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SUMMARY OF THE PROVISIONS RELATING TO EMPLOYEE BENEFIT PLANS IN HR 4173 THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT AS APPROVED BY THE HOUSE OF REPRESENTATIVES ON JUNE 30, 2010 AND THE SENATE ON JULY 15, 2010

July 15, 2010

Stable value wrap contracts and other swaps

Some retirement plans engage in swaps (derivatives) that will be regulated under the Act. Large defined benefit plans often engage in swaps to manage risk and reduce volatility. Large defined contribution may include swaps in their separately managed accounts. In addition, a large portion of defined contribution plans include a stable value product whose "wrapper" might be a covered swap under the Act, including special rules when a large plan directly negotiates a wrap agreement with the stable value provider.

In order to consider the impact of regulating stable value products under the Act, stable value contracts will not be considered swaps until the completion of a study (and the issuance of any final regulations) by the Securities and Exchange Commission and the Commodity Futures Trading Commission. The Commissions will consult with the Department of Labor, the Department of the Treasury, and the state entities that regulate the issuers of stable value contracts. The study must be completed within fifteen months of enactment of the Act. If the Commissions determine that stable value contracts are swaps under the act, then they must determine if an exemption from the definition of a swap is appropriate and in the public interest. Stable value contracts in effect prior to the effective date of the regulations will not be considered swaps.

Under the Act, ''stable value contract'' means "any contract, agreement, or transaction that provides a crediting interest rate and guaranty or financial assurance of liquidity at contract or book value prior to maturity offered by a bank, insurance company, or other State or federally regulated financial institution for the benefit of any individual or commingled fund available as an investment in an employee benefit plan (as defined in section 3(3) of the Employee Retirement Income Security Act of 1974 [any employee welfare or pension plan] , including plans described in section 3(32) [a governmental plan] of such Act) subject to participant direction, an eligible deferred compensation plan (as defined in section 457(b) of the Internal Revenue Code of 1986) that is maintained by an eligible employer described in section 457(e)(1)(A) [government] of such Code, an arrangement described in section 403(b) of such Code, or a qualified tuition program (as defined in section 529 of such Code)." *Note that the definition is limited to ERISA plans "subject to participant direction." This definition includes a 457 plan and 403(b) plans subject to ERISA, but the fact that they are also listed separately makes it unclear if those plans need to be participant directed.*

Definition of Major Swap Participant and Major Security-Based Swap Participant
The Act regulates derivative trading by swap dealers and "major swap participants" and registered security-based swap dealers and "major security-based swap participants. Under earlier language, some plans might have been considered a major swap participant or major security-based swap participant, but the definitions now exclude ''positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan." The wording of the exclusion is less than perfect for a defined contribution plan – it was written to address defined benefit plans. Another condition to be a major swap participant is to "maintain a substantial position in swaps for any of the major swap categories as determined by the Commission." This condition might be another avenue for plans to avoid the requirements of the Act under this section.

Business Conduct Standards for Swap Dealers and Major Swap Participants Under the Commodity Exchange Act and the Securities Exchange Act.
The Act contains parallel provisions setting business standards for swap dealers under the Commodity Exchange Act and the Securities Exchange Act, including special rules when dealing with "Special Entities" that include an ERISA benefit plan.

General standards
Each registered swap dealer (or registered security-based swap dealer) and major swap participant (or major security-based swap participant) must adhere to standards to be issued by the agencies that relate to—

- fraud, manipulation, and other abusive practices involving swaps (including swaps that are offered but not entered into);
- diligent supervision of the business of the registered swap dealer and major swap participant;
- adherence to all applicable position limits; and
- such other matters as the Commission determines to be appropriate.

The standards will —

- establish a duty for a swap dealer or major swap participant to verify that any counterparty meets the eligibility standards for an eligible contract participant;
- require disclosure by the swap dealer or major swap participant to any counterparty to the transaction (other than a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant) of—
    - information about the material risks and characteristics of the swap;
    - any material incentives or conflicts of interest that the swap dealer or major swap participant may have in connection with the swap; and
    - for cleared swaps, upon the request of the counterparty, receipt of the daily mark of the transaction from the appropriate derivatives clearing organization; and
    - for uncleared swaps, receipt of the daily mark of the transaction from the swap dealer or the major swap participant;
- establish a duty for a swap dealer or major swap participant to communicate in a fair and balanced manner based on principles of fair dealing and good faith; and

- establish such other standards and requirements as the Commission may determine are appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act.

Additional rules for dealing with Special Entities
Special Entities are 1), a Federal agency; 2), a state, state agency, city, county, municipality, or other political subdivision of a state; 3), any ERISA employee benefit plan, 4) including a governmental plan, or 5), any endowment, including an endowment that is an organization described in section 501(c)(3) of the Internal Revenue Code of 1986.

A swap dealer or major swap participant may not employ any device, scheme, or artifice to defraud any Special Entity or prospective customer who is a Special Entity; engage in any transaction, practice, or course of business that operates as a fraud or deceit on any Special Entity or prospective customer who is a Special Entity; or engage in any act, practice, or course of business that is fraudulent, deceptive or manipulative.

A swap dealer or major swap participant that offers to enter or enters into a swap with a Special Entity must, before the initiation of the transaction, disclose to the Special Entity in writing the capacity in which the swap dealer is acting; and comply with any standards and requirements the Commissions may determine are appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

Any swap dealer or major swap participant that offers to enter or enters into a swap with respect to a Special Entity counterparty that is an eligible contract participant within the meaning of subclause (I) or (II) of clause (vii) of section 1a(18) of the Commodity Exchange Act (as amended by this act), (a governmental entity, including the United States, a State, or a foreign government, or political subdivision of a governmental entity; or a multinational or supranational government entity) must also comply with any duty established by the Commissions that requires the swap dealer or major swap participant to have a reasonable basis to believe that the counterparty that is a Special Entity has an independent representative that—

- has sufficient knowledge to evaluate the transaction and risks;
- is not subject to a statutory disqualification;
- is independent of the swap dealer or major swap participant;
- undertakes a duty to act in the best interests of the counterparty it represents;
- makes appropriate disclosures;
- will provide written representations to the Special Entity regarding fair pricing and the appropriateness of the transaction; and
- in the case of employee benefit plans subject to ERISA is a fiduciary as defined in section 3 of ERISA.

A swap dealer that acts as an advisor to a Special Entity shall have a duty to act in the best interests of the Special Entity. The dealer must make reasonable efforts to obtain such information as is necessary to make a reasonable determination that any swap recommended by the swap dealer is in the best interests of the Special Entity, including information relating to—

- the financial status of the Special Entity;
- the tax status of the Special Entity;
- the investment or financing objectives of the Special Entity; and
- any other information that the Commission may prescribe by rule or regulation.

Note – ERISA plans rarely, if ever, seek advice from a swap dealer who is a counterparty to a swap. Doing so may constitute a prohibited transaction under ERISA.

Applicability – The Act provides that "this section" shall not apply with respect to a transaction that is initiated by a Special Entity on an exchange or swap execution facility; and one in which the swap dealer or major swap participant does not know the identity of the counterparty to the transaction. *The provision probably is not intended to apply to the entire section 731 of the Act, but, at a minimum, it most likely applies to dealings with Special Entities.*

The provisions are effective on the later of 360 days after the date of the enactment or, to the extent a provision of requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision.

Exclusion for Benefit and Compensation Plans and Regulation of Certain Service Providers Under the Bureau of Consumer Financial Protection

The new Bureau has broad powers over "financial products or services" that, without special treatment, likely include employer benefit plans and their service providers. However, the Act includes an exclusion for a person who is a 1), specified plan or arrangement; 2), engaged in the activity of establishing or maintaining, for the benefit of employees of such person (or for members of an employee organization), any specified plan or arrangement; or 3), engaged in the activity of establishing or maintaining a qualified tuition program under section 529(b)(1) of the Internal Revenue Code of 1986 offered by a state or other prepaid tuition program offered by a state.

A specified plan or arrangement is any plan, account, or arrangement described in section 220, 223, 401(a), 403(a), 403(b), 408, 408A, 529, or 530 of the Internal Revenue Code of 1986, or any employee benefit or compensation plan or arrangement, including a plan that is subject to title I of the Employee Retirement Income Security Act of 1974, or any prepaid tuition program offered by a state.

The exclusion does not apply to service providers. However, the Bureau's rulemaking and enforcement authority with respect to products or services that relate to any specified plan or arrangement is limited to two methods of rulemaking. The first method is upon the joint written request of the Secretaries of Labor and The Treasury. The second method is for the Bureau to initiate the rulemaking, but only with the consent of the two Secretaries. Service providers may be exempt from the Bureau's oversight under other exclusions.

The provision is effective on the designated transfer date, which will be determined, not later than 60 days after the date of enactment of this Act, by the Secretary (of Treasury?), in consultation with numerous other government entities, to designate a single calendar date for the transfer of functions to the Bureau.