

CLIENT ALERT

DOL Provides ERISA Fiduciary Relief to FCMs and Clearing Organizations for Certain Swap Transactions with ERISA Plans

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Yesterday, the Department of Labor (DOL) issued an [advisory opinion](#) clarifying the ERISA fiduciary status of futures commission merchants (FCMs) and clearing organizations where they perform swap transactions on behalf of ERISA plans. The advisory opinion at issue was provided by the DOL in response to a written request by the Securities Industry and Financial Markets Association (SIFMA).

Prior to the issuance of this advisory opinion, concerns had been raised that a significant number of institutions might refuse to act as FCMs or clearing organizations for ERISA plans so long as there was a risk that exercising default rights as part of the swap transaction could subject the FCM or clearing organization to potential ERISA fiduciary liability. The advisory opinion should alleviate the concerns of ERISA plans, FCMs, and clearing organizations that fiduciary hurdles could shut ERISA plans out of the swap market, a concern that seemed to have been evident to the DOL. However, as noted in more detail below, ERISA plans, FCMs and clearing organizations will need to exercise caution to ensure that their swap agreements otherwise comply with ERISA and this advisory opinion, or else risk losing the relief granted by this advisory opinion.

The advisory opinion expressly notes that the DOL has shared its opinion with the Commodity Futures Trading Commission (CFTC) and that the CFTC does not believe that the conclusions reached in the letter are inconsistent with the Commodity Exchange Act or the CFTC's regulation of cleared swap transactions thereunder. The DOL provided several key pieces of guidance (subject to the caveats highlighted below) in this advisory opinion as follows:

- **Margin.** Margin (whether held by the FCM or a clearing organization) in connection with a swap transaction is not a "plan asset" for the purposes of Title I of ERISA. Instead, the plan's assets are "the rights embodied in the swap contract as evidenced by the written agreement between the plan and Clearing Member, including rights the plan may have to gains payable to the plan that may be realized by the Clearing Member in entering into close-out and risk-reducing transactions."
- **Contractual Rights.** Agreed contractual rights relating to defaults or other events do not necessarily amount to the type of authority or control over plan assets contemplated under section 3(21)(A)(i) of ERISA. Accordingly, an FCM or clearing organization acting pursuant to the express terms of a swap agreement "would not be exercising any authority or control with regard to plan assets and would not be a plan fiduciary within the meaning of section 3(21)(A)(i) solely by reason of liquidating the swap contracts in a plan's account and selling any collateral posted as margin in order to pay off losses suffered by such account."
- **Exercise of Liquidation and Set-off.** Exercise of expressly-granted rights under a swap agreement with an ERISA plan (including liquidation and close-out rights) may qualify as an ancillary transaction for which relief from certain ERISA requirements is available under Prohibited Transaction Exemption 84-14 (the so-called "QPAM Exemption"). In

particular, the advisory opinion notes as follows:

The QPAM Exemption would provide relief for such liquidation and close-out transactions as subsidiary transactions if the agreement governing the primary transaction (in this case, the Agreement for swap clearing services) negotiated by a QPAM [(i.e., a qualified professional asset manager)] contains sufficient terms of the subsidiary transactions such that the potential outcomes of the subsidiary transactions are reasonably foreseeable to the QPAM when entering into the Agreement. Specifically, in evaluating the potential outcomes of these transactions, the QPAM would look to the terms of the Agreement regarding the rights of the Clearing Member upon a plan's default or other contractually specified event, including, but not limited to: (1) provisions addressing how the Clearing Member may engage the plan in risk-offsetting positions; (2) provisions regarding the price at which the Clearing Member may liquidate positions, as well as the liquidation process; (3) provisions addressing how the plan's positions may be auctioned off; and (4) provisions addressing how the Clearing Member may purchase the plan's positions directly.

However, the DOL imposed several limitations on this guidance that ERISA plans as well as FCMs and clearing organizations should be aware of:

- The act of entering into the swap agreement is still subject to all normal ERISA protections and duties. As such, an ERISA plan that enters into a swap agreement is still exercising ERISA fiduciary discretion in selecting and negotiating the agreement. Hence, ERISA plans should examine their swap agreements carefully to ensure that they are prudent fiduciary arrangements, and that they do not inadvertently trigger prohibited-transaction concerns.
- The service provider entering into a swap agreement with an ERISA plan will, notwithstanding the other relief provided by the advisory opinion, still be considered a "party in interest" for ERISA purposes. FCMs and clearing organizations need to ensure that their swap agreements with ERISA plans qualify for relief under an existing ERISA prohibited-transaction exemption, comply with existing ERISA fiduciary guidance and meet all requirements necessary to qualify for relief under an ERISA prohibited-transaction exemption (including, in many cases, fee-disclosure notifications under ERISA 408(b)(2)).
- The DOL's advisory opinion applies where the liquidation and close-out provisions "result from negotiations with an independent plan fiduciary, and . . . the parties understand that the Clearing Member will not be acting in a fiduciary capacity with respect to actions taken in liquidating and closing out an account." An "independent plan fiduciary" is a term of art in the ERISA context and may include a plan official acting in a fiduciary status or an independent adviser acting as an ERISA fiduciary. FCMs and clearing organizations should ensure that all of their swap agreements have been entered into in situations where there have been negotiations with an independent plan fiduciary, i.e., an entity independent of the FCM or clearing organization that has fiduciary discretion over the plan's decision to enter into a swap agreement and the terms of such agreement. If an FCM or a clearing organization has entered into swap agreements where there has not been an independent plan fiduciary, the DOL's guidance may not apply and caution is advised.

- Finally, the availability of the QPAM Exemption in the case of liquidation and close-out is premised on exercise of rights expressly granted under the terms of the swap agreement or other contractual relationship. Caution is again in order if the underlying contract is not clear or the FCM or clearing organization will be trying to act in ways not expressly permitted by the underlying agreements(s).

The DOL's limitations notwithstanding, this advisory opinion is welcome news to ERISA plans, FCMs and clearing organizations. However, FCMs or clearing organizations should review their existing agreements and processes to make sure they can avail themselves of the guidance set forth in the advisory opinion or, if necessary, the QPAM Exemption. ERISA plans should review any swap agreements they have entered, or may enter, into to ensure that they are fully consistent with their ERISA fiduciary duties. Additionally, ERISA plans, FCMs and clearing organizations will need to keep a close eye on the DOL's re-proposal of changes to ERISA's fiduciary definition. Although the DOL has stated that they will work to ensure that this re-proposal does not cause any "unintended consequences" with respect to swap transactions, it remains to be seen whether that proposal will erect any new procedural hurdles for ERISA plans, FCMs and/or clearing organizations.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

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