February 22, 2011

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

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549–1090

Re: **RIN 3038-AD06 / RIN 3235–AK65 / File No. S7–39–10**

Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" (75 Fed. Reg. 80174, Dec. 21, 2010, hereinafter the "Definitions Proposal")

Dear Mr. Stawick and Ms. Murphy:

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") and the Securities Exchange Commission (the "SEC") (together with the CFTC, the "Commissions") regarding the definitions of swap dealer ("SD"), security-based swap dealer ("SBSD", and together with SDs, "Dealers"), major swap participant ("MSP"), and major security-based swap participant ("MSSP", and together with MSPs, "Major Participants") under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").

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 individually 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.

Swaps and security-based swaps (together "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. If swaps were to become significantly more costly or burdensome to execute to plans, millions of Americans' retirement security could be jeopardized, and funding volatility could increase substantially; this would force companies in the aggregate to reserve billions of additional dollars to satisfy possible funding obligations, most of which may never need to be contributed to the plan because the risks being reserved against may not materialize. Those 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.

<u>ERISA Plans Do Not Impose Systemic Risk And Should Be Exempted From The Major Participant Definitions.</u>

The Major Participant definitions were intended to capture entities that could cause systemic risk if an entity were to declare default and become unable to satisfy its obligations to other market participants. For a variety of reasons detailed in this letter, ERISA plans do not, and cannot, cause systemic risk. In fact, it is hard to contemplate a counterparty that is less of a risk to the financial stability of the United States or any dealer than ERISA plans. ERISA plans have met their swap obligations to dealers despite the bankruptcy of Fortune 500 plan sponsors, the market crash of 2008, and every other significant financial event since the adoption of ERISA in 1974. There are a number of reasons for the uniqueness of ERISA plans. Below are just some of the reasons:

- ERISA plans are required to be prudently diversified. In entering into swaps for plans, ERISA requires that plan fiduciaries act solely in the interest of the plan's participants and beneficiaries and with the care, skill, prudence, and diligence that a prudent person familiar with such matters would use.[1] The "prudent person" standard is the highest standard of care in the American legal system.
- “Investment managers” for ERISA plans are required to be regulated entities (registered investment advisers, banks, or insurance companies) that are (1) subject to the highest standard of care under U.S. law, (2) liable for significant financial penalties for failure to comply with relevant provisions of ERISA, and (3) liable in many instances for the acts of other fiduciaries.[2]
- ERISA plan assets are required to be held in trust for future payment, subject to the oversight of a trustee which is typically a U.S. regulated bank.[3]

[1] ERISA section 404(a)(1)(B).

[2] ERISA sections 3(38) (investment manager requirements), 404(a) (fiduciary standards), 405 (co-fiduciary liability), 409 (fiduciary liability), 502 (ERISA enforcement).

[3] ERISA section 403(a).

- Because of the regulatory structure that applies to ERISA plans, subject to one narrow exception, it would be rare—if it occurs at all—for plans to have material debt.
- ERISA pension plans are subject to stringent funding requirements pursuant to the Pension Protection Act of 2006.
- ERISA plans are financially transparent; they typically have third-party custodians report their net asset value to dealers on a monthly basis and are required by law to report their holdings annually to the Department of Labor.[4]
- ERISA plans are not operating entities subject to business-line risks and competitive challenges.
- There is no provision under any law for ERISA plans to file for bankruptcy or reorganization to avoid their financial obligations to counterparties. Even the filing of bankruptcy by an ERISA plan sponsor or the involuntary termination of the plan does not relieve a plan of its financial obligations to counterparties. In fact, in an involuntary termination, the counterparty has a priority claim with respect to the plan's obligation to it.

The low financial-risk nature of ERISA plans has been reflected in prior CFTC regulations.[5] To date, the CFTC has relied on ERISA's "pervasive" regulation of plans and plan fiduciaries as the reason it does not need to regulate these plans.[6] By posing virtually no risk to the United States financial system, in conjunction with having their investment activities already subject to pervasive regulation, ERISA plans are worthy candidates for an exemption from registration as a Major Participant. We request that the Commissions recognize the unique attributes of ERISA plans and exempt them from all Major Participant requirements.

<u>If ERISA Plans are Not Expressly Excluded From the Definition of Major Participant, Dodd-Frank's ERISA Plan Exclusion in the First Prong of the Definition Should be Expanded to the Second Prong of the Definition</u>.

The first prong of the Major Participant definitions under Dodd-Frank focuses on entities with "substantial positions in swaps" and expressly excludes those "positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of section 3 of [ERISA] for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan."[7]

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4 See Form 5500.

5 See, for example, CFTC Rule 4.5.

6 *See* 50 Fed. Reg.15868, 15869 and 15873 (1985); 58 Fed. Reg. 6371, 6373 (1993).

7 MSP is defined in full (under new Section 1a(33) to the Commodity Exchange Act ("CEA"), as added by Dodd-Frank 721(a)(16)) as follows:

"MAJOR SWAP PARTICIPANT.—
(A) IN GENERAL.—The term 'major swap participant means any person who is not a swap dealer, and—
(i) maintains a substantial position in swaps for any of the major swap categories as determined by the Commission, excluding—
(I) positions held for hedging or mitigating commercial risk; and
(II) positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) for the primary purpose of hedging or mitigating any risk directly associated

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This exclusion from the first prong of the Major Participant definitions, the "substantial position" prong, reflects Congress's recognition of the unique status of ERISA plans as heavily regulated, prudently managed and safe counterparties. The exclusion for ERISA plan's hedging and risk mitigating positions gives recognition to the fact that such swap positions, even if substantial, do not pose systemic risk because such positions necessarily are supported by underlying assets, prudently diversified and managed by "prudent experts" under ERISA.

The second prong of the Major Participant definitions focuses on "substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets." The Commissions propose to use the same formula to measure "substantial position" in the first prong of the definitions and "substantial counterparty exposure" in the second prong of the definitions. Since the main components of the first two prongs of the definitions are being interpreted similarly by the Commissions, we believe it would be logically consistent for the Commissions to similarly extend the ERISA plan exclusion in the first prong of the definitions, for ERISA plan's hedging and mitigation risk swap positions, to the second prong of the definitions.

<u>The Commissions Should Provide Clarity to Dodd-Frank's ERISA Plan Exclusion</u>

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with the operation of the plan;
(ii) whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or
(iii)(I) is a financial entity that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and
(II) maintains a substantial position in outstanding swaps in any major swap category as determined by the Commission."

"(B) DEFINITION OF SUBSTANTIAL POSITION.—For purposes of subparagraph (A), the Commission shall define by rule or regulation the term 'substantial position' at the threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States. In setting the definition under this subparagraph, the Commission shall consider the person's relative position in uncleared as opposed to cleared swaps and may take into consideration the value and quality of collateral held against counterparty exposures.

"(C) SCOPE OF DESIGNATION.—For purposes of subparagraph (A), a person may be designated as a major swap participant for 1 or more categories of swaps without being classified as a major swap participant for all classes of swaps.

"(D) EXCLUSIONS.—The definition under this paragraph shall not include an entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company."

The MSSP definition under new Section 3(a)(67) of the Securities Exchange Act of 1934 ("Exchange Act"), as added by Dodd-Frank Section 761(a)(6), is identical to the MSP definition, except that the MSSP definition relates to ***security-based swaps*** maintained by a person who is not a ***security-based swap dealer*** and does not include the exclusion found in (D) of the MSP definition.

Dodd-Frank Section 721(a)(16), adding new CEA 1a(33)(A)(i)(II); Dodd-Frank Section 761(a)(6), adding new Exchange Act 3(a)(67)(A)(ii)(I).

We respectfully urge the Commissions to address critical ambiguities in this exclusion, as noted below.

"[P]ositions maintained by any employee benefit plan" We believe that the entity that should be "tested" to determine if it is a Major Participant is the counterparty entering into a swap. Thus, if a trust enters into a swap as a counterparty, it is the trust that should be tested as a possible Major Participant. Correspondingly, if a pool within a trust is the counterparty (as discussed in our letter to the CFTC dated February 7, 2011 regarding Unique Counterparty Identifiers, RIN 3038-AD19), it is the pool that should be tested as a possible Major Participant. This approach is simple and conceptually sound, and follows the statutory structure.

Based on this approach, we request that the Commission confirm that the words " positions maintained by any employee benefit plan (or any contract held by such a plan)" mean, as applied to an ERISA plan, positions held by any counterparty that holds assets of an ERISA plan as "plan assets". Thus, if a trust holds ERISA plan assets and it is the counterparty with respect to a swap, such trust is covered by the plan exception in the statute in determining whether that trust is a Major Participant. This would be true without regard to whether the trust or other counterparty also holds non-ERISA plan assets. In this regard, please note that, subject to certain exceptions, a collective investment vehicle will be viewed as holding "plan assets" if (1) the investment vehicle is not a registered investment company, and (2) plans hold at least 25% of the interests in the investment vehicle. See DOL Regulation section 2510.3-101. Also, please note that if such investment vehicles cannot benefit from the plan exclusion, it could have a material effect on their ability to continue to attract needed plan investments and could thus adversely affect an important means for plans to invest.

"[A]ny employee benefit plan as defined in [ERISA Sections 3(3) and 3(32)]" The Commissions in their proposal referenced letters from commenters requesting clarity whether welfare plans and governmental plans are included within this exclusion.[8] The Commissions note that their proposal does not extend the plan exclusion available to "additional types of entities." Dodd-Frank mandates that welfare plans and governmental plans, as well as any other plans that fall within the definition of "employee benefit plan" as defined by ERISA 3(3) or ERISA 3(32) (such as U.S. pension plans maintained by foreign sponsors), be covered by the plan exclusion; these are not additional types of entities. In light of the referenced note by the Commissions, we ask that the Commissions confirm in the final rulemaking that the plan exclusion is available to all plans that fall within the definitions in ERISA 3(3) and ERISA 3(32).

The Commissions requested comment on whether any additional types of entities should receive the plan exclusion.[9] We believe that foreign plans—which are subject to equivalent regulatory oversight in their home countries—should also receive the plan exclusion. Many of our members have foreign affiliates, and foreign plans are maintained for the benefit of those affiliates' employees. If a foreign plan is subject to regulation in its home country and a swap is entered into in the United States on behalf of the foreign plan for the primary purpose of hedging

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[8] *See* Definitions Proposal at 80201, footnote 161.

[9] Definitions Proposal at 80201.

or mitigating any risk associated with the operation of the plan, we ask that the Commissions clarify that such swaps will not be counted towards the plan's substantial position, to the extent that Dodd-Frank applies. We understand that the level of regulation may vary by jurisdiction, but we believe that the Commissions should, at the very least, recognize the comparable regulatory oversight of Canada, the United Kingdom, and EU jurisdictions.

"[F]or the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan" We agree with the Commissions' understanding that the plan exclusion applies to swaps used for various purposes, beyond traditional hedges. By stating in the preamble that "this ERISA plan exclusion, unlike the other exclusion in the first major participant test, is not limited to "commercial" risk, which may be construed to mean that hedging by ERISA plans should be broadly excluded,"[10] the Commissions confirm their understanding that many kinds of activities are covered by the ERISA plan exclusion. Indeed, even swaps positions that serve a purpose other than hedging or mitigating risk can be excluded under the statutory language so long as the "primary purpose" is to hedge or mitigate risk (unlike the commercial risk exclusion which does not include "primary purpose" language.) By specifically mentioning plan swaps strategies that go beyond traditional hedges, such as "portfolio rebalancing and diversification, and gaining exposure to alternative asset classes," the Commissions recognize that risk management strategies that are designed to mitigate broader risk factors (e.g., an adverse move in equity prices) are included in the kinds of activities Congress wanted to be excluded from the Major Participant analysis with respect to ERISA plans. We appreciate the Commissions' understanding that the plan exclusion applies to swaps used for various purposes, beyond traditional hedges. We urge the Commissions to reflect that perspective expressly in the regulations.

Asset Managers Should Not Be Major Participants As a Result of Their Clients' Positions.

We agree with the Commissions that the Major Participant definitions apply to the entities with the counterparty credit risk with respect to those positions and should not "be construed to aggregate the accounts managed by asset managers or investment advisers to determine if the asset manager or investment adviser itself is a major participant."[11] Swap positions entered into by an asset manager or investment adviser acting in its capacity as a plan fiduciary on behalf of the plan are positions of the plan, not positions of the asset manager or investment adviser itself.

We commend the Commissions for this position.

MSP Thresholds Should Be Raised

A major goal in enacting Dodd-Frank was to prevent another financial debacle where the counterparty exposure of a single company could threaten the integrity of the financial system of the United States. That concern coupled with the concern that there may be companies which are not technically "dealers" but still pose systemic risk provided the impetus for creating the

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[11] Definitions Proposal at 80201.

new registrant category of Major Participants. The key example from 2008 which gave rise to Congressional concerns was a company, not viewed at the time as a dealer, that had over $400 billion in notional amount of swaps and defaulted on those obligations when it was required to post approximately $100 billion of collateral that it did not have. We believe this example is illustrative of the type of entities that pose systemic risk but entities that have 1/10th of such company's exposure should not be captured by the Commission's Major Participant numerical thresholds. We note that the Commission has set a very low bar for systemic risk and we believe it should be substantially higher. We do not believe the goal of Dodd-Frank was to protect the swap markets from any default by a counterparty but only defaults of systemically interconnected and risky institutions. The low levels of the proposed thresholds will result in persons who pose no systemic risk being required to incur the substantial costs that Major Participant registration and regulation would cause. We therefore ask the Commissions to raise these thresholds to better target the persons Congress intended to capture when it created the Major Participant definitions.

Plans Are Not In The Business Of Swap Dealing And Should Not Be Swap Dealers.

We are concerned that the definition of a "swap dealer" does not provide enough specificity for a plan or its advisor to determine that it is not a "swap dealer." There should be no question that a plan, whose purpose is to meet its obligations to its retirees and beneficiaries, by its nature does not hold itself out as a swap dealer. We are concerned, however, that ERISA plans (which are statutorily required to employ prudent investment strategies) may, in the absence of additional clarification by the Commissions, be interpreted as "making a market" merely because there could be instances where a plan could be selling and buying certain swap instruments at the same time. For example, a plan may purchase a long position in a swap and seek to reduce the cost of such position by selling an out of the money option on a similar swap. That type of investment strategy is not currently viewed by the industry as "making a market" and would not currently cause an entity to be commonly known in the trade as a dealer or a market maker in swaps. We request that the Commission clarify what it considers to be "making a market" and confirm that investment strategies such as the one described above, by themselves, do not mean that a party "makes a market" in a particular swap.

In any event, plans are covered by the Dodd-Frank exception from the SD definition for "a person that enters into swaps (or SBS) *for such person's own account*, either individually or in a fiduciary capacity, but not as a part of a regular business."[12] The 'regular business' of plans is to provide benefits to the plans' beneficiaries and retirees. We ask that the Commissions confirm in the final release that ERISA plans are not swap dealers.

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We thank the CFTC and the SEC for the opportunity to comment on the proposed rules on the definitions of Dealers and Major Participants.

American Benefits Council Committee on Investment of Employee Benefit Assets

[12] Dodd-Frank section 721(a)(21), adding new CEA section 1a(49)(C).