From: Kent A. Mason [redacted]
Sent: Tuesday, May 03, 2011 6:56 PM
Cc: Lynn Dudley; Diann Howland
Subject: DOL letter on swaps

We reviewed the letter that the Department of Labor sent to the CFTC last week regarding the interaction of the proposed fiduciary definition with the proposed business conduct standards. First, we want to thank you for your continued hard work on this critical issue. We know that all of you are pulled in many different directions, and your continued attention to this issue and your dedication to addressing it are very much appreciated. In that regard, we have been asked if the letter addresses our concerns. Unfortunately, it does not. The e-mail below will be sent to the Hill, but we wanted you and the DOL to see it before it is sent. The e-mail explains our concerns, which we hope we can discuss with you. Since all comment periods have been reopened, would it be possible to meet again on the business conduct standards? We have a number of large companies that are very concerned about this issue and have been expressing concerns on the Hill. It would be great if we could bring them in to meet with you. Thanks. Kent

Attached is a letter that the Department of Labor ("DOL") sent to the Commodity Futures Trading Commission ("CFTC") last week addressing the interaction between the DOL's proposed fiduciary regulation and the CFTC's proposed business conduct standards. The American Benefits Council very much appreciates the time that both agencies have devoted to this critical issue, as well as their openness to our concerns. The DOL's letter is yet another indication that the agencies are willing to engage in a dialogue to ensure that the rules are structured correctly.

Unfortunately, however, the DOL letter does not resolve our three main concerns. This e-mail is intended to summarize those three concerns and explain why they are not addressed by the DOL letter, so that we can all benefit from a continued dialogue on these issues. That continued dialogue is very much needed, because if the business conduct standards were finalized in their current form, all swaps with plans would likely cease. The DOL letter would not prevent that, as discussed further below.

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

In our view, the proposed business conduct standards require swaps dealers to take three actions that would, under the DOL's proposed fiduciary regulation, convert swap dealers into ERISA fiduciaries with respect to plan counterparties: (1) the provision of information regarding the risks of the swap, (2) swap valuation services, and (3) a review of the ability of the plan's advisor to advise the plan with respect to the swap. If the swap dealer is a plan fiduciary, a swap with the plan would be a prohibited transaction, thus making all swaps with plans illegal.

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

The DOL letter's statement of DOL's intent is very helpful, as is the letter's analysis of the regulation. Unfortunately, we do not read the seller's exception in the way that the DOL does, and, to our knowledge, neither do any of our members (or their internal or external counsel). We would be more than happy to explain our analysis, but the bottom line is that it is not relevant whether we and our members are reading the regulation correctly. The bottom line is that if the regulation is not clarified so that this issue is clear, swaps with plans will likely cease. No major plan will take a chance that it is entering into a prohibited transaction in the face of a regulation that is unclear at best and adverse at worst. The letter is not helpful in that regard because the letter does not constitute legal authority and cannot be relied on in evaluating the issue as a legal matter. In fact, plans, their fiduciaries, and their counterparties are meticulous in their efforts to comply with the DOL's prohibited transaction rules; it would not be prudent, either from an ERISA or 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.

In that regard, we are very troubled by the fact that the agencies have not seemed inclined to adopt the very simple, very clear rule that we have proposed: "no action required solely by reason of the business conduct standards will make a swap dealer (or major swap participant "(MSP")) a fiduciary". If the agencies are not comfortable incorporating that statement into the law, it is hard to imagine that the private sector can get comfortable with entering into swaps involving ERISA plans.

In short, to us, the DOL's letter does not address our key point: on or before the finalization of the business conduct standards, there needs to be legal clarity on our fundamental point that no action required solely by reason of the business conduct standards will make a swap dealer or an MSP a fiduciary.

SUBJECTING DEALERS TO AN UNWORKABLE CONFLICT OF INTEREST

Under Dodd-Frank, if a swap dealer functions as an advisor to a plan, the swap dealer must act in the best interests of the plan. Unfortunately, the proposed business conduct standards interpret "advisor" so broadly that all swap dealers would be treated as advisors, e.g., by reason of providing information on the risks of the swap. This is an unworkable conflict of interest that would render swaps unavailable to plans. A swap dealer that owes a fiduciary duty to its shareholders to obtain the best possible deal with the plan cannot simultaneously act in the best interests of the plan, which is the dealer's counterparty. If the proposed business conduct standards are finalized as is in this respect, all swaps with plans would likely have to stop, due to this irreconcilable conflict.

The DOL's position on this point seems to be that a swap dealer can act as an advisor to a plan and in the plan's best interest, and the conflict of interest created by the swap dealer's dual roles

of counterparty and advisor is a workable conflict of interest that does not create an ERISA problem. This is squarely contrary to our understanding of ERISA and of general principles of law outside ERISA. A party cannot act in the best interests of itself and its counterparty. If the DOL and the CFTC want to revisit that basic concept, it would need to be addressed in binding legal guidance, not in a letter that cannot be relied on legally.

Rather than approving a conflict of interest, which hardly seems like good policy, we believe that the business conduct standards should state that a dealer or MSP is not an "advisor" if the dealer or MSP clearly and conspicuously discloses that it is functioning as a counterparty and not as an advisor.

SWAP DEALERS REVIEWING THE QUALIFICATIONS OF PLAN ADVISORS

Under the proposed business conduct standards, a swap dealer or MSP must review a plan's choice of an advisor to determine if the advisor is capable of advising the plan on the swap. We are concerned about this for two reasons. First, if a swap dealer or MSP reviews a plan's advisor, that would make the swap dealer or MSP a fiduciary under the DOL's proposed regulation (and under current law). Second, we are also concerned about the swap dealer or MSP having veto power over plan advisors. Plans do not want their counterparties to have veto power over their choice of an advisor. In addition, this veto power could very well make plan advisors hesitant to vigilantly represent the plan's interests for fear of a future dealer or MSP veto, which would likely put the advisor out of business.

The DOL describes the first concern – treatment of the dealer or MSP as a fiduciary -- as having "no merit". Again, this is how we read the proposed regulations. If our interpretation is incorrect, we need legal clarity on this point on or before the finalization of the business conduct standards. The rule that we suggest above with respect to solving the conflict between the two regulations would work here . Again, the letter itself, which cannot be relied on as a legal authority, does not provide the clarity that is needed.

The second concern – about giving dealers and MSPs a veto power over plans' advisors -- is not technically a DOL issue, and DOL's letter does not address it. It is very definitely a critical issue that needs to be addressed by the CFTC.

If you have any questions or if anything further would be helpful, please call or e-mail Lynn Dudley, Diann Howland, or me. (Lynn and Diann can be reached at 202-289-6700.) Thanks.
Kent

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