CIEBA
The Committee on Investment of Employee Benefit Assets

November 4, 2011

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

Re: RIN 3038-AD60 / Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA, 76. Fed. Reg. 58,186 (Sept. 20, 2011) ("Schedule A")

Re: RIN 3038-AC96; 3038-AC97 / Swap Transaction Compliance and Implementation Schedule: Trading Documentation and Margining Requirements under Section 4s of the CEA, 76. Fed. Reg. 58,176 (Sept. 20, 2011) ("Schedule B")

Dear Mr. Stawick:

The Committee on Investment of Employee Benefit Assets ("CIEBA") appreciates this opportunity to provide comments to the Commodity Futures Trading Commission (the "CFTC" or "Commission") regarding the proposed rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" or the "Act") and the Commodity Exchange Act ("CEA") relating to phasing in compliance with the clearing mandate under new CEA § 2(h)(1)(A), the exchange-trading mandate under new CEA § 2(h)(8)(A), trading relationship documentation standards under new CEA § 4s(i)(2) and the margin requirements for uncleared swaps under new CEA § 4s(e) (collectively, the "Relevant Dodd-Frank Requirements").

CIEBA represents more than 100 of the country's largest corporate sponsored pension funds. Its members manage more than $1.4 trillion of defined benefit and defined contribution plan assets, on behalf of 17 million plan participants and beneficiaries. CIEBA members are the senior corporate financial officers who individually manage and administer ERISA-governed corporate retirement plan assets.

We greatly appreciate the CFTC's intent in proposing rules to "afford market participants adequate time to comply" with the Relevant Dodd-Frank Requirements. *See* Schedule A at 58,193; *See also* Schedule B at 58,183. The CFTC correctly recognizes that a compliance schedule with which market participants could not comply would leave these entities exposed to risks they would otherwise have used swaps to mitigate. *See* Schedule A at 58,194; Schedule B

at 58,184. In particular, ERISA plans could be precluded from using swaps to hedge interest rate and other risks if their clearing, execution, documentation, and margining do not meet the compliance schedule.

The increase in volatility resulting from the unavailability of swaps to ERISA plans could be so substantial that plan sponsors could be forced to collectively reserve billions of additional dollars to satisfy possible funding obligations (most of which may never need to be contributed to the plans because the risks being reserved against may not materialize). Such greater reserves would have an enormous effect on the working capital that would be available to companies to create new jobs and for other business activities that promote economic growth. And as the CFTC correctly notes more generally, a departure from the swap market by market participants due to an inability to comply with the clearing and exchange trading requirements, even if only temporarily, could reduce liquidity and increase spreads in the market. *See* Schedule A at 58,194. Without the use of swaps, it could be difficult to hedge the assets that are intended to benefit ERISA plan retirees and beneficiaries. While these adverse results were not intended by Congress or by the CFTC, we fear nonetheless that the proposed compliance schedules would leave some ERISA plans unable to meet the compliance schedule and thus without swaps and with risk.

Many ERISA plans divide their plan assets into multiple accounts. Some accounts will be managed by the plan sponsor or an affiliate of the plan sponsor with expertise in investment management ("in-house manager"). It is not unusual for the plan sponsor or in-house manager to contract with investment managers who are unaffiliated with the plan sponsor ("third party managers" or "external managers"), and give third party managers discretion to trade certain of the ERISA plan accounts.[1] Our concern is that the CFTC's proposed schedules would subject an ERISA plan that is managed by both an in-house manager and a third party manager to two different schedules for purposes of compliance with the Relevant Dodd-Frank Requirements. ERISA plan accounts need consistent regulatory treatment and longer than 180 days to come into compliance. Accordingly, all ERISA plan accounts should be subject to the same compliance schedules, and at the very least, be given 270 days.

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[1] An ERISA plan typically engages a third party manager through an Investment Management Agreement ("IMA"), which will specify the kinds of activities the manager can engage in, give the manager the authority to execute, confirm, margin or clear swaps and other derivatives for the ERISA plan, and lay out investment guidelines to be followed in managing the account. The IMA can address a variety of issues in managing the account, ranging from investment benchmarks, the kinds of investments and transactions that may be used, whether the third party manager can negotiate its own master documentation or use documents already negotiated with the plan sponsor or investment manager affiliate, and of course, fees and compensation. Even where third party managers are used, a plan sponsor or in-house manager may also manage one or more of the internally managed ERISA plan accounts using an overlay strategy that is keyed off of the various strategies that are employed by the third party managers and the investment returns on those accounts (and vice-versa).

The CFTC's Proposed Schedules Would Treat ERISA Plans Disparately.

The proposals would subject an ERISA plan that is managed by both an in-house manager and a third party manager to two different schedules for purposes of compliance with the Relevant Dodd-Frank Requirements. A 270 day compliance schedule would apply to "third party subaccounts," i.e., managed accounts of an ERISA plan that require specific approval by the beneficial owner of the account to execute documentation necessary for executing, confirming, margining, or clearing swaps (which we refer to as "Category 3"). A three-month shorter 180 day compliance schedule would be applied for an ERISA plan account[2] that is *not* a third-party subaccount (described as "Category 2"). The Commission in its release says that it will consider Category 2 to include accounts managed by the pension fund itself, which presumably would include a pension fund to the extent it is managed by the plan sponsor of the assets in the pension fund or by an investment manager affiliate of that plan sponsor.

There are many operational contingencies to clearing (e.g. type/amount of required margin, collateral segregation, documentation etc.) much of which are awaiting final regulation. When these final regulations are adopted, ERISA plans, even those which have in-house asset managers, expect to look to their third party managers to assist or advise regarding the operational and portfolio implementation of clearing. Large outside asset managers have greater operational and personnel resources than plan sponsors and in-house asset managers of ERISA plans and typically have greater leverage with dealers and clearing houses. The proposed sequencing for clearing would require ERISA plans to clear three months before the great majority of their outside managers' other clients. Because ERISA plans were neither at the center of the 2008 financial crisis nor were they major players in the credit default swaps which were also at issue during that crisis, CIEBA believes that providing ERISA plans with additional time to prepare for clearing would not present significant risk to the financial system. In fact, permitting plans to be able to prepare with their outside managers (as compared to in advance of them) would allow ERISA plans to arrange their operational and legal affairs with more prudence. CIEBA believes this would be in the best interest of the financial system and the public and certainly in the best interest of ERISA plans' beneficiaries. There is a significant risk that ERISA plans will not be able to prepare for clearing in time and will have to forego very beneficial swap hedges that would protect the plans against volatile market movements. Accordingly, CIEBA respectfully requests that the Commission sequence the implementation of clearing for ERISA plans to occur at the latest possible time but at the very least no earlier than the implementation of clearing for ERISA plans' outside managers other third party accounts.

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[2] We assume that the CFTC's reference to an ERISA plan when defining a Category 2 Entity is referring to an ERISA plan account rather than the ERISA plan itself.

ERISA Plan Accounts Need Consistent Regulatory Treatment.

As proposed, an ERISA plan that is managed both by an in-house asset manager and by external managers will effectively subject the in-house manager to more expedited implementation schedules, precluding the in-house manager from incorporating lessons learned from the documentation and operational experiences of the external manager. Likewise, splitting ERISA plan accounts into two categories can be expected to impose a larger proportion of the "start-up" costs associated with implementing the clearing and trade execution mandates, at least with respect to ERISA plan-specific issues, on the in-house managers for Category 2 ERISA plan accounts than on the external managers for Category 3 ERISA plan accounts. *See* Schedule A at 58,193-4 and Schedule B at 58,183-4 (raising this argument regarding Category 1 Entities). While the CFTC notes in the cost-benefit analysis that "it is appropriate for the entities that are likely to be among the most active participants in these markets to shoulder a larger percentage of these start-up costs," there is no comparable consideration for placing a greater burden on in-house managers for ERISA plans than on external managers for those plans. *See id.* To the contrary, there is no reason for Category 2 ERISA plan accounts to bear a greater portion of the costs in finding the path to compliance than Category 3 ERISA plan accounts. The Commission's cost-benefit analysis for this proposal did not recognize that the costs of this split could be significant and would not offer benefits.

The proposed split schedules also will frustrate the important, delicately-balanced overlays that in-house managers achieve through in-house overlay strategies that are implemented when allocating plan assets to third-party managers. As mentioned earlier, plan sponsors and in-house investment manager affiliates regularly employ overlay strategies in directly managed ERISA plan accounts as a means of managing the risks of allocating plan assets to multiple managers and centralizing certain hedging and risk management functions. Requiring split schedules could also force otherwise unnecessary changes in management solely to comply with the split schedules.[3]

For the same reason that the CFTC's proposal groups all swap dealers ("SDs") and major swap participants ("MSPs") together in the same category—to enable like entities to collaborate in establishing methods of compliance—all ERISA plan accounts should be grouped together in one category. *See* Schedule A at 58,194 and Schedule B at 58,184. ERISA plans use swaps to manage risk resulting from the volatility inherent in determining the present value of the plans' liabilities, as well as to manage, and reduce reliance on, plan funding from the companies maintaining defined benefit plans. An ERISA plan's purposes of using swaps and its primary regulation by the Department of Labor raise the same kinds of pension-specific challenges when documenting new clearing arrangements, connecting to market infrastructures, and otherwise

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[3] For example, a plan sponsor might decide to manage a European bond account, while hiring a third-party manager to manage a European equities account. It would not be unusual for the plan sponsor to directly manage an overlay account that hedges the foreign currency risks of both the European bond and European equities accounts. Under the CFTC's proposals, the overlay account would be thrown into disarray between the compliance deadline for Category 2 ERISA plan in-house accounts, and the compliance deadline for Category 3 ERISA accounts managed by the third party managers.

preparing for the clearing mandate, whether through an in-house account or an account managed by an unaffiliated third party. A shared compliance deadline would allow for collaboration between in-house managers of ERISA plans and their external managers, resulting in more efficient problem-solving processes and potential cost savings to ERISA plans.

ERISA Plan Accounts Need Longer than 180 Days to Come into Compliance.

While the proposed schedule could be seen as giving Category 2 market participants 180 days to work with dealers in finding a path to compliance, we believe this will not prove to be the case. SDs will themselves be scrambling to comply for at least a considerable number of the first 90 days. SDs likely would not, and quite possibly could not, take the time to begin working through compliance issues with ERISA plans until the SDs themselves are prepared to comply with respect to swaps entered into with SDs, MSPs and active funds. This could effectively compress compliance for Category 2 accounts into as few as 90 days, which would be as quickly as would be required of the dealers. A negative byproduct of this compressed timeframe would be the opportunity for SDs to force uniform, pro-SD provisions into customer documentation under the auspices of a CFTC-mandated timeframe.

Also, the grouping of Category 2 ERISA plan accounts together with hedge funds would create competition between these ERISA plans and hedge funds for the limited, finite resources of SDs, clearing members and third party vendors during implementation. Funneling too many end-users in at the same time through the clearing brokers and then the clearinghouses would create the same kinds of "massive bottlenecks and contention problems" that were raised at the joint CFTC-SEC Staff Roundtable in May.[4] Because hedge funds typically transact a much higher volume of swaps than most ERISA plans, ERISA plans would be at a disadvantage in attracting the talent and attention from service providers that ERISA plans will need to comply. In sum, placing ERISA plans in the same category as hedge funds will put ERISA plans at a competitive disadvantage which could leave ERISA plans unable to comply by the proposed deadline.

Another reason that ERISA plans need a longer compliance window is that like third party managers, in-house managers will need to transition their swaps documentation. As the CFTC astutely recognizes, "[e]ntities that are third-party subaccounts may need up to 270 days to come into compliance to address the additional challenge of transitioning hundreds . . . of subaccounts into compliance with the clearing and trade execution requirements." Schedule A at 58,193; *See also* Schedule B at 58,183. The CFTC correctly notes that the impending CFTC rulemakings may require these entities to negotiate and formalize new agreements with each of their customers. In-house managers will face similar challenges in implementing new

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[4] *See* Statement of Bill DeLeon, PIMCO, Transcript p. 14, 11.1-5 (May 3, 2011) (stating that "…if you try to funnel all of the end-users in at once through the clearing brokers and then through the CCPs, you'll have massive bottlenecks and contention problems").

agreements for many ERISA plan accounts. While the number of accounts of an in-house manager may be less than that of a third party manager, the operations of such in-house managers are operationally significantly smaller than the operations of the major advisors. Thus, the effort needed from in-house pension fund managers to retrofit their operations for the implementation of Dodd-Frank may well be proportionately the same, or even greater than, the challenges faced by the large independent investment managers mentioned in the CFTC's release.

A compliance schedule that does not grant ERISA plan accounts sufficient time to enter into these agreements could limit the fiduciaries of ERISA plans to entering into arrangements in the short term with only a small number of dealers. Such a schedule would give dealers a competitive advantage that could be used to the disadvantage of ERISA plans when negotiating this documentation. If some ERISA plans find themselves unable to enter into executed agreements with dealers before the applicable compliance deadline, these plans may be left unable to access the swap market and, as a result, exposed to risk.

As noted by the CFTC, the Commission has not yet adopted final rules relating to the protection of cleared swaps customer contracts and collateral. *See* Schedule A at 58,189. The Commission also correctly notes that these rules must be finalized before the CFTC could determine a swap must be cleared. *Id.* However, the Commission could adopt these final rules and make the first mandatory clearing determination simultaneously. In light of ERISA and related DOL regulations, the fiduciaries of ERISA plans will need to analyze the CFTC's final segregation rules very carefully, which could require significant time and resources. These fiduciaries will need to complete their analysis of the CFTC's final segregation rules before negotiating documentation under which cleared swaps will be executed.

The need for international coordination also supports giving ERISA plans a longer window to comply with the Relevant Dodd-Frank Requirements. As Commissioner Scott O'Malia stressed in the October 18 CFTC meeting, Commission policies should not create disadvantages for United States businesses. By way of example, regulatory initiatives in the European Union will not require pension plans to clear swaps when the clearing mandate takes effect in recognition that pension plans, by their nature, pose no risk. The cost disparity between clearing in the United States at the same time pension plans are not required to clear swaps in the European Union will be even greater if in-house ERISA plan accounts are forced to rush their documentation and other compliance activities.

The Clearing Requirement Should Not Apply Until Full Physical Segregation is Available For Margin of Cleared Swaps.

ERISA plans, like other end-users, should be free to elect to have any margin they post to secure their cleared swaps held by an independent, third party custodian and segregated from their clearing firm and its other customers. Otherwise, ERISA plans that clear swaps would be exposed to the risk of a failure of a clearing member or the clearing house or to fellow customer risk.

Also, as evidenced only a few days ago, under the current clearing regime, ERISA plans' cleared swap positions and related margin could be held hostage upon discovery of a shortfall of customer funds for the plans' clearing member customer positions. The reportedly missing customer funds for futures positions cleared by MF Global demonstrate the need for customers to be able to have the margin that they post for cleared swaps segregated with an independent third-party custodian. While the shortfall in customer funds was not apparent to MF Global customers until MF Global filed for bankruptcy, much of the funds remaining in the MF customer account have been frozen for days as customer positions are sorted out. Full physical segregation of customer margin would have facilitated a more expeditious reckoning of customers with their funds and lessened the risks of exposure to the failure of a clearing member or to the clearing house.

Today, ERISA plans are able to protect their collateral that they post to secure their swaps by having it held in their name, for the benefit of a secured party counterparty, by an independent, third party custodian. CIEBA has proposed a segregation model for cleared swaps that would allow customers to elect to physically segregate margin in an individual settlement account ("ISA") pursuant to an agreement (a "Quad-party Agreement") by and between the relevant clearing house, the clearing member, the ERISA plan and a custodian that is also a settlement bank of the clearing house.[5] The ISA would be an account held in the name of the ERISA plan (for the benefit of the clearing house) at the custodian and the Quad-party Agreement would expressly provide that the ISA and its proceeds are property of the ERISA plan, and not of the clearing member. The Chicago Mercantile Exchange reviewed this approach and advised CIEBA that it believes this approach would work well.[6] CIEBA also provided the Commission with a legal opinion which provides that this segregation model should be recognized in the event of a clearing member insolvency.[7] Especially in light of the recent MF Global events, ERISA plans should be able to elect to use a Quad-party Agreement before being required to clear their swap positions.

Full physical segregation for margin posted to secure cleared swaps would be consistent with recent international regulatory developments. On Wednesday, the Basel Committee in Banking Supervision released draft rules which favor arrangements wherein clearing members may arrange for the clearing house to hold margin in a segregated entity that would not be caught up in a bankruptcy of the clearing house. *See* Financial Times article entitled "Basel Sets Clearing Capital Rules," (Nov. 2, 2011).[8] By electing this form of segregation, banks could

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5 *See* CIEBA's August 8, 2011 Letter to the CFTC in response to the CFTC's notice of proposed rulemaking entitled Protection of Cleared Swaps Customer Contracts and Collateral: Conforming Amendments to the Commodity Broker Bankruptcy Provisions ("CIEBA's August 8 Letter").

6 *See* CIEBA's August 8 Letter, note 4.

7 *See* CIEBA's August 8 Letter, Exhibit 1.

8 This article, written by Brooke Masters, is available at <http://www.ft.com/intl/cms/s/0/ea2fdb20-0575-11e1-a429-00144feabdc0.html#axzz1clQmsLWv>.

avoid applying a two percent risk-weighting to their trade exposure to central counterparties (which is a two percent increase over what is required currently by Basel II requirements). *See id*. The Basel Committee's draft rules are evidence that international regulators believe that such arrangements are not only operationally feasible, but are also obtainable and would provide material protections for bank capital. If banks are able to obtain these protective arrangements for their margin from clearing houses, CIEBA believes that the CFTC should adopt regulations which also allow ERISA plans to obtain the same segregation protections for their margin from clearing houses and clearing members.

Until the CFTC adopts rules implementing full physical segregation and until this segregation is available operationally, ERISA plans should not be subject to the clearing mandate and capital requirements should not be imposed on SDs which have the economic effect of forcing ERISA plans to clear their swaps. The implementation schedules proposed for plans should be delayed accordingly until these protections for customer margin are adopted.

Uncleared Swap Margin Requirements Should Only Take Effect After The Clearing System Is In Place.

Rules proposed by the U.S. prudential regulators and the CFTC regarding margin would create higher initial margin requirements for uncleared swaps than those applicable for cleared swaps. It will take some time for the clearing requirements to be implemented. If uncleared swap margin requirements take effect before the clearing infrastructure is in place, ERISA plans that would like to use cleared swaps will have no option but to pay the higher margin requirements under the uncleared swap rules until cleared swaps are available.

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We thank the CFTC for the opportunity to comment on the proposed rules that would provide schedules to phase in compliance with certain Dodd-Frank requirements.

Committee on Investment of Employee Benefit Assets

cc: The Office of the Comptroller of the Currency
The Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Farm Credit Administration
The Federal Housing Finance Agency