

GROUP LETTER TO CONGRESS

The undersigned plan sponsors and organizations either maintain or represent tens of thousands of retirement and other employee benefit plans across the country. We are writing today to urge that the financial services reform legislation not inadvertently do great harm to our plans and the tens of millions of participants who participate in them.

Specifically, we have two concerns. First, the Senate bill's provision requiring a swap dealer to have a fiduciary duty to a retirement plan would effectively require a swap dealer to represent both sides of a swap transaction, which is legally unworkable. Second, the House bill's definition of a "major swap participant" would subject plans to dealer-type regulation, which would inappropriately harm plans' ability to deliver benefits efficiently. In addition, we wanted to bring to your attention a separate, broader issue regarding the treatment of stable value funds under the bills. This extremely popular investment—both inside and outside the retirement plan context—could be inadvertently threatened by the bills.

As discussed further below, we ask that the Senate's fiduciary provision not be included in the conference agreement. We further urge the conferees to follow the Senate's definition of a major swap participant with respect to the treatment of plans.

Fiduciary Provision

Under the Senate bill, if a swap dealer simply enters into a swap with a public or private retirement plan (or just offers to enter into a swap with such a retirement plan), the swap dealer owes a fiduciary duty to the plan. This would require swap dealers to have conflicting fiduciary duties: one fiduciary duty to its shareholders and a conflicting fiduciary duty to the plan in negotiating the terms and price of a swap. Clearly, swap dealers cannot fulfill both duties. Thus, if the Senate provision passes Congress in its current form, swap dealers would be effectively precluded from entering into swaps with plans.

Pension plans use swaps to manage risk, such as interest rate, currency, and equity risk, and to thereby reduce funding volatility. Swap dealers play an important role as market makers for swaps. For example, swap dealers are willing to be a buy counterparty to pension plans that want to reduce risk by selling a swap and a sell counterparty for pension plans that are seeking to reduce risk by buying a swap. If the final bill contains the Senate fiduciary provision or similar language, swap dealers will simply be unable to trade swaps with pension plans because of the requirement that they represent both sides of the transaction. If swaps are unavailable to pension plans, funding volatility will increase substantially, forcing companies in the aggregate to reserve billions of additional dollars to satisfy possible funding obligations. Those greater reserves would have an enormous effect on the funds available to invest in business recovery and jobs.

Generally, it is very large defined benefit plans that enter into such swap arrangements. (Large defined contribution plans also use swaps to hedge risk in separately managed accounts offered as a plan investment option.) Such plans generally have extensive and highly competent advisers, both internally and externally to assist them in this endeavor. They recognize that the

swap dealer is their counterparty; as such, it would not make sense to look to the swap dealer for advice. Also, qualified private sector plans are subject to ERISA's strict fiduciary requirements and governmental plans are subject to trust law that requires a plan fiduciary to act in the plan's interest. In short, there is no need or interest among plans in advice from swap dealers. Moreover, because imposing a fiduciary duty on swap dealers would effectively shut down the availability of swaps, this well-intended provision would actually do great harm to plans.

Stable value funds are an extremely popular investment offered under 401(k) plans and similar arrangements (such as section 457(b) plans maintained by State or local governments). More than half of all defined contribution plans offer a stable value fund investment and 15-25% of all plan assets are invested in such funds. Stable value funds combine capital preservation with a reasonable rate of return. The funds invest in intermediate bonds; principal and a minimum rate of return are generally guaranteed contractually. It is this contractual guarantee that could be a swap under both bills, triggering the Senate bill's unworkable fiduciary duty rule. Thus, the fiduciary duty rule would have a similarly devastating effect on 401(k) plans and their participants by eliminating a valuable investment option.

In order to avoid creating great harm for plans, we urge the conferees not to include the Senate fiduciary provision.

Major Swap Participant

Under the House bill, if a retirement plan or other employee benefit plan has a "substantial net position in outstanding swaps," the plan would be a "major swap participant" ("MSP"). As such, many large plans would be subject to bank-like capital, margin, business conduct, and registration costs. These burdens could be substantial. For example, the capital requirements could require plans using swaps to hold substantial amounts of assets either uninvested or underinvested. This could materially increase plan costs, which would hurt plans and participants. In fact, this could lead to swaps being an economically unrealistic investment for plans. If that happens, the effects on defined benefit plan funding volatility would be very adverse and drastic, as described above. In addition, the business conduct and registration requirements of the bill would inappropriately regulate pension plans in a manner similar to market makers/swap dealers.

Such regulation of plans is inappropriate because, as noted, plans use swaps to mitigate risk, not to create risk, and pension plans do not act as swap market makers. Further, pension plans are not highly leveraged, a key concern in this area. Accordingly, as we understand it from numerous discussions with Members of Congress, their staffs, and representatives of the Administration, regulation of plans as MSPs was not intended. For example, CFTC Chairman Gensler explicitly told reporters in April that plans were not intended to be MSPs. For these reasons, the Senate bill provides that retirement or other employee benefit plans—both public and private—are not MSPs to the extent that they use swaps to mitigate risk. We urge the conferees to follow the Senate bill in this regard.

Please note that by asking that the conferees follow the Senate MSP provision with respect to plans, we are not asking for an exemption from the clearing requirement for plans. Under the Senate bill, plans are not MSPs but are subject to the clearing requirement.

Stable Value Contracts

As noted above, under both bills, the statutory definition of swaps is so broad that it can be interpreted to include at least some stable value contracts. Also as noted, stable value funds are extremely popular investments in 401(k) plans and other similar arrangements, such as section 457(b) plans maintained by state or local governments. Such funds are also used outside the retirement plan context, such as in section 529 qualified tuition plans.

The bills inadvertently threaten the existence of these funds by appearing to include at least some of them in the broad definition of swaps. If these arrangements are swaps, their existence would be threatened by the fiduciary issue. But even if the fiduciary issue is addressed, these arrangements could also be threatened by other swap requirements, such as the eligible contract participant rules. We believe that it is critical that the conferees carefully review the stable value fund issues in order to avoid very harmful effects on participants.

We thank you for your consideration of our views. Many of the signatories to this letter have other critical concerns regarding the pending legislation, including the end-user exemption with respect to the clearing requirement and the MSP definition. But we join together here to express our common concerns regarding critical retirement plan issues.

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The Neiman Marcus Group
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The New York State Bankers Retirement System
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cc: All Senators