

Safe Harbor 'ERISA Special Entity' and 'Non-special Entity' Letters Published by ISDA®

by Practical Law Finance

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ISDA has published sample letters that swap dealers (SDs) may provide to their swap counterparties that are either "ERISA special entities" or "non-special entities" in order to comply with final Dodd-Frank external business conduct (EBC) rules (also referred to as external business conduct standards or EBCS) for SDs and MSPs.

On May 1, 2013, ISDA® published sample letters designed to help swap dealers (SDs) comply with final Dodd-Frank external business conduct (EBC) rules (also referred to as external business conduct standards or EBCS) that prescribe how SDs must interact with certain "special entities" with which they enter into swaps. Under the final ECBS, which took effect on May 1, 2013, SDs must ensure that they remain independent of special entities in their swap dealings, or face increased advisory responsibilities. Special entities are certain local, state and federal government entities and qualified retirement plans.

- [ERISA special entity letter](#) is designed to help SDs document their independence from ERISA special entities with which they enter into swaps.
- [The non-special entity letter](#) is designed to help SDs document their independence from non-special entities with which they enter into swaps.

The letters, which are part of [ISDA's Dodd-Frank Documentation Initiative](#), contain various disclosures and representations from both parties outlining the independence of the SD from its counterparty in entering into the swap. These letters can be provided at the outset of communication by an SD with an ERISA special entity swap counterparty or potential counterparty, or a non-special entity counterparty or potential counterparty, prior to entering into a swap agreement with the counterparty to ensure that all communications relating to entering into the swap are covered by the safe harbor.

Note that the ERISA special entity letter is not necessary for parties that have already entered into the August 2012 Dodd-Frank Protocol Supplement Schedules 5 or 6, as those schedules contain representations that qualify the SD for the same safe harbor as the representations made in the ERISA special entity letter. The non-special entity letter is not necessary for parties that have already entered into the August 2012 Dodd-Frank Protocol Supplement Schedule 3, as that schedule contains representations that qualify the SD for the same safe harbor as the representations made in the non-special entity letter. For more on these Schedules, see [Practice Note, The ISDA Dodd-Frank Protocol: The August Protocol DF Supplement and Schedules](#).

ISDA also recently published a non-ERISA special entity letter, which functions similarly to the ERISA special entity letter (see [Legal Update, ISDA Publishes Sample 'Special Entities Letter for Swap Dealers'](#)).

ERISA Special Entity Letter

In the ERISA special entity letter, the SD discloses that it:

- Is acting in its capacity as a swap counterparty and is not undertaking to assess the suitability of any swap for its counterparty.
- Is not acting in the best interests of the counterparty in entering into the swap.

- Has not expressed an opinion as to whether the counterparty should enter into the swap. (This disclosure can be deleted if the counterparty selects Option 1 described below.)

In the ERISA special entity letter, the ERISA counterparty must choose between two sets of representations depending which of the following safe harbors for ERISA special entities it falls under:

- "ERISA special entity only" 23.440 safe harbor.
- "General special entity" 23.440(b)(2) safe harbor.

If the ERISA counterparty falls under the "ERISA special entity only" safe harbor (corresponding to Schedule 5 of the August Dodd-Frank Protocol documents (see [Practice Note, The ISDA Dodd-Frank Protocol: The August Protocol DF Supplement and Schedules](#)), the ERISA counterparty makes the following representations under Option 1 of the letter:

- The ERISA counterparty has selected a designated fiduciary as its "qualified independent representative" within the meaning of CFTC Regulation 23.450.
- The designated fiduciary's true name and address are as set out on the letter's signature page.
- The designated fiduciary is a "fiduciary" as defined in Section 3 of the Employee Retirement Income Security Act of 1974, as amended (ERISA), and is responsible for representing the ERISA counterparty regarding the swap.
- The ERISA counterparty either:
 - will comply in good faith with written policies and procedures reasonably designed to ensure that any "recommendation" (as used in CFTC Regulations 23.434 and 23.440) it receives from the SD that materially affects a swap transaction is evaluated by a designated fiduciary before the transaction occurs; or
 - any recommendation from the SD that materially affects a swap transaction will be evaluated on behalf of the ERISA counterparty by a designated fiduciary before the transaction occurs.
- The ERISA counterparty is exercising independent judgment in consultation with the designated fiduciary in evaluating the SD's recommendations regarding any swap.

In connection with Option 1, the designated fiduciary represents that:

- It is not relying on any recommendations by the SD.
- It is exercising independent judgment in evaluating recommendations by the SD regarding any swap that are presented to it.

If the ERISA counterparty falls under the "general special entity" safe harbor (corresponding to Schedule 6 of the August Dodd-Frank Protocol documents (see [Practice Note, The ISDA Dodd-Frank Protocol: The August Protocol DF Supplement and Schedules](#)), the ERISA counterparty makes the following representations under Option 2 of the letter:

- The ERISA counterparty has selected a designated fiduciary as its "qualified independent representative" within the meaning of CFTC Regulation 23.450.
- The designated fiduciary's true name and address are as set out on the letter's signature page.
- The designated fiduciary is a "fiduciary" as defined in Section 3 of ERISA.
- The ERISA counterparty will not rely on any "recommendation" (as used in CFTC Regulations 23.434 and 23.440) by the SD.
- The ERISA counterparty will rely on the advice of the designated fiduciary.
- The ERISA counterparty is exercising independent judgment in consultation with the designated fiduciary in evaluating the SD's recommendations regarding any swap.
- The SD has not expressed an opinion as to whether the ERISA counterparty should enter into the swap.

In connection with Option 2, the designated fiduciary represents that it is exercising independent judgment in evaluating recommendations by the SD regarding any swap that are presented to it.

The representations contained in the ERISA special entity letter are sufficient to qualify the SD for the applicable safe harbor under [17 C.F.R. § 23.440](#), which relieves it from the duty to engage in any heightened suitability analysis for the counterparty and swap in question and from qualifying

as an advisor under the CEA. While the EBCS also apply to MSPs that enter into swaps with special entities, ISDA does not address MSPs in the letter.

Non-special Entity Letter

In the non-special entity letter, the SD discloses that it is acting in its capacity as a counterparty and is not undertaking to assess the suitability of any swap for the counterparty. This letter requires the counterparty to choose between two sets of representations depending on whether or not it has a designated evaluation agent. If the counterparty has a designated evaluation agent, the counterparty makes the following representations:

- The counterparty has selected a designated evaluation agent as its "agent" to evaluate investment risks regarding swaps and any "recommendation" (as used in CFTC Regulation 23.434) regarding a swap provided by the SD and to make trading decisions on the counterparty's behalf.
- The counterparty has complied in good faith with written policies and procedures reasonably designed to ensure that the designated evaluation agent is capable of evaluating any recommendation regarding a swap provided by the SD and is capable of making trading decisions on its behalf.
- The counterparty is exercising independent judgment on consultation with the designated evaluation agent in evaluating the recommendations of the SD regarding any swap.

The designated evaluation agent represents that it is exercising independent judgment in evaluating the recommendations of the SD regarding any swap that are presented to the designated evaluation agent.

If a counterparty does not have a designated evaluation agent, it makes the following representations:

- It has complied in good faith with written policies and procedures reasonably designed to ensure that persons responsible for evaluating any "recommendation" (as used in CFTC Regulation 23.434) regarding a swap provided by the SD, and to make decisions on its behalf, are capable of doing so.
- It is exercising its independent judgment in evaluating the recommendations of the SD regarding any swap.

The representations contained in the ERISA non-special entity letter are sufficient to qualify the participating SD for the applicable safe harbor under [17 C.F.R. § 23.440](#), which relieves it from the duty to engage in any heightened suitability analysis for the swap in question and from qualifying as an advisor under the CEA. While the EBCS also apply to MSPs that enter into swaps with special entities, ISDA did not address MSPs in the letter.

For more on swaps with special entities and the special requirements surrounding them, see [Practice Note, Swap Dealers and MSPs: Final Dodd-Frank External Business Conduct \(EBC\) Rules: Swaps with Special Entities](#).

For more information about the final Dodd-Frank EBCS for SDs and MSPs, see [Practice Note, Swap Dealers and MSPs: Final Dodd-Frank External Business Conduct \(EBC\) Rules](#).

For a summary of ISDA's sample safe harbor letter for non-ERISA special entities, see [Legal Update, ISDA Publishes Sample 'Special Entities Letter for Swap Dealers](#).

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