



November 4, 2011

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA (RIN 3038 – AD60)

Dear Mr. Stawick:

Better Markets, Inc.¹ appreciates the opportunity to comment on matters identified in the above-captioned notice of proposed rulemaking (“NOPR”) of the Commodity Futures Trading Commission (“CFTC”), relating to proposed rules (the “Proposed Rules”) addressing the schedule for compliance with mandatory clearing and trade execution, pursuant to and in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) amendments to the Commodity Exchange Act (“CEA”).

INTRODUCTION

A fundamental premise of the Dodd-Frank Act is that the central clearing of derivatives reduces systemic risk. Another focus is that derivatives trade execution must be transparent and accessible by all, out of opaque shadow trading markets that obscured the accumulating risk that precipitated the recent financial crisis.

Mandatory clearing at derivatives clearing organizations (“DCOs”) and mandatory trade execution through designated contract markets (“DCMs”) and swap execution facilities (“SEFs”) are the twin pillars of the Dodd-Frank Act which will achieve these goals.

¹ Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

The financial system will not fully enjoy the protections afforded by financial reform until those pillars are in place and functioning.

As pointed out in the NOPR, several rules must be finalized before mandatory clearing and trade execution can be put into effect. Moreover, market participants must adapt to the changed requirements. The Proposed Rules lay out a flexible and effective plan which allows adaptation, but recognizes that, in this complex market, a “one-size-fits-all” schedule is not appropriate for all circumstances.

In summary, the Proposed Rules:

- Allow a reasonable (and, in some instances, generous) and appropriate period of time in which market participants can transition to mandatory clearing and trade execution, which additionally is responsive to the expressed needs of the industry; and
- Retain flexibility so that the implementation schedule can be adapted to inevitable changing conditions.

DISCUSSION OF THE PROPOSED RULES

As a threshold matter, the Proposed Rules establish triggering events² from which time the period for compliance with mandatory clearing and trade execution commence:

- For mandatory clearing, the triggering event is the issuance of a determination by the CFTC that the swap, or group, category, type, or class of swaps, is required to be cleared.
- For mandatory trade execution, the triggering event is the later of (1) the applicable deadline established under the compliance schedule for the associated clearing mandate; or (2) 30 days after the swap is made available for trading on either a SEF or a DCM.

The Proposed Rules do not address the process for determining that mandatory clearing should apply or the definition of “available for trading.” Those issues are appropriately dealt with in other rules.

The schedules for compliance are based on the types of market participants affected. It is critically important to note that the schedules constitute outside dates for compliance and do not automatically apply in all cases.

The Commission anticipates that it will exercise its authority to trigger the proposed compliance schedules

² Proposed Rules, Sections 37.12(a) and 39.5(e)(2).

each time it issues a mandatory clearing determination for a new group, category, type, or class of swaps. Under this approach, when a DCO begins offering a new swap for clearing and it is in the same group, category, type, or class of swaps and it meets the requirements imposed under a previously issued mandatory clearing determination, then the proposed compliance schedules would not be triggered.³

This approach is entirely sensible. Mandatory clearing and trade execution for a new category of swaps will require a period of adjustment. However, if a type of swap is commonly cleared already or is part of a class of swaps already subject to mandatory clearing, the adjustment required of market participants would be much less, given the prior experience of regulatory examination and ongoing market clearing experience.

Two categories of market participants are established, with individual maximum compliance schedules assigned to these categories and to all other market participants:⁴

- Category 1 Entities include swap dealers, security-based swap dealers, major swap participants, major security-based swap participants and active funds (any private fund as defined in section 202(a) of the Investment Advisors Act of 1940, which is not a third-party subaccount and that executes 20 or more swaps per month based on a monthly average over the 12 months preceding the mandatory clearing determination).
- Category 2 Entities include commodity pools; private funds as defined in section 202(a) of the Investment Advisors Act of 1940 other than an active fund; employee benefit plans as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974; and persons predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act of 1956, provided that the entity is not a third-party subaccount.

Transactions between Category I entities must be in compliance not later than 90 days after the triggering event. Transactions between Category II entities and Category I entities or other Category II entities must be in compliance within 180 days. And all other transactions must be in compliance within 270 days.

This system for scheduling compliance provides reasonable and appropriate time frames for compliance. It is responsive to the input provided by the industry, as

³ NOPR, 76 FR at page 581191.

⁴ Proposed Rules, Sections 37.12(a) and 39.5(e)(2).

described in the CFTC's analysis of costs and benefits.⁵ It must be remembered that the need to comply with mandatory clearing and trade execution has already been known by market participants for well over a year, and further, that they have been planning for the transition all along.⁶ Preparation for compliance will not commence with a triggering event, it has been clearly underway for some time.

Finally, given the very substantial legal, accounting, and financial resources of the financial services industry, **it is undeniably true that they are more aware and better prepared to deal with upcoming compliance events than perhaps any other sector of the economy.**

SPECIFIC QUESTIONS

The NOPR sets out certain specific questions inviting comment, some in the Preamble and some in Commissioner O'Malia's Statement in Appendix 4. Responses to certain of these are set forth below.

Should there be a presumption that the Commission will rely on the compliance schedule for each mandatory clearing determination that it issues, unless the Commission finds that the compliance schedule is not necessary to achieve the benefits set forth herein (e.g., facilitating the transition to the new regulatory requirement established by the Dodd-Frank Act in an orderly manner that does not unduly disrupt markets and transactions)?

When issuing a mandatory clearing determination, the Commission would set an effective date by which all market participants would have to comply. In other words, the proposed compliance schedules would be used only when the Commission believes that phasing is necessary based on the considerations outlined in this release. The Commission will provide the public with notice of its intent to rely upon the compliance schedule pursuant to the process outlined in § 39.5(b)(5). To afford more certainty to market participants, should the Commission instead create a presumption that it will rely on the compliance schedule for each mandatory clearing determination that it issues, unless it finds that the compliance schedule is not necessary to achieve the benefits set forth in the proposal (e.g., facilitating the transition to the new regulatory regime established by the Dodd-Frank Act in an orderly manner that does not unduly disrupt markets and transactions)? [From Appendix 4]

After the initial trigger events, the vast majority of designations of swaps and classes of swaps for mandatory clearing will have minimal impact on market participants. Systems will be in place and individuals and institutions will be acquainted with the new requirements. It would be totally inappropriate to create an

⁵ NOPR, 76 FR at page 58193.

⁶ See exchange between Mr. Diplas and Mr. Turbeville, Transcript of joint CFTC/SEC Roundtable on Implementation, pages 223-7, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/csjac_transcript050311.pdf

assumption that a schedule designed to accommodate a major change to systems and procedures would be applicable or necessary in every incremental designation. The flexible approach adopted in the Proposed Rules, which does not assume that every further incremental move to mandatory clearing is a novel event, gives market participants a better framework which is far more harmonious with market realities.

Is an entity's average monthly swap transaction activity a useful proxy for that entity's ability to comply with the clearing and trade execution requirements? Or whether an entity is required to be registered with the Commission (rather than whether an entity is already registered with the Commission)?

Swap transaction activity goes to the relevant issue: the ability to handle the systems and legal requirements for the transition to mandatory clearing and trade execution. Entities handling large volumes of swap transactions clearly already have a strong compliance infrastructure with the means to handle pro forma clearing and trade execution requirements. On the other hand, required registration is based on an entirely different set of standards, though registrants would all have such capabilities.

Would it be more appropriate for the Commission to measure a market participant's level of swap activity by measuring notional turnover and/or open exposure, as suggested by some commenters?

Transaction volume is the relevant test. The notional quantity of positions and the amount of exposure represented by open interest is wholly irrelevant to the ability of the entity to handle systems and legal demands. Systemic concerns regarding notional exposures are a separate issue.

What, if any, other issues not addressed in current proposed or final rulemakings should the Commission have taken into consideration when proposing the compliance schedule? For example, should the Commission have considered the extent to which its clearing and trade execution requirements apply to entities and transactions located outside the United States? Also, should the Commission have considered the extent to which such requirements apply to transactions between affiliates (whether domestic or cross-border)? If applicable, how should the Commission adjust the proposed compliance schedule to account for such issues? [From Appendix 4]

Jurisdictional reach and inter-affiliate issues are dealt with in other, substantive rules. If a transaction with international elements or a transaction between affiliates falls within the scope of the clearing and trading mandates, **the transaction is a part of the U.S. market regulated by the CFTC and should not be treated differently under the Proposed Rules.**

CONCLUSION

The Proposed Rules establish a workable schedule for implementation of mandatory clearing and trade execution. They are responsive to the needs expressed by industry representatives, yet are also flexible to adjust to the changing circumstances as the mandates are applied to classes of swaps over time. The benefits and costs of this system have been well balanced and the CFTC should be commended for the results.

We hope these comments are helpful in your consideration of the Proposed Rules.

Sincerely,



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