August 17, 2010

VIA E-MAIL:

Mark New
International Swaps and Derivatives Association, Inc.
mnew@isda.org
360 Madison Avenue - 16th Floor
New York, NY 10017

Re: Additional Provisions for Novations

Dear Mr. New:

This letter is being submitted by the American Benefits Council (the "Council") and the Committee on the Investment of Employee Benefit Assets ("CIEBA") in response to ISDA's August 11, 2010 draft regarding *Additional Provisions for Consent to, and Confirmation of, Transfer by Novation of OTC Derivatives Transactions* ("Additional Provisions"). We are writing on behalf of our members across the country that use swaps as a critical element of their retirement plan investment portfolio.

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 individually manage and administer ERISA-governed corporate retirement plan assets.

We have two concerns with the draft Additional Provisions. Our fundamental concern is with the process being used to develop the Additional Provisions and the need for a more robust and inclusive public comment process. In light of the Wall Street Transparency and Accountability Act of 2010 ("Act"), ISDA protocols will likely take on far greater significance, creating a critical need for a more open process in developing such protocols. Second, we are very concerned about the Additional Provisions themselves, as they can create significant problems for buy-side participants.

Our three organizations—the Council, CIEBA, and ISDA—have some overlap in terms of our members, and we have a common interest in an efficient and effective swaps market. In that context, we hope that the three organizations can work together on the issues identified in this letter, as well as future issues affecting swaps and plans.

PROCESS ISSUES

We are concerned that buy-side participants, including fiduciaries to pension plans, are not being given the opportunity to be meaningfully involved in the Additional Provisions. For example,

ISDA members only had four business days to review the Additional Provisions draft and to provide comments. In addition, the cover e-mail accompanying the draft Additional Provisions indicated that the comments will only be considered for one day before a final version is published. We very much understand the desire of ISDA to act quickly. But this comment process is not adequate; there needs to be opportunity for meaningful discussions. As an additional point, it would be very helpful if more buy-side input was considered in the preparation of the protocols, so that the protocols more closely reflect ISDA's membership.[1]

The lack of adequate opportunity for plan fiduciaries and other buy-side participants to be heard and considered illustrates why the Additional Provisions should not be forced upon pension plans by being hardwired into the governance of swap data repositories, swap execution facilities, clearing derivatives organizations and their security-based swap counterparts.

As you are aware, the Act will require that all uncleared swaps be reported to a swap data repository, unless no repository would accept that swap. It seems likely that the electronic platforms that already offer swap electronic confirmation services will register with the CFTC and SEC as swap data repositories and security-based swap data repositories, respectively. These platforms currently require their users to adhere to the ISDA Novation Protocol II ("Protocol") in order to novate a trade. If all of the swap data repositories that would accept an uncleared swap for reporting require adherence to the Protocol and Additional Provisions, the Protocol and Additional Provisions could effectively have the force of law, making the process issues even more troubling.

If any ISDA protocols are hardwired into the governance of swap data repositories, swap execution facilities, clearing derivatives organizations or their security-based swap counterparts, such protocols need to be developed through an open and inclusive process, including review and approval by the CFTC or SEC, as applicable. The point is that as part of the process of developing and approving protocols (at least those that are hardwired as described above), market participants should have adequate opportunity to comment and have their comments considered by the appropriate regulators.

A fuller opportunity to comment would also give us the opportunity to explore the possible effects of the Additional Provisions on defined contribution plans, such as 401(k) plans. This issue has been raised by our membership but we have not had a chance yet to pursue it.

SUBSTANTIVE ISSUES

To date, a number of institutional investors are uncomfortable with or have not adopted the Protocol. Originally, ISDA created the Protocol to solve dealers' inability to provide to their regulators and auditors the prior written evidence of consent needed to novate trades.[2] Although the

[1] ISDA reports that 15 of the 24 members on the ISDA drafting committee are sell-side participants. ISDA's website reports that ISDA has 334 buy-side members and 208 sell-side members.

[2] Prior written notice is required by section 7 of the ISDA Master Agreement. The Protocol addressed this by providing for the waiver of prior written consent and requiring instead that the Transferor obtain the consent of the Remaining

Protocol solved the dealers' problem, investors expressed concerns (and continue to be concerned today) that this solution created new burdens to customers by increasing counterparty exposure, thereby frustrating the very purpose of novation. Today, we raise this same concern that pension plans would unnecessarily face undesired counterparty exposure. In fact, ISDA's proposed Additional Provisions would exacerbate this problem by more frequently introducing such undesired counterparty exposure.

Novations enable a party to contractually transfer its legal and economic exposure from an uncleared swap to a third party. Let's assume a buy-side participant has an uncleared swap with Dealer A that it is anxious to novate to avoid exposure to Dealer A (which the buy-side participant perceives as troubled). The buy-side participant would seek out a dealer to take over the swap and its exposure.

Without the Protocol, it could seek out any dealer to take over the swap and its exposure. If another dealer, for example, Dealer B, agreed to take such swap and exposure and all three parties provided written prior consent, a novation would take place. At this point in time, the buy-side participant would not have any legal and economic exposure to Dealer A or Dealer B. But in the absence of all three parties' prior consent, there would be no transfer of the buy-side participant's trade nor would any new trade be created.

Under the Protocol, the buy-side participant must be more cautious about the dealer it seeks to take over its swap and exposure. While this dealer's creditworthiness may be immaterial if all parties provide consent in the manner set forth by ISDA, the buy-side participant may otherwise be forced to enter into a separate swap with this dealer. If the buy-side participant and Dealer B consent to the novation, but Dealer A does not provide its consent by ISDA's deadline, the buy-side participant would continue to be legally and economically exposed to Dealer A and would also be "deemed" to have concluded a trade (but not a novation) with Dealer B that is intended to be economically equivalent to the trade with Dealer A (a "Mirror Transaction"). In this scenario, the portfolio management goal of reducing exposure to a troubled counterparty would not be met and, instead, would result in the portfolio being exposed to two counterparties (potentially both of which could be troubled). As we have recently witnessed, companies that seem sound can become troubled almost overnight, making this increased exposure especially worrisome.

In our view, in the above example, if Dealer A does not consent to the novation, there should be no transfer of the buy-side participant's trade, and no new trade between the buy-side participant and Dealer B should take effect.

Party through an electronic messaging or communications system or email and that, upon obtaining consent, all parties enter into a Novation Confirmation. Annex I to the Protocol, Paragraphs 2(b) and 2(f).

It is our understanding that ISDA is proposing the Additional Provisions to replace the Protocol for novations confirmed on electronic platform under certain circumstances.[3] While we support providing alternatives to the Protocol, the Additional Provisions raise the same concerns as the Protocol except that the risk of added counterparty exposure is much greater. Instead of being triggered under only two situations, additional counterparty exposure can be triggered by twelve circumstances as set forth in Appendix A, some of which appear to be very broad.

We welcome the opportunity to meet with ISDA to discuss our comments and to collaborate in identifying alternative solutions with respect to both our substantive and our process concerns.

Sincerely,

American Benefits Council

Committee on the Investment of Employee Benefit Assets

[3] The Additional Provisions would govern a novation that the Transferor and Transferee agree to (orally or otherwise) if the Transferor submits an initial novation consent request through an electronic platform common to all parties before 6 p.m. (New York time) on the day during which novation terms are agreed upon.

Appendix A

1. Under the Protocol, counterparty risk is compounded by creating a Mirror Transaction when:

(a) the Transferee does not receive the Remaining Party's evidence of consent by 6:00 p.m. in the location of the Transferee on the day the Transferor and Transferee agree on the novation; or

(b) the Remaining Party indicates that it does not consent to the novation.

2. The Additional Provisions would trigger extra counterparty risk by creating a Mirror Transaction when:

(a) the Transferor's electronically-submitted novation request ("Novation Request") is not open as of 6:00 p.m. New York time on the day the Transferor and Transferee agree on the novation (the "Novation Trade Date Cut-off Time");

(b) the Transferor's Novation Request ceases to be open at any time between the Novation Trade Date Cut-off Time and 5:00 p.m. New York time on the first business day after the day the Transferor and Transferee agree to the novation ("Novation Consent Cut-off Time");

(c) the Transferor's Novation Request is open, but not executable, at the Novation Consent Cut-off Time;

(d) at or after the Novation Trade-Date Cut-off Time, the Transferee proposes a Mirror Transaction via the electronic platform or any other means permitted by Section 12(a) of the ISDA Master Agreement between Transferee and Transferor in response to an open, but not executable, Novation Request by the Transferor;

(e) the Remaining Party fails to respond to a Novation Request by the Novation Consent Cut-off Time;

(f) the Remaining Party responds to a Novation Request by the Novation Consent Cut-off Time, but that response is not open when the Transferee affirms the transfer;

(g) the Remaining Party responds to a Novation Request by the Novation Consent Cut-off Time, but that response is not open at the Novation Consent Cut-off Time;[4]

[4] 2(g), when read together with 2(f), raises significant concerns.

(h) the Remaining Party submits a refusal to consent to an open Novation Request prior to the Novation Consent Cut-off Time;

(i) the Transferee fails to respond to a Novation Request by the Novation Consent Cut-off Time;

(j) the Transferee responds to a Novation Request by the Novation Consent Cut-off Time, but that response is not open when the Remaining Party consents to the transfer;

(k) the Transferee responds to a Novation Request by the Novation Consent Cut-off Time, but that response is not open at the Novation Consent Cut-off Time;[5] or

(l) the Transferee proposes a Mirror Transaction via the electronic platform used by the Transferor to submit the Novation Request (i) between the Novation Trade Date Cut-off Time and the Novation Consent Cut-off Time and (ii) while a Novation Request is open, but before the Remaining Party has consented to the transfer.

[5] 2(k), when read together with 2(j), raises significant concerns.