



**January 3, 2011**

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

Re: Prohibition of Market Manipulation (CFTC RIN 3038-AD27)

Dear Mr. Stawick:

Better Markets, Inc.<sup>1</sup> appreciates the opportunity to comment on the above-captioned proposed rules (the "Proposed Rules") of the Commodity Futures Trading Commission ("CFTC"), the purpose of which are to implement Section 753 of the Dodd-Frank Financial Services Reform Act (the "Dodd-Frank Act").

### **Introduction**

In the Dodd-Frank Act, Congress enhanced the CFTC's anti-manipulation and anti-fraud authority as part of its expanded enforcement powers. Existing authority under Section 6(c)(2) of the Commodity Exchange Act prohibiting, among other things, market manipulation, was explicitly left in place.<sup>2</sup> The Proposed Rules are critical to implementing the important expansion of the CFTC's enforcement capability so that the transparent and reliable marketplace envisioned by the Dodd-Frank Act can be realized. We congratulate the CFTC for its effort to implement this new authority.

Our comments focus on the language in the Proposed Rules which describe their scope: "*in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity,*" [Emphasis

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<sup>1</sup> 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.  
<sup>2</sup> Dodd-Frank Act, Section 753(c)(1)(B).

added.]<sup>3</sup> The highlighted language is intended to establish a broad applicability of the Proposed Rule.<sup>4</sup>

An alternative approach would be to specify ways in which the prohibited activity is connected to any covered swap, contract of sale or contract for future delivery. Provided that the specified ways in which the connection is established are comprehensive, the scope is equally broad, but the potential for ambiguity is significantly less.

There is another very important reason to specify the connections between the prohibited activity and the covered contracts: consistency with parallel regulation. The Securities Exchange Commission ("SEC") has recently published proposed rules relating to the application of anti-fraud regulations in the security-based swaps markets.<sup>5</sup> In this proposed rule, the SEC employed the language "in connection with the offer, purchase or sale of any security-based swap." The SEC also targeted a specific characteristic of swaps: "the ongoing payments or deliveries between the parties throughout the life of the security-based swap pursuant to their rights and obligations."<sup>6</sup> The SEC's proposed rule is clearly focused on the performance of obligations during the life of a swap, such as collateralization, and identified a need to address this characteristic explicitly. The SEC stated its purpose: "making explicit the liability of persons that engaging misconduct to trigger, avoid, or affect the *value* of such ongoing payments or deliveries...." [Emphasis added.]<sup>7</sup>

We have no doubt that the Proposed Rules intend to capture the same conduct that is captioned by the SEC's proposed rule. However, we believe that the scope of the Proposed Rules may not be interpreted as broadly as the SEC's proposed rules. We believe that the use of specific language similar to the SEC's in the Proposed Rules is the best way to ensure that the scope of the Proposed Rules is understood to be equally broad and that the possibility for misinterpretation (and needless litigation) be reduced as well.

## Discussion of Proposed Rules

Section 180.1 of the Proposed Rules is expressly modeled on SEC Rule 10B-5.<sup>8</sup> Significant differences involve specific characteristics of the commodities markets which are distinct from the securities markets.

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<sup>3</sup> Proposed Rules, Section 180.1(a).

<sup>4</sup> Proposed Rules, Preamble, Section II(C)(3);

<sup>5</sup> 17 CFR Part 240.

<sup>6</sup> 17 CFR Part 240, page 68561.

<sup>7</sup> Id.

<sup>8</sup> Proposed Rules, page 67658.

The SEC's proposed anti fraud rule establishes the scope of behavior covered as follows:

*in connection with the offer, purchase or sale of any security-based swap, the exercise of any right or performance of any obligation under a security-based swap, or the avoidance of such exercise or performance... [Emphasis added.]*<sup>9</sup>

The parallel statement of scope in the Proposed Rules is

in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity....<sup>10</sup>

The language of the two rules should be the consistent to ensure that the scope of the two rules is understood to be the same. The emphasized language in the SEC's proposed rule is clearly designed to address characteristics applicable to swaps generally, not just security-based swaps. The language of the two proposed rules should be consistent.

We propose that the more explicit approach of the SEC rule should be adopted. One formulation is as follows:

It shall be unlawful for any person, directly or indirectly, in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity (including, without limitation, in connection with the offer, purchase, sale of any such swap, contract of sale or contract for future delivery and *the exercise of any right or performance of any obligation under any such swap, contract of sale or contract for future delivery, or the avoidance of such exercise or performance*) to intentionally or recklessly....

The above language harmonizes the CFTC Proposed Rules with the SEC's proposed rules and achieves the stated purpose of the Proposed Rules.

Once the rules are harmonized, however, there is still a potential ambiguity that must be addressed. We included proposed language to address this potential ambiguity in our comment on the SEC's proposed rule: it is important that the Proposed Rule unambiguously cover actions which alter the value of any right or performance of any

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<sup>9</sup> 17 CFR Part 240, page 68568.

<sup>10</sup> Proposed Rules, Section 180.1(a).

obligation.<sup>11</sup> The preamble to the SEC's proposed rule clearly and correctly identifies the harm that can be created by actions that change the value of ongoing payments or deliveries.

Swaps typically involve settlements, margin or collateral payments which are calculated with reference to specified factors. This is a critical sub-set of the activities that the Proposed Rule is intended to address. For example, consider the potential that a swap counterparty influences an index provider to employ a valuation methodology for a class of swaps which is favorable to it and whose influence is exercised in a way that constitutes a device, scheme or artifice to defraud or manipulate. The market participant might cause the index provider to use techniques such as weighting more heavily specific price-related listed contracts to measure the value of a type of illiquid swaps that the market participant is heavily invested in. The measured value would favor the market participant. The economic results of the affected transactions could be dramatic because of the effect on ongoing collateral (margin) and settlement payments.

Therefore, we propose that the following language be added to the proposed language set out above, immediately following the words "avoidance of such exercise or performance:"

or the valuation of any right or performance of any obligation under any such swap, contract of sale or contract for future delivery

Thus, the entire proposed language would read as follows:

It shall be unlawful for any person, directly or indirectly, in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity, (including, without limitation, in connection with: the offer, purchase, sale of any such swap, contract of sale or contract for future delivery; the exercise of any right or performance of any obligation under any such swap, contract of sale or contract for future delivery, or the avoidance of such exercise or performance: or the valuation of any right or performance of any obligation under any such swap, contract of sale or contract for future delivery) to intentionally or recklessly....

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<sup>11</sup> Better Markets, Inc. Comment Letter dated December 23, 2010 regarding SEC Proposed Rule – Prohibition Against Fraud, Deception, and Deception In Connection With Security-Based Swaps. (For convenience, we have attached a copy of that letter to this letter.)

## Conclusion

The standards established in the Proposed Rules are a needed enhancement of the CFTC's authority to encourage a reliable and fair marketplace. We support the CFTC's effort and the fundamental elements of the Proposed Rules, although we believe that the changes suggested above are essential to achieve the goals and purposes of the Proposed Rules.

We hope these comments are helpful in your consideration.

Sincerely,



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