

Impacts of Financial Regulatory Reform – Pension Funds
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FEI Summary

Companies that have pension plans and actively utilize the derivatives markets to hedge interest rates, foreign exchange, or equities, or that invest in stable value funds will be impacted by the Dodd-Frank Act (HR 4173). Most of these provisions will take effect within one year from now, so companies should be preparing now to understand potential impacts from the legislation.

The following are some potential impacts of the legislation on pension funds.

Employee Benefit Plans are Required to Centrally Clear Derivatives

Pension funds are not considered major swap participants but are characterized as financial entities. Under the legislation, financial entities are not allowed an exemption from central clearing. Thus, any customized over-the-counter hedges used by a pension plan would have to be centrally cleared and subjected to clearing entities' charges and margin requirements. These include interest rate, foreign exchange or equity hedges.

Study on Stable Value Funds

The law requires a study on the applications of swaps definition to stable value funds, widely used in pension plans. Until the study is completed, the swap clearing and margin requirements will not apply to stable value funds.

Dealers Have New Requirements Before They Can Enter Into Derivative Transactions With Employee Benefit Plans

Dealers must verify that the entity is an eligible contract participant (see definition below) and disclose (1) material risks and characteristics of the swap (2) any material incentives or conflicts of interest, and (3) the capacity in which the swap dealer is acting.

The dealer must also provide daily valuations of the transactions, and must have a reasonable basis to believe that the employee benefit plan has an independent representative to evaluate risks and make appropriate disclosures.

Pension Plans Must Meet Definition of Eligible Contract Participant

Employee benefit plans must have at least \$50 million "invested on a discretionary basis" in order to be considered an "eligible contract participant," and thus be able to enter into over-the-counter derivatives contracts.

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