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Communicating information to and among PIAC Members

WHAT DODD-FRANK MEANS TO YOU

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Many Canadian pension plan administrators are aware that the Dodd-Frank Wall Street Reform and Consumer Protection Act (**Dodd-Frank**) resulted in a major overhaul of financial services regulation in the U.S., and that it has international implications, including implications for Canadian pension plans and master trusts that are not subject to Title I of ERISA (**Canadian Pension Investors**).

The purpose of this note is to provide Canadian Pension Investors with a high level overview, so that they might better understand when to seek more specific advice about the implications of Dodd-Frank. Although Canadian legal counsel can assist in navigating this legislation and reviewing agreements with investment advisors of Canadian Pension Investor clients, Dodd-Frank is U.S. law, and should be reviewed with U.S. counsel. Canadian counsel can assist in this by ensuring U.S. counsel fully understand Canadian investment structures and terms and working as a liaison with U.S. counsel.

WHERE DOES DODD-FRANK COME FROM AND WHAT DOES IT COVER

Dodd-Frank is the U.S.'s response to the financial crisis of 2007-2010 and recommendations adopted by the G20 in 2008. It covers virtually every aspect of financial services and banking regulation in the U.S., including consolidation of regulatory agencies, strengthened disclosure rules and other investor protections, business conduct rules, procedures for dealing with or providing credit to insolvent firms, and comprehensive regulation of financial markets, as well as measures aimed at increasing international standards and cooperation, including increased transparency of derivatives and exchange controls. A main issue for Canadian Pension Investors is that buyers and sellers of over-the-counter derivatives clear their standardized trades through a central counterparty. It covers all over-the-counter derivatives, including non-spot foreign exchange products written by U.S. counterparties, forward contracts, foreign exchange futures, foreign exchange swaps (**FX Instruments**), as well as potentially, other types of swap transactions. It affects all those who participate in such instruments. Europeans have implemented their own European Market Infrastructure directive, which will impact FX Instruments written in Europe. Due to the lack of a central securities regulator in Canada, the provincial regulators are looking into adopting similar concepts for Canada.

EXTERNAL BUSINESS CONDUCT RULES

Among other things, the Dodd-Frank Act requires dealers in swaps and derivatives whose swap activities exceed a USD$8 billion threshold (**Swap Dealers**) and "major swap participants" to register with the Securities and Exchange Commission. In addition, to give effect to certain provisions of the Dodd-Frank Act, the Commodity Futures Trading Commission (**CTFC**) has issued a number of "know your customer" and "external business conduct" rules on Swap Dealers and major swap participants. These rules require Swap Dealers to conduct diligence on counterparties and ensure that swap recommendations are suitable. New swaps and the modification of existing swaps are prohibited until such time as the swap documentation is supplemented with new terms. Such supplements may be implemented by FX Instrument counterparties either on a bilateral negotiated basis or by adhering to a protocol (the **Protocol**) developed by the International Swaps and Derivatives Association (**ISDA**).

continued on page 5

IN THIS ISSUE

What Dodd-Frank Means To You
continued from page 1

THE PROTOCOL AND THE QUESTIONNAIRE

The Protocol is bilateral – both participants to a trade must adhere to it in order for the provisions of the Protocol to become effective as between the two participants. It requires detailed representations as to the legal status of the participants (e.g., eligible contract participant, Swap Dealer, major swap participant, special entity[1]). It requires that information be provided on an ongoing basis.

As discussed above, as part of the heightened duties imposed by the CTFC's external business conduct rules, Swap Dealers are subjected to suitability requirements involving conducting diligence on counterparties. The Protocol provides for the election of "safe harbours" which allow Swap Dealers to avoid these increased duties. These safe harbours are made available to a Swap Dealer if it can determine that the counterparty to a trade is capable of evaluating the risks involved in a swap. Such determination is achieved by having the counterparty represent that it has complied with certain written policies and procedures (**Policies and Procedures**).

The safe harbours are made available under Schedules to the Protocol and, in order to avoid the increased duties imposed on them, Swap Dealers may require that the appropriate safe harbour be elected before agreeing to future trades. There are two Schedules of note for Canadian investors – Schedule 3 which may be incorporated into an ISDA agreement between a Swap Dealer and a party that is not a "regulated swap entity" or a "special entity" (**Non-Special Entity**), and Schedule 4 which may be incorporated into an ISDA agreement between a Swap Dealer and a party that is "special entity" that is not an "ERISA special entity" (**Non-ERISA Entity**). A Non-ERISA Entity is defined as including not only (i) governmental plans, as defined in ERISA and the United States Internal Revenue Code (generally any plan established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing); (ii) United States Federal or State agencies; (iii) states, cities, countries, municipalities and other political subdivisions of a State; (iv) instrumentalities, departments of corporations of or established by a State or a political subdivision of a State; and (v) endowments, but also (vi) employee benefit plans defined in section 3 of the Employee Retirement Income Security Act of 1974 (**ERISA**) that are not subject to Title I of ERISA that elect to be special entities. The definition of employee benefit plan in section 3 of ERISA is not limited to US plans; non-US employee benefit plans are generally exempted from ERISA's reach by the separate provision of section 4(b) of ERISA. A Canadian Pension Investor would have the discretion to determine if it wanted to be a Non-Special Entity or a Non-ERISA Entity. Canadian pension plans may elect Schedule 4. In addition, based on SEC commentary that stated that a swap dealer will not fail to comply with the Dodd-Frank Act with respect to an ERISA plan if it otherwise complied with such requirements with respect to a master trust (i.e., a trust that holds the assets of multiple plans of a single employer or related employers), it appears that a Canadian master trust also could elect Schedule 4.

The Protocol contains a questionnaire designed to allow a counterparty to provide the representations necessary for the Swap Dealer to conduct the diligence on the counterparty and for the counterparty to elect the applicable safe harbour. Administrators and managers of Canadian Pension Investors who participate in swaps and other FX Instruments are likely to have already received such questionnaires.

SAFE HARBOURS AND THEIR IMPLICATIONS

A Canadian Pension Investor which elects to be treated as a Non-Special Entity makes the representations in Schedule 3 and represents that it has complied with Policies and Procedures designed to ensure that the person responsible for evaluating a swap and making trading decisions is capable of doing so.

A Canadian Pension Investor which elects to be treated as a Non-ERISA Entity makes the representations set out in Schedule 4 and is, in fact, representing that it has complied with Policies and Procedures designed to ensure that it has selected an independent advisor acting in the best interest of the Non-ERISA Entity, who can evaluate the swap and its risks, pricing and appropriateness, and who will make appropriate and timely disclosures to the Non-ERISA Entity, and that it can monitor the advisor's performance.

1 "Special Entity" includes employee benefit plans subject to Title I of the Employee Retirement Income Security Act, 1974; governmental plans as defined in ERISA Section 3; endowments, state and federal agencies, and other protected counterparties, the two subsets being ERISA Special Entities and non-ERISA Special Entities.

continued on page 6

CALL FOR BOARD NOMINATIONS

The PIAC Governance and Nominating Committee annually invites members to suggest names or to volunteer to be considered for PIAC's Board of Directors. The Governance and Nominating Committee is charged with recommending candidates for the Board to the Membership and requests that any names be submitted to Julie Cays, Chair of the Governance and Nominating Committee, by July 1, 2013. Julie can be reached at 416-673-9033 or jcays@caatpension.on.ca

The term of office for Directors is three years, with a maximum of two three years terms, except in the case of Directors who are serving as Officers, in which case they may be elected for additional terms in order to fulfill their responsibilities as Officers. There are normally four Board meetings per year. Two of those meetings are generally two hours in length and held via conference call. The other two meetings are half day meetings held immediately prior to the opening dinners of PIAC's Spring and Fall conferences. Participation in these meetings is very important. In addition, every Director is expected to serve on at least one PIAC Committee in order to participate fully in the life of the Association.

The Governance and Nominating Committee shall review the nominees submitted through the call for nominations together with the candidates the Committee itself has identified and shall prepare a list of nominees which it determines best reflects the demographic and geographic composition of PIAC and achieves an optimum mix of the abilities of nominees.

After determining that all the candidates being proposed for the list are prepared to stand, the Committee will contact the other candidates to explain the decision of the Committee, to encourage their participation in other ways in PIAC and to let them know that they may still stand for election, although they will not be on the recommended list.

In the event that there are still more nominees than vacancies on the Board, a ballot shall be sent to Members with a report presenting the list of nominees recommended by the Governance and Nominating Committee pursuant to the criteria above together with a list of the additional nominees. A biographical outline (maximum 100 words) of each candidate will be provided to the Members along with the ballot not later than 60 days prior to the Fall Conference with a deadline for return not more than 30 days later. The results of the ballot will be announced at the Fall Conference and publicized in Communiqué.

In the event that a ballot is not required, the Chair of the Governance and Nominating Committee shall present a report to at the Fall Conference announcing who has been acclaimed to office.

For additional details on the responsibilities of the Board as well as PIAC's Committees, please see the PIAC web site under Board/Committees.

What Dodd-Frank Means To You

continued from page 5

Obviously, in order to make such representations, the respondent to the questionnaire should ensure that there really is a process in place which complies with the concept of the Policies and Procedures discussed above. As concerns a Non-ERISA Entity, this should involve a review of any agreement with an investment advisor recommending swaps and any internal policies with respect to such advisors in order to confirm that the advisor is independent and acting in the best interest of the Non-ERISA Entity, that it can evaluate the swap and its risks, pricing and appropriateness, that it is required to make appropriate and timely disclosures, and that the advisor's performance can be monitored.

Therefore, although the Dodd-Frank Act constitutes consumer protection legislation, any insistence by Swap Dealers on safe harbour representations means that their clients are required to take steps to protect the Swap Dealers from the increased duties imposed by these new external business conduct rules.

TIMING

Originally, the external business conduct rules were to be effective as of January 1, 2013, but have been postponed until May 1, 2013. This gives Canadian Pension Investors additional time to review their internal policies and agreements with investment advisors in order to ensure that the safe harbour can be used if they so wish or are required to do so in order to continue participate in the FX Instrument market. It also provides time to obtain any Canadian or U.S. legal advice.