U.S. Department of Labor

Assistant Secretary for
Employee Benefits Security Administration
Washington, D.C. 20210

APR 28 2011

The Honorable Gary Gensler
Chairman
U.S. Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20036

Dear Chairman Gensler:

As you know, the Department of Labor (DOL) has proposed to expand the scope of its regulatory definition of fiduciary investment advisers under ERISA. Some market participants have expressed concern about the relationship between the DOL regulation and the business conduct standards under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) and proposed Commodity Futures Trading Commission (CFTC) rules for swap dealers and major swap participants engaging in transactions with ERISA-covered plans. This letter responds to your request for comment on these concerns.

The Department's proposed regulation is not broadly intended to impose ERISA fiduciary obligations on persons who are merely counterparties to plans in arm's length commercial transactions. Parties to such transactions routinely make representations to their counterparties about the value and benefits of proposed deals, without purporting to be impartial investment advisers or giving their counterparties a reasonable expectation of a relationship of undivided loyalty and trust. The proposed DOL regulation is not intended to upend these expectations by imposing ERISA fiduciary norms on parties who are on the opposite side of plans in such arm's length deals. Accordingly, the Department's proposed regulation provides that, unless the counterparty has expressly represented that it is acting as a fiduciary, it will not be treated as one if it –

> can demonstrate that the recipient of the advice knows or, under the circumstances, reasonably should know, that the person is providing the advice or making the recommendation in its capacity as a purchaser or seller of a security or other property, or as an agent of, or appraiser for, such a purchaser or seller, whose interests are adverse to the interests of the plan or its participants or beneficiaries, and that the person is not undertaking to provide impartial investment advice.

Nevertheless, some market participants have voiced concern that the business conduct standards under Dodd-Frank and the proposed CFTC rules could effectively require swap dealers and major swap participants to give advice that falls outside the scope of the counterparty exception, even when they are engaged in arm's length bilateral commercial transactions with plans that are separately represented by independent fiduciaries. In particular, they are concerned that the business conduct standards would effectively compel swap dealers and major swap participants to provide plans with impartial investment advice concerning the swaps' value, risk

characteristics, and other material information. Moreover, they argue that the heightened conduct standards would effectively preclude them from asserting that their interests are sufficiently "adverse" to plans to take advantage of the counterparty exception in the DOL regulation.

The Department understands these concerns, but it does not agree that the counterparty exception is unavailable to swap dealers and major swap participants. Nor does the Department believe that there is any inconsistency between Section 4s(h) of the Commodity Exchange Act, as enacted in Dodd Frank, and the fiduciary provisions of ERISA. In DOL's view, a swap dealer or major swap participant that is acting as a plan's counterparty in an arm's length bilateral transaction with a plan represented by a knowledgeable independent fiduciary would not fail to meet the terms of the counterparty exception solely because it complied with the business conduct standards set forth in the CFTC's proposed regulation. As the CFTC recognized in the preamble to the proposed business conduct standards, "a swap dealer has an inherent conflict of interest when it acts as both an advisor and as a counterparty to a Special Entity." 75 Fed. Reg. 80,638, 80,651 (Dec. 22, 2010). For example, under the business conduct standards, swap dealers can both recommend and enter into swaps with plans and, when the swaps move against the plans, the dealers can keep the resulting profits. Accordingly, the parties' interests are "adverse" within the meaning of the DOL's proposed regulation.

Even if the plan's swap counterparty complies with the business conduct standards, it is not "undertaking to provide impartial investment advice" within the meaning of the DOL regulation when it engages in a bilateral arm's length transaction with a plan. In the absence of misrepresentations by the swap dealer, we would expect a knowledgeable independent plan fiduciary to fully understand the adversity of the parties' interests, and to make its own independent judgments and representations about the prudence of the transaction for the plan. As the CFTC observes in the preamble to its regulation, "[t]he Commission anticipates that swap dealers and Special Entities will continue to rely on representations to inform the nature of their relationships, including, for example, representations that the Special Entity: (1) is not relying on the swap dealer; (2) has an independent representative that, by virtue of their relationship, is legally obligated to act in the best interests of the Special Entity; and (3) is relying on the independent representative's advice in evaluating any recommendation from a swap dealer." Id. at 80,650 n.100.

Certainly, the CFTC regulation provides important protections for ERISA-covered plans including, *inter alia*, disclosure obligations, duties of fair dealing, best interest and suitability requirements, fraud prohibitions, and assurances that the plan is represented by an independent fiduciary with the knowledge and ability necessary to protect the plan's separate financial interests.[1] None of these protections, however, would preclude a plan from reasonably

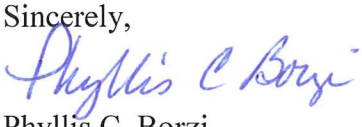
[1] It is worth emphasizing that the swap dealer's obligation to act in the "best interests" of its plan counterparty is not tantamount to an obligation to act with undivided loyalty to the plan – the standard applicable to ERISA fiduciaries. See 29 U.S.C. § 1104(a)(1)(A). Rather, as the CFTC explains in the preamble to its proposed regulation, the requirement to act in the Special Entity's "best interests" is a duty to follow certain "best interest principles" that, "in the context of a recommended swap or swap trading activity, would impose affirmative duties to act in good faith and make full and fair disclosure of all material facts and conflicts of interest, and to employ reasonable care that any recommendation given to a Special Entity is designed to further the purposes of the Special Entity." 75 Fed. Reg.at 80,650.

understanding that the swap dealer or major swap participant is acting as the plan's counterparty on the opposite side of a transaction in which the parties have divergent interests. Indeed, the proposed business conduct standards underline this point by carefully conditioning swap transactions on independent plan representation. Thus, under the proposed standards, the swap dealer or major swap participant cannot offer to or enter into a transaction with a plan unless it has a reasonable basis to believe that the plan is separately represented by a fiduciary that is independent from the plan's swap counterparty, knowledgeable about the transaction and its risks, responsible for appropriate and timely plan disclosures, obligated to act in the plan's best interests, and responsible for separately making representations about the fair pricing and appropriateness of the swaps. In this way, the business conduct standards reflect a proper understanding that plan representation is critical because of the divergent interests of plans and their counterparties.[2]

As we continue to work on the terms and substance of the fiduciary regulation, it is, of course, quite possible that the counterparty exception will be altered to reflect the comments we have received, as well as our own analyses. In our view, with careful attention to fairly straightforward drafting issues, we can ensure that the DOL regulation and the CFTC business conduct standards are appropriately harmonized. We will continue to evaluate the particular terms used to define the scope of any exception to ensure that the regulation is as clear and effective as possible, and to avoid any unintended consequences. Your help in this regard is greatly appreciated.

Thank you for your continued assistance with our fiduciary regulation and for your consistent willingness to consult with DOL as you develop the business conduct standards. We will undoubtedly benefit from your continued advice and assistance as we work together to make sure that our respective regulatory projects are harmonized to meet their important goals.

Sincerely,



Phyllis C. Borzi
Assistant Secretary, Employee Benefits Security Administration

cc: David A. Stawick, Secretary, Commodity Futures Trading Commission

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[2] Some market participants have also suggested that the swap dealer's obligation to verify that the plan is appropriately represented before entering into a swap transaction could somehow make the swap dealer an ERISA fiduciary. There is no merit to the suggestion. One does not become a plan fiduciary by refusing to engage in a transaction with a plan, even if the basis for the refusal is a low opinion of the qualifications and adequacy of the plan's fiduciary representative. Nothing in ERISA requires commercial actors to acquiesce to plan demands when engaged in negotiations with plans or to refrain from making observations about their counterparties, lest they too become plan fiduciaries. If it were otherwise, virtually every commercial transaction with a plan would trigger fiduciary status for parties on the opposite side of the transaction.