



August 29, 2011

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: File Number S7-25-11/ Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants with Counterparties

Dear Ms. Murphy:

The American Benefits Council (the "Council") appreciates this opportunity to provide comments to the Securities and Exchange Commission (the "SEC") regarding the proposed rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank" or the "Act") relating to business conduct standards for security-based swap dealers and major security-based 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.

### **SUMMARY**

- **Importance of security-based swaps.** Security-based swaps are an important tool that ERISA<sup>1</sup> plans ("Plans") use to manage asset and liability risk and control funding volatility, thereby protecting participants' benefits and protecting plans and companies from unmanageable fluctuations in funding obligations.
- **Conflict with fiduciary rules.** The Proposed Rules would require security-based swap dealers and major security-based swap dealers ("MSSPs") to provide services, analyses, and other information to ERISA plans that would transform dealers and MSSPs into fiduciaries under current and proposed ERISA regulations. If dealers and MSSPs are fiduciaries under ERISA, security-based swaps with ERISA plans would be prohibited transactions. It is critical that this regulatory conflict be resolved in legally binding guidance on or before the finalization of the Proposed Rules.

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<sup>1</sup> The Employee Retirement Income Security Act of 1974.

- **Advisor status.** The Proposed Rules establish a workable and appropriate framework for determining when a dealer is functioning as an advisor to a special entity.
- **Reviewing the qualifications of plan representatives.** Under the explicit terms of the Act, the rules requiring dealers and MSSPs to review the qualifications of representatives of certain special entities do not apply to Plans. The Proposed Rules should be conformed to the statute in this regard. If such rules are made applicable to Plans, at a minimum, the Proposed Rules should be revised so that dealers and MSSPs are required to rely on written Plan representations regarding the qualifications of Plan representatives, absent actual knowledge that the representations are incorrect. Otherwise, dealers and MSSPs would effectively have veto power over the representatives a Plan selects, which would be very harmful to Plans.
- **Permitting compliance on a master basis.** If each business conduct requirement has to be applied on a security-based swap by security-based swap basis, it would be very difficult, if possible at all, for Plans to enter into time-sensitive security-based swaps. Generally, the business conduct standards should be clarified to permit compliance through upfront master agreements.
- **Use of plan representations.** Representations made to satisfy the business conduct standards should not give any party to a security-based swap any additional rights, such as rescission. For example, neither party should be able to void a security-based swap that has become disadvantageous to it by asserting that a Plan's representative is not qualified.
- **Exemption for Exchange or SB SEF transactions.** Under the Act, the business conduct standards do not apply to security-based swaps that are subject to the rules of an exchange or a security-based swap execution facility ("SB SEF"). The Proposed Rules should be conformed to the statute in this regard.
- **Waiver of business conduct standards.** The ERISA plan sponsor community finds very limited value in the business conduct standards. By law, ERISA plans are already required to be advised by prudent experts with respect to any investment, including security-based swaps; thus, there is no reason that a Plan would need assistance from its counterparty. Moreover, no Plan fiduciary would rely on its counterparty for any type of counsel; in fact, such reliance would be imprudent and thus violate ERISA. Accordingly, the business conduct standards simply present the obstacles, costs, and risks described in this letter. In that context, Plans should be permitted to waive rules that, while intended to protect them, actually provide no such protection.
- **Effective date.** It would be patently unfair, extremely disruptive, and inconsistent with the Act for any business conduct rule to apply to transactions entered into prior to the regulatory effective date.

## **THE IMPORTANCE OF SECURITY-BASED SWAPS TO PLANS**

Security-based swaps play an important role for our members' Plans. If new rules regarding business conduct standards for dealers or MSSPs make it difficult or more expensive to enter into derivative transactions, ERISA plan ("Plan") fiduciaries might then opt to avoid using otherwise prudent security-based swaps, to the detriment of millions of Americans' retirement security.

Plans use swaps and security-based swaps to manage risk resulting from the volatility inherent in the present value of the Plan's liabilities and in the fair market value of the Plan's assets, as well as to manage, and thus reduce reliance on Plan funding from the companies maintaining defined benefit plans. If swaps and security-based swaps were to become materially less available or become significantly more costly to Plans, funding volatility could increase substantially, creating risks for participants (especially in underfunded Plans) and possibly forcing 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.

## **CONFLICT BETWEEN THE PROPOSED BUSINESS CONDUCT STANDARDS AND THE DEPARTMENT OF LABOR'S PROPOSED FIDUCIARY REGULATION**

In our view, proposed business conduct standards require security-based swap dealers and MSSPs to take three actions that likely would, under the Department of Labor's proposed regulation redefining a "fiduciary", convert security-based swap dealers and MSSPs into ERISA fiduciaries with respect to Plan counterparties: (1) the provision of information regarding the risks of the security-based swap, (2) security-based 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 security-based swap. Even under the Department of Labor's ("DOL") current fiduciary regulations, we believe that the third action could convert dealers and MSSPs into ERISA fiduciaries. If the dealer or MSSP is a plan fiduciary, a security-based swap with the plan would be a prohibited transaction and thus illegal. In such a case, all ERISA fiduciaries participating in the prohibited transaction could have liability, and the dealer or MSSP 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, generally, no one would risk them.

In a letter from Phyllis Borzi (Assistant Secretary, Employee Benefits Security Administration) to Gary Gensler (Chairman, Commodity Futures Trading Commission ("CFTC")) dated April 28, 2011, the DOL takes the position that business conduct standards proposed by the CFTC would not convert swap dealers and major swap participants ("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 swap 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 dealers would all be unable to obtain opinions from internal or external counsel that a dealer's compliance with the SEC'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 rules are modified so that this issue is clear, most security-based swaps with Plans will likely cease. We believe that Plans will generally not take a chance that they are entering into prohibited transactions in the face of a DOL 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."

The seller's exception was clearly intended to treat promotional and marketing information as "selling" rather than as advice. This makes perfect sense. The problem is that the type of services required to be provided by a dealer or MSSP under the Proposed Rules—such as security-based swap valuation and review of a Plan's representative—are not promotional or marketing in any sense, and they are not the types of services that are normally provided by a seller "in its capacity as a...seller". Accordingly, to try to fit these required actions into the seller's exception is difficult at best; reliance on the seller's exception without regulatory clarity would be extremely problematic.

In addition, it is not entirely clear on its face that the DOL's proposed exception covers all types of transactions, including bilateral agreements. Also, where a dealer has numerous obligations to provide information, including information about risks and pricing, and an obligation to provide information in a "fair and balanced" manner, dealers and MSSPs 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 security-based swap dealer or MSSP under the SEC's regulation are fundamentally inconsistent with the burden of proof (and *caveat emptor* assumptions) in the currently proposed seller's exception.

Regardless of the agencies' intentions, the DOL's proposed 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 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 dealer or MSP/MSSP a fiduciary" under current law. In addition, we believe it is critical that (1) the preamble to the final business conduct regulations states that the DOL has informed the SEC that such statement will be included in the final DOL fiduciary regulations, effective as of the effective date of the final business conduct standards, and (2) the SEC's regulations themselves make clear that complying with the provisions of the SEC's regulations, by themselves, will not make a dealer a fiduciary, or advisor, to any person. If the agencies do not provide such an Advisory Opinion and do not incorporate these statements into the applicable regulations and preamble, it will severely chill, if not end, the use of security-based swaps by Plans to hedge risk.

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

The Department of Labor has informed the Commission that, in the case of a security-based swap with a plan subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), no action of a security-based swap dealer or major security-based swap participant that is required by reason of these business conduct regulations will make such security-based swap dealer or major security-based 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 security-based swap dealer or major security-based swap participant that is required by reason of these business conduct regulations will make such security-based swap dealer or major security-based swap participant a fiduciary under ERISA with respect to such plan.

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

In short, in order to avoid the very negative consequences to Plans of being unable to use security-based swaps, on or before the finalization of the business conduct standards there needs to be legal clarity that no action required by reason of the business conduct standards will make a security-based swap dealer or an MSSP a fiduciary under current law or under the final version of the DOL's proposed regulation.

### **SAFE HARBORS AND USE OF REPRESENTATIONS TO DETERMINE WHEN A DEALER IS NOT AN ADVISOR TO A SPECIAL ENTITY**

Under Dodd-Frank, if a security-based swap dealer functions as an advisor to a Plan, the security-based swap dealer must act in the best interests of the Plan. We applaud the SEC for a very appropriate and workable approach to determining the circumstances under which a dealer is treated as an advisor to a Plan. Under the SEC's safe harbor proposed as Rule 15Fh-2(a), a security-based swap dealer is not treated as an advisor to a special entity if (1) the special entity represents in writing that the special entity will not rely on the dealer's recommendations and will rely on advice from a qualified independent representative, (2) the dealer has a reasonable basis to believe that the special entity is advised by a qualified independent representative, and (3) the dealer discloses to the special entity that it is not undertaking to act in the best interests of the special entity.

We believe that the proposed safe harbor is eminently sensible and is consistent with how most special entities structure their advisory relationships. Most special entities do not have two advisors advising them on the same security-based swap transaction, and they definitely do not rely on dealers for advice or recommendations. It would be strikingly imprudent to do so in light of the fact that the dealers are their counterparties. In fact, it would be a violation of ERISA's prudence rules for a plan to rely on its counterparty for advice given that the dealer counterparty has a conflict of interest in that it is seeking to make a profit from trades with the special entity and cannot reasonably be expected to be considering only the interests of the special entity. Section 404(a)(1)(B) of ERISA requires a plan fiduciary to act with the "care, skill, prudence, and diligence" of a prudent expert; reliance on a counterparty for advice would seem to be a *per se* violation of such requirement. What prudent expert would rely on its counterparty for any material advice with respect to a contemplated transaction?

In short, we strongly support the structure of proposed safe harbor. However, we are concerned that clause (2) of the safe harbor—requiring a dealer to have a reasonable basis to believe that the special entity is being advised by a qualified independent representative—implies that the dealer's opinion of a Plan's representative could "trump" the opinion of the fiduciary to a Plan which selected the Plan's representative. We are also concerned that this language could also be utilized by the Plan's dealer counterparty to gain access to confidential information regarding the Plan or its representative.

It is essential that a Plan's dealer counterparty not have veto power over the Plan's representative; allowing a counterparty to indirectly choose a Plan's representative is inherently harmful to Plans. This veto power could also render unavailable the QPAM exemption, which is necessary to allow security-based swaps to proceed. In addition, this veto power could very well make Plan representatives hesitant to vigilantly represent the Plan's interests for fear of a future

dealer veto, which would likely put the representative out of business. We fail to see how this is consistent with the clear intent under the Act to protect Plans.

In addition, dealers may otherwise refuse to face the risks associated with determining the capability of a representative, and thus cease trading with Plans. Dealers would face potential litigation risk if they approved a representative who is subsequently determined to be lacking needed expertise, even if such lack of capability had no effect on the transaction. In addition, dealers would be subject to litigation from representatives whom they have chosen to disqualify.

The SEC has indicated that it might address these concerns by adopting a system that would permit a dealer counterparty to a special entity "to rely on [representations regarding the qualifications of the special entity's representative] without further inquiry, absent special circumstances." Proposed Rules at 42, 428. However, to ensure that this approach would protect Plans and would not give Plans' dealer counterparties discretion over which qualified representative a Plan selects, we urge the SEC to adopt its proposed definition of "special circumstances" as occurring when the dealer or MSSP "knows that the representation is not accurate." See Proposed Rules at 42,425 and 42,428. Absent actual knowledge that a representation is incorrect, dealers should have no ability to second-guess a Plan's selection of a representative or to make inquiries in that regard. Otherwise, dealers could have veto rights over a Plan's representative and/or gain confidential information regarding a Plan's representative to the detriment of such representative and/or the Plan.

As discussed more globally later in this letter, we also believe that it is impractical for a special entity or dealer to have to provide representations on a transaction by transaction basis. Such a requirement could result in Plans being unable to execute important and timely investment decisions during volatile market conditions while dealer's counsel reviews the representations provided by the Plan. Accordingly, we recommend that the SEC allow dealers and special entities to make the representations necessary to qualify for the safe harbor on an upfront basis (as explained further later in this letter).

With respect to the suitability requirements in Proposed Rule 15Fh-3(f)(1) that would generally require that recommendations made by a dealer to its counterparty be suitable for the counterparty, we strongly support the safe harbor in Proposed Rule 15Fh-3(f)(3). Proposed Rule 15Fh-3(f)(3) correctly acknowledges that a dealer would already satisfy the suitability requirements in Proposed Rule 15Fh-3(f)(1) if the dealer is deemed not to be an advisor pursuant to Proposed Rule 15Fh-2(a).

As noted above, subject to the clarifications described above, we support the SEC's proposed framework for determining when a dealer acts as an advisor to a special entity. We want to emphasize how critical it is that the SEC maintain its approach to this issue. This emphasis is important in light of the very problematic approach taken by the CFTC.

The CFTC's 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 revisions by the CFTC that clarify this issue, we are concerned that virtually all swaps with Plans (as well as other special entities) would likely have to stop, due to this conflict.

Notwithstanding genuine attempts by the DOL in its April 28 letter to harmonize the CFTC's approach with ERISA, the CFTC's approach 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 SEC's basic approach is sound. If a dealer informs a special entity that it is not acting in the best interests of the special entity, and the special entity is relying on a qualified independent representative, it is eminently clear that the dealer is not advising the special entity. This is especially true in the context of Plans where reliance on a counterparty for advice would be imprudent and thus a violation of ERISA section 404(a)(1)(B).

### **THE QUALIFICATIONS OF PLAN REPRESENTATIVES**

The Act added a new section 15F(h)(5) to the Securities Exchange Act of 1934 (the "1934 Act"), which sets forth certain business conduct standards that the SEC may impose on security-based swap dealers and MSSPs that offer to enter into or enter into a security-based swap with a special entity ("Counterparty Business Conduct Standards"). We offer the following comments on the Proposed Rules implementing that provision.

#### **The Counterparty Business Conduct Standards should not apply to ERISA Plans.**

The Act provides that security-based swap dealers and MSSPs must comply with the Counterparty Business Conduct Standards with respect to "a counterparty that is an eligible contract participant within the meaning of subclause (I) or (II) of clause (vii) of section 1a(18) of [the Commodity Exchange] Act." Dodd-Frank 764(a), adding Securities Exchange Act of 1934 ("1934 Act") §15F(h)(5)(A). Therefore, the Counterparty Business Conduct Standards only apply to a counterparty that is:

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

(II) A multinational or supranational government entity.

Since Plans do not fall within either (I) or (II) above, security-based swap dealers and MSSPs should not need to comply with the Counterparty Business Conduct Standards when entering into trades with Plans. We strongly object to the recharacterization of the statutory requirements of section 15F(h)(5)(A). The language of the Act clearly provides that the Counterparty Business Conduct Standards apply only to certain governmental special entities. By applying the Counterparty Business Conduct Standards to all special entities, the SEC has

extended its regulatory reach significantly beyond the scope of the statute. In addition, the statutory exclusion of Plans from the Counterparty Business Conduct Standards is a proper policy outcome since Plans already have similar or greater protections under ERISA with respect to each of the requirements.

Section 15F(h)(5)(A) of the 1934 Act sets forth seven Counterparty Business Conduct Standards. The seventh of these standards explicitly applies to Plans. As discussed more extensively in the Council's September 8 letter to the SEC (and the CFTC), we believe that it is entirely consistent with the statute to require Plans to be subject to subclause (VII), but not the other subclauses, of section 15F(h)(5)(A).

In addition, to impose the Counterparty Business Conduct Standards on Plans, which are heavily regulated by ERISA with respect to the same issues, would create exactly the type of "redundant" and "overlapping" regulations that the President intended to prevent through his Executive Order issued earlier this year. At a minimum, the Counterparty Business Conduct Standards should not apply to a Plan that has an advisor with respect to its security-based swaps that is sufficiently regulated, as noted above, such as a bank, an SEC-registered investment advisor, an insurance company, a registered municipal advisor, or a similarly qualified advisor (such as a QPAM, INHAM, or other ERISA service provider).

In short, to comply with the statute as written, the Proposed Rules need to be modified to exclude Plans, at a minimum, from the first six of the new Counterparty Business Conduct Standards. This would require a Plan to provide a dealer a single representation with respect to Rule 15Fh-5(a): "The Plan's representative is a fiduciary as defined in section 3 of ERISA."

**If the Counterparty Business Conduct Standards apply to Plans, Representations Alone Must be Sufficient to Satisfy such Standards.**

If the SEC retains its current position that, contrary to the statute, all of the Counterparty Business Conduct Standards apply to Plans, it is even more critical that the SEC adopt in its final rules a rule providing that a dealer has a reasonable basis to believe that a Plan's representative is a qualified independent representative upon receiving written representations to that effect, absent actual knowledge to the contrary. These representations must be able to be made once, at the beginning of a trading relationship between a Plan and a security-based swap dealer or MSSP or, if later, the beginning of a representative's relationship with a Plan. Plans that invest funds for tens of thousands of participants enter into a large number of derivative transactions and it would be inefficient to require their counterparties to conduct a new review of a Plan's representative each time a new transaction was proposed. In fact, as discussed further below, requiring a separate inquiry with respect to each security-based swap would cripple Plans' ability to implement the time-sensitive security-based swaps that are needed to effectively hedge their risks. This rule would apply continuously, not just at the commencement of the relationship.

If the dealer or MSSP counterparty has no actual knowledge that any of the following representations is incorrect and has not received a notification that any of the representations has changed, and discloses to its Plan counterparty the capacity in which it is acting, receipt of representations from a Plan fiduciary (which may be the Plan representative) should be

sufficient. Dealers and MSSPs should have no duty to investigate the accuracy of any representation; such a duty would simply create the types of severe problems described above. In these circumstances, the following representations should be sufficient with respect to a Plan.

- The representative of the Plan:
  - Has the knowledge required by ERISA to evaluate security-based swap transactions and risks;
  - Is not subject to a statutory disqualification under ERISA, the Commodity Exchange Act, or the Securities Exchange Act of 1934 (the “1934 Act”), to the extent applicable;
  - Does not have a relationship with the dealer or MSSP that would give rise to a prohibited transaction under ERISA with respect to the security-based swap;
  - Shall undertake to act in the best interests of the Plan as required by ERISA;
  - Shall provide all disclosures that are appropriate under ERISA;
  - Shall review the price and appropriateness of each security-based swap pursuant to the investment guidelines established by the Plan in accordance with ERISA; and
  - Is a fiduciary under ERISA with respect to each security-based swap for which it provides advisory services to the Plan; and
- The Plan fiduciary shall notify the dealer or MSSP if any of the above has changed.

As discussed further below, we note that with respect to the representation above regarding the pricing and appropriateness of the security-based swap, this representation would be consistent with the Council's September 8 letter to the SEC which is cited in the Proposed Rules at 42431, note 241. We greatly appreciate this preliminary confirmation for that particular representation; confirmation with respect to all of the above representations in the SEC's final rules would provide much needed comfort to Plans.

#### **PRESUMPTION OF QUALIFICATION OF INDEPENDENT REPRESENTATIVES**

The SEC has requested comment on whether an independent representative should be deemed “qualified” if it is “a sophisticated, professional adviser such as a bank, Commission-registered investment adviser, insurance company or other qualifying [Qualified Professional Asset Manager (“QPAM”)] or INHAM for Special Entities subject to ERISA, a registered municipal advisor, or a similar qualified professional.” We believe that the SEC should adopt this presumption.

#### **DISCLOSURES TO BE MADE REGARDING A SECURITY-BASED SWAP SHOULD BE STREAMLINED**

In the preamble, the SEC raises the possibility of allowing parties to make certain required disclosures (which would be required to be made before the security-based swap is entered into) on an omnibus basis for multiple security-based swaps through master agreements.

See preamble to the Proposed Rules at 42,406. It is critical that the Proposed Rules permit all business conduct requirements to be satisfied upfront at the beginning of a trading relationship between a Plan and a security-based swap dealer or MSSP, and/or (2) to permit a Plan to waive application of the business conduct standards, as discussed below. The business conduct standards were intended to protect Plans. It would be sadly ironic if a Plan were exposed to far greater risk by reason of being unable to hedge its risks effectively because of the time-consuming nature of the business conduct requirements.

There is simply no time for all of the extensive business conduct disclosures to be made on a transaction-by-transaction basis. If a security-based swap needs to be executed by the end of the day to protect a Plan from a material risk, there is no time to or need for the dealer or MSSP to provide information regarding, for example:

- The material characteristics and risks of the security-based swap;
- The dealer or MSSP's material incentives or conflicts of interest; or
- The Plan's clearing rights.

There is also no time to or need for the dealer or MSSP to disclose to a Plan counterparty the capacity in which it is entering into a security-based swap (which would be generally required by Proposed Rule 15Fh-5(b)).

## **CAPACITY DISCLOSURES**

With respect to the requirement that the dealer or MSSP disclose the capacity in which it is entering into a security-based swap, we urge the SEC to (1) remove the disclosure requirement regarding a dealer's business dealings with a Plan other than with respect to security-based swaps and (2) clarify that the disclosure about the dealer's capacity with respect to security-based swaps can be made on an "omnibus" basis for multiple swaps on an annual basis.

**Capacity.** Nearly all security-based swaps are executed under ISDA Swap Agreements which contain representations and covenants. We urge the SEC to allow dealers and MSSPs to represent the capacity in which they are acting with respect to the Plan for security-based swaps in a Schedule or other amendment to an ISDA Master Agreement, other transactional document, or in an annual disclosure document provided by the dealer or MSSP to the special entity, which could be changed with respect to an individual security-based swap if a dealer or MSSP were to act in a different capacity. As Plans generally deal with dealers and MSSPs in the same capacity (as counterparties), we believe that this would be an effective and non-burdensome way to make such representations.

The Proposed Rules require the "capacity disclosure" to occur prior to "the initiation of a security-based swap". We are not sure what that means. We believe that requiring inclusion in a Schedule or other amendment to an ISDA Master Agreement, other transactional document, or in an annual disclosure document provided by the dealer or MSSP to the special entity prior to "execution" of the security-based swap that is not executed on an exchange or SB SEF would clarify the SEC's intent and would achieve the purpose of the statute very effectively.

**Other relationships.** Although we have no objection to a dealer or MSSP disclosing the capacity in which it is or will be entering into security-based swaps, we do not believe it is helpful, and in fact may be harmful to a special entity, to require a dealer or MSSP to disclose how such capacity is different from other capacities in which the dealer or MSSP has acted with respect to such special entity. Many dealers with which Plans trade have global operations with myriad lines of business (e.g., custodian, transfer agent, administrator, securities lending agent, underwriter, prime broker, transition manager, investment manager, futures commission merchant, etc.). Requiring dealers to list all such relationships, and for the Plan to review such disclosures, would be a very significant administrative burden. We are doubtful that a global dealer with diverse operations could, without incurring significant costs, keep track of every business connection with a Plan, particularly where the Plan has multiple investment managers and service providers which may also have contacts with the dealer related to the Plan. The costs of such “relationship” disclosure compliance will likely be passed on to special entities. In addition, since such relationships are often completely independent of a security-based swap transaction, this information would not be meaningful to the Plan, especially in a context where the dealer is clearly acting as a counterparty (and has already represented so, as per the above paragraph). Finally, such disclosures could delay trades by a special entity which in turbulent times, like the present, could be critical to the financial well being of a Plan.

**DEALERS AND MSSPs (1) SHOULD BE REQUIRED TO RELY ON REPRESENTATIONS OF A SPECIAL ENTITY OR ITS REPRESENTATIVE ABSENT ACTUAL KNOWLEDGE TO THE CONTRARY AND (2) SHOULD NOT BE PERMITTED TO USE REPRESENTATIONS AGAINST THE PLAN OR ITS REPRESENTATIVE**

The SEC has sought comment on alternative standards for when it would be appropriate for a dealer or MSSP to rely on representations. As discussed above, we believe that a dealer or MSSP should be **required** to rely on representations from a special entity or its representative unless it has actual knowledge that such representations are not accurate. Otherwise, a provision of Dodd-Frank which was clearly intended to protect special entities could enable dealers or MSSPs to gain information regarding a special entity or its investment advisers to the special entity’s detriment.

We further urge the SEC to state explicitly that any representations provided by a Plan or its representative made to satisfy the Counterparty Business Conduct Standards do not give any party any additional rights, such as rescission or monetary compensation. For example, if, due to changing economic conditions, a security-based swap between a dealer and a Plan has become very disadvantageous for the dealer, the dealer should not be able to void the security-based swap, or make any other type of claim against the Plan or its representative, by asserting that one or more of the representations made by the Plan or its representative were incorrect. The Counterparty Business Conduct Standards, which were meant to protect Plans and other special entities, should not be turned into a weapon that can be used against Plans or their representatives.

This approach would be consistent with other regulations. For instance under Rule 144A, if the certification as to a party's QIB status is reasonably obtained, the recipient of the

certification may treat its counterparty as a QIB. A subsequent determination that the certification was wrong will not retroactively void the QIB institution status of the counterparty. We urge the SEC to establish a similar standard for representations by Plans.

### **KNOW YOUR COUNTERPARTY RULE**

Under the “know your counterparty” rule in section 240.15Fh-3(e), a security-based swap dealer or MSSP must “establish, maintain and *enforce* policies and procedures reasonably designed to obtain and retain a record of the essential facts concerning a counterparty . . . .” (emphasis added). Such essential facts include “facts required to comply with applicable laws, regulations, and rules” and, “if the counterparty is a special entity, such background information regarding the independent representative as the security-based swap dealer reasonably deems appropriate.”

We are concerned about this rule for three reasons. First, we are very troubled by the word “enforce”. This suggests that the regulations are empowering dealers to adopt rules that have the force of law with respect to their counterparties, which cannot be the case.

Second, even if the policies do not have the force of law, if a dealer adopts pro-dealer policies, dealers should not be able to point to the Proposed Rules in resisting any deviations from such policies requested by their counterparties. Dealers should be required to adopt policies designed to comply with the law. Such policies should not be binding in any way to the extent that they require more than the law requires.

Third, we see no purpose for paragraphs (2) – (4) of the “know your counterparty” rule. Shouldn’t it be enough that the dealer obtain facts necessary to comply with the law? Paragraph (4) is especially troubling, which seems to give dealers unlimited discretion to collect information about the representatives of special entities. As noted above, dealers should not be able to veto Plans’ representatives; thus, dealers should have no reason to have to collect information with respect to such representatives. Moreover, Plan representatives may, for example, have trading policies and proprietary information that, if disclosed, would give dealers an inappropriate competitive advantage.

### **DEFINITION OF INDEPENDENT REPRESENTATIVE**

Under the regulation, the SEC requires that a special entity be represented by an entity that is “independent” of the swap dealer for a particular swap transaction. Under the SEC’s proposed safe harbor, a representative shall be deemed “independent” if:

- (1) The representative is not and, within one year, was not an associated person of the security-based swap dealer or major security-based swap participant; and
- (2) The representative has not received more than ten percent of its gross revenues over the past year, directly or indirectly from the security-based swap dealer or major security-based swap participant.

In the case of Plans (i.e., plans subject to ERISA), we see no need for a new definition of independence. If a Plan's representative is not independent of the Plan's counterparty, the transaction violates the prohibited transaction rules under ERISA section 406(b). Plans do not need or want overlapping regulation not fine-tuned to their needs.

The Proposed Rules raise concerns that would be avoided by a simple cross reference to ERISA. For example, investment management companies, like other businesses, can be subject to acquisitions and spin-outs. If an investment management company owned by or affiliated with a dealer is sold, then such investment management company should be deemed to be "independent" of such dealer even though it had been owned by the bank within the prior year.

In addition, Plans could lose access to some of the best investment managers for security-based swaps and some of the best counterparties as a result of the regulation restricting investment managers from serving as a qualified independent representative to a special entity if they receive certain revenues, even if indirectly, from dealers or MSSPs. For example, the proposal raises practical difficulties for any investment manager which manages mutual funds. Managers are paid based on assets under management and it is very common for banks to underwrite and/or distribute shares of mutual funds. Because the assets that will go into a mutual fund come from the sale of fund shares, virtually every fund manager which has its funds distributed by a bank, which also has a swap unit, could be deemed to be receiving revenues indirectly from such bank. The result would be that such investment managers could not serve as qualified independent representatives for swap trades with certain banks.<sup>2</sup> Given the consolidation of the industry since the financial crisis of 2008, special entities have fewer counterparties to trade with than before 2008. The loss of even just one major bank as a counterparty could have a serious impact on the availability or cost of certain security-based swaps for special entities.

Also, the administrative burden of applying the gross revenue test could in many cases be enormous at best and simply unworkable at worst. As noted above with respect to "capacity disclosures", many dealers have global operations with myriad lines of business. Determining all relationships between all such global lines of businesses and all operations of a national or international entity serving as a Plan's representative could be a staggering task at best in many cases.

In the case of Plans, the concerns that lie behind the proposed revenue restriction, e.g., that the investment manager will not forcefully negotiate the best terms for the special entity, are dealt with under ERISA, which has prohibitions on conflicts of interests.

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<sup>2</sup> Investment managers which utilize security-based swaps for special entities may face the choice of continuing the distribution of their mutual funds by particular banks (given that more than one bank may distribute a fund's shares) or managing the assets of a special entity. It is likely that certain investment managers will refuse to manage special entity assets, if they involve security-based swaps, rather than lose critical fund distributors.

## **DISCLOSURES BY QUALIFIED INDEPENDENT REPRESENTATIVES TO SPECIAL ENTITIES REGARDING SECURITY-BASED SWAPS**

The SEC has proposed that dealers and MSSPs must have a reasonable belief that a special entity's representative will make "*appropriate* and *timely* disclosures to the special entity of *material information* concerning the security-based swap". As discussed above, in the case of Plans, we believe that the determination of whether disclosure by a qualified independent representative to a special entity is "appropriate" and "timely" should be made by reference to ERISA.

Security-based swaps can be a significant part of a Plan portfolio managed by a qualified independent representative or security-based swaps can be a relatively small holding in a portfolio comprised of primarily non-security-based swap instruments. Security-based swaps are typically not the most material investment in a Plan portfolio. Accordingly, it would be expected that if security-based swaps were a small, less risky portion of a portfolio managed by a qualified independent representative, such qualified independent representative would, consistent with ERISA, provide very general disclosure to a Plan regarding such positions (as it would for any other immaterial non-swap position) unless otherwise requested by the special entity, and that would be "appropriate".

Conversely, if security-based swaps were a significant part of a portfolio when a qualified independent representative was providing a portfolio review, it would be reasonable to expect a more fulsome discussion of the investment results of such instruments with the Plan; but the level of detail should be dictated by the type of cost/benefit analysis required by ERISA. It would be inappropriate and inconsistent with ERISA for the SEC to require excessive and costly disclosure, the benefit of which is outweighed by the cost. On the contrary, in the case of Plans, as noted above, disclosures should be governed by ERISA. Accordingly, a representation that a representative will make disclosures in accordance with ERISA should be sufficient.

If the SEC does not choose to have the disclosure regime governed by ERISA (which we strongly believe should be the standard for Plan disclosure), we would request that the SEC clarify that the following representations shall satisfy the Proposed Rules: representations that (1) the representative shall provide the special entity with such information, at such times, as the special entity may reasonably request regarding any swap trade (either individually or in the aggregate) entered into by such representative on behalf of the special entity and (2) in the absence of specific instruction to the contrary by the special entity regarding swap trade disclosure, the representative shall comply with the disclosure requirements imposed on the representative under other applicable law (e.g., ERISA) and by the special entity under the special entity's investment management agreement and investment guidelines. Providing the special entity with the ability to tailor the type of swap information that it wants from the qualified independent representative is consistent with giving an investor the information that it would consider "material" to its investment decisions and provides clarity to the term "appropriate disclosure" in the regulation.

## **FAIR PRICING AND APPROPRIATENESS OF A TRANSACTION**

A dealer or MSSP must have a reasonable basis to believe that a special entity's representative will provide written representations to the special entity regarding fair pricing and appropriateness of the transaction. As cited favorably in the preamble to the Proposed Rules, we believe it "should be sufficient if the representation states that the representative is obligated, by law and/or contract, to review pricing and appropriateness with respect to any swap transaction in which the representative serves as such with respect to the plan." See our September 8, 2010 letter to the SEC cited in footnote 241 of the preamble to the Proposed Rules. We urge the SEC to incorporate this approach into the Proposed Rules.

## **SPECIAL ENTITIES**

We urge the SEC to clarify that the definition of "special entity" does not include collective investment vehicles in which Plans invest and that collective investment vehicles would not become special entities as a result of investment by special entities in such vehicles. Examples of such vehicles include bank collective trust funds that consist of assets of unrelated Plans<sup>3</sup> and investment funds that are more than 25% held by ERISA plans and thus subject to ERISA.<sup>4</sup> If the SEC does not clarify that collective investment vehicles are not special entities, it would create significant confusion in the market. Dealers and MSSPs could not be certain if their counterparties require the same protections as special entities. In addition, dealers and MSSPs would have to conduct thorough analyses of counterparties to determine if they contained any special entity assets (no matter how minor), as they would otherwise be at risk of violating the business conduct rules. It would go against the statutory intent to regulate a collective investment vehicle as a special entity merely because certain of its participants are special entities, even in the case of a collective investment vehicle containing all special entity assets but of special entities with different investment objectives or policies (even if affiliated).

Certain provisions of the business conduct standards would not make sense if the SEC were to adopt such an overly broad definition of a special entity. For example, the requirement that a dealer determine that a special entity is represented by a qualified independent representative that has agreed to act in the best interests of the special entity would not make sense in the context of an investment manager for a collective investment vehicle containing multiple investors. The investment manager's duties are to the collective investment vehicle as a whole and not to an individual investor in the vehicle merely because it is a special entity. If there were more than one special entity in a collective investment vehicle, the fund manager may find itself unable to act "in the best interest" of a particular special entity if any other special entity's interests in the collective investment vehicle were different from such special entity. Therefore, we urge the SEC to provide clarity to the markets and adopt a standard which

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<sup>3</sup> See, e.g., Section 3(c)(11) of the Investment Company Act of 1940; Section 3(a)(2) of the Securities Act of 1933; and CFTC Regulation 4.5 (each providing applicable exclusions for bank collective trust funds).

<sup>4</sup> See ERISA "Plan asset regulation"; 29 CFR § 2510.3-101.

excludes collective investment vehicles in any form (e.g., trusts, mutual funds, etc.) from the definition of special entity.

We also do not believe that Congress intended to provide special protection for foreign pension plans under Dodd-Frank. Accordingly, we would request that the Commission clarify that non-U.S. entities will not be deemed to be special entities.

### **EXEMPTIONS FOR ALL EXCHANGE-TRADED AND SB SEF SECURITY-BASED SWAPS**

Congress provided an exemption from the business conduct standards added by Dodd-Frank as Section 15F(h) of the 1934 Act. This exemption called "Applicability" states in its entirety that "[t]his *subsection* shall not apply with respect to a transaction that is (A) initiated by a special entity on an exchange or security-based swap execution facility; and (B) one in which the security-based swap dealer or major security-based swap participant does not know the identity of the counterparty to the transaction." New 1934 Act section 15F(h)(7). By "[t]his subsection," Congress was referring to all of the business conduct standards in subsection (h) of section 15F. In other words, Congress intended the exemption in new 1934 Act section 15F(h)(7) to apply to the entirety of both the business conduct standards under new 1934 section 15F(h) and any rules the SEC adopts to implement these business conduct standards. A more narrow reading of "[t]his section" to mean the exemption provision under section 15F(h)(7) would render this provision meaningless as the *only* words appearing in the entirety of section 15F(h)(7) are included above.

The SEC's proposed business conduct rules restate the statutory exemption in new 1934 Act section 15F(h)(7) three times, once in the proposed rules addressing dealers acting as advisors to special entities (section 240.15Fh-4), a second time in the proposed rules addressing Special Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants Acting as Counterparties to Special Entities (section 240.15F-5), and a third time in the proposed rules addressing political contributions by certain security-based swap dealers with respect to security-based swaps entered into with municipalities (section 240.15Fh-6(b)). This could be read to mean that the SEC intends for the exemption to only apply with respect to these three rules. This would mean that the SEC 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 SB SEF; and (B) one in which the dealer or MSSP does not know the identity of the counterparty to the transaction, even though these transactions are clearly exempted from the 1934 Act's business conduct standards under new 1934 Act section 15F(h)(7).

The essence of the statutory exemption is that the business conduct standards should apply only when transactions are not entered into on an exchange or SB SEF, 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; security-based swaps initiated by a special entity on a SB SEF or exchange even if not blind should be excluded from the business conduct rules.) Trades on SB SEFs using RFQ systems are not blind, but could include both clearable and uncleared security-based swaps that will be entered into subject to the SB SEF's trading protocols. Especially in light of

the ongoing deliberations on whether SB SEFs should include RFQ platforms and what kind of RFQs should be allowed, Congress should not be understood to have intended that the SEC would limit the reach of the exemption to only some trades conducted subject to the rules of an exchange or SB SEF. The business conduct rules make sense only when applied to privately-negotiated, bi-lateral transactions that are not subject to exchange or SB SEF rules.

The SEC should therefore clarify that its business conduct standard rules will not apply to any security-based swap transaction that is entered into by a special entity on a DCM or SEF by adopting the following rule. The language below would resolve the statutory ambiguities in new 1934 Act section 15F(h).

Securities and Exchange Act of 1934 section 15F(h) and the provisions in sections 240.15Fh- through 240.15fh-6 and section 240.15Fk-1 shall not apply to any security-based swap transaction that is:

- (i) entered into by a special entity on, or subject to the rules of, a designated contract market; or
- (ii) entered into by a special entity on, or subject to the rules of, a registered security-based swap execution facility.

## **WAIVER OF BUSINESS CONDUCT STANDARDS**

Plans are required by law to have their own prudent experts advising them with respect to all investments, including security-based swaps. We believe that if, consistent with its duties under ERISA, a fiduciary to a Plan believes that it is in the best interests of such Plan to opt out of certain dealer business conduct standard protections, the SEC should permit such opt out. Congress clearly intended to protect special entities. It would, in our view, be consistent with Congressional intent to permit a special entity to opt out of a business conduct duty imposed on a dealer or MSSP, particularly when a Plan fiduciary believes that a business conduct standard “protection” could be utilized or applied in a manner which actually harms the special entity. For example, if a dealer utilizes the business conduct standards to seek information about the special entity which would give the dealer a trading advantage over the special entity or its investment managers, then it is understandable that a fiduciary to the special entity would want the ability to inform the dealer that it is “opting out” of the particular business conduct standard provision which gave rise to the potentially harmful information request. We urge the SEC to permit Plans to waive application of the business conduct standards with a dealer or MSSP.

## **EFFECTIVE DATE**

We strongly support the SEC's statement that the proposed business conduct rules would not apply to security-based swaps entered into prior to the compliance date of these rules. *See* Proposed Rules at 42,401. None of the business conduct standards should apply to any transaction entered into prior to the regulatory effective date or any amendment or novation of

such transaction. We see the potential for serious harm to Plans if this were not the case. For example, if a plan had an pre-existing security-based swap trade that the Plan fiduciary desired to amend to adopt a particular ISDA protocol or other term which is in the best interest of the Plan, a dealer may refuse to accommodate such request because it may give rise to duties that the dealer could have not contemplated at the time of the original trade. The Plan as well could not have envisioned at the time of the original trade that the trade could never be amended at a future date because of new duties imposed upon its counterparty. It would be patently unfair, extremely disruptive, and inconsistent with the Act for any business conduct rule to be applied to a transaction that was negotiated and executed based on the law in effect at the time of execution or any amendment or novation of such transaction.

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It is critical that Plans continue to be able to use security-based swaps to provide retirement security and health benefits to millions of Americans across the country. Plans are unique, heavily regulated entities that are required by law to act prudently in the sole interest of Plan participants and that do not need extra layers of unnecessary requirements that would adversely affect participants. It is critical that the new law not be interpreted in such a way as to eliminate important tools that Plans now use to obtain mitigate risks with respect to their Plan assets and liabilities.

We thank the SEC for the opportunity to comment on the Proposed Rules.

American Benefits Council