



January 24, 2011

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

Re: Registration of Swap Dealers and Major Swap Participants (CFTC RIN 3038-AC95)

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 establish the process for registering Swap Dealers ("SDs") and Major Swap Participants ("MSPs") as required by provisions of the Dodd-Frank Financial Services Reform Act (the "Dodd-Frank Act").

### **Introduction**

The Proposed Rules implement the provisions of the Dodd-Frank Act that require the registration with the CFTC of SDs and MSPs and establish standards for initial and continued registration.<sup>2</sup> The Proposed Rules provide an efficient, fair and practically workable process for registration.

However, two specific areas require further regulatory attention:

- the division of responsibility between the CFTC and the National Futures Association ("NFA") in determining initial and ongoing compliance by SDs and MSPs; and

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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 731.

- the swap dealing activities outside of the United States which would require registration of the entity engaging in those activities to register as an SD or MSP.<sup>3</sup>

We propose that the responsibilities for determining initial and ongoing compliance be divided between the CFTC and NFA. Generally, matters relating to reports, records and documentation should be the responsibility of NFA. However, the other requirements of the Dodd-Frank Act relating to SDs and MSPs are absolutely critical to achieving the transparent, fair and safe marketplace that Congress demanded. These responsibilities must not be delegated and must reside with the CFTC.

The Release describes standards for non-US swap dealing activities which focus on regular transacting of swaps with US persons by a non US entity.<sup>4</sup> This is an appropriate approach. A central question involves the identification of US entities. While this status is sometimes obvious, the activities of affiliates of US entities may not be and this potentially opens a very serious loophole that will almost certainly invite regulatory arbitrage.

Therefore, the affiliates of US entities must be considered as US entities for purposes of assessing the swap activity of their non-US counterparties. Any other result would simply incentivize SDs and MSPs to manipulate the regulatory outcome for counterparties that are not US entities merely by establishing affiliate organizations and allocating trading activity to them. Such loopholes, allowing form to avoid substantive regulatory requirements, contributed substantially to the financial crisis and eliminating them was a key objective of the Dodd-Frank Act.

## Discussion of Proposed Rules

### *Allocation of Responsibility between CFTC and NFA*

The Dodd-Frank Act's approach to dealers and major swap market participants is a dramatic departure from prior law governing derivatives markets. It is a core component of the structure that Congress established. A central feature is required registration of SDs and MSPs. The fundamental duty to determine initial and continuing compliance to qualify for registration is entrusted to and must remain with the CFTC.

Some elements of determining compliance are primarily ministerial. But there is no escaping that others require involvement that is focused, decisive and utterly free from *even the appearance* of influence brought to bear by SDs and MSPs. These responsibilities must remain in the hands of the representatives of the government to assure that the marketplace does not continue to be dangerously out-of-control. The responsibility for these determinations must not be delegated by the CFTC to any other organization.

The release suggests three approaches: full delegation to NFA, no delegation to NFA and partial delegation to NFA. While, ideally, the CFTC would retain all responsibility for determining compliance, we recognize that some delegation might increase the efficiency

<sup>3</sup> CFTC Release ("Release"), Federal Register, Volume 75, No. 225, page 71382.

<sup>4</sup> Id.

of the process of determining initial and ongoing compliance. But regardless of efficiencies, some duties must not be delegated. Below are two lists: the duties that, in our view, may be delegated if it is *determined that material efficiencies can be achieved*; and the duties that must not be delegated. If delegation of an enumerated duty does not achieve material efficiencies, we suggest that such duty not be delegated, even though it is included in the first list.

The Dodd-Frank Act lays out the various elements for compliance.<sup>5</sup> We propose that the following duties may be delegated to the NFA if delegation is justified by efficiencies:

- Reporting and recordkeeping.
- Daily trading records.
- Swap documentation structure.
- Designation of chief compliance officer.
- Filing of annual compliance reports.

We propose the following duties must not be delegated:

- Capital and margin requirements.
- Business Conduct Standards
  - Fraud, manipulation and other abusive practices.
  - Diligent supervision of business.
  - Adherence to position limits.
  - Responsibility and requirements with respect to Special Entities.
  - Verification of eligibility of counterparties.
  - Disclosure and duty to communicate in a fair and balanced manner.
  - Duties when acting as an advisor.
- Monitoring of trading and risk management.
- Conflicts of interest.
- Antitrust considerations.

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<sup>5</sup> Dodd-Frank Act, Section 731.

*Extraterritorial Application of SD and MSP Registration Requirements*

The extraterritorial reach of SD and MSP registration requirements is clear. It is also an essential element of the regulatory structure. Derivatives markets are interconnected and trading can easily be accomplished in jurisdictions of choice. The CFTC has wisely focused on the swaps activity with US entities as a major factor in determining required registration.

A central issue is raised by the ability of US entities to locate trading activity in non-US affiliates. The question is whether the result should be different merely because the activity happens to be in the non-US affiliate rather than the US entity. If the purpose of the Act is not to be defeated, and if form is not to trump substance, the only answer possible is "no."

Any other result would allow multi-national entities to locate activities tactically to game the regulatory system. The US entity would simply accommodate the exclusively non-US entity by trading through the affiliate. The non-US entity would prefer to trade through the affiliate because doing so would not increase the probability that it would become subject to registration as an SD or MSP. Other US entities, which did not offer a trading relationship with a foreign affiliate, would be at a trading disadvantage. They would be incentivized to set up their own offshore trading affiliate. The requirement of non-US entities to register as SDs or MSPs simply must not be determined by the artificial allocation of trading to affiliates of US market participants.

As a result, two important conditions must be imposed:

- US entities must report activity with non-US entities, even when transacted through an affiliate, identifying the non-US counterparty and other necessary information; and
- Affiliates of US entities trading with non-US entities must disclose that the activity increases the likelihood that the non-US entity becomes subject to registration requirements as an SD or MSP.

**Conclusion**

Registration requirements are at the core of the Dodd-Frank Act's regulation of SDs and MSPs. Standards of business conduct and other important requirements are given force because of the potential for a failure to meet registration conditions or a loss of registration. The Proposed Rules fulfill this purpose, but must be modified as suggested to be effective and to achieve the purposes of the Act.

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

Sincerely,



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