February 28, 2011

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

Re: **RIN3038-AC96 – Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants**

Dear Mr. Stawick:

The American Benefits Council (the "Council") and the Committee on Investment of Employee Benefit Assets ("CIEBA") appreciate this opportunity to provide comments to the Commodity Futures Trading Commission (the "CFTC" or "Commission") regarding confirmation, portfolio reconciliation and portfolio compression requirements for swap dealers ("SDs") and major swap participants ("MSPs") under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") and the Commodity Exchange Act ("CEA").

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 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 manage and administer ERISA-governed corporate retirement plan assets. CIEBA's recent annual survey of members showed an increased emphasis on managing and reducing plan risks and a corresponding increase in usage of swaps to address those risks.

IMPORTANCE OF SWAPS TO PLANS

Swaps play a critical role for our members' plans. Many plans regulated by the Employee Retirement Income Security Act of 1974 ("ERISA") use swaps to hedge or mitigate the risks

endemic to plan liabilities and investments. These plans conduct swap transactions through fiduciaries that are subject to stringent regulation under ERISA. When entering into a swap, ERISA requires a fiduciary to negotiate the best terms available and to act solely in the interests of the plan's participants. Consistent with ERISA, we are sure the Commission will want to avoid any possibility that the reporting of swaps, directly or indirectly, would adversely affect an ERISA fiduciary's ability to obtain the best possible swap terms for plan participants.

If swap trading becomes materially less available to plans, millions of Americans' retirement security would be detrimentally affected. Moreover, funding volatility could increase substantially, undermining participants' retirement security and forcing companies in the aggregate to needlessly reserve billions of additional dollars to satisfy possible funding obligations. Those greater reserves would vastly diminish working capital that would otherwise be available to companies to create new jobs and for other business activities that promote economic growth.

SUMMARY

The proposed rules create unnecessary risks to plans that should be remedied in the final rules. Plans should not be required to participate in portfolio compression exercises because these exercises pose a serious threat of increasing market risk for plans with multiple investment advisers.

With respect to confirmation, portfolio reconciliation, and portfolio compression, the CFTC should delete all references to SDs and MSPs "enforc[ing]" their procedures. SDs and MSPs are not registered entities and should not have the ability to enforce any rule. On the contrary, the regulations should protect non-SD, non-MSP counterparties by requiring SDs and MSPs to follow their swap agreements even if those agreements are contrary to the SD's or MSP's unilaterally adopted procedures.

The CFTC should amend its proposed rules to prevent SDs or MSPs from requiring electronic confirmation or imposing unnecessary costs on counterparties through confirmation and reconciliation requirements.

A regulatory scheme that merely requires SDs and MSPs to implement procedures without providing guidance for those procedures or requiring consent from counterparties affected by those procedures could lead to an inflexible, expensive market that minimizes the roles of plans and other end-user entities. The CFTC should maintain flexibility and fairness in the swaps market by (1) requiring an SD or MSP to provide all terms of a swap in writing to its counterparty, (2) requiring agreement between counterparties before a third party is used to perform portfolio reconciliation, and (3) requiring impartial rules for portfolio reconciliation.

COMMENTS

Plans, Whether or Not They are MSPs, Should Not Be Required to Engage in Portfolio Compression Exercises.

Proposed rule 23.503 would require SDs and MSPs to engage in portfolio compression exercises on a periodic basis to close out offsetting positions. For non-SDs and non-MSPs, the

Commission would not mandate portfolio compression exercises. However, in proposed rule 23.503(d)(2), the Commission would require SDs and MSPs to maintain written policies and procedures for periodically terminating fully offsetting swaps and periodically engaging in compression exercises with counterparties who are not SDs or MSPs. In addition, the Commission asks whether financial entities (defined to include plans) should be subject to the portfolio compression requirements being proposed for SDs and MSPs.

Plans should not be subject to the proposed portfolio compression requirements for SDs and MSPs. The purpose given for the proposed portfolio compression requirements is to reduce risk and improve operational efficiency for trades that are "[i]n many cases, redundant or economically-equivalent positions [that] serve no useful business purpose."[1] Such trades occur rarely, if ever, for plans. This is because all trades for plans must have a business purpose. Under ERISA, all decisions to use swaps are entered into by a fiduciary that has to determine that the trades are in the best interests of the plan. To reach this conclusion, the fiduciary must have already concluded that the trade serves a business purpose for that fiduciary's plan. Thus, portfolio compression would not serve to mitigate risk or eliminate unnecessary transactions. Rather, it is likely to create havoc and increase risk.

This increased risk is especially clear in the context of plans that have multiple investment advisers. Plans often hire more than one investment adviser to advise them regarding their portfolio. It is not uncommon for two different investment advisers to manage similar mandates for the same pension plan. An adviser may unknowingly enter into positions that are equal and opposite to the positions of another adviser, but its respective positions are placed with its specific investment account mandate in mind, not the other mandates of the plan for other advisers (which are typically unknown to them). In fact, even though an SD or MSP may be aware of a plan's offsetting positions, it is very likely that the plan (and certainly its managers) will not have a system that would identify offsetting positions, and will likely be completely unaware of such positions. Removing such positions by compression could wreak havoc on pension plan portfolio management with devastating consequences, such as unhedged positions, confusion among managers, and losses as a result of market movements which had been previously been hedged by positions that had to be undone by compression.

Even in non-multi-manager situations, portfolio compression could be detrimental for plan trades. It is not unusual for a single investment adviser to have two separate accounts with two different mandates for a single plan. In carrying out these separate mandates, the adviser may well enter into positions in one account that are equal and opposite to positions in the other account. Removing such positions by compression would eviscerate the purpose of having the separate mandates, creating confusion and dismantling the careful trading strategies intended to serve the business purpose of the plan.

Moreover, the proposed rules could create natural incentives for SDs and MSPs to be overinclusive in drafting their procedures for compression. Because an investment adviser to a plan must have a business reason for engaging in a trade, if the trade is compressed, that investment adviser will have to enter into another trade to maintain that exposure. Applying

[1] 75. Fed. Reg. 81525.

compression requirements to plans is therefore likely to encourage investment advisers to engage in even more trades, a result at odds with the portfolio compression goal of reducing the trade count. While additional trades may be beneficial to SD counterparties, they come at a significant cost to plans.

Accordingly, we strongly urge the CFTC to exclude plans from the portfolio compression requirements in 23.503, whether such requirements are for MSPs or non-MSPs. We also request that the Commission modify the proposal for written procedures for trades with non-SDs and non-MSPs in 23.503(d)(2) so that under such written procedures , a swap with a plan cannot be compressed without the plan's explicit consent.

Policies and Procedures of SDs and MSPs Should Not Have the Force of Law Against non-SDs and MSPs.

Section 731 of Dodd-Frank reflects Congress' concern with the anticompetitive effects of certain conduct by swap dealers, creating CEA section 4s(j), which generally prohibits SDs or MSPs from imposing "any material anticompetitive burden on trading or clearing." Section 731 also creates CEA section 4s(i)(2), which provides that "[t]he Commission shall adopt rules governing documentation standards for swap dealers and major swap participants." In proposed rules 23.501(a)(3), 23.502(b), 23.502(b)(4) and 23.502(d)(1), the CFTC has proposed that SDs and MSPs shall "*establish, maintain, and enforce written procedures* " with respect to confirmations, portfolio reconciliation and portfolio compression.

The use of the term "enforce" with respect to SDs and MSPs is contrary to the Dodd-Frank Act. Neither an SD nor an MSP is a "registered entity." See CEA § 1a(40) (defining registered entity to include derivatives clearing organizations, swap execution facilities, designated contract markets and swap data repositories). Only "registered entities" have statutory authority under the CEA to enforce compliance with their rules. Dodd-Frank Act § 725(c) (creating core principle of compliance with rules for derivatives clearing organizations); Dodd-Frank Act § 733 (creating core principle of compliance with rules for swap execution facilities); Dodd-Frank Act § 735(b) (creating core principle of compliance with rules for designated contract markets). *See also* CEA § 6b (providing the Commission authority to impose cease and desist orders and civil penalties for failing to enforce rules of registered entities).

The CFTC has acted accordingly, proposing rules to administer those core principles. See Proposed Rules 17 C.F.R. 38.150-160 (establishing core principle of enforcing compliance with rules for DCMs); Proposed rules 17 C.F.R. 37.200-37.207 (establishing core principle of enforcing compliance with rules for SEFs). Congress elected to require these bodies to act in a self-regulatory capacity but created no analogous requirements for SDs and MSPs.

We respectfully request that the Commission delete the term "*enforce*" wherever it appears in this proposal and clarify in its release accompanying the final regulation that (i) an SD's or MSP's procedures will *not* unilaterally govern if they contradict the terms of its counterparty agreements and (ii) an SD or MSP will not be in violation of the proposed rules if it cannot follow its procedures because a counterparty has not consented to such procedures being applied to it. Without such a clarification, SDs and MSPs may attempt to assert their procedures as having the

force of law over non-SDs and MSPs which would be contrary to Congressional intent and could gravely harm plans by eviscerating protections that plan fiduciaries have negotiated in their swap documentation.

It Is Unnecessary and Detrimental to Impose the Same Confirmation Requirements for Interest Rate Swaps As Those for Credit Default Swaps.

As background for its recommendations, the proposal states that "the industry" has recently made significant changes in how credit default swap (CDS) trade confirmations are processed and that such changes should be imposed now by regulations applying to all swaps. As proof of this change by "the industry", the proposal notes the Federal Reserve Bank of New York's success in achieving electronic confirmation of CDS trades and compressed confirmation times.

The CDS market, however, is not reflective of other much broader swaps markets, such as the interest rate swap market. The CDS swap market is the second smallest market of the total swap market[2] and is primarily dominated by hedge funds, dealers and a few large asset managers. The Federal Reserve Bank of New York's success is more indicative of (1) the CDS market's small size relative to the overall swaps market, (2) the fairly small size of the "industry" for CDS swaps, and (3) the fact that dealers were permitted to require their counterparties to utilize a confirmation system that the dealers already used. These facts do not reflect that the "industry is capable of swift movement." 75 Fed. Reg. 81521.

The interest rate swap market is the largest swap market and plans regularly participate in this market. Standards set by dealers, large asset managers, and hedge funds for CDS trade confirmation should not be imposed on plans. Rather, the CFTC should recognize that interest rate swap market participants come in all sizes, be they plans, companies, municipalities or finance companies. Dealers and large asset managers may be comfortable making significant capital and technological investments to process swap trades given their trading volume and their business models. However, the CFTC should not require that plans, many of which manage a portion of their assets "in-house," be required to make the same capital, operational and technological outlays and human resource commitments as dealers. These outlays are "overkill" and may be prohibitively expensive for plans that may have large notional amounts of swaps, but small trade volumes.

We note that, in certain instances, dealers or service providers may entice plans to utilize certain technology by providing a free service or offering to pay for plans to utilize certain platforms. The fact that plans are not charged, at least for now, does not mean that there are no costs to the plan for such services. In fact, there can be significant costs associated with:

(i) reviewing and negotiating legal documents,

(ii) determining whether a platform is technologically compatible with a plan's current technology or whether other costly changes to the plan's technology platform need to be made to accommodate the service,

---

[2] http://www.bis.org/statistics/otcder/dt1920a.pdf

(iii) integrating such platform with the plan's outside investment managers,

(iv) training personnel, outside managers and third party administrators in the use of the platform, and determining if the platform presents any IT or compliance risk, and

(v) assigning personnel to be responsible for oversight of the service and dealing with the typical "glitches" that accommodate the use of any new technology.

These costs, in addition to the risks inherent in integrating new technology, may well outweigh the benefits of the technology.

Accordingly, we urge the CFTC to ensure that the confirmation and reconciliation regulations do not impose upon plans, directly or indirectly (*i.e.*, via SD or MSP requirements), swap confirmation or reconciliation processes that necessarily require (1) engaging third party service providers, (2) introducing new technology, such as electronic confirmation platforms, and (3) unnecessarily expending dealer-level resources.

Pension Plan Counterparties to SDs and MSPs Should Be Able To Choose Whether to Use Electronic or Non-Electronic forms of Confirmation.

We commend the Commission for recognizing that some swap counterparties use non-electronic forms of confirmation and that such forms may be the most cost-effective and efficient way for a pension plan to confirm its swaps. Nonetheless, we remain concerned that dealer commitments to use electronic confirmation cited by the Commission could result in plans being otherwise required, by SDs or MSPs, to use an electronic confirmation platform. We note that there is only one such electronic confirmation platform service today in the United States. Because dealers are the primary counterparties to buy-side market participants, without a regulation prohibiting dealers from mandating electronic confirmation as a condition to trading with them, the Commission could in effect be mandating electronic confirmation by all market participants with one company.

There are significant implementation requirements and costs associated with electronic confirmation and the movement of a nearly $600 trillion market onto one company's platform. This company's user agreement, with exhibits, is over 1,000 pages long and actual legal expenses to review the user agreement can exceed $50,000 per customer. There are serious questions whether this company currently has the operational and legal bandwidth to accommodate all individual market participants' unique operational requirements/circumstances if electronic confirmation is to be implemented in short order. Of course, if all market participants are forced to use this company's services, market participants may not have any meaningful choice as to contractual terms of usage and the company could insist on market participants adhering to a non-negotiable user agreement. Such a user agreement could have one-sided provisions with respect to fees, indemnifications, and notifications. We believe that a proposal by the CFTC which results, directly or indirectly, in plans being required by SDs or MSPs to use a particular private service provider which has an effective monopoly and would thus have the ability to control applicable user agreement terms is not consistent with the CFTC's mandate to protect the public interest.

We note that the CFTC has received comments from the Department of Justice[3] regarding its concerns about the potential for certain market participants, such as SDs and MSPs, to "limit access and insulate themselves from competition." Unless market participants have the right to determine whether their trades are confirmed electronically or manually, many SDs and MSPs could insist on plans using this one electronic confirmation service provider, effectively "insulating" this service provider from competition. SDs have an incentive to continue to insulate this service provider because they currently use the service provider and some SDs take part, directly or indirectly, in the service provider's governance (which may raise conflict of interest issues).

Dodd-Frank section 731 creates a new CEA section 4s(i)(2), which provides that "[t]he Commission shall adopt rules governing documentation standards for swap dealers and major swap participants." Section 731 also reflects Congress' concern with the anticompetitive effects of certain conduct by swap dealers, creating CEA section 4s(j), which generally prohibits SDs or MSPs from imposing "any material anticompetitive burden on trading or clearing." We strongly urge the CFTC to (1) adopt a rule which would prohibit a dealer from requiring that, in order to trade with the dealer, a counterparty must use a particular confirmation or reporting platform and (2) establish by rule that a party to an uncleared swap that is not an SD or MSP has the right to determine whether the confirmation for that swap will occur electronically or manually if its swap counterparty is an SD or MSP.

The Commission Should Establish by Regulation that All the Terms of A Swap, Except Terms Related to Price, Must Be Disclosed in Writing to an SD's or MSP's Counterparty Prior to Execution.

Plans sometimes have to deal with the very troublesome reality that sales desks of dealers get only the basic economic terms finalized and then leave their back office confirmation group and their legal department to introduce the dealer's "standard terms," which may well not be known to the dealer's customer prior to the trade. This pattern results in delays in confirming trades and circuitous negotiations that may not be finalized before the trade reaches its term or is otherwise terminated. This pattern is not unique to paper confirmations, but can exist in electronic confirmations as well. We request that the Commission require all terms, except terms related to price, be disclosed in writing prior to the time of execution. This requirement will diminish confirmation disputes as to what was agreed to at execution and will make confirmation processes significantly quicker.

Plans' Current Swap Contractual Terms and Their Order of Priority Among the Components of a Swap Agreement Should Not Be Changed as a Result of the Regulation.

The definition of confirmation would require that a confirmation "legally supersede any previous agreement (electronically or otherwise)." Proposed rule 23.500(c). We request that the Commission confirm that this proposed requirement means that a confirmation only supersedes prior agreements outside the scope of the package of documentation that makes up the 'Agreement'

---

[3] http://www.cnbc.com/id/40842246/Justice_Department_Seeks_Tougher_CFTC_and_SEC_Rules

and that this proposed requirement would not mean that a confirmation supersedes terms in the package of documentation that make up the 'Agreement' unless the parties themselves so agree. This is important because some fiduciaries of plans ensure that the terms of a swap are the best terms available from the perspective and interests of the plan participants by having the lead fiduciary centralize the negotiation of the terms of the ISDA Schedule and Paragraph 13 to the ISDA's Credit Support Annex.

Where a lead fiduciary negotiates ISDA documentation on a centralized, relationship basis, there sometimes will be a provision that the ISDA's terms legally supersede the confirmation's terms unless the fiduciary entering into the swap for the plan represents that the terms in the confirmation which are inconsistent with the Schedule or Paragraph 13 are more beneficial to the plan than the terms in the Schedule or Paragraph 13. Lead fiduciaries are able to do this because the master agreement is the same agreement (not a previous agreement) as the rest of the confirmation. The confirmation portion of the Agreement can only legally supersede the master agreement portion of the Agreement if so provided contractually by the parties. The Commission's recognition of this contractual reality in proposed rule 23.500(c) will preserve one means through which fiduciaries have protected plans in negotiating swaps. To find otherwise would interfere with plans' contractual terms. We ask that the CFTC confirm this contractual reality in its final release.

The CFTC's "Same Calendar Day" Confirmation Requirement Would Unduly Hamper Late in the Day Trading and Negatively Affect Plans and Market Liquidity.

Many plans are not constant traders in the swap market and may not have the back-office, operational resources that SDs and MSPs have to turn around swaps documentation in the "same day" timeframes in proposed rule 23.501(a)(3). To require all plans to have such operational capacity would be costly and ultimately would discourage or even stop some plans from using swaps or to limit their trading to earlier parts of the trading day. Consistent with the "policy choice made by Congress in Dodd-Frank to place lesser burdens on non-SD/MSP counterparties,"[4] we request that the Commission revise proposed rule 23.501(a)(3) to either exclude plans from any time limit on confirming swap transactions or provide that plans and other non-SD/MSP counterparties have 24 hours (excluding holidays and weekends) after execution of the swap to confirm a transaction. If the CFTC elects to permit 24 hours for confirmation of trades between SDs/MSPs and plans, the rule should require that an SD or MSP must provide an acknowledgment to the plan at the time of execution and that an SD or MSP should provide a draft acknowledgement to the plan before execution.

The CFTC's Proposed Regulation Regarding "Reconciliation by Qualified Third Parties" Should Allow the Use of a Third Party Only if All Counterparties Agree.

Proposed rule 23.502(b)(1) would require portfolio reconciliation between an SD or MSP and its counterparty by requiring an SD or MSP to agree in writing with each of its counterparties on the terms of the portfolio reconciliation. Under proposed rule 23.502(b)(2), portfolio

[4] 75 Fed. Reg. 76579.

reconciliation could be performed by the counterparties or a "qualified third party." When read together, we are concerned that these two rules may leave ambiguity as to whether both counterparties would have to agree upon a third party before that third party could be used for portfolio reconciliation purposes. We believe that the CFTC should explicitly require that the third party must be selected by agreement of both parties and recognize the distinct possibility that each party may well have its own third party for portfolio reconciliation purposes.

In addition, the CFTC neither defines the term "qualified third party" nor gives it meaningful discussion in the release, except, in the context of confirmations, to note that a number of swaps are processed by third-party "matching" services. We are concerned that the qualification requirement could be interpreted in a manner which would result in plans having to replace their existing service providers or that liability could attach for a determination by a pension plan fiduciary that a service provider is qualified if, later, the service provider is deemed unqualified for some reason. For that reason, we suggest that the CFTC should delete the term "qualified" and allow the counterparties to a trade to determine whether their service providers are qualified.

The CFTC should amend proposed rule 23.502(b)(1) to state:

"Each swap dealer or major swap participant shall agree in writing with each of its counterparties on the terms of the portfolio reconciliation, ***including agreement on the selection of any third party***."

We believe that the CFTC should amend proposed rule 23.502(b)(2) to state:

"The portfolio reconciliation may be performed on a bilateral basis by the counterparties or by ***one or more*** third part***ies selected by the counterparties in accordance with Rule 203.501(b)(1)***."

SDs and MSPs Should be Required to Have Fair, Impartial and Even-Handed Procedures for Reconciling Portfolio Discrepancies.

Proposed rule 23.502(b)(4) only requires that the SDs and MSPs enact procedures regarding resolution of discrepancies; it does not impose any standards on the procedures that SDs and MSPs implement. Accordingly, unless the "written procedures" requirement imposes a standard, SDs and MSPs could design their procedures in a manner that favors themselves. In light of Section 731's goal of limiting anti-competitive burdens on trading, we believe that proposed rule 23.502(b)(4) should be revised to require that the written procedures (1) shall not apply to the extent inconsistent with the terms of an agreement with a counterparty, and (2) must be fair, impartial and even-handed so that plans and other market participants will not be placed at a disadvantage when dealing with SDs and MSPs. In addition, to ensure that these procedures are applied in an impartial manner, we ask that the CFTC provide the SD or MSP's counterparty with the right, in addition to any contractual rights, to designate one or more third parties to resolve any discrepancies and require the SD and MSP to cooperate with such third parties.

Accordingly, we respectfully request the Commission to revise proposed rule 23.502(b)(4) as follows:

> "Each swap dealer or major swap participant shall establish and maintain written procedures reasonably designed to resolve any discrepancies in the material terms or valuation of each swap identified as part of a portfolio reconciliation process in a ***fair, impartial, even-handed and*** timely fashion ***provided that any written procedure that is contrary to the terms of any agreement with a counterparty shall not apply to the portfolio reconciliation of swaps with such counterparty***. ***These procedures must permit the swap dealer or major swap participant's counterparty to, in addition to any contractual rights that it has under the relevant agreement with the swap dealer or major swap participant, designate one or more third parties to resolve any discrepancies and require the swap dealer and major swap participant to cooperate with such third parties.*** A difference between the lower valuation and the higher valuation of less than 10% of the higher valuation need not be deemed a discrepancy."

We thank the CFTC for the opportunity to comment on the proposed rules on the confirmation, portfolio reconciliation and portfolio compression requirements.

American Benefits Council   Committee on Investment of Employee Benefit Assets