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CFTC and SEC consultation on definitions of "swap dealer" etc
File Number S7-39-10

BTPS Management is pleased to respond to the consultation on proposed interpretations of the definitions of terms in the Dodd-Frank Act.

By way of background, the BT Pension Scheme is the largest corporate pension plan in the UK, and we are active participants in the derivatives markets in order to hedge and mitigate the risks the plan faces. We carry out this risk management on behalf of our assets of more than $55 billion and our 340,000 individual beneficiaries.

We have some specific comments with regard to the proposed interpretations below. We have also attached as an appendix a brief outline of why we use derivatives and why our use of them reduces risk in the financial markets rather than increasing it.

II Definitions of "Swap Dealer" and "Security-Based Swap Dealer"

We support the interpretation regarding whether a person is a swap dealer, and in particular support the interpretation making a clear distinction between those carrying out these activities as part of a regular business rather than on the person's own account, either individually or in a fiduciary capacity.

IV Definitions of "Major Swap Participant" and "Major Security-Based Swap Participant"

We welcome the acknowledgement in the legislation that employee benefit plans should be exempted from the definition of major participants where they are using swaps to hedge or mitigate particular risks. We would note that the current definition used for employee benefit plans may in some circumstances be interpreted as including only plans based in or originating from the US. We believe that this is inappropriate as the arguments for excluding employee benefit plans apply equally to US schemes and their foreign equivalents – it is clearly in the interests of reducing overall risk in the financial system that the exemption should apply to foreign as well as US plans. We believe that it would be appropriate for the Commissions to make this clear in their interpretation of the exclusion, and that this would reflect the intent for international harmonisation embedded within the Act, most notably at s752.

We would also welcome the Commissions making clear in their interpretations that the exemption extends to wholly-owned fund vehicles or subsidiaries used by pension funds to carry out their hedging or risk management activities.

We would also hope that the Commissions will not read the term "the operation of the plan" narrowly in the context of the phrase "for the primary purpose of hedging or

mitigating any risk directly associated with the operation of the plan". In particular, it is our belief that there are many appropriate uses of swaps and other derivatives which hedge and mitigate risks faced by pension schemes by the nature of their assets and liabilities. Hedging and mitigating these risks reduces overall risk in the financial system rather than increasing it – and therefore there is a clear public interest in the interpretation of the Dodd-Frank Act being broad in this respect, and this must be the intended interpretation of the legislation. It would be unfortunate if "the operation of the plan" were interpreted narrowly and so in effect restricted the ability of pension plans to reduce the risks which they face; the impact of such a narrow interpretation would be to increase risk in the markets overall.

Appendix: The BT Pension Scheme and derivatives

Why our access to over-the-counter derivatives is an important element of investment protection for our 340,000 beneficiaries, and limits rather than increases risk

The BT Pension Scheme is the largest corporate pension plan in the UK, and manages investments intended to secure the long-term financial well-being of 340,000 current and future pensioners.

We are active users of OTC derivatives and this note is a brief outline of why these instruments are important to us, and how they limit rather than increase risk in the markets. We believe that this approach and these perspectives will be shared by many other pension plans from around the world.

Our use of derivatives is to mitigate and diversify risk on behalf of our beneficiaries. We use derivatives reflect long-term investment positions arising from our asset allocation and to hedge risks which we regard as excessive, reducing our need to trade in underlying assets and thus reducing the volatility of the market. We use derivatives particularly as a way to access the commodities markets. By investing in derivatives, we gain the inflation-hedging benefits of commodities investment while avoiding having any effect on the price of the underlying assets – which could happen if we invested in physical commodities. We are thus an end-user of derivatives: actively using them to mitigate risks inherent in our portfolios, to reduce liquidity and concentration risks and manage our liability risks. We are not an active trader in derivatives seeking to profit from out-performing other participants in the market.

We welcome the intention to encourage more derivative trading to be based on standardised derivatives and to be cleared through a central clearinghouse. As major investors we suffered significant disruption in the recent market dislocations and welcome moves to address systemic risk. However, we note that these structures are designed around active derivative traders, active on both sides of the market, rather than end-users of derivatives such as pension plans. In particular, the requirement to post collateral reflecting net positions means that we as end-users would bear a disproportionate share of the costs of the market: though we are much lower users of the market our positions would not net off and thus our collateral requirements would exceed much more significant traders.

We therefore urge that in all forthcoming derivatives regulation flexibility is retained to allow end-users of such instruments such as pension plans like ourselves to continue to employ OTC derivatives to manage our risks.

If OTC derivatives are no longer in practice available – and this might happen either because regulatory authorities explicitly bar them or because they become significantly more expensive because of additional regulatory burdens – the BT Pension Scheme is likely to be forced to use more standardised contracts or underlying physical assets which do not match the risks we are seeking to hedge as effectively. The result will be increased risk and volatility and higher costs, and not reduced risk.