April 11, 2011

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

Re: RIN 3038-AC 96 – Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants;

RIN 3038-AC 96 – Orderly Liquidation Termination Provision in Swap Trading Relationship Documentation for Swap Dealers and Major Swap Participants for Derivatives

Dear Mr. Stawick:

The American Benefits Council (the "Council") and the Committee on the Investment of Employee Benefit Assets ("CIEBA") appreciate this opportunity to provide comments to the Commodity Futures Trading Commission (the "CFTC" or "Commission") regarding the CFTC's proposed rules entitled "Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants" and "Orderly Liquidation Termination Provision in Swap Trading Relationship Documentation for Swap Dealers and Major Swap Participants" (the "Proposed Rules") under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") and the Commodity Exchange Act ("CEA").

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.

CIEBA represents more than 100 of the country's largest pension funds. Its members manage more than $1 trillion of defined benefit and defined contribution plan assets on behalf of 15 million plan participants and beneficiaries. CIEBA members are

the senior corporate financial officers who manage and administer corporate retirement plan assets governed by the Employee Retirement Income Security Act of 1974 ("ERISA"). CIEBA's recent annual survey of members showed an increased emphasis on managing and reducing plan risks and a corresponding increase in usage of swaps to address those risks.

SUMMARY

As further discussed below, we believe that:

- SDs and MSPs should not be permitted to enforce their policies and procedures as having the force of law over plans or other end-users.
- Plans need the ability to negotiate customized swaps and a general desire for swap standardization should not prevent that.
- A deadline for documentation compliance could give SDs a basis for imposing one-sided documentation on plans.
- All swaps terms should be agreed upon in writing on or before a trade.
- Proposed rules should make clear that plans are not required to post initial margin or allow rehypothecation.
- Swap valuation methods should be objective and transparent, and contractually agreed upon valuation dispute procedures should not be overridden.
- Orderly liquidation rules should not go beyond the corollary FDIC statutory provisions in any manner that would restrict ERISA plan rights.

IMPORTANCE OF SWAPS TO PLANS

Swaps play a critical role for our members' plans. Many plans regulated by ERISA use swaps to hedge or mitigate the risks endemic to plan liabilities and investments. These plans conduct swap transactions through fiduciaries that are subject to stringent regulation under ERISA such as a duty to act solely in the interests of the plan's participants. Consistent with ERISA, we are sure the Commission will want to avoid any possibility that the documentation requirements of swaps, directly or indirectly, would adversely affect an ERISA fiduciary's ability to obtain the best possible swap terms for plan participants.

If swap trading becomes materially less available to plans, millions of Americans' retirement security would be detrimentally affected. Moreover, funding volatility could increase substantially, undermining participants' retirement security and forcing companies in the aggregate to needlessly reserve billions of additional dollars to satisfy possible funding obligations. Those greater reserves would vastly diminish working capital that would otherwise be available to companies to create new jobs and for other business activities that promote economic growth.

I. SWAP TRADING RELATIONSHIP DOCUMENTATION REQUIREMENTS

A. *SDs and MSPs Should Not Be Permitted to Enforce Policies and Procedures Over End Users.*

Section 731 of Dodd-Frank creates CEA section 4s(i)(2), which provides that "[t]he Commission shall adopt rules governing documentation standards for swap dealers and major swap participants." To that end, the CFTC has proposed rule 23.504(a), which would require that SDs and MSPs shall "*establish, maintain, and enforce written procedures"* with respect to swap trading relationship documentation.

The use of the term "enforce" with respect to SDs' and MSPs' procedures is contrary to Dodd-Frank, because it implies that such procedures have the force of law. Only certain entities have statutory authority under the CEA to enforce compliance with their rules, e.g., designated clearing organizations, swap execution facilities, designated contract markets.[1] Congress elected to require these registered bodies to act in a self-regulatory capacity. Congress created no analogous requirements for SDs and MSPs.

Accordingly, we respectfully request that the Commission delete the term "*enforce*" from proposed rule 23.504(a). Without this clarification, we are concerned that SDs and MSPs may attempt to assert their procedures as having the force of law over end-users. If this occurs, we are concerned that plans could lose protections that plan fiduciaries have negotiated in their swap documentation and we do not believe that Congress intended this result.

B. *The CFTC's push toward standardized swap documentation has anticompetitive effects.*

The proposal repeatedly emphasizes the importance of standardization, stating that "increasing standardization of swap documentation should improve the market by . . . facilitating automated processing of transactions; increasing the fungibility of . . . contracts; [and] improving valuation and risk management," among other things. Proposed Rules at 6,717. As examples of "the benefits" of standardization, the Commission highlights the credit default swap market and the "Big Bang Protocol", noting that "credit derivative market participants have standardized CDS product design and post-trade processes in tandem, leading to greater operational efficiencies . . . " *Id.* The CDS market, however, is not reflective of other much broader swaps markets, such as the interest rate swap market. The CDS market is the second smallest market of the

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[1] See, Dodd-Frank § 725(c) (creating core principle of compliance with rules, for derivatives clearing organizations); Dodd-Frank § 733 (creating core principle of compliance with rules for swap execution facilities); Dodd-Frank § 735(b) (creating core principle of compliance with rules for designated contract markets); *but see* Dodd-Frank § 728 (not including a core principle of compliance with rules for swap data repositories). *See also* CEA § 6b (providing the Commission authority to impose cease and desist orders and civil penalties for failing to enforce rules of derivatives clearing organizations, swap execution facilities and designated contract markets).

total swap market[2] and is primarily dominated by hedge funds, dealers and a few large asset managers.

The CFTC highlights the commitment by the G-20 leaders that "all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties." 76 Fed. Reg. 6717. This commitment is significant because it does not call for *all* OTC derivative contracts to become standardized; it only calls for those that ***are*** standardized to be traded on certain platforms.

More importantly, Congress acknowledged the need for customized swaps, which plans need to use to hedge effectively their liabilities, by ***not*** requiring that all derivative contracts become standardized. In the absence of such a mandate, the CFTC should refrain from requiring customized terms to become standardized terms.

Standardization comes at a serious cost of depriving market participants of an opportunity to negotiate terms applicable to their unique circumstances. Each plan has unique liabilities and the ability of a plan's fiduciary to negotiate swap terms (beyond standard price, quantity, and timing terms) is what allows the plan's particular liabilities to be hedged effectively. The use of swaps with only standardized terms would create gaps between the plan's liabilities and the plan's swap protections that would leave plans exposed unnecessarily to risk, a result which is certainly not in the interest of the plan. This is not the intent of Dodd-Frank and we do not believe that this is the intent of the Commission either.

C. ***Adverse effects of an early deadline for documentation compliance.***

The Commission asks how long SDs and MSPs would need to bring their documentation into compliance with proposed 23.504. We note that a number of members have reported that it is not uncommon for SDs to take up to a year to finalize an ISDA agreement with a plan fiduciary. If SDs were required to revise all their swap agreements, we believe that it could take years. We are also concerned that a deadline for SDs and MSPs to bring their documentation into compliance would allow SDs and MSPs to present buy-side participants with a newly standardized set of documentation, and would result in buy-side participants having insufficient input into the substance of the documentation.

D. ***The CFTC's swap trading relationship documentation rules correctly recognize that all terms should be agreed upon on or before a trade.***

Proposed rule 23.504(b)(1) provides that "swap trading relationship documentation shall be in writing and shall include all terms governing the trading relationship between the swap dealer or major swap participant and its counterparty. . . . " We commend the CFTC for including all terms in swap trading relationship documentation. This approach will minimize the potential for disputes over swap terms

[2] http://www.bis.org/statistics/otcder/dt1920a.pdf

during the confirmation process caused by the introduction of new "standard" terms after the swap is executed (a not infrequent occurrence today).

We ask that the CFTC confirm in its final rules that the requirement that documentation "shall include all terms governing the trading relationship between the swap dealer or major swap participant and its counterparty" would require ***all*** terms to be in writing ***prior to or at the time of*** entering into the swap transaction, except for terms such as price, quantity and tenor, that are customarily agreed to contemporaneously with entering into a swap transaction. These remaining terms should be required to be documented in writing ***contemporaneously with*** entering into the swap transaction. Given that swap transactions may be required to be reported in "real-time," the provision of such information will facilitate accurate and timely reporting of swap trades. We also believe that the rules should be practical and permit SDs and MSPs and their counterparties to have forms of agreed confirmations which could be delivered once and would, unless the parties otherwise agree, not have to be re-delivered for each transaction.

E. ***Proposed rule 23.504(b)(3) should be clarified to make clear that end-users are not required to post initial margin or allow rehypothecation.***

Proposed rule 23.504(b)(3) provides that requisite swap documentation "shall include credit support arrangements, which shall contain . . . initial and variation margin requirements; . . . [and] investment and rehypothecation terms for assets used as margin for uncleared swaps." We agree with the CFTC that credit support arrangements should be documented, but are concerned that the proposed rule could be read as requiring plans (which are neither SDs nor MSPs) to post initial margin and allow rehypothecation of uncleared swaps.

Requiring plans to post initial margin extends beyond that required by Dodd-Frank. The requirements that initial margin be posted for uncleared swaps are not intended to apply to end-users like plans. *See* Dodd-Frank Section 731, adding new CEA 4s(e). Senator Chris Dodd, in a colloquy with Senator Blanche Lincoln, states clearly that "[t]here is no authority to set margin on end users, only major swap participants and swap dealers." Congressional Record--Senate, S5904, July 15, 2010.

To clarify that not all terms listed in proposed rule 23.504(b)(3) would apply to all parties, we request that the Commission revise the proposed rule by adding the words ***"if any"*** to the end of each of subsections (i) through (iv). This will best recognize that not all terms listed are required to be present in credit support arrangements between a SD/MSP and an end-user.

F. ***Proposed rule 23.504(b)(4) appropriately recognizes the need for objective and agreed-upon procedures to resolve valuation of swaps.***

Proposed rule 23.504(b)(4) provides that swap trading relationship documentation shall include documentation reflecting an agreement between counterparties on the

methods for valuing swaps at any time from execution to termination. Proposed rule 23.504(b)(4) further provides that to the "maximum extent practicable", swap valuations should be based on objective criteria and requires that methods for valuation be agreed upon prior to, or contemporaneously with, execution.

We commend the CFTC for requiring objective and specific valuation mechanisms in swaps documentation. We believe that this requirement will limit the potential for valuation disputes between counterparties. However, requiring objective and specific valuation mechanisms is not enough. The CFTC's proposed rules should require dealers to value swaps on transparent models that can be replicated by their counterparty. The CFTC should also acknowledge in its final rules that when disputes do arise, the mechanisms or procedures by which the disputes are resolved must be fair and even-handed and must not override existing contractual protections negotiated by the parties.

Proposed rule 23.504(b)(4)(ii) would require that methods, procedures and rules for valuation "shall include alternative methods for determining the value of the swap in the event of the unavailability or other failure of any input required to value the swap, provided that the alternative methods for valuing the swap comply with the requirements of this section." It is not possible to anticipate every possible contingency that might affect the valuation of a swap, and attempting to do so would be very costly. The parties should be able to agree on processes to address such situations, rather than being forced to devise a precise method.

G. *Proposed Rule 23.505 must not permit SDs or MSPs to gain access to the confidential non-public information of their counterparties.*

In proposed rule 23.505, the CFTC proposes to require each SD and MSP to obtain "documentation sufficient to provide a reasonable basis on which to believe that its counterparty" meets the end-user exemption to the mandatory clearing requirement. 76 Fed. Reg. 6726. Among the documentation that the rule would require is documentation that the counterparty is hedging or mitigating a commercial risk and documentation demonstrating that the counterparty meets its financial obligations associated with non-cleared swaps. 76 Fed. Reg. 6726. While plans currently do not qualify for the end-user exception, we are concerned about the precedent that this proposal would create that could be applied to plans in other contexts.

This rule could create significant problems for end-users. This "documentation" requirement could easily result in SDs and MSPs obtaining confidential non-public information from their counterparties, which would give the SDs and MSPs a trading advantage.

We request that the CFTC require that the SD or MSP simply obtain from the party claiming the end-user exemption a written representation that the end-user qualifies for the exemption.

H. ***Commission Questions***

The Commission requests specific comments on the following:

- *should 23.504 include a safe harbor for trades entered into on, or subject to the rules of a board of trade designated as a contract market?*

The rule should create a safe harbor for trades entered into on, or subject to the rules of, designated contract markets. Rule 23.504 should similarly create a safe harbor for trades entered into on, or subject to the rules of, a swap execution facility.

- *should the requirement for agreement on events of default and further termination events be further defined?*

No, it is essential that parties be permitted to determine between themselves how events of default and termination events will be addressed. Requiring the standardization of these provisions would disadvantage smaller market participants by reducing their ability to negotiate terms with SDs and MSPs who have set the "standardized" terms.

- *should 23.504 specifically delineate the types of payment obligation terms that must be included in the trading relationship documentation?*

No, the CFTC need not dictate every term that must appear in swap trading relationship documentation. It is important to plans to be able to negotiate these kinds of terms in their documentation.

- *should specific requirements for valuation dispute resolution (such as time limits) be included in 23.504?*

No, with the exception of requiring the availability of independent valuation agents that are agreed upon by the parties, such requirements should not be included. The CFTC should propose only a set of fair and even-handed principles for resolving disputes.

- *should all the terms of the cleared swap be required to conform to the templates established by a DCO or could particular terms could be retained?*

Where parties to a swap have particular terms that go beyond a DCO's template, those particular terms should be retained, and those swaps that do not have conforming terms should not be subject to the clearing requirement.

- *are there anticompetitive implications to the proposed rules?*

Yes, the proposed rules generally benefit the interests of SDs and MSPs and could eliminate the ability of market participants to negotiate non-standardized terms with SDs

and MSPs. Certain SDs have a business model where they enter into a swap trade with one counterparty and profit by the spread between that trade and a second trade which serves as a hedge to the first trade. Standardized terms help ensure that the SDs' first trade and second trade are perfectly matched and reduce the SDs' risk of having to pay on the first trade. Although an SD or MSP may find standardized terms desirable in such an instance, other counterparties may prefer "custom" terms which more appropriately match their portfolio management needs. Standardized terms in many instances could deprive market participants of meaningful portfolio management tools.

II. ORDERLY LIQUIDATION TERMINATION PROVISION

Title II of Dodd-Frank provides the statutory authority to liquidate failing financial companies that pose a "significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard." Dodd-Frank 204(a). As part of this authority, the statute empowers the Federal Deposit Insurance Corporation ("FDIC"), as receiver for a "covered financial company,"[3] to transfer "qualified financial contracts"[4] to another counterparty. Dodd-Frank Section 210(c)(10)(B) also suspends for one business day the rights of a counterparty to a qualified financial contract with a covered financial company to terminate, liquidate or net the contract due to the FDIC being appointed receiver. The Federal Deposit Insurance Act ("FDIA") contains a similar provision[5] that applies to qualified financial contracts with insured depository institutions.

The CFTC's proposed rule 23.504(b) would require that SDs and MSPs include in their documentation with counterparties a provision that confirms both parties' understanding of how the orderly liquidation authority may affect their portfolios of uncleared, over-the-counter bilateral swaps. The CFTC notes several times that its proposed rule governing orderly liquidation is closely modeled after Dodd-Frank and the FDIA. 76 Fed. Reg. 6711-12.

In fact, the proposed language is similar to, but not the same as, the text in Dodd-Frank and the FDIA; we are concerned that the differences among these texts could harm plans. By substituting terms and apprising parties of some, but not all, of their rights, the proposed rule increases the risk of disputes and creates uncertainty as to what will be required to comply with both the statute and the regulatory regime.

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[3] Section 201(a)(8) defines covered financial company to mean "a financial company for which a determination has been made under section 203(b) . . . not includ[ing] an insured depository institution." A determination under 203(b) generally requires that the financial company be facing serious danger of a default that could have serious adverse effects on the financial stability of the United States. *See* Dodd-Frank § 203(b).

[4] Dodd-Frank Section 210(c)(8)(D)(i) defines "qualified financial contract" to mean "any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, and any similar agreement that the Corporation determines by regulation, resolution, or order to be a qualified financial contract for purposes of this paragraph."

[5] FDIA Section 11(e)(10)(B).

For example, Dodd-Frank Section 210(c)(9)(A)(i) states that, in the context of orderly liquidation, the FDIC may elect to "transfer to one financial institution, (i) all qualified financial contracts . . . or (ii) transfer none of the qualified financial contracts, claims, property or other credit enhancement referred to in clause (i) (with respect to such person and any affiliate of such person)." In other words, if the FDIC elects to transfer, it must transfer all qualified financial contracts. In contrast to Dodd-Frank, the proposed rule uses "may," which suggests that the FDIC has the discretion to transfer less than all qualified financial contracts (a level of discretion not provided for by statute). Proposed rule 23.504(b)(5)(ii) provides that "a transfer pursuant to section 210(c)(9)(A) of [Dodd-Frank] or 12 U.S.C. 1821(e)(9)(A) ***may*** include: (A) all swaps between a counterparty that is not a covered party . . . " To avoid ambiguity and to comply with Dodd-Frank, we recommend that the CFTC change "may" to "shall."

We note that the proposed regulation would remain effective even if the statutory provision it implements is repealed or amended. This could result in parties being forced to waive rights that protect their financial interest in times of market turmoil. We believe all of these concerns would be alleviated if the Commission replaces proposed rule 23.504(b)(5) and all of its subsections with the following:

> *"The swap trading relationship documentation must include a written statement in which the counterparties agree that they will comply with the requirements, if any, of 210(c)(10)(B) of the Dodd-Frank Act and section 11(e)(10)(B) of the Federal Deposit Insurance Act."*

This would satisfy the CFTC's stated purpose of "promot[ing] legal certainty for market participants and lower litigation risk" and avoid additional inconsistencies between the statutory and regulatory requirements. 76 Fed. Reg. 6709.

Should the CFTC determine not to replace 23.504(b)(5), we request that either:

i) the CFTC withdraw proposed rule 23.504(b)(5) and require instead that SDs and MSPs include a risk disclosure in their swap documentation explaining the orderly liquidation authority in Dodd-Frank Section 204(a) and FDIA Section 11(e)(1)(B), and that the exercise of this authority by the FDIC may affect a counterparty's qualified financial contracts; or

ii) the CFTC add an additional section to proposed rule 23.504(b)(5) to reflect a counterparty's right to suspend payments to the covered party for the period of the stay, as provided in Dodd-Frank Section 210(c)(8)(F)(ii).

We thank the CFTC for the opportunity to comment on the proposed rules on the swap trading relationship documentation requirements.