March 23, 2012

Mr. Sean D. Campbell
Board of Governors of the Federal Reserve System
20th and C Streets, NW
Washington, DC 20551

Re: Meeting on Proposed Uncleared Swap Margin Rules

Dear Mr. Campbell:

The Committee on Investment of Employee Benefit Assets ("CIEBA") and the American Benefits Council (the "Council") thank you for meeting with us on March 1, 2012 regarding the proposed margin rules for uncleared swaps.[1] During that meeting we discussed the position of CIEBA and the Council that ERISA plans should not be subject to uncleared margin requirements. As a follow-up, we are providing our view as to (i) the statutory authority of regulators under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") to exclude ERISA plans from any requirement on dealers to collect from them uncleared swap initial margin and (ii) why we believe that Congress did not intend for regulators to impose uncleared swap margin requirements on ERISA plans merely because of their "financial entity" designation under Dodd-Frank.

As you are aware, the rules proposed by the Prudential Regulators[2] and the Commodity Futures Trading Commission ("CFTC") (collectively, the "Regulators") use the definition of "financial entity" as a guidepost for the uncleared swap margin requirements. Dodd-Frank, however, does not direct the Regulators to utilize or make distinctions, for purposes of establishing uncleared swap margin requirements, based upon on whether an entity is a "financial entity." Instead, Dodd-Frank requires that the Regulators establish risk-based margin requirements for uncleared swaps.[3] We believe that, under a risk-based approach to initial

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1 Margin and Capital Requirements for Covered Swap Entities, Proposed Rules, 76 Fed. Reg. 27,564 (May 11, 2011) and Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, Proposed Rules, 76 Fed. Reg. 27,621 (May 12, 2011) (together, the "Uncleared Swap Margin Rules"). For convenience, we refer to both "swaps" and "security-based swaps" simply as "swaps."

2 The Prudential Regulators are the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, FDIC, Farm Credit Administration, and the Federal Housing Finance Agency.

3 *See* Dodd-Frank §§ 731, adding new § 4s to the Commodity Exchange Act ("CEA"); and 764, adding new § 15F to the Securities Exchange Act of 1934 ("Exchange Act'). The Securities and Exchange Commission

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margin, the Regulators should conclude that ERISA plans present virtually no risk to dealers and should not be required to post initial margin with respect to uncleared swaps.

Excluding ERISA plans from the requirement to post initial margin would also be consistent with current industry practice. ERISA Plans are treated as highly creditworthy counterparties by dealers and are virtually never required to post any initial margin. The reasons why dealers consider ERISA Plans highly creditworthy counterparties that pose virtually no counterparty risk are set forth in Exhibit A.

The Utilization of "Financial Entity" Status for Determining Whether Swap Margin Should Be Collected From a Swap Dealer Counterparty Is Not Consistent With Dodd-Frank

The designation of "financial entity" is critical to whether an entity is subject to the clearing mandate in CEA § 2 and Exchange Act § 3C. The clearing requirement provides detailed rules for the CFTC and SEC that apply to "financial entities" and affords the CFTC and SEC little discretion in determining to whom the rules apply. The clearing requirement is, importantly, ***not*** "risk-based" in that financial entities that are highly creditworthy are required to clear their swaps while lower creditworthy non-financial entities are exempted from the clearing mandate. Although the designation of "financial entity" is critical to whether an entity is subject to the clearing mandate in CEA § 2 and Exchange Act § 3C, those sections are separate and distinct from the statutory uncleared margin provisions.

CEA § 4s and Exchange Act § 15F set out general principles, directing the Regulators to create uncleared swap margin requirements "appropriate for the risk associated with the non-cleared swaps" held by a swap dealer.[4] Unlike the mandatory clearing provisions of Dodd-Frank, these provisions (i) give Regulators substantial discretion to determine when and to whom the rules apply and (ii) require that such determination be risk-based. Importantly, these provisions do not reference at all the term "financial entity." Thus, the Regulators are required to set margin requirements for entities based on the risk posed to their swap dealer counterparty rather than on whether an entity is or is not a "financial entity."

Dodd-Frank Requires Risk-Based Margin Requirements For Uncleared Swaps. Because ERISA Plans Present Virtually No Risk to Swap Dealers, No Initial Margin Should be Required For ERISA Plans' Uncleared Swaps

The Prudential Regulators' proposed Uncleared Swap Margin Rules would permit certain types of counterparties not to post initial and variation margin below credit-based thresholds. The Prudential Regulators also proposed that those thresholds could be unlimited for certain counterparties that pose the least risk. Likewise, the CFTC's proposed Uncleared Swap

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("SEC") is also required to established margin rules for uncleared security-based swaps. As of the date of this letter, the SEC had not yet proposed uncleared margin rules.

[4] Dodd-Frank §§ 731(e)(3)(A)(ii), adding new CEA § 4s(e)(3)(A)(ii); and 764(e)(3)(A)(ii), adding new Exchange Act § 15F(e)(3)(A)(ii).

Margin Rules relating to "non-financial entities" would only require that the parties to a transaction have a credit support agreement and determine initial and variation margin levels, if any, by agreement. This approach would be entirely consistent with the risk-based uncleared margin requirement in Dodd-Frank *if* the Regulators either (i) *included* ERISA plans in the lowest risk category or (ii) did not require ERISA plans to post initial margin on their uncleared swaps. (References here to the lowest risk category are references to the treatment of non-financial entities, not to the treatment of "low-risk financial end users.")

ERISA plans, as much as or more than the types of counterparties proposed to be in the lowest risk category, pose the least risk to swap dealers. As noted in Exhibit A, ERISA plans present virtually no risk to dealers and accordingly there is no policy reason for requiring dealers to collect initial margin from ERISA plans. Unless ERISA plans, which present virtually no risk to swap dealers, are treated at least as favorably as other counterparties that present greater risk to swap dealers (even if the risk presented by those other types of counterparties is also low), we believe that the Regulators will not have met the "risk-based" directive in Dodd-Frank.

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In sum, exempting ERISA plans from the uncleared swap margin requirements is not only well within the Regulators' statutory authority, but is actually required by Dodd-Frank's risk-based directive for uncleared swap margin.

Committee on Investment of Employee Benefit Assets American Benefits Council

cc: Federal Deposit Insurance Corporation
Commodity Futures Trading Commission

EXHIBIT A

Below is a summary of some of the reasons ERISA plans present virtually no counterparty risk.

- ERISA plans are required to be prudently diversified. In entering into swaps for plans, ERISA requires that plan fiduciaries act solely in the interest of the plan's participants and beneficiaries and with the care, skill, prudence, and diligence that a prudent person familiar with such matters would use.[5]
- "Investment managers" for ERISA plans are required to be regulated entities (registered investment advisers, banks, or insurance companies) that are (1) subject to the highest standard of care under US law, (2) liable for significant financial penalties for failure to comply with relevant provisions of ERISA, and (3) liable in many instances for the acts of other fiduciaries.[6]
- ERISA plan assets are required to be held in trust for future payment, subject to the oversight of a trustee which is typically a US regulated bank.[7]
- Because of the regulatory structure that applies to ERISA plans, ERISA plans typically have minimal leverage (if at all).
- ERISA plans are subject to stringent funding requirements pursuant to the Pension Protection Act of 2006.
- ERISA plans are financially transparent; they typically have third-party custodians report their net asset value to dealers on a monthly basis and are required by law to report their holdings annually to the Department of Labor.[8]
- ERISA plans are not operating entities subject to business-line risks and competitive challenges.
- There is no provision under any law for ERISA plans to file for bankruptcy or reorganization to avoid their financial obligations to counterparties. Even the filing of bankruptcy by an ERISA plan sponsor or the involuntary termination of the plan does not relieve a plan of its financial obligations to counterparties.
- ERISA plans are typically (and correctly) not treated the same as unregulated investment entities in CFTC regulations. For example, Rule 4.5 excludes certain ERISA plans from the definition of a "commodity pool" and operators of most ERISA plans from the definition of "commodity pool operator." The CFTC has relied on ERISA's "pervasive" regulation of plans and plan fiduciaries as a reason it does not need to regulate these

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5 ERISA section 404(a)(1)(B).

6 ERISA sections 3(38) (investment manager requirements), 404(a) (fiduciary standards), 405 (co-fiduciary liability), 409 (fiduciary liability), 502 (ERISA enforcement).

7 ERISA section 403(a).

8 *See* Form 5500.

plans.[9] Similarly, pension trusts are exempt from registration as "investment companies" with the SEC.[10]

- Based on a survey of over a dozen major dealers by one of our members, ERISA plans have in all cases met their swap obligations to dealers despite the bankruptcy of Fortune 500 plan sponsors, the market crash of 2008, and every other significant financial event since the adoption of ERISA in 1974.

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[9] *See* Commodity Pool Operators; Exclusion for Certain Otherwise Regulated Persons From the Definition of the Term "Commodity Pool Operator," Final Rules, 50 Fed. Reg. 15,868, 15,869 and 15,873 (1985); 58 Fed. Reg. 6,371, 6,373 (1993).

[10] Section 3(c)(11) of the Investment Company Act of 1940 ("Investment Company Act").