SWIB State of Wisconsin Investment Board

February 22, 2011

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

Re: Proposed Regulations on Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, RIN 3038-AD25

Dear Mr. Stawick:

The State of Wisconsin Investment Board (SWIB) is the ninth largest public pension plan in the United States. We manage over $79 billion in assets on behalf of more than 566,000 beneficiaries in the Wisconsin Retirement System. SWIB invests in a wide variety of asset classes and, as part of its investment and risk management strategies, SWIB uses derivatives to hedge investment risk and as an economical and efficient substitute for investing in physical securities. Approximately half of these assets are managed by SWIB's internal investment staff. The other half is managed on SWIB's behalf by external managers either in commingled funds or in separate accounts in SWIB's name. Access to over-the-counter (OTC) swap markets is critical to SWIB's ability to effectively manage the assets entrusted to it.

Together with several other public pension funds, including the California Public Employees Retirement System and the Missouri State Employees Retirement System, SWIB filed a letter (Joint Letter) commenting on certain provisions in the Proposed Regulations referenced above, specifically the requirement that a Swap Dealer (SD) or major swap participant (MSP) that offers to enter into, or enters into, a swap with a Special Entity must have a reasonable basis to believe that the Special Entity has a representative (IR) who both (a) is independent of the SD or MSP and (b)meets the requirements set forth in Proposed Regulation § 23.450. A copy of the Joint Letter is attached. In addition to the Joint Letter, SWIB submits this letter to comment on other aspects of the referenced Proposed Rule and to respond to some of the questions to which the Commission specifically requested comment.

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Anonymity "Prior to Transaction"

The applicability of at least two provisions of the Proposed Rule depends on whether the SD or MSP knows the identity of the counterparty prior to the swap transaction. Proposed § 23.450 (requirements for SDs and MSPs acting as counterparties to Special Entities) and § 23.40 (an SD or MSP must verify that a counterparty meets the eligibility standards for an eligible contract participant before entering into a swap) would not apply to a swap that is initiated on a DCM or SEF where the SD or MSP does not know the Special Entity's identity prior to the transaction. In general, this distinction is logical. The problem with the reference to "prior to the swap transaction" arises when swaps are executed using systems such as FX Connect and Tradeweb, in which the identity of an otherwise anonymous counterparty automatically becomes known immediately prior to the execution of the swap. The identity of the counterparty does not affect the investment decision because it is not known while the counterparties are analyzing and making an investment decision about the swap; however, because the identity of the counterparty is disclosed before the final execution of the swap, it would be a technical violation of the Rule. The Commission should address this issue in the final Rule.

SD Acting as an Advisor to a Special Entity

1. The Commission asks if the proposed clarification of the term "acts as an advisor to a Special Entity" is appropriate and whether it should further define the term (Page 80651).

   Yes, the Commission should further define what constitutes acting as an advisor. The Proposed Rule imposes a duty on an SD or MSP who acts as an "advisor" to a Special Entity to act in the Special Entity's "best interests." It clarifies that a SD who merely provides "general transaction, financial, or market information" or that provides swap terms as part of a response to a competitive bid request from the special entity does not fall within the definition. SWIB strongly encourages the CFTC to further clarify the term "acts as an advisor to a Special Entity" in the following ways.

   "General transaction, financial, or market information." This phrase is not clear and may be interpreted too narrowly. We believe that it should extend to research and recommendations provided to institutional investors, including Special Entities, that is not specifically designed as advice for an individual institutional investor. SWIB regularly receives investment research from firms that are SDs. That market research includes the firms' forecasts and recommendations on positions investors should take with respect to those assets. Those positions can be taken directly or through swaps. The research and related recommendations are not specific to SWIB and do not take into account SWIB's individual situation or SWIB's "best interests," nor does SWIB expect that the research and recommendations are tailored to SWIB's position. SWIB is aware

that one reason firms provide that research is the hope that SWIB and the other recipients of the research, if they agree with the research, will make a trade with or through the firm. SWIB considers the research and recommendations, along with the research and analysis of its own internal investment professionals and external managers, and reaches its own conclusion about the position it will take with respect to the asset, if any. If an investment firm that is an SD has a duty to take into account the best interests of every recipient of its research and recommendations that is a Special Entity, the SD will very likely avoid providing its research and related recommendations to Special Entities. This outcome would disadvantage Special Entities, limiting their access to research. It should be obvious to any investor, including Special Entities, that this research and the related recommendations, even though related to specific companies, currencies or securities, do not take into consideration the specific situation and the "best interests" of each recipient of the research and related recommendations.

"Swap terms as part of a response to a competitive bid request from the Special Entity." SWIB does not always issue a competitive bid request for a swap transaction. We frequently respond to proposals or inquiries from SDs, and we also initiate direct contacts with SDs without issuing a request for a competitive bid. Further, when we need to enter a currency exchange forward or swap, for example, it is not always clear which party is "offering" to make the transaction. There is no reason that swap terms obtained in a non-competitive situation should be treated differently from swap terms obtained in a competitive situation. Such a distinction will significantly restrict SWIB's options for counterparties and the way it does business, without providing any additional protection. It is also important to note that there is a market distinction between a bid (buy) and an offer (sell). The rule specifies only a bid request and may inadvertently limit the exclusion to proposals to buy, which also would disadvantage SWIB.

"Scenario analysis." In addition, the CFTC should clarify that an SD will not be deemed to be providing "advice" to a Special Entity when it provides the scenario analysis required for a high-risk bilateral swap in Proposed Regulation 23.431. *See also* Joint Letter, footnote 7.

2. The Commission asks if it should define "best interests" in the context of Proposed Rule §23.440, and if so, what the definition should be.

SWIB's response to these questions is directly related to its comments in Item 1 above relating to the definition of "advice." If an SD is acting in a truly advisory capacity to a Special Entity, providing advice that is tailored expressly for the Special Entity's position, then a "best interests" standard of care is appropriate. However, if the definition of "advice" is not limited as discussed in Item 1 above, then the standard "best interests" requires the SD to assume a duty that is not

expected by financial institutions, including Special Entities, and, as discussed above, will make SDs less willing to share research with Special Entities. As drafted, the Proposed Rule casts a net that is too broad and will disadvantage Special Entities.

3. The Commission asks whether, when acting as both an advisor and counterparty to a Special Entity, an SD should have to disclose any positions it holds from which it may profit should the swap in question move against the Special Entity?

   No. By definition, a counterparty has a position from which it will profit should the swap move against the Special Entity. If the SD has other positions from which it would profit, those positions are likely proprietary and, if required to disclose them, the SD will likely choose not to enter a swap with a Special Entity, limiting the Special Entity's access to swap markets.

4. The Commission asks whether the proposed rule would preclude swap dealers from continuing their current practice of both recommending and entering into swaps with Special Entities.

   Yes. It is not possible for one counterparty to a swap transaction to act in the best interests of the other party to the transaction. By definition, a party to a contract is acting in its own best interests. In a swap transaction, the counterparties take the opposite sides of a "bet." The best interests of each side are, by definition, opposite to each other. Thus, an SD that has a duty to act in the best interests of a Special Entity by virtue of providing advice to the Special Entity would not be able to act as a counterparty in the swap on which the SD provided advice. (Please refer to SWIB's position on what constitutes providing advice in Item 1 above.)

SD or MSP Acting as a Counterparty to Special Entity

5. The Commission asks a number of questions relating to the reasonableness of the representations that an SD or an MSP can rely on.

   The Commission should clarify and simplify the provision that an SD or an MSP may rely on representations of a Special Entity to satisfy its obligation to have a reasonable basis to believe the Special Entity is an IR. As discussed in the Joint Letter, the requirements imposed by the proposed rule for an SD or an MSP's reliance on a Special Entity's use of an IR are confusing and make for uncertainty that will very likely result in a reluctance on the part of SDs and MSPs to do business with Special Entities. The Joint Letter suggests an alternative to "the reasonable basis for reliance on representations" provision. If, however, the Commission retains the provisions that allow the SD or MSP to rely on the

representation of the Special Entity if it has a reasonable basis, the provision should be amended to provide clarity and certainty so that an SD or MSP can rely on a simple representation made by the Special Entity to the effect that it is "advised by an IR that meets the requirements of §23.450(b)." If the SD or MSP must conduct due diligence each time it enters into a swap with a Special Entity to ensure that its reliance is reasonable, the cost of the swap increases and the SD/MSP either will not enter swaps with Special Entities or will pass on the increased costs to the Special Entity. Either result is not beneficial for Special Entities.

6. The Commission should clarify that an SD and MSP has no "best interests" duty to a Special Entity that has an IR that meets the requirements of § 23.450(b).

   An IR has a duty to act in the best interests of the Special Entity; thus, the Special Entity is not looking to the SD or MSP to play that role. The SD or MSP is recognized as a party on the other side of a transaction with its own interests that it is protecting. The Proposed Rule itself says only that a SD or MSP that offers to or enters into a swap with a Special Entity must have a reasonable basis to believe that the Special Entity has an IR. Proposed Rule § 23.450(b) does not mention that the SD or MSP has a duty to the Special Entity as a counterparty. A logical inference is that, under the Proposed Rule as drafted, the "best interests" duty applies only when an SD is providing advice. The CFTC's discussion of the Proposed Rule, however, states that, even if a Special Entity has an IR that meets the criteria in Section 4s(h)(5) and proposed §23.450, it "would not relieve the swap dealer of its duty to act in the 'best interests' of the Special Entity." Page80651. This statement, if accurate, makes the IR irrelevant and does not solve the problem created by imposing a "best interests" duty on a party that is taking the other side of a swap contract from a Special Entity. SWIB asks that the Commission make clear that acting as a counterparty does not trigger a duty for an SD or MSP to act in the best interests of the Special Entity.

We appreciate the opportunity to provide comments on the Proposed Rule. Please feel free to contact either Jane Hamblen at 608.266.8824 or myself at 608.266.9451 if you have any questions or wish to discuss these comments further.

Very truly yours,

Keith Bozarth
Executive Director

February 18, 2011

By Hand Delivery

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Washington, DC 20581

Re: Proposed Regulations on Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, RIN 3038 – AD 25

Dear Mr. Stawick:

I. INTRODUCTION

We are pleased to submit this comment letter, on behalf of the undersigned Public Pension Funds (Funds), who in aggregate represent $720 billion in assets under management, regarding the regulations proposed by the Commodity Futures Trading Commission (CFTC) on business conduct standards for swap dealers (SDs) and major swap participants (MSPs) with counterparties.[1] We have concerns with the proposed regulations; but, we have set forth a positive alternative proposal in this letter.

Our Funds are classified as governmental plans under Section 3 (32) of the Employee Retirement Income Security Act of 1974 (ERISA), and therefore come within the definition of a "Special Entity" under Section 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which enacted a new Section 4s of the Commodity Exchange Act (CEA) that will become effective in July to govern the registration and regulation of SDs and MSPs. To fulfill obligations to our members, we invest in a wide variety of asset classes, including alternative investment management, global equity, global fixed income, inflation-linked assets, and real estate. As part of our investment and risk management policies, we have authorized the use of certain derivatives. The authorized derivatives include futures,

[1] 75 Fed. Reg. 80637 (December 22, 2010).

forwards, swaps, structured notes and options. Accordingly, we have an interest in the regulation of the swap market.

II. CURRENT PROPOSALS AND CONCERNS

The objective of protecting vulnerable or gullible parties in the swap market may be well-intentioned. However, the proposed business conduct standards for SDs and MSPs, as they would apply when SDs and MSPs deal with a Special Entity, could be wholly unworkable and adversely affect pension fund members. In particular, we are concerned about the proposed regulations that would require that an SD or MSP that offers to enter into, or enters into, a swap with a Special Entity have a reasonable basis to believe that the Special Entity has a representative who is independent of the SD or MSP and who meets certain other requirements.[2],[3] We are also concerned about the proposed regulations regarding: (1) the

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[2] Under Proposed Regulation 23.450, a SD or MSP must have a reasonable basis to believe that the Special Entity has a representative who is independent of the SD or MSP (although not necessarily independent of the Special Entity) and that:

(1) has sufficient knowledge to evaluate the transaction and risks;
(2) is not subject to statutory disqualification from registration applicable to futures professionals;
(3) undertakes a duty to act in the best interests of the Special Entity;
(4) makes appropriate and timely disclosures to the Special Entity; and
(5) evaluates, consistent with any guidelines provided by the Special Entity, fair pricing and the appropriateness of the swap.

[3] Proposed Regulation 23.450(d)(2) further proposes that an SD or MSP could rely upon representations made by the Special Entity about the independent representative, provided such representations are sufficiently detailed. Relevant considerations would include:

(1) The nature of the relationship between the Special Entity and the representative and the duties of the representative, including the obligation of the representative to act in the best interests of the Special Entity;
(2) The representative's capability to make hedging or trading decisions, and the resources available to the representative to make informed decisions;
(3) The use by the representative of one or more consultants;
(4) The general level of experience of the representative in financial markets and specific experience with the type of instruments, including the specific asset class, under consideration;
(5) The representative's ability to understand the economic features of the swap involved;
(6) The representative's ability to evaluate how market developments would affect the swap; and
(7) The complexity of the swap or swaps involved.

treatment of recommendations to counterparties, and (2) when SDs will be considered to be acting as an advisor to Special Entities.[4]

Although the CFTC proposals might appear to provide SDs and MSPs that would want to enter into swap transactions with Special Entities a means to do so, the process could be unworkable in some cases. Specifically, there is an inherent conflict of interest for one of the parties to a transaction also to be responsible for determining who might represent the other side of a transaction. The proposed independent representative requirement would give undue influence to an SD or MSP to determine who qualifies to fill that role.[5]

Swaps have not previously been subject to regulation in the United States, so there is a lack of precedents for parties and their counsel to rely upon in deciding whether particular transactions could be lawfully entered into. Certain of the proposed relevant terms, such as "best interests," "fair pricing," and "appropriateness," are quite vague. The SD or MSP would nonetheless be required to make judgments as to the competency of a particular representative, in effect performing functions customarily performed by a regulatory body or self-regulatory organization.

Moreover, the proposed solution to the inherent conflict of interest between an SD or MSP and a Special Entity, requiring the SD or MSP to make a written record of any determination that a person did not qualify as a representative and to submit such determination to its Chief Compliance Officer for review, is inadequate, because such a review will remain in-house at the SD or MSP without any independent analysis. SDs and MSPs would have substantial discretion in determining who qualifies as an independent representative and this could be exercised in a completely arbitrary fashion, leaving a Special Entity without recourse.

Separately, even those SDs and MSPs that would wish to comply with the CFTC's requirements in a conscientious manner may find the requirements vague and intrusive, forcing them to make very difficult judgments. The SDs and MSPs could be expected to at least pass on these extra compliance costs to the Special Entity in the price of their offers or, if they conclude that the potential liability is too great, simply not offer to deal with Special Entities at all with respect to those customized swaps that would not be traded on designated contract

[4] More specifically, Proposed Regulation 23.431 provides that, in the case of a high-risk bilateral swap, the SD provide a scenario analysis, designed with the counterparty, to allow the counterparty to assess its risks. However, by providing such a scenario analysis, the SD is at risk for running afoul of the requirements contained in Proposed Regulations 23.434 and 23.440, which, taken together, provide that an SD recommending a swap to a Special Entity is acting as an advisor to the Special Entity.

[5] 75 Fed. Reg. 80637, 80653 & n.127.

markets or swap execution facilities.[6] Therefore, in the guise of attempting to protect a Special Entity, the proposed regulations may make it impractical for SDs and MSPs to deal with Special Entities due to the increased and unquantifiable risks, additional costs and other burdens involved. SDs and MSPs would be encouraged to take their business to end users or other entities that are not Special Entities, because off-exchange transactions with entities other than Special Entities would provide greater legal certainty and be less costly and cumbersome to complete. Special Entities would be left to deal with less desirable counterparties, if they could find any at all. In the case of our Funds, this could result in dramatically limiting the ability to enter into certain swaps that may benefit our portfolios and the interests of our members.

Therefore, we respectfully request that the CFTC consider an alternative approach that would achieve the same goal without causing undue hardship to entities like us and our members. The alternative approach is outlined below.

III. ALTERNATIVE APPROACH

We respectfully request that the CFTC consider an alternative approach to the independent representative issue. The alternative approach would provide another, supplemental way to meet the independent representative requirements. Under the proposal that we are putting forward, the Special Entity would be able to elect, on an entirely voluntary basis, whether it relies on the framework set forth in the CFTC proposed regulation or the alternative approach outlined below.

Under the alternative approach, SDs and MSPs would be permitted to enter into off-exchange swap transactions with a Special Entity so long as the Special Entity had a representative, either internally or at a third-party, certified as able to evaluate swap transactions. The SD and MSP would be permitted to rely on the certification broadly for all aspects of the transaction with the Special Entity.[7] Further, this would eliminate possible confusion among

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[6] Proposed Regulation 23.450, pursuant to paragraph (g) thereof, would not apply to a swap that is initiated on a designated contract market or swap execution facility where the SD or MSP does not know the identity of the Special Entity.

[7] For example, as noted previously, by providing the scenario analysis in the case of a high-risk bilateral swap as required in Proposed Regulation 23.431, an SD could run afoul of the requirements contained in Proposed Regulations 23.434 and 23.440, which, taken together, provide than an SD recommending a swap to a Special Entity is acting as an advisor to the Special Entity. Under the alternative approach, the SD would be permitted to rely on the certification of the independent representative for the purposes of these requirements. Consequently, because the representative is able to independently assess the information, communications between the SD and the certified independent representative would not be a recommendation.

SDs and MSPs about the extent to which they can rely upon the representations from a Special Entity.

This certification process would involve passage of a proficiency examination to be developed by the CFTC or by an appropriate self-regulatory organization, such as the National Futures Association (NFA) or another recognized testing organization. To maintain the status of a certified independent representative after passing the examination, the person would be required to complete periodic ethics training, similar to that required of registrants.[8] These requirements are intended to be in furtherance of Dodd-Frank and the proposed regulation.

Under the alternative approach, the requirement to be independent of an SD or MSP would remain. However, persons employed by a Special Entity that have extensive experience in the swaps and other financial markets could presumably qualify for the certification and thus not be blocked from serving as an independent representative by an SD or MSP. The alternative approach would be voluntary, so no person would be forced to take a test to serve as an independent representative.

This alternative approach is within the CFTC's authority. Dodd-Frank Section 731 requires SDs and MSPs to comply with any duty established by the CFTC for an SD or MSP with respect to a counterparty that is an eligible contract participant (ECP) within the meaning of subclause (I) or (II) of clause (vii) of CEA Section 1a(18). That clause of the ECP definition, which was amended by Dodd-Frank, relates to government entities. It is the *preceding* clause of the ECP definition that refers to a government employee benefit plan and other pension plans. Although it is unclear that the CFTC has authority to adopt any requirements with respect to independent representatives of a government plan, the CFTC appears to have relied upon a phrase in the Joint Explanatory Statement of the Committee of Conference on Dodd-Frank that refers to "pension funds" as its authority for the proposals regarding independent representatives of Special Entities. However, even pension funds are separately denoted from government plans under the Dodd-Frank Special Entity definition,[9] and the Joint Explanatory Statement is clearly at odds with the plain and very detailed statutory provision. This statutory construction certainly leaves open to substantial question whether proposed Regulation 23.450 should apply to government plans at all, strengthening the case for an alternative approach.[10] Additionally and by way of background, the CFTC

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[8] *See* Appendix B to Part 3 of the CFTC's Regulations – Statement of Acceptable Practices With Respect To Ethics Training.

[9] CEA Section 4s(h)(2)(C)(iii) and (iv), which are tracked in proposed Regulation 23.401 as paragraphs (3) and (4) under the proposed regulatory definition of the term "Special Entity."

[10] 75 Fed. Reg. 80637, 80651 & nn.106 and 107. As was noted when ERISA was adopted, "State and local governments must be allowed to make their own determination of the best method to protect the pension rights of municipal and state employees. These are questions of state and local sovereignty and the Federal government should not interfere." I Legislative

has similarly provided for an alternative approach in the case of introducing brokers (IBs), which can be analogized to the proposed alternative approach for certification of independent representatives.[11]

We envision our recommendation for a process to certify independent representatives through testing and training, bringing greater legal certainty to the interaction of SDs, MSPs and entities like us without giving any party undue influence over the other.

IV. CONCLUSION

We believe we have outlined a reasonable alternative to what could be unworkable proposals regarding independent representatives for Special Entities. We fully understand that it will take time to create the testing framework discussed above, so should the proposal advance, it may be necessary to delay the effective date of the independent representative provision of the regulations to permit implementation of the alternative approach.

We would welcome the opportunity to discuss this alternative recommendation in greater detail with Commissioners and staff at your convenience. Please feel free to contact Anne Simpson of CalPERS at 1-916-795-9672 if you have any questions or wish to discuss this matter further.

History of the Employee Retirement Income Security Act of 1974, 97th Cong., 2d Sess. 224 (Comm. Print 1976). This rationale was also cited by the CFTC when it excluded governmental plans from the definition of commodity pools under CFTC Regulation 4.5. *Exclusion for Certain Otherwise Regulated Persons from the Definition of the Term "Commodity Pool Operator"; Other Regulatory Requirements*, 50 Fed. Reg. 15868 (April 23, 1985), *reprinted in* [1984-1986 Transfer Binder] Comm. Fut. L. Rep. CCH ¶22,550, at 30,376.

[11] The IB registration category was created by Congress as part of the CFTC's reauthorization in 1982. One aspect of those amendments authorized the CFTC to adopt minimum financial requirements for IBs and, in 1983, the CFTC proposed minimum adjusted net capital requirements for IBs, requiring all IBs to maintain their own amount of highly liquid assets. Many IBs, which had previously operated as "agents" of futures commission merchants (FCMs), commented that they would be unable to meet the proposed requirements and would be forced out of business. Several FCMs that had used extensive networks of these former "agents" suggested that they be permitted to guarantee the obligations of IBs under the CEA in lieu of IBs being required to maintain their own capital. This "alternative" minimum capital requirement resulted in the CFTC developing a standard form guarantee agreement between an FCM and an IB that has proven to be very successful and the preferred method of operation by IBs (approximately two-thirds of IBs conduct business this way). The CFTC could rely upon the resources of FCMs to back up IBs in most cases, and those FCMs that wished to use IBs extensively could do so with a guarantee agreement, which was voluntary for both sides, in effect a win-win-win situation.

Sincerely,

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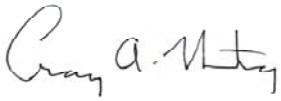

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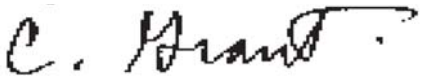

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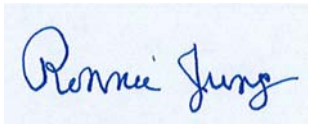

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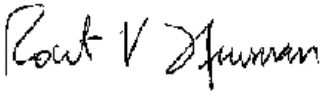

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