

## SUMMARY OF CONCERNS WITH POSSIBLE NEW FIDUCIARY PROVISION

The overarching flaw in the new fiduciary provision proposed by Senators Harkin, Casey, and Lincoln is that, like the Senate-passed bill, it seeks to protect plans by having the swap dealer look out for the plans' best interests, even when the swap dealer is not giving advice, but is just "offering" to be the counterparty to a swap. This approach does not work. A plan's opposing party cannot and should not be the one protecting the plan. Plans should be protected by qualified internal or external advisors independent of the opposing party.

More specifically, set forth below are some of the problematic aspects of the proposal. Please note that the proposal adds welfare benefit plans to the group of counterparties to which the special rules apply. So, for example, VEBAs would be disadvantaged, in addition to private and public retirement plans, governments, and endowments. For convenience of presentation, the rules are discussed below by reference to plans.

- (1) If a swap dealer "initiates" a swap with a plan, but does not provide any advice to the plan, the swap dealer must "have reasonable grounds to believe that the swap is in the best interests of the [plan]." In addition, in order to make this determination, the swap dealer must make reasonable efforts to obtain relevant information about the plan's financial situation. This is unworkable for many reasons. First, it is unclear what it means to "initiate" a swap. In light of that lack of clarity, many swap dealers will likely need to assume that they initiated the swap if they take **any** pro-active steps.

Second, the best interests standard is strikingly similar to a fiduciary standard. If the swap dealer believes that the plan could negotiate for a better deal, it is hard to conclude that the swap is in the best interests of the plan. This fiduciary-type standard alone would cause swap dealers not to enter into swaps with plans. Third, swap dealers would not be able to satisfy this fiduciary-type standard (even if they wanted to), unless they have access to all the plan's financial information. (It is our understanding that it was not intended that swap dealers have access to non-public information about the plan, but it would be difficult to satisfy a best interests standard based only on public information. So the legislative language may not reflect the intent in this regard.) Nothing could be worse for plans' negotiating position than to disclose all their financial information -- including other swaps -- to the opposing party. In other words, in an effort to help plans, the proposal would give swap dealers an enormous information advantage in negotiating with plans.

- (2) Even if the plan "initiates" the swap (and receives no advice or recommendations from the swap dealer), the swap dealer must "have reasonable grounds to believe

that the swap is suitable for the [plan]". In order to satisfy this obligation, the swap dealer must again seek relevant plan information. So even in this situation, the plan could only enter into a swap if the plan provides the swap dealer with its financial information, creating a huge negotiating disadvantage for the plan. And this requirement makes every swap far more expensive and cumbersome by forcing swap dealers to do lengthy investigations in order to enter into a swap with a plan. The swap dealer is the plan's counterparty, not its advisor; the plan should be relying on its own advisor for suitability determinations.

- (3) The business conduct standards would require a swap dealer or major swap participant to provide a plan with a written representation that the swap is "appropriate". It is not clear what this adds to the suitability or best interests standards, but it is another similarly problematic standard.
- (4) Swap dealers would, in all cases, be prohibited from using a plan's "information for purposes of trading against the positions of [the plan]". On its face, this provision can be read to prohibit swap dealers from hedging their liabilities related to a swap with a plan, which would be yet another enormous reason for swap dealers not to enter into swaps with plans. It is our understanding, however, that the intent was to prohibit the swap dealer from using, in its negotiations with the plan, the information it learns from the plan in the course of making its best interests or suitability determinations. That is a very worthy objective, but it creates another serious problem for swap dealers and another reason for them not to enter into swaps with plans. If challenged, how could a swap dealer prove that it did not use the plan's information in the negotiations? Proving a purely subjective negative like that is very difficult, if not impossible, in the context of a unique transaction.