nor does it give us comfort that ERISA plans ultimately will have the ability to continue to utilize swaps. As discussed more fully below, ERISA plans, their asset managers, and their dealer counterparties are extremely conscientious in complying with ERISA's fiduciary and prohibited transaction rules, where small missteps can lead to severe penalties, and need regulatory guidance that provides as much certainty as possible so that they can fairly rely on it.

This supplemental comment letter summarizes our three main concerns and explains why they are not solved by the DOL letter, so that we can all benefit from a continued dialogue on these issues. ***That continued dialogue is very much needed, because if the business conduct standards were finalized without simultaneous guidance from the DOL, we are concerned that in many cases, ERISA plans would be locked out of the swaps market by laws and regulations designed to protect them.*** We are certain this result is not intended by Congress, the CFTC, or the DOL, but we are concerned that that will be the result and, unfortunately, the DOL letter does little to ameliorate that result.

This letter also addresses two important additional issues. ***The first issue is that, as discussed below, some assert that an especially problematic portion of the business conduct rules takes effect as of July 16, 2011, even in the absence of regulations. The CFTC needs to address this issue by July 16, 2011.*** Second, the letter also addresses the exception from the business conduct standards for swaps initiated on designated contract markets ("DCMs") or swap execution facilities ("SEFs").

## CONFLICT BETWEEN THE PROPOSED BUSINESS CONDUCT STANDARDS AND THE PROPOSED FIDUCIARY REGULATION

In our view, the proposed business conduct standards require swaps dealers and major swap participants ("MSPs") to take three actions that would, under the DOL's proposed fiduciary regulation, convert swap dealers and MSPs into ERISA fiduciaries with respect to plan counterparties: (1) the provision of information regarding the risks of the swap, (2) swap valuation, such as providing mandated daily marks, and (3) a review of the ability of the plan's advisor to advise the plan with respect to the swap. Even under the DOL's current investment advice regulations, we believe that the third action could convert swap dealers and MSPs into ERISA fiduciaries. If the swap dealer is a plan fiduciary, a swap with the plan would be a prohibited transaction and thus illegal. In such a case, all ERISA fiduciaries participating in the transaction could have liability and the dealer or MSP could be subject to an excise tax equal to

15% per year of the amount involved in the transaction. The penalties are so severe that absent regulatory certainty, no one would risk them.

The DOL letter takes the position that the business conduct standards would not convert swap dealers and MSPs into fiduciaries, because of the "seller's exception" (also referred to as the counterparty exception) in the proposed DOL regulation. Further, the DOL confirms that treatment of swaps dealers and MSPs as fiduciaries was not intended.

The DOL letter's statement of DOL's intent is helpful, as is the letter's analysis of the regulation. Unfortunately, the letter is non-binding, and thus cannot be relied on by attorneys in analyzing or giving opinions with respect to this issue. Based on our members' experience, we believe that ERISA plans, investment advisers, and swap dealers would all be unable to obtain opinions from internal or external counsel that a swap dealer's compliance with the CFTC's business conduct standards would not expose such dealers and the plan fiduciaries to the risk of a prohibited transaction under ERISA. As noted above, because of the severe penalties involved, unless the regulation is modified so that this issue is clear, most swaps with plans will likely cease. We believe that major plans will not take a chance that they are entering into prohibited transactions in the face of a regulation that is unclear at best and adverse at worst. Plans, their fiduciaries, and their counterparties are meticulous in their efforts to comply with the DOL's prohibited transaction rules and we are concerned that they will conclude that it would be inadvisable, from both an ERISA and business perspective, for anyone to rely on a non-binding letter in the face of a regulation that is, as noted, at best unclear and at worst adverse.

Moreover, in assessing the applicability of the "seller's exception," it is important to look at the exact language of that exception. Under this exception, a person will not be considered to have provided "investment advice," which would make the person a fiduciary, if:

> "such person can demonstrate that the recipient of the advice knows or, under the circumstances, reasonably should know, that the person is providing the advice or making the recommendation in its capacity as a purchaser or seller of a security or other property, or as an agent of, or appraiser for, such a purchaser or seller, whose interests are adverse to the interests of the plan or its participants or beneficiaries, and that the person is not undertaking to provide impartial investment advice."

It is not entirely clear on its face that the DOL's proposed exception covers all types of transactions, including bilateral agreements. In addition, we think that where a dealer has numerous obligations to provide information, including information about risks, scenario analyses, and pricing, and an obligation to provide information in a "fair and balanced" manner, dealers legitimately will be concerned that they will find it difficult to meet their burden of proof that the Special Entity "reasonably should know that . . . the [dealer] is not undertaking to provide impartial investment advice." In the end, one could easily be concerned (and it is easy to see how a court might conclude) that the duties of a swap dealer or MSP under the CFTC's regulation are fundamentially inconsistent with the burden of proof (and *caveat emptor* assumptions) in the currently proposed "seller's exception."

Regardless of the agencies' intentions, as drafted, the DOL's "seller's exception" provides far less than the certain outcome that is necessary for business to continue in this area.

Consistent with the public policy behind the penalties for violating ERISA's fiduciary and prohibited transaction rules, this simply is an area where ERISA plans, their investment advisers, and dealers do not undertake the kind of risks the current situation would entail.

We have met with the DOL and have suggested that the DOL issue an Advisory Opinion that will make clear that "no action required by reason of the business conduct standards will make a swap dealer or major swap participant a fiduciary" under current law. In addition, we believe it is critical that the preamble to the final business conduct regulations states that the DOL has informed the CFTC that such statement will be included in the final fiduciary regulations, effective as of the effective date of the final business conduct standards, and that the CFTC's regulations themselves make clear that complying with the provisions of the CFTC's regulations, by themselves, will not make a dealer a fiduciary, or advisor, to any person. If the agencies are not comfortable providing such an Advisory Opinion and incorporating these statements into the regulation and preamble, it is hard to imagine that the private sector can get comfortable in most cases with entering into swaps involving ERISA plans.

Very specifically, here is the language we recommend be inserted in the preamble to the CFTC's final business conduct standards:

> The Department of Labor has informed the Commission that, in the case of a swap with a plan subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), no action of a swap dealer or major swap participant that is required by reason of these business conduct regulations will make such swap dealer or major swap participant a fiduciary under ERISA with respect to such plan, either under current law or under the final version of the Department of Labor's proposed regulations with respect to the definition of a fiduciary. The Department of Labor has further informed the Commission that the Department will, within 180 days of publication of the Commission's final business conduct regulations, state in regulations, rules, or similar guidance, effective as of the effective date of the Commission's final business conduct regulations, that no action of a swap dealer or major swap participant that is required by reason of these business conduct regulations will make such swap dealer or major swap participant a fiduciary under ERISA with respect to such plan.

***If the business conduct standards are finalized without this or similar language, swaps with plans will generally cease. Such language is essential.***

In short, in order to avoid the very negative consequences to pension plans of being unable to use swaps, on or before the finalization of the business conduct standards there needs to be legal clarity on our fundamental point that no action required by reason of the business conduct standards will make a swap dealer or an MSP a fiduciary <u>under current law or under the final version of the DOL's proposed regulations</u>.

**SUBJECTING PLANS TO AN UNWORKABLE CONFLICT OF INTEREST**

Under Dodd-Frank, if a swap dealer functions as an advisor to a plan, the swap dealer must act in the best interests of the plan. Unfortunately, the proposed business conduct standards interpret "advisor" so broadly that all swap dealers would be treated as advisors, *e.g.*, by reason of providing information on the risks of the swap. This is an unworkable conflict of interest that in virtually every circumstance would render swaps unavailable to plans. It is not clear to us how a swap dealer that owes a fiduciary duty to its shareholders to obtain the best possible deal with the plan can simultaneously act in the best interests of the plan, which is the dealer's counterparty. Absent clarification of this issue, if the proposed business conduct standards are finalized as is in this respect, we are concerned that virtually all swaps with ERISA plans (as well as other Special Entities) would likely have to stop, due to this conflict.

The DOL's position on this point seems to be that a swap dealer can act as an advisor to a plan and in the plan's best interest under the proposed business conduct standards, and the conflict of interest created by the swap dealer's dual roles of counterparty and advisor under such proposed rules is a workable conflict of interest that does not create an ERISA problem. This is squarely contrary to our understanding of ERISA and of general principles of law outside ERISA. We do not understand how a party can act in the best interests of itself and its counterparty. If the DOL and the CFTC want to revisit that basic concept, it would need to be addressed in binding legal guidance, not in a letter that cannot be relied on legally.

Rather than approving a conflict of interest, which hardly seems like good policy, we believe that the business conduct standards should state that a dealer or MSP is not an "advisor" if the dealer or MSP represents in writing that it is functioning as a counterparty and not as an advisor. Similarly, if a swap dealer or MSP makes such a representation, the swap dealer or MSP should be deemed not to have "recommended" a swap strategy for purposes of triggering the Proposed Rules' provision regarding institutional suitability.

This "advisor" issue requires additional attention for another reason. Some law firms have asserted that this requirement goes into effect as of July 16, 2011, without regard to whether implementing regulations have been issued. While we do not believe any business conduct statutory standards go into effect on July 16, we understand the issue is not free from doubt. If the CFTC does not clarify the effective date issue or issue any business conduct rules by July 16, the swaps market may have to deal with the uncertainty of this advisor issue as well as its possible effects under ERISA, as discussed above. This uncertainty would be heightened by having adverse proposed regulations outstanding. Accordingly, it is critical that the CFTC issue binding guidance addressing this problem as soon as possible.

## SWAP DEALERS REVIEWING THE QUALIFICATIONS OF PLAN ADVISORS

Under the proposed business conduct standards, a swap dealer or MSP must review a plan's choice of an advisor to determine if the advisor is capable of advising the plan on the swap. We are concerned about this for two reasons. First, if a swap dealer or MSP reviews a plan's advisor, that would make the swap dealer or MSP a fiduciary under the DOL's proposed regulation and under current law. Second, we are also concerned about the swap dealer or MSP having veto power over plan advisors. Plans do not want their counterparties to have veto power over their choice of an advisor. This veto power could also render unavailable the QPAM exemption, which is necessary to allow swaps to proceed. In addition, this veto power could

very well make plan advisors hesitant to vigilantly represent the plan's interests for fear of a future dealer or MSP veto, which would likely put the advisor out of business.

The DOL describes the first concern – treatment of the dealer or MSP as a fiduciary – as having "no merit". We appreciate the DOL's view on this issue, but we do not think a court would be swayed by this non-binding statement. Accordingly, we need that conclusion to be expressed formally in an Advisory Opinion, in the preamble to the final business conduct standards, and in the final fiduciary regulations (as discussed above), so that counsel relied upon by pension plans or their counterparties can analyze the issue and give opinions consistent with the DOL's view. Unfortunately, law firms, as well as internal counsel, have expressed views contrary to the DOL's interpretation regarding both the proposed regulations <u>and current law</u>. If such interpretation is incorrect, they need legal clarity on this point on or before the finalization of the business conduct standards so that they can issue opinions to pension plans and swap dealers. The approach that we suggest above with respect to solving the conflict between the two regulations would work here. Again, the letter itself, which cannot be relied on as a legal authority, does not provide the clarity that is needed.

The second concern – about giving dealers and MSPs a veto power over plans' advisors – is not addressed by the DOL's letter. For the reasons briefly referenced above and discussed more fully in our February 22 letter, it is an issue that needs to be addressed by the CFTC. Very briefly, it is critical that the CFTC adopt a rule under which a swap dealer or MSP is deemed to have a reasonable belief that an ERISA plan's representative meets the statutory requirements if the swap dealer or MSP receives a representation from the plan or the representative that the representative is an ERISA fiduciary. Without such a rule, we believe that the CFTC will provide dealers with too much power over who an ERISA plan engages to represent it. We fail to see how this is consistent with the clear intent under Dodd-Frank to protect ERISA plans.

**EXEMPTIONS FOR ALL DCM AND SEF SWAPS**

Congress provided an exemption from the business conduct standards section of the CEA. This exemption called "Applicability" states in its entirety that "[t]his ***section*** shall not apply with respect to a transaction that is (A) initiated by a Special Entity on an exchange or swap execution facility; and (B) one in which the swap dealer or major swap participant does not know the identity of the counterparty to the transaction." New CEA section 4s(h)(7). By "[t]his section," Congress was referring to the entire business conduct standards section it adopted under section 4s(h). In other words, Congress intended the exemption in new CEA section 4s(h)(7) to apply to the entirety of both the business conduct standards under new CEA section 4s(h) and any rules the CFTC adopts to implement these business conduct standards. A more narrow reading of "[t]his section" to mean the exemption provision under section 4s(h)(7) would render this provision meaningless as the *only* words appearing in the entirety of section 4s(h)(7) are included above.

The CFTC's proposed business conduct rules restate the statutory exemption in new CEA 4s(h)(7) twice, once in the proposed rules addressing Verification of Counterparty Eligibility (23.430(c), but only covering swaps initiated on a SEF) and again in the proposed rules addressing Requirements for Swap Dealers and Major Swap Participants Acting as Counterparties to Special Entities (23.450(g)). This could be read to mean that the Commission intends for the exemption to only apply with respect to these two rules. This would mean that

the CFTC intends all of its other business conduct standard rules *to apply* to a transaction that is (A) initiated by a Special Entity on an exchange or swap execution facility; and (B) one in which the swap dealer or major swap participant does not know the identity of the counterparty to the transaction, even though these transactions are clearly exempted from the CEA's business conduct standards under new CEA 4s(h)(7).

In any event, the essence of the statutory exemption seems to be that the business conduct standards should apply only when transactions are not entered into on a designated contract market or swap execution facility, regardless of whether the transactions are blind. (The use of the semi-colon in the statutory provision confirms this view by setting out the two elements of the exemption as independent, not conjoined, elements; swaps initiated by a Special Entity on a SEF or DCM even if not blind should be excluded from the business conduct rules.) Trades on SEFs using RFQ systems are not blind, but could include both clearable and unclearable swaps that will be entered into subject to the SEF's trading protocols. Especially in light of the ongoing CFTC deliberations on whether SEFs should include RFQ platforms and what kind of RFQs should be allowed, Congress should not be understood to have intended that the CFTC would limit the reach of the exemption to only some trades conducted subject to the rules of a DCM or SEF. The business conduct rules make sense only when applied to privately-negotiated, bilateral transactions that are not subject to DCM or SEF rules.

The CFTC should therefore clarify that its business conduct standard rules will not apply to any swap transaction that is initiated by a Special Entity or otherwise entered into by a Special Entity on a designated contract market or swap execution facility by adopting the following rule. The language below would resolve the statutory ambiguities in new CEA section 4s(h).

> CEA Section 4s(h) and the provisions in CFTC Part 23, Subpart H shall not apply to any swap transaction that is:
>
> > (i) entered into by a Special Entity on, or subject to the rules of, on a designated contract market; or
> >
> > (ii) initiated by a Special Entity on, or subject to the rules of, a registered swap execution facility.
>
> For purposes of this exemption, a Special Entity will be considered to have initiated a swap transaction when the Special Entity or its executing broker or other representative makes a "request for quote" for a swap on, or subject to the rules of, a swap execution facility.

We appreciate your consideration of our views.

American Benefits Council Committee on Investment of Employee Benefit Assets