CALSTRS
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July 11, 2011

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

Re: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (RIN 3038–AC97; 76 Fed. Reg. 23,732 (Apr. 28, 2011))

Dear Mr. Stawick:

This letter is submitted on behalf of the members of the California State Teachers' Retirement System ("*CalSTRS*"). CalSTRS is the second-largest public pension system in the U.S., with nearly $150 billion in assets that are managed on behalf of over 840,000 members and beneficiaries. We appreciate the opportunity to submit this comment letter to address certain aspects of the proposed margin requirements for uncleared swaps in the above-cited release (the "*Proposing Release*").[1]

Like public pension plans that are subject to the fiduciary and other standards imposed by the Employee Retirement Income Security Act ("*ERISA*"), CalSTRS operates under a stringent and carefully considered legal framework.[2] Both the California Constitution and the California Education Code mandate that investments made on behalf of CalSTRS members and beneficiaries be administered under the prudent person standard.[3] Additionally, oversight of CalSTRS is the exclusive fiduciary responsibility of the CalSTRS Board, comprised of twelve

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1 We are submitting similar comments to the several prudential regulators in respect of their joint proposal "Margin and Capital Requirements for Covered Swap Entities" (Department of Treasury (RIN 1557-AD43), Board of Governors of the Federal Reserve System (RIN 7100 AD74), Federal Deposit Insurance Corporation (RIN 3064-AD79), Farm Credit Administration (RIN 3052-AC69), Federal Housing Finance Agency (RIN 2590-AA45) (May 11, 2011)).

2 We note that any amendments to CalSTRS' Investment Policy must also be approved by the CalSTRS Board after a statutorily-mandated public notice and comment period.

3 CalSTRS has plenary authority and fiduciary responsibility for investment of moneys and administration of the system. Cal. Const., Art. XVI, § 17 (2nd paragraph), § 17(a); *see also* Cal. Educ. Code § 22250. CalSTRS' duty to its participants and their beneficiaries takes precedence over any other duty. Cal. Const., Art. XVI, § 17(b).

members, including elected beneficiary representatives, state-wide elected officials and appointed representatives.[4] Further, applicable California law imposes stringent fiduciary duties on investment advisers (both internal and third-party) that advise CalSTRS.[5] In summary, CalSTRS is a sophisticated and legally accountable governmental pension fund.

As a large public pension fund, CalSTRS must have access to a variety of investment options on equal footing with other large institutional participants. CalSTRS' Investment Policy requires benchmarking with other large pension funds' investments and costs to ensure that CalSTRS is operating in a reasonable manner within our legal framework. Access to cost-effective investments is critical to CalSTRS' investment success.

Swaps are an important component of the tools used by CalSTRS' investment professionals and third-party advisers to protect plan assets as part of a cost-effective and prudent long-term investment strategy. CalSTRS uses these instruments solely as an end-user[6] to hedge against market fluctuations, interest rate changes and other factors that create volatility and uncertainty with respect to plan funding. Swaps are also used as a means to effect a rebalancing of an investment portfolio, to enhance investment diversification and as a prudent means by which to gain exposure to particular asset classes without direct investment.

The long-term nature of CalSTRS' liabilities and CalSTRS' constitutional and statutory responsibilities as a fiduciary to its members and beneficiaries makes efficacy and efficiency of the global financial markets of significant importance to CalSTRS. We thus support the efforts of the Commission to implement Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("*Dodd-Frank*") to enhance the transparency of the over-the-counter derivatives market and thus protect the U.S. financial market from systemic risk.

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[4] Members of the Board of CalSTRS are required to discharge their duties with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims. Cal. Const. Art. XVI, § 17(c), *see also* Cal. Educ. Code § 22250(b). Any board member who breaches his fiduciary duties requiring assets to be held for the benefit of members and their beneficiaries (Cal. Educ. Code § 22251), who engages in any prohibited transaction (Cal. Educ. Code § 22252) or who violates a statutory prohibition on conflicts of interest (Cal. Educ. Code §22253) or who participates in or conceals such a violation by another Board member (Cal. Educ. Code § 22256) shall be personally liable to make restitution to the fund for any losses resulting therefrom. Cal. Educ. Code §§ 22254, 22256.

[5] Investment professionals employed by CalSTRS as well as third-party investment advisers retained by CalSTRS are subject to fiduciary duties in the performance of their duties. Cal Educ. Code § 22254 (with respect to investment professionals employed by CalSTRS); Cal Educ. Code § 22257 (with respect to third-party investment advisers retained by CalSTRS).

[6] For CalSTRS to act as a dealer in swaps would be inconsistent with its statutorily-imposed mandate, which is to invest on behalf of its beneficiaries.

Summary

CalSTRS agrees with the Commission that, as a general matter, counterparties that are commonly viewed as financial entities pose potentially greater risk to covered swap entities, or "*CSEs*" (defined in the Proposing Release as Swap Dealers and Major Swap Participants for which there is no prudential regulator), and thus to the U.S. markets in general, than do counterparties that are commonly viewed as end-users. For that reason, we support the Commission's proposal that margin be required to be posted by certain financial entities for uncleared swaps.

However, CalSTRS respectfully disagrees with the Commission's proposal to include employee benefit plans in the definition of financial entity for purposes of the Proposing Release (or for any other purpose under Title VII of Dodd-Frank). We do not believe there is any basis to view the activities or risk profile of employee benefit plans,[7] which are end-users of swaps, as posing greater risks to CSEs or to the U.S. markets in general as compared to other end-users of swaps. We further believe that, due to the heightened fiduciary duties imposed on employee benefit plans, the activities and risk profiles of such plans are demonstrably different, and materially less risky, than those of even well-managed and regulated CSEs. Moreover, pension funds are distinguishable from other end-users, in that in addition to their fiduciary and statutory obligations, they primarily hold assets that are more liquid than those held by other types of commercial enterprises. We believe that the overlay of the fiduciary standards imposed upon pension funds and the type of assets they hold mitigate any potential risk that otherwise could be posed by a particularly large swap portfolio and distinguish employee benefit plans such as CalSTRS from other end-users from a risk profile point of view.[8]

Further, if, notwithstanding our view that employee benefit plans should not be required to post margin in respect of uncleared swaps, the Commission enacts rules containing this requirement, then we believe that CSEs also should be required to post margin to their non-exempt counterparties in respect of uncleared swaps.[9] To require otherwise would impose risk upon CSE counterparties (including employee benefit plans), which will increase the risk to the U.S. market, and would be inconsistent with long-standing practice.

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[7] CalSTRS, which was established pursuant to the California State Constitution, is a Governmental Plan. Section 3(3) of the Employee Retirement Income Security Act of 1974 ("ERISA") includes in the definition of "employee benefit plans" governmental plans. 29 U.S.C. § 1003(3). Section 3(32) of ERISA defines a "governmental plan" as a "plan established or maintained for its employees by . . . the government of any State or political subdivision thereof . . .." 29 U.S.C. § 1003(32).

[8] As discussed in more detail below, fiduciary and prudential duties are imposed upon CalSTRS by statute as well as by the terms of the California State Constitution. References herein to fiduciary and prudential standards that are statutorily imposed upon employee benefit plans includes such standards that are also imposed by any State Constitution.

[9] We believe that this proposition is also true for other financial entities that face CSEs in uncleared swaps and that will, under the Proposed Release, be required to post margin.

To the extent that CalSTRS or other end-users are required to, or do, provide collateral to a CSE to meet either initial or variation margin requirements in association with any uncleared swaps, CalSTRS agrees with the Commission that posted margin should be afforded protection to prevent its dissipation. For this reason, CalSTRS supports the Commission's proposal to protect margin posted to end-users by prohibiting rehypothecation of margin and by requiring that such margin be held in a segregated account. In order to comply with ERISA, as well as with general risk mitigation practices, we further suggest that such margin also be required to be held in the United States.[10]

CalSTRS also supports the Commission's proposal that the final margin regulations for uncleared swaps should not apply to positions executed before the date of adoption of these rules. If a swap dealer or major swap participant seeks to voluntarily include pre-effective date swaps in portfolios margined pursuant to the final rules, such pre-effective date swaps should be so included only if the counterparty to the swap dealer or major swap participant expressly consents.

1. Employee Benefit Plans Should Not Constitute Financial Entities for Purposes of Title VII of Dodd-Frank.

Dodd-Frank requires the Commission to establish margin requirements for swap dealers and major swap participants for which there is not a prudential regulator imposing capital requirements and that are not cleared by a clearing organization. Dodd-Frank imposes this requirement with the instruction that any regulations be designed to "offset the greater risk to the swap dealer or major swap participant and the financial system arising from the use of swaps that are not cleared."[11]

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[10] 29 USC § 1104(a)-(b). Alternatively, this requirement could be limited to margin posted by employee benefit plans.

[11] Dodd Frank § 731, adding § 4s(e)(3)(A) to the Commodities Exchange Act ("CEA"). While new CEA § 4s(e)(3)(A)(i) states that the margin rules must be designated to ensure the "safety and soundness of the swap dealer or major swap participants," we believe that the plain language of CEA § 4s(e)(3)(A), as cited in the text above, clearly requires the margin rules to be designed with a view not only to the swap dealer or the major swap participant but to the U.S. financial system as a whole ("to offset the greater risk to the swap dealer or major swap participant *and* the financial system. . .) (emphasis added); *see also* CEA § 4s(e)(3)(C), which requires the prudential regulators and the Commission to prescribe margin regulations that are consistent with "(i) preserving the financial integrity of markets trading swaps; and (ii) preserving the stability of the United States financial system." We thus believe that any margin regulations regarding uncleared swaps must be calibrated to the U.S. financial system in its entirety and not solely with a view toward the safety and soundness of swap dealers and major swap participants. We note the foregoing analysis applies equally to margin requirements in respect of uncleared security-based swaps. *See* § 764 of Dodd Frank, adding § 15f (e)(3)(A)(i) (margin rules must be designated to ensure the "safety and soundless of the security-based swap dealer or major security-based swap participant."), § 15f (e)(3)(A) (security-based swap margin rules to be designed "to offset the greater risk to the security-based swap dealer or major security-based swap participant *and* the financial system. . .") (emphasis added) and § 15f (e)(3)(C) (margin requirement should be proscribed consistent with "margin regulations that are consistent with "(i) preserving the
(continued...)

As the Commission notes, during the financial crisis significant sums were expended as the result of losses incurred in connection with uncleared swaps.[12] However, CalSTRS is not aware of any of these losses being incurred with respect to employee benefit plans. Margin requirements serve as a check on risk-taking behaviors that might exceed a party's financial capacity. In distinction, employee benefit plans such as CalSTRS, which are subject to statutorily-imposed fiduciary and prudential duties, are by their nature prohibited from taking any such excessive risks. In addition and as mentioned above, employee benefit plans primarily utilize swaps in order to hedge against market and interest rate risks, a purpose that serves to decrease risk rather than create it.

Congress has stated that the margin required for uncleared swaps should "be appropriate for the risk."[13] The proposed regulations do not impose margin requirements on non-financial entities because, as a whole, these entities are correctly perceived as not posing a high level of risk. Employee benefit plans should be included in this category for the same reason. Employee benefit plans do not pose the risk to the financial system, or to CSEs, as do the entities included in the proposed definition of financial entity that are commonly viewed as such by the market. Thus, it is consistent with Congressional intent to exclude employee benefit plans from the margin requirements for uncleared swaps. [14]

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financial integrity of markets trading security-based swaps; and (ii) preserving the stability of the United States financial system.") to the Securities Exchange Act of 1934.

[12] Proposing Release, 76 Fed. Reg. at 23,733.

[13] Proposing Release, 76 Fed. Reg. at 23,734.

[14] Senator Lincoln, a strong proponent of the Dodd-Frank provisions regulating swaps, recognized that it is "appropriate for the CFTC and the SEC to consider the nature and current regulation of the entity when designating an entity a major swap participant or a security-based swap participant." In making this statement, Senator Lincoln recognized that "entities such as . . . employee benefit plans are already subject to extensive regulation relating to their usage of swaps under other titles of the U.S. Code." She observed that a principal objective of Dodd-Frank was "to protect Main Street," and that Congress "should try to avoid doing any harm to pension plan beneficiaries" when it regulated swaps. 156 Cong. Rec. S5906-07 (daily ed. July 15, 2010) (statement of Sen. Lincoln). *See also* Letter from Chairman Debbie Stabenow, Committee on Agriculture, Nutrition and Forestry, U.S. Senate, Chairman Frank D. Lucas, Committee on Agriculture, United States House of Representatives, Chairman Tim Johnson, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, and Chairman Spencer Bachus, Committee on Financial Services, United States House of Representatives to Secretary Timothy Geithner, Department of Treasury, Chairman Gary Gensler, U.S. Commodity Futures Trading Commission, Chairman Ben Bernanke, Federal Reserve Board, and Chairman Mary Shapiro, U.S. Securities and Exchange Commission (April 6, 2011); Letter from Chairman Christopher Dodd, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, and Chairman Blanche Lincoln, Committee on Agriculture, Nutrition, and Forestry, U.S. Senate, to Chairman Barney Frank, Financial Services Committee, United States House of Representatives, and Chairman Collin Peterson, Committee on Agriculture, United States House of Representatives (June 30, 2010); Letter from Chairman Debbie Stabenow, Committee on Agriculture, Nutrition and Forestry, and U.S. Senate, Chairman Frank D. Lucas, Committee on Agriculture, United States House of Representatives to Chairman Sheila C. Blair, Federal Deposit Insurance Corporation, Acting Comptroller Mr. Jolm G. Walsh, Office of the Comptroller of the Currency, Administrator of National Banks, Chairman Ben Bernanke, Federal Reserve Board, Chairman and CEO, Farm Credit Administration, Chairman Mary Shapiro, U.S. Securities and Exchange Commission, Acting Director Edward J. Demarco Federal (continued...)

Unlike commercial entities, employee benefit plans exist for the purpose of paying benefits, and such plans are managed in order to discharge their benefit obligations. Such plans use swaps to hedge a wide variety of risks that affect the value of the plans' assets, the magnitude of their liabilities, or both. For example, a plan might use credit default swaps to hedge the risk of defaults affecting the value of its bond portfolio, or it might use currency swaps to mitigate the risk that changes in the foreign exchange rate will affect the value of its securities. A plan might also use interest rate swaps to hedge the risk that changes in interest rates will increase the present value of its liabilities; if this risk were not hedged, it could compromise the plan's ability to pay promised benefits.[15]

If employee benefit plans are required to post margin for uncleared swaps, they will be forced to satisfy new regulatory requirements that will make it more expensive for such plans to use swaps prudently to hedge risk and diversify investments. Each dollar an employee benefit plan spends to satisfy new regulatory requirements will be a dollar less that is available to pay benefits to beneficiaries and their families. To the extent that plan fiduciaries elect not to enter into swap transactions in light of cost concerns imposed by margin requirements, employee benefit plans will be forced to abandon risk-mitigation strategies that have proved both prudent and beneficial and that have helped the plans to weather economic downturns. As a result, imposing margin requirements for uncleared swaps on employee benefit plans might have the unintended effect of introducing more risk into the U.S. financial system, contrary to the clear mandate of Dodd Frank.[16]

The Commission states in the Proposing Release that it "believes that financial entities, which generally are not using swaps to hedge or mitigate commercial risk, potentially pose greater risk to covered swap entities than non-financial entities [do]."[17] As mentioned previously, employee benefit plans do primarily use swaps to hedge or mitigate the commercial risks they face (namely market and interest rate risks) and thus do not pose greater risk than non-financial entities. In addition, employee benefit plans rarely incur any substantial amount of debt. The strict fiduciary standards to which CalSTRS and other employee benefit plans are subject preclude it from engaging in highly-leveraged or other speculative transactions.

As explained above, CalSTRS is held to strict standards of conduct that prohibit it from taking high-risk or speculative positions in swaps. The assets of employee benefit plans (including assets of CalSTRS) generally are held in trust for the benefit of its members and their beneficiaries. There is no mechanism by which an employee benefit trust can declare

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Housing Finance Agency, and Chairman Gary Gensler, U.S. Commodity Futures Trading Commission (June 20, 2011); *see also* 156 Cong. Rec. S5904 (daily ed. July 15, 2010) (statement of Sen. Lincoln).

[15] The present value of a plan's liabilities, which is used to measure adequacy for future funding obligations, is materially affected by changes in interest rates.

[16] Dodd Frank §§ 731, 764; *see* footnote 11 above.

[17] Proposing Release, 76 Fed. Reg. at 23,735.

bankruptcy and thus avoid its obligations to its creditors.[18] Accordingly, an employee benefit plan would create counterparty exposure only if its obligations under outstanding swaps exceeded its assets; CalSTRS' statutory and constitutional requirements for the prudent investment and diversification of plan assets ensure that it will not take on swap obligations approaching this magnitude.

Thus, continued utilization by employee benefit plans and their counterparties of bilateral Credit Support Annexes under ISDA documentation, which is customary in the market and requires the employee benefit plan to post collateral that is specifically tailored to the risk tolerance guidelines of its counterparty, affords sufficient protection for CSEs and the U.S. financial system with respect to employee benefit plan counterparty risk. Margin requirements will far exceed the market standards for collateral under CSAs, thus imposing significant additional cost upon employee benefit plans, which will be borne directly by plan beneficiaries. Therefore, CalSTRS believes that employee benefit plans should not be required to post margin in respect of uncleared swaps.

We recognize that employee benefit plans are included in the definition of financial entity for purposes of the end-user exemption from clearing.[19] While we do not agree with that provision of Dodd-Frank, we recognize that the Commission is bound by that statutory provision insofar as it relates to the exemption from mandatory clearing for end-users. We do not believe, however, that such a limited provision of the statute should be extended to other provisions requiring distinctions between financial entities and end-users.

We respectfully suggest that there is no basis to conclude that employee benefit plans should be treated as financial entities for purposes of margin, or any other provisions of Title VII of Dodd-Frank. Extending that concept solely to maintain consistency with an anomalous provision of the statute does not justify this proposal. Further, there is no cost-benefit justification supporting the proposition that the imposition on employee benefit plans and their beneficiaries of the significant costs that mandatory margin for uncleared swaps would impose is justified by purported risk reduction for the U.S. market. In fact, we submit that any cost-benefit analysis of this proposition would clearly demonstrate that the costs vastly outweigh any benefits, given the fiduciary structures under which CalSTRS and other employee benefit plans operate.

In conclusion, CalSTRS respectfully submits that employee benefit plans should not be included in the definition of "financial entity" and thus should not be required to post

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18 In addition, the State of California cannot declare bankruptcy.

19 Dodd-Frank Act § 723. We have found no legislative history or other evidence of the intent of Congress in providing that employee benefit plans may not avail themselves of the end-user exemption from the mandatory clearing obligation for swaps imposed by Title VII of Dodd-Frank. While we thus cannot determine Congressional intent in including this provision in Dodd-Frank, we speculate that this provision may reflect a decision to subject employee benefit plans to clearing on the theory that the enhanced transparency afforded by clearing will ultimately benefit plan participants. We respectfully suggest that there is no cost-benefit analysis that supports this potential explanation. Alternatively, this provision may simply reflect an oversight by Congress.

margin for uncleared swaps. We believe that this outcome is entirely consistent with the requirement of Dodd-Frank that margining in respect of uncleared swaps be imposed so as to protect the U.S. financial system as a whole,[20] and also with the Congressional intent.[21] In the event that certain employee benefit plans do pose greater risk to the U.S. financial system, clause (7) of the proposed definition of "financial entity" gives the Commission the power to designate individual persons as financial entities if warranted by their activities and risk profile.[22] This specific action would be a more appropriate safeguard than imposing margin requirements on all employee benefit plans by including this category in the definition of "financial entity."

2. Covered Swap Entities Should Be Required to Post Margin to Their Counterparties.

If, notwithstanding our view that employee benefit plans should not be required to post margin in respect of uncleared swaps, the Commission enacts rules containing this requirement, then we believe that CSEs also should be required to post margin to their non-exempt counterparties in respect of uncleared swaps.[23] To require otherwise would impose risk upon CSE counterparties (including employee benefit plans), which will increase the risk to the U.S. financial system. It is quite common, and very well accepted practice in the market, that collateral arrangements in ISDA Master Agreements or other swap documentation apply bilaterally.[24] While we recognize that large commercial and investment banks will be subject to greater regulation under Dodd-Frank, these changes will not eliminate all risks that a counterparty faces when transacting with a CSE.[25] We do not believe that Congress, in enacting Dodd-Frank, intended to force end-users to forego customary risk prevention tools when engaging in swaps. In fact, this could cause employee benefit plans and other end-users to violate existing risk management guidelines (including, in the case of employee benefit plan, statutorily-imposed mandates).

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[20] Dodd Frank §§ 731, 764; *see* footnote 11 above.

[21] *See* footnote 14 above.

[22] Dodd-Frank Act § 723.

[23] We believe that this proposition is also true for other financial entities that face CSEs in uncleared swaps and that will, under the Proposed Release, be required to post margin.

[24] International Swaps and Derivatives Association Publication, Release 2.0, *Market Review of OTC Derivatives Bilateral Collateralization Practices*, at 43 "Market Practice" (March 1, 2010) ("[c]ollateral agreements are negotiated on a bilateral basis between parties to the derivatives transaction."); Bank for International Settlements, Committee on Payment and Settlement Systems, *New Developments in Clearing and Settlement Arrangements for OTC Derivatives*, at 12 (March 2007) ("[t]ypically, before a trade is executed between two parties, they will establish the parameters of their trading activities through a bilateral master agreement and . . . collateral agreement").

[25] Adam J. Levitin, *In Defense of Bailouts*, 99 GEO. L.J. 435, 439 (2011) (". . . regulation can, at best, mitigate, but not eliminate, systemic risk . . .").

We further believe that this aspect of the Proposing Release clearly contradicts the literal language, *as well as the intent*, of Sections 731 and 764 of Dodd-Frank, with requires the Commission to adopt capital and margin standards that are designed "to offset the greater risk to the [swap entity] *and the financial system* arising from the use of [swaps] that are not cleared." (emphasis added). Forcing a significant component of the swap market to dispense with a commonly-utilized risk reduction technique will increase the risk to that component of the market. As we have seen, the interconnectedness of the swap markets facilitates the rapid migration of risk from one component of the market to others. A failure of a CSE, the uncleared swap positions of which were not supported by margin or collateral, will impose losses on a wide array of counterparties. While the precise impacts of these losses cannot be predicted, they will adversely affect the U.S. financial system (which includes CSEs as participants in the system). This is precisely the type of risk that Congress sought to prevent in passing Title VII of Dodd-Frank. We thus strongly believe that margin requirements should apply equally to all counterparties to uncleared swaps, just as collateral requirements now commonly apply on a bilateral basis.

3. All Margin Should be Held in Segregated Accounts.

Dodd-Frank requires the Commission to adopt requirements to safeguard margin assets posted to CSEs.[26] In the Proposing Release, the Commission has set forth a rule requiring CSEs to segregate collateral provided by end-users and allowing end-users to select a custodian that is not affiliated with the CSE or the end-user to hold that collateral.[27] This requirement facilitates quicker recovery of margin assets in the event of a CSE's bankruptcy, and is consistent with the Commission's intent to safeguard customer collateral against such events. Moreover, Congress indicates, in other sections of Dodd-Frank, that ''segregating'' customer collateral supporting swaps, or holding such collateral in an account (or location) that is separate from the property belonging to the counterparty, is an appropriate way to offset the risks associated with placing collateral at the reach of a counterparty.[28] Therefore, CalSTRS supports the proposal that initial and variation margin be held in a segregated account. In order to comply with ERISA, as well as with general risk mitigation practices, we also recommended that the rules mandate that such margin also be required to be held in the United States.[29]

4. It Should be Impermissible for Margin to be Rehypothecated.

In order to further safeguard margin assets posted to CSEs, the proposed rules provide that neither a custodian holding margin assets, a CSE, or a counterparty can rehypothecate margin assets or invest them in assets that are not permitted forms of margin.[30]

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[26] Proposing Release, 76 Fed. Reg. at 23,739.

[27] Proposing Release, 76 Fed. Reg. 23,748, § 23.158.

[28] Dodd-Frank Act §§ 724, 763; *see also* Proposing Release, 76 Fed. Reg. 33,818.

[29] 29 USC § 1104(a)-(b). Alternatively, this requirement could be limited to margin posted by employee benefit plans.

[30] Proposing Release, 76 Fed. Reg. 23,748, § 23.158(b)(1)(i).

These limitations are designed to prevent the pledged assets from being used by the secured party for other purposes, including as margin for its own swap positions. As we learned in the Lehman bankruptcy, it can be difficult to return rehypothecated collateral, if it becomes necessary to return it to the pledger, particularly upon the insolvency of the secured party.

CalSTRS supports a rule prohibiting rehypothecation on the basis that it is consistent with Dodd-Frank's goal of preserving the financial integrity of markets trading swaps and the stability of the U.S. financial system because it helps ensure that collateral will be available when a swap agreement, and the related collateral documents, requires it to be used (or returned). Moreover, CalSTRS supports a rule prohibiting rehypothecation because such a rule is consistent with the laws governing employee benefit plans generally, which provide for the discharge of plan assets only on the basis of a prudent standard of care and provides that such assets shall be maintained within the jurisdiction of the courts of the U.S.[31] Thus, in order to protect collateral posted by end-users, we strongly support the Commission's proposed rule prohibiting rehypothecation of margin assets.

5. The Commission's Margin Rules for Uncleared Swaps Should Not Apply to Pre-Effective Date Swaps Unless Both Parties to the Swap Expressly Consent.

CalSTRS supports the Commission's proposal that the final margin regulations for uncleared swaps should not apply to positions executed before the date of adoption of these rules. To impose such a requirement now would disrupt previously negotiated arms-length transactions and would impose, unexpectedly, further burden on only one of the counterparties to those transactions, thus disrupting the swap market. If a swap dealer or major swap participant seeks to voluntarily include pre-effective date swaps in portfolios margined pursuant to the final rules, such pre-effective date swaps should be so included only if the counterparty to the swap dealer or major swap participant expressly consents.

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[31] 29 U.S.C. § 1104 (a) & (b).

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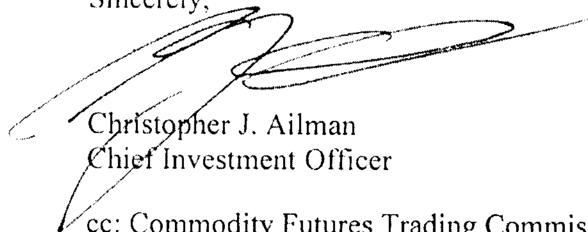
CalSTRS appreciates the opportunity to submit these comments. If we can be of further assistance to the Commission as it considers these important issues, please let us know.

Sincerely,



Christopher J. Ailman
Chief Investment Officer

cc: Commodity Futures Trading Commission

The Honorable Gary Gensler, Chairman
The Honorable Bart Chilton, Commissioner
The Honorable Michael Dunn, Commissioner
The Honorable Scott D. O'Malia, Commissioner
The Honorable Jill E. Sommers, Commissioner
Daniel M. Berkovitz, General Counsel
John C. Lawton, Deputy Director
Thomas Smith, Deputy Director
Thelma Diaz, Associate Director, Division of Clearing and Oversight