National Association of College and University Business Officers

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February 22, 2011

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

Re: Proposed Rules – Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties (RIN number 3038–AD25)

Dear Mr. Stawick:

The National Association of College and University Business Officers (NACUBO) is pleased to have the opportunity to comment on rules proposed by the Commodity Futures Trading Commission (the "Commission") concerning business conduct standards for swap dealers and major swap participants with counterparties.[1] NACUBO is a membership organization, representing 2,100 colleges and universities in the United States, including virtually every college and university that manages endowment funds. Many colleges and universities use customized over-the-counter swaps as a cost-effective tool for managing a diverse range of risks facing each of their institutions. By submitting these comments we aim to preserve for our members the same advantages and market access afforded to end users whose relationships with dealers would not be regulated by the proposed business conduct rules. We have focused our comments on (a) clarifying the circumstances under which an advisory relationship may arise between a Special Entity [2] and a swap dealer or major swap

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[1] See 17 CFR Parts 23 and 155, Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 75 FR 80638 (December, 20, 2010) (the "Proposed Rules Release").

[2] Section 4s(h)(2)(C)(v) of the Commodity Exchange Act (the "CEA") and proposed Section 23.401 include in the definition of "Special Entity" any "endowment, including an endowment that is an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986." Our plain reading of this definition would exclude colleges and universities that are tax-exempt under 501(c)(3) of the Internal Revenue Code of 1986, the assets of which may include endowed funds. In the absence of further clarification by the Commission, however, colleges and universities face some risk that swap dealers and major swap participants will apply this definition in an overly broad fashion, treating all such colleges and universities as Special Entities. Our comments address this practical concern by seeking clarity regarding the business conduct rules as applied to "Special Entities," however "Special Entity" may ultimately be defined and applied in the market. In addition, a smaller number of colleges and universities may have endowment funds established as separate 501(c)(3) entities that would likely fall within the plain meaning of the definition and our comments would apply equally to these institutions.

participant and (b) memorializing in the final rules the Commission's view that a Special Entity's independent representative need only be independent of the swap dealer or major swap participant counterparty, and not independent of the Special Entity as well.

Proposed § 23.440—Requirements for Swap Dealers Acting as Advisors to Special Entities

We are concerned that the proposed rules delineating the conditions under which a Swap Dealer[3] owes a fiduciary-like duty to a Special Entity are too broad and too uncertain, potentially discouraging Swap Dealers from transacting with Special Entities. If Special Entities are shut out of the swaps market or face significantly increased costs to participate therein, they will lose an important tool for managing risks. Many universities manage a diverse array of risks in a global environment that are similar to the risks that any end user operating a complex enterprise may face (such as exposures to commodity prices, interest rates and financial market fluctuations). Federal policy should preserve continued access to these cost-effective risk management tools and promote access parity among end users.

Proposed Section 23.440(b)(1) would require a Swap Dealer to act in the "best interest" of any Special Entity for which it "acts as an advisor." A Swap Dealer would be deemed to act as an "advisor" to a Special Entity where such Swap Dealer "recommends a swap or trading strategy that involves the use of swaps to a Special Entity."[4] Proposed Section 23.440(a) provides a limited exclusion from advisor status for instances where a Swap Dealer provides a Special Entity with (a) information that is general transaction, financial, or market information or (b) swap terms in response to a competitive bid request from the counterparty.

The exclusions set forth in Section 23.440(a) are helpful, but they are extremely narrow, leaving a host of situations that could trigger advisor status notwithstanding the intent or sophistication of the parties. In the course of day-to-day operations, Special Entities may seek an open line of communication with a Swap Dealer – whether with respect to a current transaction or a potential one – that will not necessarily follow in response to a formal request for a proposal. The potential for triggering fiduciary-like obligations, combined with the increased liability exposure Swap Dealers face under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act")[5] may create a chilling effect on communications between Swap Dealers and Special Entities, placing the latter in a disadvantaged position relative to other end users. Why, for example, should an end user in the airline industry enjoy more risk management choices and preferred access to swap market information relative to Special Entities that manage equally complex and far reaching enterprises? To prevent disparity among end users, we believe that a Special Entity possessing a certain level of sophistication, based on

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[3] For ease of reference, we use the term "Swap Dealer" to include both swap dealers and major swap participants.
[4] See proposed Section 23.440(a).
[5] Pub. L. No.111-203, 124 Stat.1376 (2010).

either a net worth or financial assets under management test, should be permitted to determine for itself if and when an advisory relationship arises between it and its Swap Dealers.

In addition, there is some question as to whether a Swap Dealer's compliance with proposed Section 23.450 (requirements for Swap Dealers acting as counterparties to Special Entities) or its general obligations under proposed Section 23.402 (general provisions), Section 23.430 (verification of counterparty eligibility) and Section 23.431 (disclosure of material information), in and of itself, could give rise to the conclusion that a "recommendation" has been made to the Special Entity within the meaning of proposed Section 23.440(a), causing the Swap Dealer to have acted as an "advisor."[6] The combined effect of the disclosure and reporting obligations and the narrow advisory exceptions may cause Swap Dealers to take a cautious default position that they must act in the "best interest" of any Special Entity with whom they engage in a swap transaction. Such a default position could lead Swap Dealers interested in transacting only on an arm's length basis to limit their transactions with Special Entities. Special Entities could be denied market access while other end users not within the definition of "Special Entity" would have continued market access. We believe this is an unintended consequence of the proposed business conduct rules that the Commission can easily remedy.

Accordingly, to ensure the continued access by our members (to the extent deemed to be Special Entities) to the same information and customized swaps available to non-Special Entities, we suggest the following:

1. The Commission should clarify in the final rules that a Swap Dealer's compliance with its obligations under Section 23.450 or its compliance with its general obligations for all swap transactions with Special Entities shall not in and of itself give rise to an advisory relationship with the Special Entity.

2. The Commission should adopt a rule permitting a Special Entity to certify to its Swap Dealer counterparty that such Special Entity does not intend for an advisory relationship to arise, regardless of the level and type of communications that may arise between the counterparties. The Commission could make this option available only to certain

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[6] For example, a dealer would be reasonable to conclude out of an abundance of caution that disclosures tailored to a particular swap transaction so that a Special Entity could evaluate the transaction's material risks could be viewed as advice. The "scenario analysis designed in consultation with the counterparty" referenced in proposed rule Section 23.431(a)(1)(ii) could also reasonably be viewed by a Swap Dealer taking a conservative approach as constituting advice. Even the Swap Dealer's diligence regarding an independent representative's qualifications, as required in proposed rule Section 23.450(b)(3), and the Swap Dealer's conclusion regarding the representative's satisfaction of its own duties regarding fair pricing and the appropriateness of the swap for the Special Entity could require such a level of knowledge of the Special Entity's organization, risk profile and strategy as to fall within the scope of what could reasonably be viewed as advice.

"sophisticated" Special Entities, such as those with a certain minimum threshold of (a) financial assets under management[7] or (b) net financial assets[8] (measured as the difference between the value of a Special Entity's assets and the value of its liabilities, including, but not limited to, pension obligations), in either case, set at a significant bar such as $100 million.

3. If an opt-out rule applicable to sophisticated Special Entities is not adopted, the Commission should clarify that communications between a Swap Dealer and a Special Entity's independent representative (who meets the criteria enumerated in proposed Section 23.450(b)) shall not give rise to an advisory relationship if (a) the communications have been made in response to such independent representative's standing solicitation of information from the Swap Dealer, and (b) in connection with any swap transaction arising from such communication, the Swap Dealer receives a certification from the Special Entity's independent representative that no advisory relationship is intended to arise in such transaction.

Proposed § 23.450—Requirements for Swap Dealers Acting as Counterparties to Special Entities

For a Special Entity and a Swap Dealer to qualify a transaction under Section 23.450, such Swap Dealer must have a reasonable basis to believe that the Special Entity has a representative that, among other criteria, is independent of the Swap Dealer.[9] The Commission acknowledged that the "formulation of the duty is intended to clarify that 'independent' as it relates to a representative of a Special Entity means independent of the swap dealer or major swap participant, not independent of the Special Entity."[10] We request that the Commission add further strength to this statement (and the legislative intent expressed in proposed rule release footnote 115) by incorporating a statement into the final rules clarifying that, for purposes of Section 23.450, the Special Entity's representative need not be independent of the Special Entity and may be an employee, officer, agent, associate, trustee, director or affiliate of the Special Entity (so long as such representative is independent of the Swap Dealer counterparty).

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[7] A financial assets under management test could be implemented by reference to existing, well-established standards for sophistication of institutional investors, such as the definition of "qualified purchaser" in the Investment Company Act of 1940 (for example, "Special Entities that own and invest on a discretionary basis not less than $100,000,000 in investments, as defined for purposes of section 2(a)(51) of the Investment Company Act of 1940").

[8] As an analogy, albeit with respect to individuals, the Act acknowledges that aggregate "net worth" is, in certain circumstances, an acceptable proxy for investor sophistication. See Section 413(a) of the Act and the Securities and Exchange Commission's proposed rules "Net Worth Standard for Accredited Investors," Release Nos. 33–9177; IA–3144; IC–29572; File No. S7–04–11, 76 FR 5307 (January 31, 2011).

[9] See proposed Section 23.450(b)(3).

[10] See Proposed Rules Release, p. 75 FR 80652.

We are grateful for the opportunity to comment on these important rules. We also appreciate the Commission's effort to craft rules that protect the interests of Special Entities without hindering their ability to prudently and effectively engage in the swap markets to manage operational risk.

Sincerely,

John D. Walda
President and Chief Executive Officer