



# AMERICAN BENEFITS COUNCIL

January 25, 2012

## SUMMARY OF CFTC FINAL BUSINESS CONDUCT STANDARDS WITH RESPECT TO ERISA PLANS UNDER DODD-FRANK ACT

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On January 18, the Commodity Futures Trading Commission (CFTC) released [final regulations](#) relating to business conduct standards for swap dealers and major swap participants in their dealings with counterparties, including ERISA plans, under the [Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 \(the Dodd-Frank Act\)](#).

The Council's key issues were addressed in a favorable manner. Although there are challenges that the final regulations will pose, there do not appear to be any regulatory provisions that would prevent plans from entering into swaps.

Set forth below is a brief summary of the key issues the Council had worked on.

### CONFLICT WITH DOL FIDUCIARY RULES

We had been very concerned that the business conduct rules would require swap dealers and major swap participants ("MSPs") to perform duties that would make them ERISA fiduciaries under the current DOL rules and under the new fiduciary definition that DOL is expected to repropose. As fiduciaries, dealers and MSPs would be prohibited from entering into swaps with plans.

This issue was addressed in a very appropriate manner. The DOL sent a letter to the CFTC, which is an appendix to the final regulations. The letter states:

*The Department of Labor has reviewed these final business conduct standards and concluded that they do not require swap dealers or major swap participants to engage in activities that would*

*make them fiduciaries under the Department of Labor's current five-part test defining fiduciary advice 29 C.F.R. § 2510.3-21(c). In the Department's view, the CFTC's final business conduct standards neither conflict with the Department's existing regulations, nor compel swap dealers or major swap participants to engage in fiduciary conduct. Moreover, the Department states that it is fully committed to ensuring that any changes to the current ERISA fiduciary advice regulation are carefully harmonized with the final business conduct standards, as adopted by the CFTC and the SEC, so that there are no unintended consequences for swap dealers and major swap participants who comply with these business conduct standards.*

Moreover, the CFTC reiterates the key points in the preamble to the regulations, stating:

*The Commission understands from DOL that compliance with the business conduct standards ... will not, by itself, cause a swap dealer or major swap participant to be an ERISA fiduciary to an ERISA plan. Furthermore, DOL stated its intention to continue to coordinate and appropriately harmonize with Commission rules when it re-proposes its rule on the definition of a fiduciary.*

This works very well to address our concerns.

#### **TREATMENT OF SWAP DEALERS AS PLAN ADVISORS**

We were very concerned that a swap dealer would be treated as a plan advisor (and thus required to act in the plan's best interests) by reason of (1) normal sales and marketing activity by the swap dealer, and (2) compliance with the business conduct standards themselves. This could have created a conflict for the dealers, which would be required to act in their own best interests and in the best interests of their counterparty. This concern was squarely addressed in a favorable manner. With respect to the second point, the preamble states:

*The Commission confirms that compliance with [the business conduct requirements] ... will not, by itself, cause a swap dealer to "act as an advisor to a Special Entity"....*

With respect to the first point, the regulations establish a very workable safe harbor under which a swap dealer will not be treated as an advisor to an ERISA plan. A swap dealer fits within the safe harbor if the following requirements are satisfied:

- (1) The Special Entity represents in writing that it has [an ERISA] fiduciary . . . that is responsible for representing the Special Entity in connection with the swap transaction;
- (2) The fiduciary represents in writing that it will not rely on recommendations provided by the swap dealer; and

(3) The Special Entity represents in writing:

- a. That it will comply in good faith with written policies and procedures reasonably designed to ensure that any recommendation the Special Entity receives from the swap dealer materially affecting a swap transaction is evaluated by a fiduciary before the transaction occurs; or
- b. That any recommendation the Special Entity receives from the swap dealer materially affecting a swap transaction will be evaluated by a fiduciary before that transaction occurs.

These requirements are workable and consistent with ERISA. Moreover, the requirements very sensibly reflect the reality that ERISA plans rely (and are required to rely) on their fiduciary, not on their counterparty, for advice.

#### **DEALER ABILITY TO VETO PLAN REPRESENTATIVE**

Generally, under the statute, a dealer or MSP must have a reasonable basis to believe that a Special Entity has a qualified independent representative advising it regarding the swap. We were very concerned that this rule could give dealers substantial leverage over plans and their representatives. In this regard, the final rules came out in a very appropriate manner. Specifically, with respect to ERISA plans, this “reasonable basis” requirement is satisfied if the ERISA plan (1) provides the name and contact information of the plan’s representative, and (2) represents in writing that the representative is an ERISA fiduciary (which is true by definition).

In other words, because ERISA fiduciaries are held to a prudent expert standard and must be independent of the plan’s counterparty, swap dealers and MSPs inherently have a reasonable basis to believe that ERISA fiduciaries are qualified and independent. This makes perfect sense. Moreover, the required written communications described above are very workable.

#### **OTHER IMPORTANT ISSUES**

We had a number of other important issues, almost all of which were resolved in a very appropriate and workable manner.

**(1) Representations on a relationship basis.** Under the final rules:

*A swap dealer or major swap participant may rely on the written representations of a counterparty to satisfy its due diligence requirements under [these rules], unless it has information that would cause a reasonable person to question the accuracy of the representation. If agreed to by the counterparties, such representations may be contained*

*in counterparty relationship documentation and may satisfy the relevant requirements of [these rules] for subsequent swaps offered to or entered into with a counterparty, provided however, that such counterparty undertakes to update any material changes to the representations.*

In other words, representations can be provided on a relationship basis, rather than on a swap by swap basis, which would be unworkable. There is a similar rule regarding required disclosures. However, care needs to be taken in the case of swaps where, for example, different swaps have sufficiently different characteristics that the required disclosures with respect to one swap cannot satisfy the rules with respect to a second swap. On its face, this is a concern for the dealers, but if their systems have to be slow and cumbersome, that will be an issue for plans too.

- (2) **Collective investment vehicles.** The preamble states that “the Commission has determined as a matter of statutory interpretation . . . that the definition of Special Entity does not include collective investment vehicles that have any Special Entity participants.” This makes perfect sense.
- (3) **Transactions using a DCM or SEF.** We had asked for clarification that the business conduct rules do not apply to any transactions executed on a DCM or SEF. However, the final rules generally condition the exemption from the business conduct rules on the swap dealer or MSP not knowing the identity of the counterparty to the transaction prior to execution.
- (4) **Fiduciary status.** Aside from the specific ERISA fiduciary issue, the preamble states that the “Commission . . . does not view the business conduct standards . . . to impose a fiduciary duty on a swap dealer or major swap participant with respect to any other party.”
- (5) **Suitability.** A swap dealer that recommends a swap or trading strategy involving a swap to a plan must have a reasonable basis to believe that the recommended swap or trading strategy is suitable for the plan. Very briefly, this suitability rule can be satisfied with a series of workable representations and disclosures and therefore should not present an obstacle to plans entering into swaps.
- (6) **Know your counterparty requirement.** The rules require that if a swap dealer knows the identity of its swap counterparty prior to execution, the swap dealer must implement policies and procedures reasonably designed to obtain and retain a record of “essential facts” concerning the counterparty, such as facts the swap dealer requires to implement its credit and operational risk management policies.

(7) **Effective date.** The final rules are “effective” on the date that is 60 days after publication in the Federal Register. However, swap dealers and MSPs are not required to comply with the new rules until the later of (1) 180 days after the effective date, or (2) the date that on which swap dealers or MSPs are required to apply for registration. In this regard, the preamble states that “the business conduct rules will not apply to unexpired swaps executed before the effective date of [these rules] . . . ; however, the Commission will consider a material amendment to the terms of a swap to be a new swap and subject to [these rules].”