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August 29, 2011

By electronic submission to www.sec.gov

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Business Conduct Standards for Security-based Swap Dealers and Major Security-based Swap Participants (File No. S7-25-11)

Dear Ms. Murphy:

The Asset Management Group (the "**AMG**") of the Securities Industry and Financial Markets Association ("**SIFMA**") appreciates the opportunity to provide the Securities and Exchange Commission ("**SEC**" or "**Commission**") with our comments regarding the proposed rules (the "**SEC Proposal**"),[1] published on July 18, 2011, regarding business conduct standards for security-based swap dealers ("**SBS Dealers**") and major security-based swap participants ("**Major SBS Participants**") (together, "**SBS Entities**").

The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 ("**ERISA**") pension funds and private funds such as hedge funds and private equity funds. In their role as asset managers, AMG member firms, on behalf of their clients, engage in transactions for hedging and risk management purposes that will be classified as "security-based swaps" and "swaps" under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").

[1] Securities and Exchange Commission, Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 Fed. Reg. 42396 (July 18, 2011).

The SEC Proposal would implement statutory provisions that are largely identical to those addressed in the Commodity Futures Trading Commission's December 22, 2010 proposal (the "**CFTC Proposal**")[2] regarding business conduct standards for swap dealers ("**Swap Dealers**") and major swap participants ("**Major Swap Participants**") (together "**Swap Entities**"). On February 22, 2011, the AMG submitted a comment letter in response to the CFTC Proposal (the "**February 22 Letter to the CFTC**").[3]

Both Proposals are of paramount importance to AMG members that manage accounts of Special Entities.[4] Our comments focus primarily upon aspects of the SEC Proposal that could result in unintended harm to Special Entities by restricting or delaying their ability to enter into security-based swaps or increasing the costs of these transactions due to requirements that would apply to SBS Entities with whom they do business. We strongly support the SEC's proposed exclusion from many of the business conduct rules for Special Entities represented by a qualified independent representative, which would ameliorate these potential adverse consequences, and we recommend several clarifications to enhance the exclusion's utility and effectiveness. In addition, we highlight several other aspects of the SEC Proposal as to which modifications or clarifications are desirable to advance the goal of protecting investor interests without "unduly limiting hedging and other legitimate activities by discouraging participation in security-based swap markets."[5]

Specifically, we discuss below our concerns relating to potential consequences of the "best interests" standard in the Proposal, the exclusion for special entities represented by qualified independent representatives, disclosure concerning dealer capacity, potential characterization of SBS Dealers and Major SBS Participants as ERISA fiduciaries, the pay-to-play provisions, and related issues.

Potential Consequences of the "Best Interests" Standard

Under Proposed Exchange Act Rule 15Fh-4(b), an SBS Dealer that acts as an advisor to a Special Entity regarding a security-based swap has a duty to act in the best interests of the Special Entity. Under the SEC Proposal, an SBS Dealer is deemed to be acting as an advisor to a Special Entity when it recommends a security-based swap or a trading strategy that involves the use of a security-based

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[2] Commodity Futures Trading Commission, Business Conduct Standards for Swap Dealers and Major Swap Participants, 75 Fed. Reg. 80636 (Dec. 22, 2010).

[3] The February 22 Letter to the CFTC is available at http://www.sifma.org/issues/item.aspx?id=23511.

[4] The Dodd-Frank Wall Street Reform and Consumer Protection Act defines "Special Entities" to include government agencies, employee benefit plans under ERISA, governmental plans as defined in ERISA, endowments and municipalities.

[5] *See* SEC Proposal at 42398.

swap to the Special Entity, unless the Special Entity has a "qualified independent representative" and the additional conditions of the exclusion proposed below are satisfied. The AMG believes that, absent clarification of the specific types of conduct giving rise to the "best interests" duty, this proposed standard may include a broad range of normal commercial activities, potentially leading SBS Dealers who do not intend to take on this heightened duty to restrict their communications with Special Entities to providing only the most generic information or to reduce their participation in security-based swaps transactions with Special Entities (including those that would help Special Entities to hedge their portfolios). We propose several modifications to the SEC Proposal to address this concern.

The SEC Proposal would deem an SBS Dealer to be an advisor to a Special Entity when it recommends a security-based swap or a trading strategy that involves the use of a security-based swap to the Special Entity unless the Special Entity is represented by a qualified independent representative and meets the other requirements of the proposed exclusion.[6] The SEC did not propose a definition of "recommendation," but expressed the preliminary view that a determination of whether an SBS Dealer makes a recommendation to a counterparty should turn on the facts and circumstances of a particular situation.[7] The AMG believes that Special Entities (and their representatives) as well as SBS Dealers would benefit from a "bright line," objective standard that will unambiguously assure that both parties to a security-based swap understand the scope of the SBS Dealer's duty to the Special Entity in connection with the transaction. A "facts and circumstances" test such as the SEC proposes would embed uncertainty in transactions in which clear allocations of responsibility are necessary to protect the interests and expectations of both parties. Moreover, such a diffuse standard could invite hindsight characterizations of the parties' conduct as a basis for avoiding obligations or seeking damages. To avoid such uncertainties, the AMG recommends that an explicit agreement by the parties should determine whether the SBS Dealer acts as advisor to the Special Entity. Under this approach, unless there is specific agreement that information provided by the SBS Dealer to the Special Entity is to be used as the primary basis for an investment decision, communications between an SBS Dealer and a Special Entity should not be considered to be a recommendation.[8] Under this standard,

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[6] *See* Proposed Exchange Act Rule 15Fh-2(a). We also note that Proposed Exchange Act Rule 15Fh-3 would require an SBS Dealer that recommends a security-based swap or trading strategy involving a security-based swap to any counterparty other than an SBS Entity or Swap Entity, to have a reasonable basis to believe based on reasonable diligence, that the recommended security-based swap or trading strategy involving a security-based swap is suitable for the counterparty. *See* Proposed Exchange Act Rule 15Fh-3(f).

[7] *See* SEC Proposal at 42415. The SEC noted that this approach is consistent with the approach taken by FINRA. *See id.*

[8] Such an agreement could be reflected in trade documentation, including standard master agreements or confirmations, between the parties but, when a potential counterparty does not have (…continued)

there should be no potential for the Special Entity to be misled concerning whether the SBS Dealer is advocating that it pursue a particular SBS transaction or strategy or is simply providing information from which the Special Entity must develop its own trading decisions. Further, an SBS Dealer will be able to provide information to the Special Entity without concern that these communications will later be recharacterized as recommendations. Otherwise, Special Entities and their advisors may be provided less trade and market information from SBS Dealers or may even be precluded from transacting in security-based swaps.

At a minimum, we recommend that the final rules make clear that customary product explanations and marketing activities by SBS Dealers would not cause an SBS Dealer to be deemed to be making a recommendation. For example, an essential aspect of selling a financial product is explaining to a potential counterparty how a given instrument is designed and how the product may help address a need that the customer might have. The SEC should make clear that these activities would not, alone, trigger advisor status. In addition, we request that the final rules explicitly state that providing general market information, quotes in response to requests, and information pursuant to requirements in the business conduct rules, such as the proposed daily mark disclosure requirement,[9] would not cause an SBS Dealer to be deemed to be making a recommendation.

Exclusion for Special Entities Represented by Qualified Independent Representatives

Proposed Exchange Act Rule 15Fh-2(a) would provide that an SBS Dealer will not be deemed to be an "advisor"[10] if: (1) the Special Entity represents in writing that: (a) the Special Entity will not rely on recommendations provided by the SBS Dealer and (b) the Special Entity will rely on advice from a qualified independent representative as defined in Proposed Exchange Act Rule 15Fh-5(a); (2) the SBS Dealer has a reasonable basis to believe that the Special Entity is advised by a qualified independent representative as defined in Proposed Exchange Act Rule 15Fh-5; and (3) the SBS Dealer discloses to the Special Entity that it is not undertaking to act in the best interest of the Special Entity.[11]

(continued…)

such preexisting trade documentation in place, the required understanding could be established on the basis of a notice provided by the SBS Dealer.

[9] *See* Proposed Exchange Act Rule 15Fh-3(c).

[10] Under Proposed Exchange Act Rule 15Fh-4(b), an SBS Dealer that is deemed to be acting as an advisor to a Special Entity would be required to act in the "best interests" of the Special Entity and make reasonable efforts to obtain information that it needs to determine that the recommendation is in the "best interests" of the Special Entity.

[11] *See* Proposed Exchange Act Rule 15Fh-2(a).

"Reasonable Basis" to Believe Representative Has Adequate Knowledge

In order to rely upon the exclusion from advisor status with respect to a Special Entity to which it makes a recommendation, an SBS Dealer would be required to have "a reasonable basis to believe" that the Special Entity has a qualified independent representative that, among other qualifications, "[h]as sufficient knowledge to evaluate the transaction and risks."[12] The AMG believes that it would be unnecessary, costly and ultimately counterproductive to require an SBS Dealer to undertake an independent due diligence investigation to determine whether a Special Entity's representative has sufficient knowledge to evaluate the transaction before it may rely upon the exclusion. Such a requirement would effectively impose upon the SBS Dealer a duty to second-guess the Special Entity's own assessment of its representative and provide the SBS Dealer with the ability to trump a Special Entity's choice of asset manager.

In addition, such a requirement could result in Special Entities having fewer available security-based swap counterparties. SBS Dealers would likely have concerns about potential claims that they failed to discharge their obligation to evaluate the adequacy of the advisor, reached an erroneous conclusion as to the advisor's qualifications, or are otherwise responsible for the performance of a transaction – even where they have performed their required assessment but the end result of the transaction does not ultimately favor the Special Entity. An SBS Dealer required to make such a determination is likely to restrict its transactions with Special Entities to avoid the potential liability, cost, delay, and uncertainty arising from the responsibility for making such an assessment or to pass on to the relevant Special Entity the significant additional costs as a result of that responsibility.

Consequently, the AMG believes when a representative of the Special Entity provides the SBS Dealer with written representations concerning the qualifications of the Special Entity's independent representative, the SBS Dealer should be *required* to rely on any such written representations, absent special circumstances. We strongly support the use of written representations to establish a representative's qualifications, absent circumstances that call those representations into question. We note that the SEC has expressed its preliminary view that it would be *reasonable* for the SBS Dealer to rely on such representations, absent special circumstances.[13] However, we believe that the interests of both the Special Entity and the SBS Dealer are better served by *requiring* the acceptance of such representations unless the SBS Dealer has factual evidence that call those representations into question. This approach protects the Special Entity's right to assess and select its own representative and

[12] *See id.*
[13] *See* SEC Proposal at 42428.

relieves the SBS Dealer of the costs and risks of bearing the responsibility for evaluating the representative, with follow-on costs to the Special Entity.

The SEC proposed two alternative approaches to establishing what "special circumstances" would warrant additional inquiry.[14] One approach would permit an SBS Dealer to rely on a representation from the Special Entity unless it knows that the representation is not accurate. The second would permit an SBS Dealer to rely on a representation unless it has information that would cause a reasonable person to question the accuracy of the representation. The AMG believes that, for the reasons stated above, only in the event that the Special Entity has actual knowledge of facts to the contrary, should the SBS Dealer be permitted to interfere in the Special Entity's choice of representative. For this purpose, the category of "special circumstances" should be narrowly construed and should depend upon the SBS Dealer's actual knowledge of facts that clearly controvert material aspects of the representative's qualifications as represented to it.[15]

Written Representations Regarding Fair Pricing and the Appropriateness of the Security-based Swap

A "qualified independent representative," as defined in Proposed Exchange Act Rule 15Fh-5 would also be required to provide "written representations to the [S]pecial [E]ntity regarding fair pricing and the appropriateness of the security-based swap."[16] In the release, the SEC noted its support for the proposition that this standard could be satisfied by a written representation that states "that the representative is obligated, by law and/or contract, to review pricing and appropriateness with respect to any swap transaction in which the representative serves as such with respect to the plan."[17] We believe that a written representation that the representative is obligated, under law or agreement or undertaking, to review pricing and appropriateness, should fully satisfy the purposes of the proposed rule, and we recommend that this standard be incorporated in the final rules.

"Appropriate and Timely Disclosures"

A "qualified independent representative," as defined in Proposed Exchange Act Rule 15Fh-5 would be required to make "appropriate and timely

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[14] *See* SEC Proposal at 42424.

[15] Further, the AMG believes that an SBS Dealer should be expected to establish the requisite "reasonable basis" without requiring investment advisers to open their books to SBS Dealers. A similar issue is created by the SEC's proposed "know your counterparty" obligations, which would require SBS Dealers to obtain and retain a record of "such background information regarding the independent representative as the [SBS Dealer] reasonably deems appropriate." *See* Proposed Exchange Act Rule 15Fh-3(e).

[16] *See* Proposed Exchange Act Rule 15Fh-5(a)(5).

[17] *See* SEC Proposal at 42431.

disclosures" to a Special Entity of material information concerning the security-based swap.[18] The proposed requirement is unclear in scope and creates potentially adverse consequences. For example, the proposed requirement could be read to mandate pre-execution disclosure on a transaction-by-transaction basis. Such a requirement would overturn customary practices in many contexts and have the potential to cause unacceptable delays in the execution of security-based swaps, diminishing Special Entities' ability to hedge positions and portfolio risks and depriving them of trading opportunities. We recommend that the final rules explicitly state that the "appropriate and timely disclosure" requirement would be satisfied if a written representation is provided to the SBS Dealer that states that the representative is obligated by law and/or agreement or undertaking to provide appropriate and timely disclosures to the Special Entity. This approach would recognize that existing advisory relationships carefully define the disclosure duties of advisors to Special Entities and would avoid creating a new and potentially counterproductive standard of communication between investment advisers and their clients.

Automatic "Qualification" for Certain Entities

We urge the SEC to provide in the final rules that an independent representative would be deemed qualified under Proposed Exchange Act Rule 15Fh-5 if the independent representative is an SEC-registered investment adviser, a registered municipal advisor, a bank, an ERISA fiduciary, an insurance company, other Qualified Professional Asset Manager ("QPAM") or In-House Asset Manager ("INHAM") for Special Entities subject to ERISA, or any other similarly qualified professional.[19] Applicable federal and/or state regulations governing these entities impose requirements that ensure a minimum qualification level. For example, an ERISA fiduciary is required to, among other things, discharge its duties with respect to a plan "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use . . . ."[20] Investment advisers are required to act as fiduciaries to their clients,[21] and municipal advisors, banks, and insurance companies are all highly regulated entities. In these cases, any additional evaluation of the representative's qualifications would add little or

[18] *See* Proposed Exchange Act Rule 15Fh-5(a)(4).

[19] The SEC noted that SIFMA, in its February 17 Letter to the CFTC, suggested that an independent representative should be deemed "qualified" if it is "a sophisticated, professional advisor such as a bank, Commission-registered investment adviser, insurance company or other qualifying [Qualified Professional Asset Manager ("QPAM")] or INHAM for Special Entities subject to ERISA, a registered municipal advisor, or a similar qualified professional". *See* SEC Proposal at 42428. The SEC solicited comment on this suggestion. *See id.*

[20] *See* 29 U.S.C. § 1104(a)(1)(B).

[21] *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963) (construing Advisers Act Section 206(1) and (2) as establishing a federal fiduciary standard governing the conduct of investment advisers).

no value, but a requirement for such an assessment would create costs that would ultimately be borne by the Special Entity.

Independence Standard

Under Proposed Exchange Act Rule 15Fh-2(c), the representative of a Special Entity would be deemed to be independent as long as: (1) the representative is not and, within one year, was not an associated person[22] of the SBS Dealer or Major SBS Participant; and (2) the representative has not received more than ten percent of its gross revenues over the past year, directly or indirectly from the SBS Dealer or Major SBS Participant.[23]

The AMG urges the SEC to refine the proposed independence standard to eliminate unintended consequences, including undue restriction of Special Entities' choice of representatives. We recommend that the SEC eliminate the twelve-month "look-back" under which any representative who was an associated person of the SBS Entity at any time during the preceding year would be disqualified from serving as an independent representative. The presumption implicit in the proposed rule – that status as an associated person at any time during the past year results in a loss of independence – would deprive Special Entities of representatives whose affiliations with an SBS Dealer may have been brief, peripheral to their primary business or fully terminated without any residual economic connection. For example, an advisor that recently was acquired from, or otherwise became independent of an SBS Entity within the past year would not satisfy the safe harbor as currently proposed, even though it lacks any continuing connection to the SBS Entity and no other factual basis for an inference of lack of independence exists. Consequently, we recommend that a representative be deemed to be independent if it is not an associated person of the SBS Dealer or Major SBS Participant at the time of the transaction. We note that in 2005, the Department of Labor (the "**DOL**") eliminated a similar "look-back" provision in its Prohibited Transaction Class Exemption 84-14 (the "QPAM Exemption"), reportedly due to difficulties in compliance resulting from consolidation in the financial services industry.[24]

If the SEC determines to keep a "look-back" requirement for associated person status, we believe that it should apply only where there is a continuing

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[22] The term "associated person of a security-based swap dealer or major security-based swap participant" is defined in Exchange Act Section 3(a)(70).

[23] *See* Proposed Exchange Act Rule 15Fh-2(c)(3).

[24] *See* Amendment to Prohibited Transaction Exemption (PTE) 84-14 for Plan Asset Transactions Determined by Independent Qualified Professional Asset Managers, 70 Fed. Reg. 49305 (Aug. 23, 2005). The deleted provision had made the QPAM Exemption unavailable if a party in interest or one of its affiliates had exercised authority to appoint or terminate the QPAM as the manager of a plan's assets or to negotiate the QPAM's asset management agreement with the plan during the one-year period preceding the relevant transaction.

agreement between the advisor or other representative and the SBS Dealer, such as an ongoing corporate services agreement. In addition, we believe that the SEC should revise the proposed restriction to make clear that the disqualification provision would only be triggered by the SBS Dealer and the advisor or representative and that it would not be triggered by any associated persons of the SBS Dealer or the advisor or representative.

We also urge the SEC to eliminate the provision that precludes treating as "independent" representatives who have received more than ten percent of their gross revenues during the past year, directly or indirectly, from the SBS Dealer or Major SBS Participant with which the Special Entity is transacting. Such a restriction could unduly limit the class of representatives available to the Special Entity and would create a revenue ceiling that is both unduly restrictive and difficult to apply. For example, this standard could require a representative to multiple collective investment vehicles to consider the multiple distributors to each vehicle as potential sources of indirect revenue to a representative compensated based upon assets under management. The revenue restriction thus would be extremely complex and overly broad in application. We do not believe that the multiple sources of "indirect" revenues that may be relevant to a representative would, at a ten percent level, compel an inference of lack of independence. Furthermore, we question whether revenue is even an appropriate standard for measuring independence.

If the revenue provision is maintained, the SEC should clarify in the final rules how gross revenues are to be calculated, for example, whether gross revenues are to be calculated on an accrued basis or on a cash basis. We also note that the proposed rolling twelve-month look-back period in both the associated person and revenue provisions are moving targets that would substantially complicate compliance and impose additional administrative burdens and costs on advisors and Special Entities. If the SEC elects to keep the twelve-month look-back period, we recommend that the period be defined as a calendar year rather than a rolling twelve-month period.

The AMG believes that the representative's independence, like its expertise, is best assessed by the Special Entity, and we therefore recommend that the SEC provide in the final rules that it will entertain requests for exemptive relief from Special Entities and their representatives that are unable to meet the requirements of the safe harbor. Finally, we also request that the SEC explicitly state in the final rules that an advisor or representative that is a fiduciary to an ERISA plan is deemed to be independent under Proposed Exchange Act Rule 15Fh-2, reflecting that ERISA standards have appropriate prohibitions on

conflicts of interest which are the equivalent of "independence standards" and need not be duplicated in this context.[25]

Independence standards based upon broad presumptions of undue influence are likely to constrain Special Entities' range of choice among representatives, many of whom are likely to have relationships with multiple financial institutions that could implicate the proposed independence restrictions. We urge the SEC to provide in the final rules that it will entertain requests for exemptive relief from Special Entities who wish to retain a representative who would otherwise be rendered ineligible by the proposed independence criteria. At the same time, we recognize that any exemptive procedure will necessarily entail costs, delay and loss of opportunities for affected Special Entities. Consequently, while we support an exemptive procedure to address circumstances that fall outside the independence restrictions of the rule, we submit that more narrowly drawn independence conditions, such as we have specified above, would satisfy the objectives of the rule without unduly constraining Special Entities' choice of advisors or requiring that they seek special relief in order to effect that choice.

Disclosure Concerning Dealer Capacity

The SEC Proposal would require an SBS Dealer to disclose in writing, before the initiation of a security-based swap with a Special Entity, the capacity in which the SBS Dealer is acting and, if the SBS Dealer engages in business with the entity in more than one capacity or has done so within the preceding twelve months, the material differences between such capacities in connection with the security-based swap and any other financial transaction or service involving the Special Entity.[26]

This proposal raises several concerns. First, the proposed requirement may conflict with the obligations of large financial institutions to keep certain lines of business separated from one another.[27] As noted in the SEC release,[28]

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[25] *See* 29 U.S.C. § 1104(a) (requiring a fiduciary to, among other things, discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries); 29 U.S.C. § 1106(b) (prohibiting a fiduciary from, among other things, dealing with the assets of the plan in his own interest or for his own account and receiving any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan).

[26] *See* Proposed Exchange Act Rule 15Fh-5(b).

[27] *See, e.g.*, Exchange Act Section 15(f), which generally requires broker-dealers to establish, maintain, and enforce policies and procedures reasonably designed to prevent the misuse of material, nonpublic information.

[28] *See* SEC Proposal at 42432 (noting that commenters have observed that "a firm may be acting in multiple capacities in relation to a Special Entity, for example, as underwriter in a bond offering as well as counterparty to a security-based swap used to hedge the financing transaction.").

many SBS Dealers are part of extremely large, multifaceted financial institutions with a multitude of different relationships with the same Special Entity. In order to comply with this proposed requirement, SBS Dealers could be forced to review activities throughout their entire organizations, in some cases across information walls that separate the different business lines of the firm, including, but not limited to, an affiliated asset management division.

Second, the SEC Proposal is likely to have unintended adverse consequences for Special Entities, including execution delays during the time it would take for an SBS Dealer to determine the disclosures it must make to the Special Entity. Further, the additional administrative costs that would be incurred by SBS Dealers to comply with the proposed rule would likely be passed along to Special Entities. The AMG believes that what is critical for Special Entities to know is whether the SBS Dealer is acting in a capacity to the Special Entity other than as a counterparty. If the SEC elects to maintain this requirement in the final rules, we recommend that it address these concerns by simply requiring the SBS Dealer to identify whether it is acting in any capacity other than as a counterparty to a Special Entity. In the alternative, we recommend that the SEC provide in the final rules that this requirement may be satisfied by a generic disclosure by the SBS Dealer that explains the different capacities in which the SBS Dealer may act for its various clients, rather than mandating disclosures customized to each Special Entity.

In addition, as recommended above in the context of the independence standard, we believe that the SEC should make clear in the final rule that this disclosure requirement applies only to the SBS Dealer and the Special Entity and does not include any associated persons of either the SBS Dealer or the Special Entity.[29] We also have the same concerns regarding the proposed rolling twelve-month "look-back" period as articulated above regarding the independence standard and have the same recommendations in this context.

Potential Characterization of SBS Dealers and Major SBS Participants as ERISA Fiduciaries

Under current ERISA rules, a party that provides advice to an ERISA fund or account in a manner that meets all the elements of a five-part test is a "fiduciary" under the meaning of ERISA. Under that test, an entity is a fiduciary if it: (a) renders advice as to the purchase, sale or value of securities or other property (b) on a regular basis (c) pursuant to a mutual understanding, written or otherwise, (d) that the advice will serve as a primary basis for investment decisions with respect to plan assets and (e) will be individualized to the

[29] Otherwise, in some cases it would be almost impossible to determine all such relationships involving affiliates.

particular needs of the plan.[30] Where an SBS Dealer engages in a transaction with an ERISA counterparty, it might be difficult to determine whether the dealer's fulfillment of its duties under the SEC Proposal would cause it to be deemed to be providing advice to the counterparty under the above ERISA rules, particularly where the dealer has an ongoing trading relationship with the ERISA counterparty.

Recently, the DOL proposed to significantly broaden the scope of the definition of investment advice under ERISA[31] by substituting for the conjunctive five-part test a disjunctive list of characteristics, any of which would constitute investment advice.[32] The DOL's proposed definition would significantly broaden the types of communications that could constitute investment advice and cause a party to be deemed a fiduciary under ERISA. This would exacerbate the potential concerns in the SEC Proposal, for example, that satisfying the proposed daily mark requirement, which would require SBS Entities to provide ongoing valuations to their counterparties,[33] could trigger fiduciary status under the DOL's proposal. Furthermore, the DOL's proposed definition includes an exception for advice provided by a party in the context of sales or purchases of securities or other property, provided that the ERISA plan knows, or under the circumstances reasonably should know, that the party is providing the advice in its capacity as an adverse seller or purchaser (the "**DOL Transaction Exception**").[34] However, it remains uncertain whether the DOL Transaction Exception will apply to security-based swap transactions and, if so, whether it will be available in all potential transaction scenarios.

If an SBS Dealer were deemed an ERISA fiduciary, it would be required to adhere to ERISA's fiduciary standards.[35] Most significantly, under the prohibited transaction rules of ERISA and parallel provisions of the federal tax code, fiduciaries are deemed disqualified persons[36] that are prohibited from entering into transactions with an ERISA plan due to conflicts of interest. If an SBS Dealer was deemed to be an ERISA fiduciary, any security-based transaction

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[30] 29 C.F.R. § 2510.3-21.

[31] The DOL proposed changes to the definition of the term "Fiduciary" under ERISA, 75 Fed. Reg. 65263 (Oct. 22, 2010) (the "**DOL Proposal**").

[32] DOL Proposal § 2510.3-21(c)(1)(i).

[33] *See* Proposed Exchange Act Rule 15Fh-3(c).

[34] DOL Proposal § 2510.3-21(c)(1)(i).

[35] Under ERISA, fiduciaries are prohibited from dealing with the assets of a plan in their own interest or for their own account. 29 U.S.C. § 1106(b)(1). ERISA fiduciaries are also prohibited from acting in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan. 29 U.S.C. § 1006(b)(1)–(2). The ERISA fiduciary duty of loyalty prohibits a fiduciary from acting with respect to a plan in situations where it has a conflict of interest. A fiduciary that breaches these duties must restore any losses incurred by the plan or disgorge any profits earned as a result of the breach. 29 U.S.C. § 1109(a).

[36] 26 U.S.C. § 4975(e)(2).

it enters into on a principal basis with a Special Entity would be a non-exempt prohibited transaction under ERISA.

When a prohibited transaction occurs, the fiduciary must reverse the transaction when detected and put the plan in the same position it would be in had the transaction not occurred.[37] Both the advisor to the ERISA plan, as well as the SBS Dealer, could be subject to liability if the SBS Dealer is deemed to be an ERISA fiduciary. Parties in interest that enter into prohibited transactions are subject to a 15% excise tax for every full or partial calendar year that the transaction is outstanding.[38] If a prohibited transaction is not corrected promptly upon enforcement action by the DOL or the Internal Revenue Service, the tax is raised to 100% of the amount involved.[39] This substantial penalty would serve as a serious disincentive for SBS Dealers from engaging in security-based swap transactions with Special Entities subject to ERISA if there were any uncertainty as to whether they would be fiduciaries under ERISA.

The SEC acknowledges the importance of the ability of SBS Dealers to offer security-based swaps to Special Entities that are subject to ERISA and notes that SEC and CFTC staff have been consulting with the staff of the DOL and will continue to do so concerning the potential interface between ERISA and the business conduct rules of the Dodd-Frank Act.[40] We note that Assistant Secretary of Labor of the Employee Benefits Security Administration Phyllis Borzi sent a letter to CFTC Chairman Gary Gensler in April 2011 which stated, among other things, that the DOL's proposal "is not broadly intended to impose ERISA fiduciary obligations on persons who are merely counterparties to plans in arm's length commercial transactions."[41] While helpful, the DOL's letter does not provide sufficient assurance that compliance with the business conduct standards for SBS Entities or Swap Entities will not trigger ERISA fiduciary status. The AMG urges the SEC to provide legal certainty concerning this issue in the final rules. The needed certainty could be provided by the SEC obtaining and confirming in the final business conduct release that it has obtained definitive

[37] 29 U.S.C. § 1109(a).
[38] 26 U.S.C. § 4975(a).
[39] 26 U.S.C. § 4975(b).
[40] Proposal at 42398.
[41] *See* Letter from Phyllis C. Borzi, Assistant Secretary, Employee Benefits Security Administration, U.S. Department of Labor, to Gary Gensler, Chairman, U.S. Commodity Futures Trading Commission (Apr. 28, 2011). In recent testimony before the House Committee on Education and the Workforce, Subcommittee on Health, Employment, Labor, and Pensions, Assistant Secretary Borzi acknowledged the potential intersection of ERISA standards and the Title VII business conduct standards, citing "DOL's plans to harmonize its fiduciary regulation with the CFTC's and SEC's proposed business conduct standards for swap dealers." *See* Testimony of Phyllis C. Borzi, Assistant Secretary, Employee Benefits Security Administration, U.S. Department of Labor, Before the House Committee on Education and the Workforce, Subcommittee on Health, Employment, Labor, and Pensions (July 26, 2011), available at http://www.dol.gov/ebsa/newsroom/ty072611.html.

advice from the DOL that compliance with the business conduct standards for SBS Entities will not trigger ERISA fiduciary status, or, alternatively, by a legally binding advisory opinion from the DOL that provides these assurances before the effective date of the business conduct standards for SBS Entities.

The Pay-to-Play Provisions Could Adversely Affect Certain Special Entities

The SEC Proposal would prohibit SBS Dealers from entering into security-based swap transactions with municipal entities if they, or one of their specified associates, have made a contribution to an official, including incumbents, candidates and successful candidates for elective office of a municipal entity, [42] within a two-year period.[43] To comply with this prohibition, SBS Dealers must carefully monitor their personnel's political contributions to ensure that contributions do not exceed the *de minimis* contribution threshold and that they do not violate the two-year bar on entering into swaps or trading strategies following any forbidden contributions.

We believe that the SEC should create a safe harbor from the pay-to-play provision for a Special Entity that is represented by a "qualified independent representative" that affirmatively selects the SBS Dealer. This safe harbor would assist municipal entities and their advisors by preserving their ability to execute security-based swap transactions.

We also note that, as proposed, the rule would trigger heightened requirements for certain state established plans that are managed by third-party advisors, such as 529 college savings plans. The heightened compliance requirements imposed upon SBS Dealers transacting with such plans and their managers could deter SBS Dealers from entering into security-based swaps with them, diminishing liquidity in the security-based swaps market for such plans. Accordingly, we recommend that the SEC specifically exclude these plans from pay-to-play provisions.

Other Concerns

Opt-Out for Special Entities Represented by Qualified Independent Representatives

The SEC solicited comment on whether certain types of counterparties should be able to opt-out of any of the protections contemplated in the proposed

[42] The SEC Proposal defines "municipal entity" to include "any plan, program or pool of assets sponsored or established by the State, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof." *See* Proposed Exchange Act Rule 15Fh-6(a)(4).

[43] *See* Proposed Exchange Act Rule 15Fh-6(b)(1).

rules.[44] The AMG supports carefully drawn opt-out provisions for certain entities. In particular, Special Entities represented by "qualified independent representatives," as defined in Proposed Exchange Act Rule 15Fh-5(a), should be able to waive protections of the business conduct rules based upon the safeguards inherent in their representation by a qualified independent entity. As noted above, business conduct requirements that are intended to be protective may have unintended negative consequences when applied to entities that have retained expert advisors for the purpose of protecting their interests in security-based swaps and other transactions. In particular, the proposed business conduct requirements could lead to execution delays during the time required for an SBS Dealer to determine the disclosures it must make to the Special Entity. Further, the additional administrative costs that would be incurred by SBS Dealers to comply with the proposed rules would likely be passed along to Special Entities. A Special Entity advised by a qualified independent representative should be able to effect an informed waiver of the protections of the proposed rules based upon its own assessment of the costs and benefits of those protections.[45]

Compliance with Business Conduct Standards Should Not Trigger Municipal Advisor Status

The AMG is also concerned that an SBS Entity's compliance with the proposed disclosure obligations – particularly the risk disclosure and daily mark disclosure requirements under Proposed Exchange Act Rule 15Fh-3(b) and (c) – may cause the SBS Entity to be deemed a municipal advisor when it is transacting with a Special Entity that meets the definition of municipal entity.[46] We ask the SEC to state in the final release that compliance with the business conduct standards, including, but not limited to any applicable risk and daily mark disclosure obligations, would not cause an SBS Entity to be deemed a municipal advisor. Absent such legal certainty, SBS Entities may not be willing to enter into security-based swaps with certain Special Entities.

[44] *See* SEC Proposal at 42402.

[45] For similar reasons, other categories of large sophisticated institutions, such as "qualified institutional buyers" under Rule 144A of the Securities Act of 1933, and entities that do not meet the Rule 144A definition of "qualified institutional buyer," but have total assets over $100 million, should have the ability to opt-out of the business conduct protections after their advisors make an evaluation of the transaction. We do not believe that any counterparties should be able to opt-out of the basic minimum protections, such as Proposed Exchange Act Rule 15Fh-3(g), which requires SBS Entities to communicate with counterparties in a fair and balanced manner based on principles of fair dealing and good faith.

[46] *See generally* Exchange Act Section 15B(e)(4) (defining "municipal advisor").

Scenario Analysis Requirements Would Be Harmful

The SEC solicited comment on whether it should specifically require SBS Entities to provide scenario analysis disclosures.[47] We believe that such a requirement would have potentially significant adverse consequences for Special Entities and other counterparties. Development of scenario analyses depends upon the specific terms agreed by the parties and therefore cannot be performed until full agreement on the material terms is reached. Consequently, such a requirement would likely delay execution of transactions and expose Special Entities and other counterparties to market risk for potentially extended periods of time, including at critical times when the Special Entity is seeking to hedge its positions in volatile markets. In addition, the development of such analyses would cause SBS Entities to incur substantial costs, which would be passed on to Special Entities. The AMG urges the SEC to refrain from requiring that scenario analyses be provided to Special Entities and other counterparties.

Definition of "Special Entity"

The SEC, like the CFTC, proposed to adopt the statutory definition of the term "Special Entity"[48] and has requested comments concerning whether it should interpret "Special Entity" to exclude a collective investment vehicle in which one or more Special Entities have invested.[49] The AMG believes that collective investment vehicles should be excluded from the definition of Special Entity. Had Congress intended to define Special Entities to include collective investment vehicles containing a specific ownership interest, it would have included such a requirement in the statutory text.

Moreover, from a pragmatic standpoint, it would be highly impractical to impose the heightened duties required in respect of Special Entities on the broad range of investors that participate in collective investment vehicles.[50] Sifting through the identities and relative assets of each investor in a collective

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[47] *See* SEC Proposal at 42409. The CFTC Proposal would require Swap Dealers and Major Swap Participants to provide, for high-risk complex bilateral swaps, scenario analysis to non-Swap Entity/non-SBS Entity counterparties. The CFTC Proposal would also provide such counterparties with the ability to opt-in to obtain a scenario analysis for non-high-risk complex bilateral swaps that are not available for trading on a designated contract market or swap execution facility. *See* § 23.431(a)(1), CFTC Proposal at 80558-59

[48] *See* Proposed Exchange Act Rule 15Fh-2(e) (proposing to define the term "Special Entity" to mean: (1) a Federal agency; (2) a State, State agency, city, county, municipality, or other political subdivision of a State; (3) any employee benefit plan, as defined in section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002); (4) any governmental plan, as defined in section 3(32) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(32)); or (5) any endowment, including an endowment that is an organization described in section 501(c)(3) of the Internal Revenue Code of 1986).

[49] *See* SEC Proposal at 42422.

[50] *See* SIFMA February 17, 2011 Letter to the CFTC at 29.

investment vehicle would be unworkable.[51] The complexity associated with collective investment vehicles would make it impracticable to carry out suitability and diligence requirements under the SEC Proposal. Applying the heightened standards for Special Entities to collective investment vehicles would inappropriately subject them and their investors, which could include Special Entities and non–Special Entities, to the increased costs, decreased efficiency and execution delays described above. Therefore, collective investment vehicles should not be subject to the heightened requirements for Special Entities.

The AMG also believes that a definition of "Special Entity" which captures collective investment vehicles would be illogical in light of the other provisions of the statutory business conduct standards. For example, SBS Dealers are required to determine under the statute that a qualified independent representative has agreed to act in the best interests of *the* [emphasis added] Special Entity. Such an agreement by an advisor would not be possible in the context of a collective investment vehicle invested in by multiple Special Entities. The investment manager is a fiduciary to the collective investment vehicle and must consider what is in the best interest of the shareholders of the fund as a group as compared to determining what is in the best interest of a particular shareholder such as a Special Entity.

The AMG believes the inclusion of collective investment vehicles in which one or more Special Entities have invested in the definition of Special Entity may ultimately limit Special Entities' non-security-based swap investment options. Collective investment vehicle managers may either limit or prohibit investments by Special Entities to avoid limitations on their security-based swap trading activities. Such managers might also be concerned that other non–Special Entity investors may redeem their interests or avoid investing their assets in a fund that may be subject to restrictions on trading activities because of investments in the fund by Special Entities.

We also recommend that the SEC revise its definition of Special Entity to specifically exclude all foreign entities. The Dodd-Frank Act creates comprehensive business conduct protections that are applicable to all counterparties to security-based swaps other than SBS Entities and Swap Entities. The additional, heightened safeguards for Special Entities are made applicable only to five enumerated types of entities, none of which is drafted to expressly reach foreign entities. The Special Entity definition contrasts in this respect with other statutory provisions relevant to security-based swaps that make specific reference to foreign entities. The eligible contract participant ("**ECP**") definition, for example, refers to foreign entities specifically and unambiguously, in defining, among other ECP categories, "an insurance company that is regulated by a State,

[51] For example, as many as 100 or more plans may have assets in a given collective investment vehicle.

or that is regulated by a foreign government and is subject to comparable regulation as determined by the [CFTC]," "an employee benefit plan subject to [ERISA], a governmental employee benefit plan, or a foreign person performing a similar role or function subject as such to foreign regulation" and "a governmental entity (including the United States, a State, or a foreign government) or political subdivision of a governmental entity."[52] The failure to incorporate any references to comparable foreign entities in the definition of Special Entity argues strongly that they were not intended to be accorded the heightened protections applicable to Special Entities.

The potential extension of Special Entity protections to foreign entities would also appear to be at odds with the significant additional duties imposed upon SBS Dealers when they are dealing with Special Entities and the potential restrictions upon activity by Special Entities. It is unlikely that Congress intended to accord more protective safeguards with respect to some non-U.S. entities than to the majority of U.S. security-based swap counterparties (i.e., non-Special Entities), particularly when such protections may exceed the safeguards that would otherwise apply in the relevant non-U.S. jurisdiction.

Amendments to Preexisting Security-Based Swaps Should Not Trigger Business Conduct Rules

The AMG strongly supports the SEC's confirmation that the proposed business conduct rules would not apply to security-based swaps executed prior to the compliance date of the final rules.[53] The AMG urges both the SEC and CFTC to codify this approach in their final releases. In addition, the AMG requests that both agencies clarify in their final releases that the business conduct rules would not apply to subsequent amendments, through novation, assignment, or otherwise, of security-based swaps or swaps executed prior to the compliance date of the final rules. A contrary approach would run counter to the reasonable expectations of many Special Entities and other security-based swap counterparties. Moreover, the potential application of rules that did not exist at the time that a Special Entity negotiated and structured a transaction would force a Special Entity to have to abide by rules that were not originally contemplated by the Special Entity and could impair a Special Entity's ability to transfer or unwind a position.

Potential Trading Ahead and Frontrunning Prohibitions

The CFTC Proposal includes a prohibition against any Swap Entity "knowingly" and without specific counterparty consent entering into a transaction for its own benefit ahead of: (i) any executable order for a swap received from a counterparty; or (ii) any swap that is the subject of a negotiation with a

[52] *See* 7 U.S.C. § 1a(12).
[53] *See* SEC Proposal at 42401.

counterparty.[54] The AMG believes that the CFTC's proposed prohibition presents a risk of significant unintended consequences if construed to preclude legitimate hedging activities that are undertaken to hedge the risk of a security-based swap that is the subject of a negotiation with specific counterparties or the subject of an executable order for a security-based swap received from a counterparty.

The SEC Proposal does not include any comparable prohibition, and the AMG urges the SEC to continue to eschew such a bar and to explicitly confirm in the final rules that anticipatory hedging transactions for a particular transaction with a Special Entity are not intended to be prohibited provided such transactions were not entered into with the intent to manipulate the market or disadvantage the Special Entity. If the SEC were to adopt any such prohibitions of this nature, we urge it to include an exemption for anticipatory hedging transactions. To the extent that a trading ahead or frontrunning prohibition is read to preclude anticipatory hedging, it would reduce the willingness and ability of SBS Entities to enter into security-based swaps with Special Entities and all other counterparties. Also, if SBS Entities are unable to effectively hedge, their costs will increase, which will be passed along to Special Entities and all other counterparties.

Scope of Exception for Electronically Executed Transactions

The SEC Proposal would exempt certain exchange-executed security-based swaps from several of the proposed requirements that would otherwise be imposed on SBS Dealers and SBS Entities. In particular, the SEC Proposal provides that the requirements of Proposed Exchange Act Rules 15Fh-4(b) and 15Fh-5, and the prohibition in Proposed Exchange Act Rule 15Fh-6(b)(1), would not apply with respect to a security-based swap if (1) the transaction is executed on a registered security-based swap execution facility or registered national securities exchange; and (2) the SBS Entity does not know the identity of the counterparty, at any time up to and including execution of the transaction.[55]

The concerns addressed in the SEC Proposal will be largely inapplicable to transactions in security-based swaps entered into through registered security-based swap execution facilities, swap execution facilities, or registered national securities exchanges (collectively referred to as "exchanges") and then cleared through registered clearing organizations. In the exchange-traded environment, when transacting in a central limit order book, there is no negotiation with the SBS Dealer over the terms of the security-based swap and no expectation of anything other than an arms-length relationship between counterparties. In addition, as clearing of security-based swap transactions substantially reduces counterparty credit risk,

[54] *See* § 23.410(c), CFTC Proposal at 80658.
[55] *See* Proposed Exchange Act Rules 15Fh-4(b)(3), 15Fh-5(c), and 15Fh-6(b)(2)(iii).

market participants will generally seek the best price without regard to the creditworthiness of the counterparty.

Given these key differences between the current, bilateral security-based swap environment and the exchange-traded environment contemplated by the Dodd-Frank Act, the AMG believes that when a security-based swap is cleared and exchange-traded, the transaction should not be subject to the requirements of the SEC business conduct standards irrespective of whether the identity of the counterparty is known at the time of execution. In addition, as a practical matter, it is anticipated that parties to exchange-traded security-based swaps may know the identity of their counterparty before the transaction is executed, either because the exchange uses a request for quote system (where the participants can seek quotes from specific counterparties) or a single-dealer platform or because information about the counterparties to the trade is necessary to complete the execution process. If mere knowledge of a counterparty's identity triggers compliance with the proposed rules, the outcome will be delay, additional complexity, individual negotiation and potentially less transparency – precisely the result that the trading and clearing requirements of the Dodd-Frank Act seek to avoid. We do not believe that the mere identification of an SBS Entity as a counterparty to a transaction conducted through a highly regulated venue should trigger the provisions of the business conduct standards.

Regulatory Coordination

The AMG commends the SEC for its consideration of the more than 70 comment letters received by the CFTC on its business conduct proposals with a view to achieving the best approach for security-based swaps. We believe that several aspects of the SEC Proposal will better serve the objectives of balancing investor protection and promoting "efficiency, competition, and capital formation,"[56] including, but not limited to, the proposal to establish an exclusion that would allow Special Entities to opt-out of certain protections that would otherwise apply when an SBS Dealer is acting as an advisor; the proposal to establish an objective test for determining if a representative is independent; and the omission of any proposed requirement for providing scenario analyses or proposed prohibitions against trading ahead and frontrunning. We believe that the CFTC should consider the SEC's approach to these issues and adopt the same standards, as may be modified based on input to the SEC Proposal, for swaps within its jurisdiction. In addition, we ask that the SEC and CFTC coordinate the effective dates of their respective business conduct rules to facilitate the development of compliance systems that address both sets of rules.

We also urge continued coordination by the SEC, CFTC, and DOL with respect to the intersection of the business conduct rules for both Swap Entities and

[56] *See* SEC Proposal at 42398, note 17.

SBS Entities and the DOL rules pertaining to the definition of the term "fiduciary" under ERISA. Given the significant potential financial consequences to SBS Entities, Swap Entities, asset managers and ERISA plans, the AMG believes that it is imperative that the SEC, CFTC, and DOL fully coordinate their rulemakings and interpretations of the rules so that all three regulatory schemes are harmonized in a manner that does not result in SBS Entity or Swap Entity counterparties to ERISA plans deemed fiduciaries under ERISA.[57]

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The AMG thanks the SEC for the opportunity to comment on the proposed rulemaking regarding business conduct standards for SBS Dealers and Major SBS Participants under Title VII. The AMG would welcome the opportunity to further discuss our comments with you. Should you have any questions, please do not hesitate to call the undersigned at 212-313-1389.

Respectfully submitted,

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cc: Chairman Mary L. Schapiro, SEC
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Chairman Gary Gensler, CFTC
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Commissioner Michael Dunn, CFTC
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[57] All such coordination would be consistent with President Barack Obama's January 18, 2011 Executive Order, in which he requested that federal agencies undertake greater coordination to avoid redundant, inconsistent or overlapping regulations. Although the SEC is not technically bound by this order, the importance of regulatory coordination described therein seems highly relevant in this instance.