BETTER MARKETS
TRANSPARENCY · ACCOUNTABILITY · OVERSIGHT

February 7, 2011

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

Re: Swap Data Recordkeeping and Reporting Requirements (CFTC RIN 3038-AD19)

Dear Mr. Stawick:

Better Markets, Inc.[1] appreciates the opportunity to comment on the above-captioned proposed rules (the "Proposed Rules") of the Commodity Futures Trading Commission ("CFTC"), implementing provisions of the Dodd-Frank Financial Services Reform Act (the "Dodd-Frank Act") applicable to swap data recordkeeping and reporting requirements for swap data repositories, derivatives clearing organizations, designated contract markets ("DCMs"), swap execution facilities ("SEFs), swap dealers, major swap participants and other swap counterparties (collectively, "Swap Market Entities").

Introduction

The Proposed Rules establish a comprehensive and effective set of processes for reporting and recordkeeping by Swap Market Entities. Transparency of the derivatives markets is a central goal of the Dodd-Frank Act. Complete and accessible records are an essential factor in achieving this goal and the Proposed Rules effectively address this need.

Furthermore, the CFTC can fulfill its duties only if it has ready access to these data. However, access is only meaningful if the data are organized and formatted according to the practical realities of the marketplace.

We note the requirement in the Proposed Rules that the primary economic terms data for swaps of each asset class (including interest rates, currencies, credit, equity and other asset classes) includes futures contract equivalents and futures contract equivalent units of

[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.

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measure, as further defined by applicable regulation.[2] The significance of this feature cannot be overstated. To understand the mass of data that will be accumulated by the Swap Market Entities it is essential that it be organized and presented in an understandable language. The use of futures equivalents is a method which has evolved through market practice and is central to the meaning of the data. The measurement and understanding of positions is only one benefit of this approach. This aspect of the Proposed Rules constitutes a significant step forward for the CFTC and the market as a whole.

In addition, the requirement for Unique Swap Identifiers, Unique Counterparty Identifiers and Unique Product Identifiers is a critical step forward toward understanding the market.[3] Some market participants have and will continue to focus attention on the work needed to construct a system of unique identifiers which is accepted by the market. Notably absent from their discussion is an alternative which results in usable data sets. The data cannot be simply compiled only to languish in some database. It must be accessible and conducive to analysis. The benefits from such a system are enormous.

The CFTC must urge market participants to transform their obsession with problems (which only delays the implementation of the Dodd-Frank Act market structure) into a focus on solutions. The major dealers have all addressed these issues for their individual needs; if they collaborate with the CFTC and other Swap Market Entities, they can ease the burden and shorten the time of transition.

Our additional comments are limited to two topics: clarification of primary economic terms data which is in possession of a SEF or DCM; and the need for procedures for reporting of mixed and multi-asset swaps, as defined in the proposing release ("Release").[4] Like the issue of futures equivalents, this concerns the use of a "language" which makes sense of the data set. It similarly reflects the practices of market participants. It is a critical tool for the CFTC and the market as a whole.

Discussion

Disaggregation of Composite Swaps into Understandable Units

In the recent CFTC roundtable on unique identifiers and other topics, one of the industry's representatives described how composite derivatives are broken down into more conventional units or legs for purposes of recording and monitoring a market participant's portfolio.[5] His analysis of the need for disaggregation is correct. Often dealers structure derivatives which are composites of straightforward swaps. They may bridge asset classes or be composed of different products within asset classes.

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2 Proposed Rules, Appendix 1.
3 Proposed Rules, Section 45.4.
4 CFTC Proposed Rulemaking (December 8, 2010), 75 FR 76574.
5 CFTC Roundtable, January 28, 2011. Swap Data Recordkeeping and Reporting, Comments of Adam Litke commencing on Transcript page 187.

Sometimes they are characterized as "bespoke" or customized transactions, suggesting impenetrable complexity. However, the claimed complexity is almost always artificial. In fact, it is manufactured and misleading, too often intentionally so. Eliminating this seeming complexity requires nothing more than to follow the lead of the industry as discussed by several participants in the roundtable: disaggregation by the reporting entities of composite transactions into legs based on risk, rather than limiting the data by the documented form of the transaction.

The following example may be helpful. Power Plant Owner A enters into a swap with Dealer B to guarantee the difference between the price of natural gas and power at given delivery points for gas and power serving the plant. It is used by Power Plant Owner A to fix the difference between the cost of fuel expected to be consumed at its plant in eastern Maryland and the electricity output expected to be sold into the grid. Power Plant Owner A expects to consume 329,333 mmbtu of gas and generate 34,667 mwh of electricity for sale. The difference in cost and price guaranteed by the swap is $486,573, which is the fixed amount paid by Dealer B. Plant Owner A will pay the actual difference in prices on the notional quantities.

In reality, the transaction example is nothing more than a combination of the following two swaps:

- A natural gas swap at the delivery point (Tetco M3) for the period with a quantity equal to the quantity of assumed consumption fixing the price at $4.36/mmbtu; and

- A power swap at the delivery point (Pepco) with a quantity equal to the quantity of assumed power sold fixing the price at $55.47/mwh.

The industry participants in the January 28 roundtable hosted by the CFTC indicated that only a tiny percentage of all transactions require recordation beyond the capacity of their trade data capture systems. This means that virtually all of the transactions which are characterized as bespoke are simply composites of understandable derivatives risks handled by disaggregation as described by those industry representatives. This makes sense: traders deal in derivatives risks and it would be very troubling (to say the least) if the individual risks in a given transaction could not be described and measured with a very high degree of confidence. Combining risks in a single instrument must not be allowed to obstruct reporting of meaningful information.

This type of transaction might meet specific needs of a customer. But why not simply enter into multiple swaps which are each more transparent than the composite transaction? Convenience is one answer, but it is not very persuasive since documentation is almost exclusively electronic. There are other possibilities. A composite swap obscures the market price of each of the component swap units. It may even allow the dealer and the customer to record the separate composite risks at different prices. It may also simply have the marketing appeal of an apparently clever solution to a seemingly complicated problem.

Regardless of the reason(s), the market data available to the CFTC must be at least as useful and decipherable as the data available to dealers as they measure and monitor their own positions. The reporting entity must assign a market-based price to the components of a composite swap, whether it is mixed (partially within the domain of the SEC's regulation of security-based swaps) or multi-asset (composed of multiple assets classes). Likewise, swaps within asset classes but involving different products or temporal terms must be assigned component prices.

To require less ignores reality and incentivizes complex documentation of straightforward and understandable derivatives transactions. This not only frustrates transparency, it encourages obscurity, behind which will be all manner of unseen risks.

We have commented on this subject in a prior comment letter relating to the agricultural commodity definition.[6] The importance of this issue goes beyond the meaningfulness of the data set generated pursuant to the Dodd-Frank Act. Bringing transparency to the reported data will eliminate a major incentive for non-standard documentation of standard derivatives transactions. Ultimately, all market participants, *including the swap dealers,* will benefit from eliminating the transient allure of obscuring individual transaction terms.

Possession of Certain Data by a SEF or DCM

The Proposed Rules require a SEF or DCM to report all primary economic terms data which is in its possession for the swap asset class of a swap as soon as technologically practicable after execution of a swap.[7]

It is important to clarify that "information in the possession of" a SEF or SDR must include all data that has been made public by the CFTC. For example, futures equivalents for the swap asset class published by the CFTC must be considered to be in the possession of every SEF and DCM. The ambiguity on this point must be clarified to avoid a technical argument that SEFs and DCMs have no duty to monitor and use the information made available by the CFTC, a result which would make implementation of the Proposed Rule needlessly more complicated.

Conclusion

As stated above, we commend the CFTC for its monumental effort to bring transparency and an understandable "language" to the large and diverse derivatives markets. It is a job which can – and must -- be done. When the task at hand is completed, the markets will be enormously more transparent and secure.

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[6] Better Markets, Inc. Comment Letter to the CFTC regarding Proposed Rule on Agricultural Commodity Definition, November 26, 2010.

[7] Proposed Rules, Section 45.3(a)(i)(A) and (a)(ii)(A).

We hope that our suggestions are helpful.

Sincerely,

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