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Timothy W. Cameron, Esq.
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COMMENT

April 5, 2011

Chairman Gary Gensler
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Recent Title VII Comment Letters submitted by the Asset Management Group ("**AMG**")[1] of the Securities Industry and Financial Markets Association ("**SIFMA**")

Dear Chairman Gensler:

Attached please find copies of certain comment letters that express SIFMA AMG member concerns related to Title VII of the Dodd-Frank Act. The comments have been submitted to the appropriate files at the relevant Commission.

- Registration and Regulation of Security-Based Swap Execution Facilities; Release No. 34–63825, File No. S7–07–11, submitted to the SEC on April 4, 2011.
- Notice of Proposed Rulemaking — Position Limits for Derivatives; (RIN 3038–AD15 and 3038–AD16), submitted to the CFTC on March 28, 2011.

For your convenience, you will also find, separately attached, an earlier comment letter, heavily referenced in our Registration and Regulation of Security-Based Swap Execution Facilities comment letter. This comment was submitted to the appropriate files at the CFTC. Hard copies of this comment letter were also mailed out on March 9th.

- Core Principles and Other Requirements for Swap Execution Facilities; (RIN 3038-AD18), submitted to the CFTC on March 8, 2011.

Please feel free to contact me with any questions. I can be reached by telephone at 212-313-1389 or by e-mail at tcameron@sifma.org.

Sincerely,

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

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[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, state and local government pension funds, universities, 401(k) or similar types of retirement funds, and private funds such as hedge funds and private equity funds. In their role as asset managers, AMG member firms, on behalf of their clients, may engage in transactions, including transactions for hedging and risk management purposes, that will be classified as swaps and security-based swaps under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

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April 4, 2011

COMMENT

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Registration and Regulation of Security-Based Swap Execution Facilities; Release No. 34–63825; File No. S7–07–11

Dear Ms. Murphy:

The Asset Management Group (the "**AMG**") of the Securities Industry and Financial Markets Association ("**SIFMA**") appreciates the opportunity to provide the Securities and Exchange Commission's ("**SEC**") with comments on its proposed rule on registration and regulation of security-based swap execution facilities (the "**SEC Proposal**"), published on February 28, 2011.[1] The AMG previously provided the SEC and the Commodity Futures Trading Commission (the "**CFTC**" and, together with the SEC, the "**Commissions**") with its views on swap execution facility ("**SEF**") and security-based swap execution facility ("**SB SEF**") requirements in a pre-rulemaking comment letter dated November 24, 2010,[2] and on block trading definitions and reporting issues in a comment letter dated February 7, 2011 (the "**Block Trading Comment Letter**").[3]

The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, state and local government pension funds, endowments, ERISA funds, 401(k) and similar types of retirement funds, and private funds such as hedge funds and private equity funds. In their role as asset managers, AMG member firms, on behalf of their clients, engage in transactions, including transactions for hedging and risk management purposes, that are classified as

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[1] Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10,948 (Feb. 28, 2011) (adding 17 CFR Pts. 240, 242 and 249).

[2] November 24, 2010 AMG Comment Letter, *available at* http://www.sec.gov/comments/df-title-vii/mandatory-facilities/mandatoryfacilities-23.pdf.

[3] February 7, 2011 AMG Comment Letter, *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27614&SearchText.

"swaps" or "security-based swaps" ("**SB swaps**" and, together with CFTC-regulated "swaps," "**Swaps**") under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**").

The AMG supports the flexible approach to the definition of SB SEF proposed by the SEC. In particular, the AMG supports the SEC's proposed interpretation of the definition of an SB SEF to include a trading platform that provides multiple participants with the *ability* to accept bids or offers made by multiple participants but would *permit* a participant to send an RFQ to any number of liquidity providers, including just a single liquidity provider. We believe that this strikes the appropriate balance among promoting transparency, preserving liquidity and ensuring appropriate pricing in SB swap transactions, thereby encouraging market participants to transact on SB SEFs. As we indicated in our March 8, 2011 letter to the CFTC regarding its proposed rule on core principles and other requirements for SEFs,[4] the AMG is concerned that requiring market participants to send RFQs to any minimum number of liquidity providers greater than one will have an adverse effect on buy-side users of Swaps. The AMG also agrees with the SEC's decision not to require a delay following the entry of certain customer orders comparable to the 15-second pause that the CFTC has proposed for certain swap transactions submitted to SEFs.[5] As we discussed in greater detail in our March 8, 2011 letter to the CFTC, because such a requirement would create market uncertainty, impose unnecessary costs on end users and discourage trading on SEFs contrary to Congressional intent, no delay requirement should be included in final rulemaking for SEFs or SB SEFs.

In this letter, we highlight several aspects of the SEC Proposal that we believe should be modified. First, the AMG believes that responses to a request for quote ("**RFQ**") should not be included in an SB SEF's composite indicative quote stream. Second, we believe that block trades should be given a broad exemption from minimum pre-trade price transparency and interaction requirements. The thresholds for block trades should also be flexible and vary by asset class. Third, we support requiring specific objective criteria to be used by swap review committees to determine which and when SB swaps have been made available to trade. Fourth, the AMG believes that an SB SEF's authority to collect information regarding participants should be limited. Fifth, we believe that SB SEFs should not be permitted to exclude non-registered eligible contract participants from becoming participants in a discriminatory manner or impose heightened capital requirements for participants in excess of those imposed on such participants by the SEC. Sixth, we believe that SB SEF rules should not be self-certified, but instead should be subject to public comment. Seventh, we believe the SEC should exempt certain packaged SB swap transactions from mandatory execution. Finally, the AMG believes that the Commissions should harmonize their final rulemakings with respect to SEFs and SB SEFs.

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[4] March 8, 2011 AMG Comment Letter, *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=31341&SearchText=.

[5] Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1,214,§ 37.9(b)(3) (Jan. 7, 2011) (the "**CFTC Proposal**").

Responses to RFQs should not be included in an SB SEF's composite indicative quote stream.

RFQs generally. The SEC Proposal requires SB SEFs that operate RFQ platforms to include any response to an RFQ in a composite indicative quote, which would show an average quote for each SB swap available and be accessible to all participants of the SB SEF on a quote screen. An RFQ system is a valuable execution model for SB swaps, especially those that are illiquid, precisely because it permits a seeker of liquidity to obtain pricing information from one or more liquidity providers without signaling to the market its trading strategy. The requirement that RFQ responses be included as part of a composite indicative quote, however, would detract from the benefits that an RFQ system provides participants. If information about SB swap quotes executed on an RFQ system must be streamed to other participants that are external to the transaction, such other participants may act opportunistically ahead of the execution of the RFQ transaction on the basis of information from the composite indicative quote to the detriment of the quoting liquidity provider. As a result, liquidity providers will have less of an incentive to transact through RFQs on SB SEFs and consequently liquidity in SB swaps may be negatively impacted. Buy-side participants, including AMG members on behalf of their clients, may therefore find it more difficult or more costly to enter into SB swap transactions.

RFQs for blocks. The detrimental effects are especially pronounced in the context of block trades. As we mentioned in our November 24, 2011 letter to the Commissions,[6] block trades allow participants to execute a large order at a single negotiated price without signaling to the entire market information about the participant's position or trading strategy. If this information becomes publicly available before sufficient time has passed for parties to hedge their exposure and reduce their risk for the large-size trade, other participants may engage in "front-running" and bid/ask spreads may increase, ultimately resulting in increased costs for end users that use SB swaps for risk-management purposes. The requirement that pre-trade price information must be reported as part of a composite indicative quote could give rise to these harmful effects because participants would perceive the occurrence of a block trade based upon a spike or trough in the composite indicative quote.

Additionally, the inclusion of pricing information obtained in responses to RFQs for block trades in a composite indicative quote could distort SB swap prices. As we discussed in the Block Trade Comment Letter, prices for block trades do not accurately reflect and are not relative to market prices for smaller, social size transactions and therefore, including them in an SB SEF's composite indicative quote could skew market prices. At a minimum, to ensure the SB SEF's composite indicative quote stream is not misleading, as well as the appropriate pricing of block trades, and to preserve liquidity, the SEC should exclude information received in response to RFQs for block trades from dissemination on the composite indicative quote stream.

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[6] November 24, 2010 AMG Comment Letter, *available at* http://www.sec.gov/comments/df-title-vii/mandatory-facilities/mandatoryfacilities-23.pdf.

Block trades should be given a broad exemption from transparency and interaction requirements, and the SEC should provide flexible and tailored standards for what constitutes a block trade.

Although the SEC Proposal provides that SB SEFs generally may establish different trading rules for block trades than for other SB swap transactions,[9] the discussion in the release indicates that the SEC would require that block trades executed on an SB SEF be subject to the same minimum pre-trade reporting requirements as other SB swaps and interact with existing interest on the SB SEF. The AMG believes that imposing these requirements with respect to block trades is not required by Dodd-Frank and would severely undermine the utility of block trades.

The SEC Proposal would require block trade orders to interact with resting bids and offers available through its other systems. For example, the SEC Proposal states that an SB SEF that operates both an RFQ system and a central limit order book would need to have functionality to allow an RFQ for a block trade to interact with resting bids and offers on a central limit order book before the RFQ is executed. In support of this approach, the SEC Proposal states that these requirements are necessary to prevent block trades from being executed off of the SB SEF and then reported to the SB SEF in such a way as to circumvent the mandatory trade execution requirement and undermine the goals of providing for more transparent and competitive trading on an SB SEF."[7]

The AMG believes that Dodd-Frank's mandatory trade execution requirement requires neither minimum transparency requirements nor interaction requirements with respect to particular block transactions. Instead, SB SEFs must adopt rules regarding appropriate trading procedures for block trades, and block transactions effected pursuant to such rules would be permissible. While transparent and competitive trading on SEFs are objectives of Dodd-Frank, such objectives must be balanced against concerns of liquidity and significant increased costs of transactions for users of Swaps. Congress clearly contemplated such balancing, in the context of trade reporting, when it directed the SEC to adopt rules to establish an "appropriate time delay for reporting large notional security-based swap transactions (block trades)."[8]

As we have indicated above and in our Block Trade Comment Letter and our March 8, 2011 letter to the CFTC, imposing certain pre-trade price transparency requirements on block trades would signal to market participants that a block trade is being contemplated, even if the notional amount of a block trade is not disseminated.

Moreover, the AMG believes that SB SEFs should indeed be permitted to allow block trades to be executed off of the SB SEF, or by any other modality of execution. This approach would grant SB SEFs discretion regarding how block trades will be

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[9] SEC Proposal § 242.811(d)(9), at 11,061.

[7] SEC Proposal, at 10,974.

[8] Securities Exchange Act of 1934 § 78m(m)(1)(E)(iii), as amended. See also Regulation SBSR—Regulation and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75,208 (Dec. 2,2010) § 242.902(b) and discussion at 75,225.

handled pursuant to Proposed Rule 811(d)(9).[9] This model would also be consistent with the way in which block trades in futures are treated. Under the rules of the CME, CBOT, NYMEX and COMEX, block trades are privately negotiated futures, options or combination transactions that are permitted to be executed apart from the public auction market so long as they are entered into at a "fair and reasonable price." The SEC should explicitly provide for such an exemption in its final rulemaking.

The SEC Proposal also allows SB SEFs to determine what constitutes a block trade until the SEC establishes criteria for such a determination.[10] Such a rule could result in the inconsistent treatment of comparable SB swap transactions, which would generate uncertainty among participants in the market who wish to transact in SB swaps. To avoid such uncertainty, the SEC should establish clear block trade thresholds before SB SEFs establish rules on how block trades will be handled. These block trade thresholds should vary by asset class and provide the flexibility necessary to address distinctions such as tenor and liquidity among SB swaps. As we mentioned in the Block Trading Comment Letter, the SEC should also periodically reexamine these factors as they change over time.

The number of participants actively trading an SB swap, frequency of trading and transaction size should be among the objective criteria that swap review committees of SB SEFs use to determine whether a swap is available to trade.

The AMG strongly supports the SEC's view that the determination of when an SB swap should be considered to have been "made available to trade" should be made pursuant to "objective measures established by the [SEC], rather than by one or a group of SB SEFs."[11] Without clear, objective criteria, SB SEFs may make inconsistent determinations regarding whether an SB swap is available to trade. Such inconsistencies would be problematic if an SB SEF were to act opportunistically and use its authority to determine whether a swap is available for trading in a manner that would draw participants to its facility to the detriment of other facilities. We also agree that there may not yet be sufficient data available to set appropriate thresholds for such a determination.

While the possible criteria suggested in the SEC Proposal[12] may all be workable, the AMG believes that, at a minimum, the SEC should specify minimum levels for the number of participants actively trading an SB swap, the frequency of trading and transaction size. These criteria measure the relative liquidity of an SB swap in a manner that swap review committees of SB SEFs could uniformly understand, track and follow. The SEC also should make clear that the same objective criteria to be used in determining

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[9] SEC Proposal § 242.811(d)(9) (granting SB SEFs the authority to establish and enforce rules regarding "the manner in which block trades will be handled, if different from the handling of non-block trades").

[10] SEC Proposal, at 10,974.

[11] SEC Proposal, at 10,969.

[12] SEC Proposal, at 10,969.

that an SB swap should be made available to trade may also be used to determine that an SB swap should no longer be made available to trade.

The final rule should resolve an inconsistency in the proposed rule. On the one hand, the discussion in the release indicates that the SEC will establish the objective criteria to be used in determining whether an SB swap has been made available to trade.[13] On the other hand, the proposed rule itself provides that swap review committees are to determine the criteria upon which they shall base their review of SB swaps.[14] The AMG agrees that the SEC, and not SB SEFs, should make this determination. In any event, the SEC should establish the criteria for making the determination and should allow sufficient time for public comment on proposed criteria.

The SEC should also provide further guidance regarding the composition of swap review committees. The SEC Proposal currently provides "for the fair representation of participants of the [SB SEF] and other market participants, such that each class of participant and other market participants shall be given the right to participate... and that no single class of participant or category of market participant shall predominate."[15] Because of the significant impact that determinations that a transaction has been made available to trade will have on the SB swap market, swap review committees must require meaningful buy-side participation.

The reach of an SB SEF's information-gathering authority should be limited.

The AMG urges the SEC to limit the authority of an SB SEF to collect information from participants. The SEC Proposal charges SB SEFs with the authority to establish and enforce rules to capture information including, for example, financial information, books, accounts, records, files, memoranda, correspondence and other information relating to a trading interest entered and transactions executed on or through an SB SEF.[16] Although the SEC Proposal prohibits SB SEFs from using confidential information for non-regulatory purposes,[17] the AMG requests that the SEC clarify the scope of "non-regulatory purposes" to protect participants from the inappropriate dissemination of proprietary information. Such a limitation would encourage participants to trade SB swap transactions on SB SEFs.

Allowing SB SEFs to exclude certain eligible contract participants and to impose capital requirements that exceed those established by the SEC would result in discriminatory effects.

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[13] SEC Proposal, at 10,969.

[14] *See* SEC Proposal § 242.811(c)(3) ("The security-based swap execution facility shall establish criteria that the swap review committee shall consider in determining which security-based swaps shall trade on the security-based swap execution facility.").

[15] SEC Proposal § 242.811(c)(2).

[16] SEC Proposal § 242.814(a)(1).

[17] SEC Proposal § 242.810(c).

The AMG generally supports the SEC's approach to ensuring impartial access to, and the financial integrity of transactions on, an SB SEF in compliance with Core Principles 2 and 6. The SEC Proposal would permit an SB SEF to choose whether to permit eligible contract participants that are not registered as a security-based swap dealer, major SB swap participant or broker ("**non-registered ECPs**") to become direct participants in the SB SEF, subject to not unreasonably discriminatory standards and appropriate risk management controls and procedures. Direct access to trading platforms is essential to many AMG members that likely will be non-registered ECPs but who have long-standing trading relationships with security-based swap dealers. The AMG is concerned that denying non-registered ECPs direct access to SB SEFs could force buy-side market participants to execute transactions through other entities, which could be costly, or may prevent them from executing such transactions at all. Therefore, the AMG believes that all non-registered ECPs should be permitted to become participants on an SB SEF, provided that they meet objective eligibility criteria established by the SEC.

The SEC Proposal also requires SB SEFs to establish their own recordkeeping and reporting requirements.[18] If such requirements vary among SB SEFs, compliance would become unnecessarily burdensome and costly for non-registered ECPs who execute transactions on multiple SB SEFs. Therefore, the AMG believes that the SEC should establish uniform recordkeeping and reporting requirements to be applied across all SB SEFs.

In seeking to balance the objectives of impartial access and financial integrity, the SEC has requested comment on whether SB SEFs should be permitted to impose higher capital requirements on participants than those that may be imposed on such participants by the SEC.[19] The AMG believes that granting such authority to SB SEFs would endorse discriminatory behavior by SB SEFs. If certain SB swaps are only available to trade on a small number of SB SEFs, and those SB SEFs impose heightened capital requirements, buy-side entities that do not meet the heightened capital requirements would be denied direct access to such SB swap transactions. Prohibiting direct access to such transactions would be contrary to Dodd-Frank's goal of ensuring equal access to swap transactions in the marketplace. The related limitations on access could simultaneously drive down the price of an SB swap, benefiting only those entities that meet the SB SEF-established capital requirements.

Self-certification by SB SEFs of their rules and amendments thereto should be replaced with broad requirements for public comment.

The SEC has proposed self-certification rules for SB SEFs similar to those proposed by the CFTC for SEFs.[20] Unlike the CFTC's proposal, however, which

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[18] SEC Proposal § 242.809(c)(2)(ii).

[19] SEC Proposal, at 10,979.

[20] *Compare* CEA § 5c(c) *and* Provisions Common to Registered Entities, 75 Fed. Reg. 67,282 (proposed November 2, 2011) (amending 17 CFR Pt. 40) (implementing the amended procedures for self-certification of rules mandated by § 745 of Dodd-Frank, which amended § 5c(c) of the CEA, by codifying amended self-certification procedures in Proposed Rule 40.6) *with* SEC Proposal §§ 242.806, 242.807.

implements the self-certification and approval procedures explicitly required by Section 745 of Dodd-Frank, the SEC's proposed rule is not required by statute.

Under the SEC proposal, a new rule or rule amendment of an SB SEF that is certified by the SB SEF will become effective within ten business days after the SEC receives the self-certified rule or amendment.[21] The SEC may stay the certification under certain limited circumstances,[22] which would trigger a review period of up to 90 days from the date of the notification of the stay, including a 30-day public comment period.[23]

As stated in our March 8, 2011 comment letter to the CFTC, the AMG is concerned that the rules and amendments relating to the operations of SB SEFs will have an extremely important impact on participants in the SB swap markets. This is particularly true in light of the SEC's proposal which permits a good deal of flexibility in the scope and design of SB SEFs. The AMG firmly believes that public input is critical to informing the nature of the swap markets. Thus, the AMG requests that the SEC include opportunities for public comment with respect to SB SEF rules and amendments.

If the SEC determines that it must provide SB SEFs with the ability to self-certify their rules and amendments, then, at a minimum, the SEC should impose the three requirements proposed in our CFTC SEF letter. First, SB SEFs should be required to notify the public a reasonable amount of time in advance of any intent to self-certify a rule or amendment and include in its self-certification submission any and all objections voiced by market participants. In addition, the SEC should reserve the right to stay any such rule or amendment on the basis of any material market participant objections provided in the self-certification submission.

Second, as a means of establishing compliance with SB SEF Core Principle 12 – Financial Resources, each SB SEF should be required to submit to the SEC and make available for public comment evidence demonstrating that the SB SEF will have in place sufficient legal, business and technological resources (including appropriate systems, policies and procedures and adequate personnel) to process user applications and accommodate the transactional flow of the number of market participants that it reasonably estimates will become users of the SB SEF over time.

Finally, the SEC should require SB SEFs to submit for public comment prior to self-certification the forms of user agreements, all terms to be incorporated into such user agreements and all business and technological requirements for market participants.

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[21] *Id.*

[22] *Id.* (SEC Proposal § 242.806(c)(1) would stay the certification of a rule if the SEC determines that the new rule or amendment raised one of three issues, including: if the rule or rule amendment "present[s] novel or complex issues that require additional time to analyze, the new rule or rule amendment is accompanied by an inadequate explanation, or the new rule or rule amendment is potentially inconsistent with the Act or Commission rules or regulations thereunder.").

[23] *Id.* at § 242.806(c)(1)-(2).

The SEC final rules should contain exceptions from mandatory execution on an SB SEF for certain packaged SB swap transactions.

As stated in our March 8, 2011 comment letter to the CFTC, some AMG members engage in "packaged" or "combination" SB swap transactions which combine into a single transaction two or more component transactions. These components can consist of other SB swaps, futures, cash market transactions or other financial instruments. Because the pricing and economic rationale of the packaged SB Swap transaction depends on the pricing of its components, such packaged SB swap transactions have unique pricing, trading and credit characteristics.

Requiring an SB swap component of such a transaction to be executed on an SB SEF because that component, when traded independently, is available for trading on an SB SEF would impair the viability of the packaged SB swap transaction. Decoupling the packaged SB swap transaction and requiring it to be executed on an SB SEF may not reflect the true price of the packaged instrument and does not promote accurate pricing information to market participants trading such instruments. Similarly, the AMG believes that the entire combination instrument should be excluded from the SB SEF execution requirement. When asset managers execute packaged SB swap transactions on behalf of their clients, they seek the best price on the overall transaction, and are not just looking at its component parts. Similarly, the SB SEF rules should look at these packaged products on the basis of the overall transaction, and not its individual component parts. Thus, the AMG believes that the final SEC rules should explicitly exempt packaged SB swap transactions from the SB SEF trade execution requirements.

The SEC and the CFTC should coordinate their final rulemakings for SB SEFs and SEFs.

As the SEC states in the SEC Proposal, the approach that the SEC and CFTC may take to the regulation of SB SEFs and SEFs, respectively, may differ in various respects. The SEC attributes this to the "differences between the markets and products that the [SEC] and the CFTC currently regulate."[24] The AMG is concerned, however, that many market participants will engage in both swaps and SB swaps and thereby will be subject to both regulatory regimes. Requiring such market participants to execute similar types of transactions in dissimilar ways on separate trading platforms will add significant administrative and compliance costs and risks, generating unnecessary confusion. The AMG does not believe it is necessary or appropriate for the SEC and the CFTC to have different rules on SEFs and SB SEFs, despite their oversight of different swap products.

In a recent letter to Chairpersons Mary Schapiro and Gary Gensler, Congressman Barney Frank stressed the need for harmonization and coordination between the Commissions for Dodd-Frank rulemaking.[25] Congressman Frank expressed a concern regarding unnecessary differences between the Commissions' rules, which would "drive

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[24] SEC Proposal, at 10,950.

[25] Letter from Barney Frank, Ranking Member, H.R. Comm. on Fin. Servs., to Hon. Mary L. Schapiro, Chariman, Sec. Exch. Comm'n, and Hon. Gary Gensler, Chairman, Comm. Fut. Trading Comm'n (Feb. 18, 2011).

up the cost of implementation, without improving the regulatory structure," and cited discrepancies between the approaches the SEC and CFTC have taken regarding their proposed rules on SB SEFs and SEFs, specifically with respect to RFQ systems and block trades.[26] Congressman Frank surmised that the differences between the existing equity and futures markets do not justify differing treatment of SB swaps and swaps. He also pointed out that Swaps are "very different products from those currently traded in the highly evolved equities and futures markets" and that, therefore, the rules for the trading of Swaps should not be based on those existing markets or differences between those markets.[27] Congressman Frank's concerns are consistent with President Barack Obama's recent Executive Order, in which he requested that federal agencies undertake greater coordination to avoid redundant, inconsistent or overlapping regulations.[28]

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[26] *Id.*

[27] *Id.*

[28] *See* Executive Order, "Improving Regulation and Regulatory Review" (Jan. 18, 2011) (recognizing that, generally speaking for all regulatory agencies, "[s]ome sectors and industries face a significant number of regulatory requirements, some of which may be redundant, inconsistent, or overlapping" and "[g]reater coordination across agencies could reduce these requirements, thus reducing costs and simplifying and harmonizing rules"). These principles seem highly relevant to the Commissions' coordination on Swaps rulemaking.

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The AMG thanks the SEC for the opportunity to comment on proposed rulemaking concerning the registration and regulation of security-based swap execution facilities under Title VII. The AMG would welcome the opportunity to further discuss our comments with you. Should you have any questions, please do not hesitate to call the undersigned at 212-313-1389.

Respectfully submitted,

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

cc: Chairman Mary L. Schapiro, SEC
Commissioner Luis A. Aguilar, SEC
Commissioner Kathleen L. Casey, SEC
Commissioner Troy A. Paredes, SEC
Commissioner Elisse B. Walter, SEC
Chairman Gary Gensler, CFTC
Commissioner Bart Chilton, CFTC
Commissioner Michael Dunn, CFTC
Commissioner Scott D. O'Malia, CFTC
Commissioner Jill E. Sommers, CFTC

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Invested in America

March 28, 2011

COMMENT

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

Re: Notice of Proposed Rulemaking — Position Limits for Derivatives

Dear Mr. Stawick:

The Asset Management Group (the "**AMG**") of the Securities Industry and Financial Markets Association ("**SIFMA**") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "**CFTC**" or the "**Commission**") with our comments and recommendations set forth below regarding the proposed rules (the "**Proposed Rules**") published in the Commission's Notice of Proposed Rulemaking (the "**NPR**")[1] relating to position limits under Section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").

The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans and state and local government pension funds, many of whom invest in commodity futures, options and swaps as part of their respective investment strategies.

As previously discussed in the AMG's Pre-Rulemaking Position Limits Comments letter dated November 23, 2010 (the "**AMG Prior Letter**"),[2] the AMG supports the goals set forth in the Dodd-Frank Act for setting appropriate position limits, namely to prevent market manipulation, ensure sufficient market liquidity for bona fide hedgers, and deter disruption to price discovery, including preventing price discovery from moving to foreign boards of trade ("**FBOTs**"). However, position limits also present the danger of undermining the stated purposes, particularly if set prematurely or at too restrictive levels and without proper exclusions. Indeed, Congress recognized that position limits, if set inappropriately, may adversely impact market liquidity, disrupt the price discovery function of the U.S. commodity markets and cause migration of trading activity to FBOTs.

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[1] Position Limits for Derivatives, 76 Fed. Reg. 17, 4752 (Jan. 26, 2011) ("**NPR**"), available at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-1154a.pdf.

[2] *See* AMG Prior Letter (filed Nov. 24, 2010), available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission26_112410-sifma.pdf.

With this background and as discussed in further detail below, the AMG respectfully requests that the Commission consider the following recommendations:

- The AMG urges the CFTC to delay adoption of position limits until an "appropriateness" determination can be made. In making that determination, the Commission should consider the impact of any proposed limits in causing price discovery to shift to FBOTs.

- If the Commission should choose to proceed with the adoption of limits, it should limit the scope of Phase One and not adopt proposed Phase Two at this time, given the absence of sufficient market data and the lack of evidence that non-spot-month positions have caused excessive price volatility.

- With respect to any position limits adopted by the Commission, the following changes should be made:

    - The AMG recommends that the Commission permit disaggregation of separately owned funds and accounts. At a minimum, if separately owned funds and accounts are required to be aggregated, the AMG emphatically requests that the Commission retain the independent account controller safe harbor for financial as well as non-financial entities.

    - The AMG recommends that the Commission consider safe harbor or other exemptive treatment for registered investment companies, ERISA and similar accounts, and funds and accounts that are diversified and unleveraged and take passive, long-only positions.

    - The AMG recommends that grandfathering treatment be extended to rolled futures and swaps positions that exist as of the effective date of any position limit rule.

    - The AMG recommends that the bona fide hedging exemption include economic risk mitigation, as a narrow interpretation runs counter to the mandate that the Commission limit only speculative positions.

    - A "position points" regime should not be implemented without a formal rulemaking process.

I. The AMG encourages the CFTC to delay adoption of position limits until an "appropriateness" determination can be made.

The AMG respectfully disagrees with the Commission's assertion in the Proposed Rules that it has been granted authority by Congress to impose position limits prophylactically.[3] As discussed in the AMG Prior Letter, the AMG strongly believes that

[3] Commissioner Dunn appears to agree with this view. *See* Commissioner Michael V. Dunn, Opening Statement, Public Meeting on Proposed Rules Under Dodd-Frank Act (Jan. 13, 2011) ("**Dunn**
(...continued)

the Commission must first make an appropriateness determination before any limits are established.[4] The AMG believes that in order for the Commission to set position limits "as appropriate" to the enumerated goals set forth in the Dodd-Frank Act, factual support must demonstrate the necessity, consistent with these enumerated objectives, for position limits to be established, and any position limits so established should be appropriately tailored to both the type of underlying commodity and the class of traders being targeted.[5] In addition, the Commission must strive to ensure that any limits imposed will not cause commodity price discovery to shift to FBOTs.[6] However, as discussed further below, the Proposed Rules do not address this concern or provide any factual support or data evidencing that the proposed limits are either necessary or appropriate.[7] Until such an appropriateness determination can be made, the AMG requests the CFTC to postpone the adoption of any position limits.

A. There is insufficient evidence that speculation is generally affecting the commodities markets.

The Commission states in the Proposed Rules release that its statutory authority for adopting the Proposed Rules originates from its congressional mandate to address unreasonable price fluctuations attributable to excessive speculation.[8] Although some commentators have opined that speculators have distorted the price of commodities in the past, the AMG is not aware of any empirical, peer-reviewed academic study that adequately proves this out. In contrast, numerous studies have found no substantial evidence of excessive speculation, including the following findings:

(continued...)

January 13 Statement"), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/dunnstatement011311.html.

[4] Specifically, the Commission is directed to set position limits "*as appropriate* . . . [and] to the maximum extent practicable, in its discretion, to (i) diminish, eliminate or prevent excessive speculation . . .; (ii) deter and prevent market manipulation, squeezes, and corners; (iii) ensure sufficient market liquidity for bona fide hedgers; and (iv) ensure that the price discovery function of the underlying market is not disrupted (emphasis added). Section 4a(a)(3)(B) of the CEA.

[5] As Commissioner Sommers has noted, "Section 4a(a)(1) of the Commodity Exchange Act, Congress specifically authorized the Commission to consider different limits on different groups or classes of traders. This language was added in Section 737 of Dodd-Frank. The proposal before us today does not analyze, or in any way consider, whether different limits are appropriate for different groups or classes of traders." Commissioner Jill E. Sommers, Opening Statement, Public Meeting on Proposed Rules Under Dodd-Frank Act (Jan. 13, 2011) ("**Sommers January 13 Statement**"), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/sommersstatement011311.html.

[6] Section 4a(a)(2)(C) of the CEA.

[7] *See* Dunn January 13 Statement, *supra* note 3 ("Price volatility exists in markets that have position limits and in markets that do not have position limits."); Commissioner Scott D. O'Malia, Statement, Prior to Notice of Proposed Rulemaking – Position Limits for Derivatives (Jan. 13, 2011) ("**O'Malia January 13 Statement**"), available at http://www.cftc.gov/pressroom/speechestestimony/omaliastatement011311.html ("I do not believe that the absence of position limits has had any impact on prices in the past, and I do not believe that setting them now will be effective in preventing a barrel of oil from going over $100/barrel."); Sommers January 13 Statement, *supra* note 5.

[8] NPR, *supra* note 1, 76 Fed. Reg. at 4753-54.

- No clear evidence of a causal relationship between increased financial market participation and commodity prices;[9]

- No clear evidence that speculation has affected underlying supply and demand for agricultural products;[10]

- No clear evidence as to whether derivatives have a long-term impact on commodity price levels;[11] and

- That fundamental supply and demand factors in the commodity markets, rather than participation by non-commercial market participants, were more likely to have caused price volatility in commodities in 2005-2008.[12]

The AMG believes that Commissioner Michael V. Dunn summed it up best with the following remarks made at the Commission's January 13, 2011 open meeting in which the Proposed Rules were approved: "To date, CFTC staff has been unable to find any reliable economic analysis to support either the conclusion that excessive speculation is affecting the markets we regulate, or that position limits will prevent excessive speculation. . . .With such a lack of concrete economic evidence, my fear is that, at best, position limits are a cure for a disease that does not exist or at worst, a placebo for one that does."[13]

B. Insufficient data currently exists to appropriately establish and enforce limits.

As discussed in the AMG Prior Letter, adequate data on the swaps market is not yet available to accurately establish and enforce position limits and will not be for some time. The AMG agrees with the views expressed by Commissioner Jill E. Sommers that sufficient and reliable swaps market data must be collected before the Commission can reasonably analyze the appropriateness of any position limit formulas to be established.[14]

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[9] Global Financial Stability Report: Financial Stress and Deleveraging, Macrofinancial Implications and Policy – Annex 1.2, International Monetary Fund (October 2008).

[10] Global Agricultural Supply and Demand: Factors Contributing to the Recent Increase in Food Commodity Prices, USDA (May 2008). *See also* Causes of High Food Prices, Asian Development Bank (October 2008).

[11] OECD-FAO Agricultural Outlook 2008-2017 (2008).

[12] *See, e.g.,* Dwight R. Sanders and Scott H. Irwin, *A speculative bubble in commodity futures? Cross-sectional evidence*, Agricultural Economics 41, 25-32 (2010); October 2008 IMF World Economic Outlook. As another example, preliminary analysis of the CFTC Inter-Agency Task Force on Commodity Markets in July 2008 suggested that fundamental supply and demand factors are the underlying cause of oil price volatility rather than speculators. *See* Interim Report on Crude Oil, Interagency Task Force on Commodity Markets (July 2008), available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/itfinterimreportoncrudeoil0708.pdf.

[13] *See* Dunn January 13 Statement, *supra* note 3.

[14] *See* Sommers January 13 Statement, *supra* note 5 ("[T]he Commission "should conduct a complete analysis of the swap market data before [it] determine[s] the appropriate formula to propose.")

Until such time, the AMG believes that the imposition of limits, including any Phase One spot-month position limits, is premature and presents the danger of unintended consequences that could, in fact, undermine the stated purposes for position limits articulated in the Dodd-Frank Act. Furthermore, the current lack of adequate infrastructure for any position limits on swaps to be reasonably enforced is a concern that should be addressed before any limits become effective.[15]

C. In establishing limits, the Commission must consider the impact of any proposed limits in causing price discovery to shift to FBOTs.

Section 4a(a)(2)(C) of the Commodity Exchange Act (the **"CEA"**), as amended by Section 737 of the Dodd-Frank Act, requires the CFTC to "strive to ensure that trading on foreign boards of trade in the same commodity will be subject to comparable limits and that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading on the foreign boards of trade."[16] As Commissioner Sommers has noted, the Proposed Rules fail to even consider or mention this goal.[17] It appears that foreign regulators either are not currently acting on position limits for commodity derivatives or are significantly behind the Commission's proposed timeline.[18]

The AMG believes that unless foreign jurisdictions are also coordinated and ready to apply comparable position limits (if indeed any such limits are determined to be appropriate) on the same timeline, it would seem that it would run counter to this mandate for the Commission to impose position limits at this time.[19] We share the concerns expressed by Representative Scott Garrett, Chairman of the Subcommittee on Capital Markets and Government Sponsored Enterprises, that in order to prevent

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[15] As Commissioner Sommers expressed, "it is bad policy to propose regulations that the [Commission] does not have the capacity to enforce." *Id.* The AMG agrees with the views of Commissioners Dunn and Sommers (reiterated in sentiments expressed by the Senate Committee on Banking, Housing and Urban Affairs) that more rigorous economic analysis and data, and additional time for adoption of relevant rules, is needed before any limits are imposed. *See* Dunn January 13 Statement, *supra* note 3; Letter to the Commission, the Securities Exchange Commission, the Federal Reserve, the FDIC and Office of the Comptroller of the Currency, United States Senate Committee on Banking, Housing and Urban Affairs (Feb. 15, 2011).

[16] Section 4a(a)(2)(C) of the CEA.

[17] Sommers January 13 Statement, *supra* note 5.

[18] For example, in response to questions posed by Commissioner Dunn about international efforts at the Commission's open meeting on December 16, 2010, Jacqueline Mesa, the CFTC's Head of the Office of International Affairs, stated that the European Commission was not expected to issue an initial proposal regarding the harmonization of position limits across EU authorities until May 2011,at the earliest, and would not likely act upon such a proposal for at least four to six months later. Transcript of the Open Meeting on the Eighth Series of Proposed Rulemakings Under the Dodd-Frank Act (Dec. 16, 2010), available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission13_121610-transcri.pdf.

[19] *See* Dunn January 13 Statement, *supra* note 3 ("If we determine that position limits are appropriate to diminish, eliminate or prevent excessive speculation, I think we must then work with our sister regulators around the globe to ensure that limits set here in US markets, are not simply evaded by trading in other venues around the world.")

regulatory arbitrage, "real, concrete assurances" are needed in this regard.[20] Without more careful study and policy coordination with foreign jurisdictions, the imposition of position limits in the United States would likely result in moving commodities trading overseas, undermining the directive to the Commission in the Dodd-Frank Act.

D. Position limits established inappropriately may result in unintended adverse consequences that affect all participants in the commodities markets.

The Commission is directed to set position limits consistent with the objectives of ensuring sufficient market liquidity for bona fide hedgers and that the price discovery function of the underlying market is not disrupted.[21] As noted in the AMG Prior Letter, position limits imposed inappropriately, without the benefit of fully analyzing sufficient data concerning open interests in each market and the impact of limits on liquidity, bona fide hedging and prices could actually run counter to these enumerated purposes, potentially resulting in unintended adverse consequences to the commodities markets affecting not only holders of substantial positions, but all market participants generally. Set inappropriately either as to timing of implementation or level, position limits could negatively affect the ability of bona fide hedgers, including commodity producers and end-users, to hedge and reduce risk; potentially increase volatility in commodity prices; and impair liquidity and price discovery of the U.S. commodity markets. In turn, these effects could inhibit legitimate business activities, such as new commodity production and exploration projects, causing supply distortions and thereby potentially leading to higher commodity (or other) prices. Commodity-related companies and end-users could also elect to undertake normal activities without hedging their risks due to limited market liquidity, thereby creating more risk in the marketplace. The AMG strongly agrees with Congressmen Spencer Bachus and Frank Lucas, Ranking Members of the House Committees on Financial Services and Agriculture, respectively, that "[o]verly-prescriptive limits would drain existing liquidity from the capital markets, impair price discovery for commercial producers and their counterparties, and cause unnecessary harm to the futures markets and small investors."[22]

The AMG therefore questions the appropriateness of position limits at all in light of the enumerated purposes of ensuring market liquidity and price discovery set forth under Section 737 of the Dodd-Frank Act.

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[20] Representative Scott Garrett, Letter to the Chairman Gary Gensler (Mar. 3, 2011), available at http://dealbook.nytimes.com/2011/03/08/republicans-seek-to-slow-c-f-t-c-rule-writing/

[21] Section 4a(a)(3)(B) of the CEA.

[22] *See* Letter dated December 16, 2010 from Congressman Spencer Bachus and Congressman Frank Lucas to the Honorable Timothy Geithner, the Honorable Gary Gensler, et al. (the "**Bachus/Lucas Letter**"), available at http://online.wsj.com/public/resources/documents/bachus.pdf.

II. Should the Commission choose to proceed with adoption of limits, the AMG would recommend solely adopting a more limited version of Phase One of the proposed regime.

A. Phase One of the Proposed Rules should be more limited.

If the Commission proceeds with Phase One of its position limits proposal, the AMG recommends that limits on cash-settled contracts should be forgone at this time. A limit based on the estimated spot-month deliverable supply of the referenced commodity on cash-settled contracts, as opposed to a limit based on open interest, seems arbitrary as the number of cash-settled contracts does not have a direct correlation to the spot-month deliverable supply of the underlying commodity. In addition, the AMG does not believe that it is appropriate for the Commission to have the discretion to determine estimated deliverable supply if it does not agree with figures provided by designated contract markets; it is also unclear what criteria the Commission would apply in making this determination. Market participants should also be permitted to net their cash-settled and physically-settled positions in a spot month in order to accurately reflect their aggregate spot-month positions.

Importantly, if too restrictive limits are imposed on cash-settled contracts, market participants could migrate to the physical commodity markets themselves, which are not subject to the Commission's jurisdiction. This migration could not only result in liquidity providers to hedgers disappearing from the cash-settled market, but could also result in pricing pressure being applied to the market for underlying physical commodities, thereby counteracting the intentions of position limits.[23]

B. Phase Two of the Proposed Rules should not be adopted.

The AMG is not aware of evidence that non-spot-month positions of any size have contributed to excessive price volatility or otherwise pose a threat to markets, or of any reasoning offered in support of such a conclusion. In addition, the AMG believes that the opportunity for excessive speculation or market manipulation in non-spot months is either non-existent or dramatically lower than in the spot month. Accordingly, we respectfully suggest that it is premature at this time to consider imposing position limits outside the spot month.

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[23] For example, in the face of position limits, a large institutional investor that elects to invest in cash-settled contracts for oil due to efficiency and convenience could decide to limit its purchase of oil contracts and purchase oil directly (assuming it had the capacity to store it) or indirectly through an exchange-traded fund (ETF) that holds nothing but physical oil. Purchasing oil, or an ETF that purchases oil, would have a more direct effect on the price of oil than investing in cash-settled derivative contracts. The investor would offer less liquidity to hedgers in the cash-settled contract market and would have a greater impact on the price of oil as a result of its actions in response to the cash-settled contract limits. *See also* Craig Pirrong, The Problems With Physical Commodity ETFs, Seeking Alpha (Oct. 27, 2010), available at http://seekinga~pha.c~m/artic~e/232559-~ae-pr~b~ems-wi~a-physica~~c~mm~dit'/-etfs ("There is a perverse irony here. The whole rationale (supposedly) for position limits is that speculation somehow distorts physical markets. There is precious little evidence . . . that this is a real problem. But by driving those that want exposure to metals prices . . . , regulations are making it more likely that speculation will distort prices and the physical markets.")

Further, as discussed above, even if there were evidence that non-spot-month limits were necessary to prevent excessive speculation, there is not yet adequate data on the size of the market for economically equivalent swaps relating to the referenced commodities, or on the concentration, trading and other characteristics of that market. The AMG submits that without such data, and careful economic analysis of its implications where the policies underlying position limits are concerned, any formula for determining limits is necessarily arbitrary and poses a greater risk of negative, unintended consequences.

The AMG respectfully submits that the appropriateness of the Commission's proposed formula for all months combined and single (non-spot) month limits is unsupported by any analysis or data. For a large market of, for example, 500,000 contracts of average open interest for all months combined,[24] the "10 percent, 2.5 percent" limit would end up working out to under 3 percent of average open interest. Without further support or examples of cases in the past where positions of this size have caused harmful instability, the AMG believes that a limit of this size would be an inappropriate result. If Phase Two position limits are adopted at this time, the AMG recommends that they be set sufficiently high until appropriate market data is known. Levels higher than ten percent of all contracts may be appropriate until sufficient information is available; as Commissioner Chilton has acknowledged, it is most prudent "to err on the high side at first—precisely to avoid any negative consequences—and re-calibrate as we move forward and know more about the markets."[25] Furthermore, once adequate data is available on open interest, it may make sense to adopt different limits for different commodities to properly reflect the relative sizes of the relevant markets. At this stage, however, the AMG recommends forgoing the proposed Phase Two limits.

III. Funds and accounts managed by an investment adviser should be disaggregated in applying any limits adopted by the Commission.

A. Positions held in separately managed funds and accounts do not pose the risks that the Commission has associated with concentrated positions and should not be aggregated.

The Commission states in the NPR that the economic justification for limits is that large concentrated positions "can potentially facilitate price distortions given that the capacity of any market to absorb the establishment and liquidation of large positions in an orderly manner is related to the size of such positions relative to the market."[26] The Commission adds that concentration of positions can also "create the unwarranted

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[24] The February 2011 month-end open interest for the referenced CBOT Wheat, Corn and Soybeans futures contracts, for example, were all near or over 500,000. *See* CME Group CBOT Exchange Open Interest Report, available at http://www.cmegroup.com/wrappedpages/web_monthly_report/Web_OI_Report_CBOT.pdf. When swap open interest is added, totals will obviously be considerably higher, and limits under the proposed formula lower as a percentage matter.

[25] *See, e.g.*, Interconnectedness: Keynote Address of Commissioner Bart Chilton to the 13th Annual Structured Trade and Finance in the Americas Conference (Mar. 15, 2011), available at http://cftc.gov/PressRoom/SpeechesTestimony/opachilton-40.html.

[26] NPR, *supra* note 1, 76 Fed. Reg. at 4755.

appearance of appreciable liquidity."[27] The assumption underlying both concerns appears to be that the holder of a large concentrated position is likely to disrupt prices and liquidity in the market if it establishes or disposes of most of its position all at once or is forced to liquidate.

This assumption does not hold true when the "holder" of a position is in fact a multitude of accounts and funds with disparate owners and investment considerations, as discussed in the AMG Prior Letter.[28] Even where accounts and funds have a common investment adviser, each is a distinct client, and the adviser as a fiduciary is required to base purchase and sale decisions *solely* on the interests of that client, based on its unique circumstances. The AMG believes that the statutory fiduciary obligations[29] of investment advisers sufficiently mitigate the risk of coordinated action. An adviser's decision to increase or decrease a position held by a given client in a given commodity contract necessarily depends on a number factors specific to that client, including: the client's investment objectives and guidelines; the nature of the client and its investors or beneficiaries; its instructions to the adviser; its benchmarks and asset mix; its hedging needs; its choice of collateral; and the extent of leverage it utilizes, if any, among other factors. Similarly, if one fund or account managed by a particular adviser is required to liquidate, it does not follow that other funds or accounts managed by the same adviser would unwind their positions at the same time. Furthermore, in order to address conflict of interest issues that may arise in serving as fiduciaries to multiple clients—for example, to achieve best execution and allocate investment opportunities in accordance with each client's best interests—advisers often have procedures in place that do not permit the sharing of information, let alone the coordination of trading activity, among separate funds and accounts. Any concern that separate funds and accounts would necessarily act in concert when establishing or disposing of positions or exiting the market seems unfounded.

It is therefore incorrect to assume that disparate funds and accounts of a given adviser will trade in tandem in a manner that results in major market impacts, and that aggregation among separately owned funds and accounts is therefore required to protect markets from disruption. Senator Lincoln recognized this when she stated in a July 16, 2010 Senate Colloquy that she "would encourage the CFTC to consider whether it is appropriate to aggregate positions of entities advised by the same advisor where such entities have different and systematically determined investment objectives." Such aggregation is particularly inappropriate in the case of funds that are tracked to an index, such as the Dow Jones-UBS commodity index, and mechanically increase or decrease positions based on entry and withdrawal by investors. Purchase and sale decisions for these types of funds are in effect made more by large numbers of individuals acting

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[27] *Id.*

[28] *See* AMG Prior Letter, *supra* note 2, at 9-10.

[29] *See* Section 206 of the Investment Advisers Act of 1940; SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 192-93 (1963). Advisers to registered investment companies and ERISA and similar plans are subject to further statutory fiduciary provisions; *see, e.g.,* Section 36 of the Investment Company Act of 1940 (the "**Investment Company Act**"); Section 404(a)(1)(B) of the Employee Retirement Income Security Act ("**ERISA**") ("a fiduciary shall discharge his duties with respect to a plan *solely* in the interest of the participants and beneficiaries and . . . *for the exclusive purpose* of providing benefits to participants and their beneficiaries"(emphasis added)).

independently than by the adviser exercising investment discretion, let alone at a coordinated level across all funds and accounts of the adviser.

B. If the Commission does require aggregation among separately managed funds and accounts, it should preserve the exemption for separately controlled accounts.

As stated above, the AMG believes that aggregation across separately owned funds and accounts is overly expansive, but thinks it is even more unjustified in cases where the separate funds and accounts have independent controllers. The Commission's proposal to require aggregation *even* where separately owned accounts have independent controllers would represent a major and unwarranted departure from long-standing and effective practices. The AMG and many other members of the public commented in advance of the NPR[30] that elimination of the safe harbor under Reg. 150.3(a)(4)(i) (the **"Independent Account Controller Safe Harbor"**) would have considerable negative consequences to market participants. The Commission recognizes these public comments in the NPR and proposes to "address the concern of not having an independent account controller exemption by establishing the owned non-financial entity exemption."[31] The AMG strongly believes that an exemption that relates only to non-financial entities is insufficient and requests that the Commission reconsider this aspect of its proposal.

Elimination of the Independent Account Controller Safe Harbor for financial entities would be costly and damaging to asset managers and their clients. Some AMG firms are members of large and diverse multi-national financial services groups that are affiliated through a common international parent or major shareholder. Affiliates of a single U.S. asset management firm may include, for example, insurance companies, banks, broker-dealers and other asset management firms based and regulated in multiple countries. The Commission's proposed treatment of each of these entities, *and* each of their distinct clients, as a single combined trader, would be expected to have extensive consequences. Some financial services firms could expect to incur considerable expense to gather and monitor swaps positions across companies, countries, funds and accounts that currently operate independently. The cost would be likely to be borne in significant part by advisers' clients—by way of increased expenses, but also by way of constrained investment options, as funds and accounts might be unable to benefit from the strategies that best suit their needs where the global combined positions of all entities that are required to be aggregated are cumulatively at or near the applicable limit.

Elimination of the Independent Account Controller Safe Harbor would be costly and damaging to market participants generally, and to the goals of the Dodd-Frank Act. Although the most direct effects of the proposed elimination of the Independent Account Controller Safe Harbor would be borne by financial entities and their clients, as described above, the AMG anticipates that negative consequences could be much more widespread. Advisers may reduce legitimate trading activity in commodity derivatives, both because of the proposed limits themselves and because of the difficulty and expense of implementing reliable monitoring and compliance procedures for aggregation. This, in

[30] *See* NPR, *supra* note 1, 76 Fed. Reg. at 4756.

[31] *Id.*

turn, could have negative consequences that would be borne market wide;[32] liquidity would be impaired, with resulting higher derivative prices for all participants, and potentially, in direct contravention of the Commission's goals, increased vulnerability to sudden price movements. A less-liquid market where many participants are constrained by limits from accommodating sudden increases in demand or supply is likely to experience more extreme price volatility.

Elimination of the Independent Account Controller Safe Harbor could impair the integrity of information barriers that serve as important safeguards within financial institutions. In order to monitor their aggregated positions, disparate units and accounts that do not currently share information would be required to share and coordinate trading decisions on a real-time basis. The aggregation requirement could therefore have the counter-productive effect of increasing the very risks of concerted action (deliberate or inadvertent) that, the Commission has said, underlie its proposal to eliminate the Independent Account Controller Safe Harbor for financial entities.[33] In many cases, units and accounts not only do not, but are not permitted to, share information or decision-making, because of institutional barriers in place to address other regulatory, contractual or fiduciary concerns or requirements, as discussed above. Requiring financial entities to monitor positions across managed funds or accounts where such information barriers exist would likely cause advisers to breach these barriers, in contravention of internal firm policies and, in many cases, other legal obligations.

In addition, multiple advisers or sub-advisers to a given fund or account often maintain barriers designed to prevent the flow of information from one institution to another. Where such barriers exist, advisers are not required to aggregate the positions of the funds and accounts managed by other advisers for other purposes, such as Sections 13 and 16 of the Securities Exchange Act. The Proposed Rules' attribution of all positions of such a fund to its main adviser would require multiple advisory firms to share and coordinate information on an intra-day basis and would challenge the information barriers that the firms have put in place for regulatory or other valid business purposes.

The Commission has not offered a convincing justification for discarding an effective and widely recognized approach. The main rationale offered for eliminating the Independent Account Controller Safe Harbor for financial firms is that the safe harbor "may be incompatible with the proposed Federal position limit framework and used to circumvent its requirements."[34] The Commission appears to expect that firms may violate their procedures in order to illegally circumvent limits, and that in the case of financial entities the risk of deliberate circumvention is significant enough to justify discarding long-standing barrier procedures and dramatically expanding the scope of aggregation.

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[32] *See, e.g.*, Letter dated Jan. 24, 2011 from Prof. Craig Pirrong, paragraphs 4,10, 29; available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27433&SearchText.

[33] *See* NPR, *supra* note 1, 76 Fed. Reg. at 4762; *see also* Akin Gump Letter (Oct. 28, 2010), available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission26_102810-akingump.pdf.

[34] *Id.*

The AMG respectfully recommends that, before withdrawing the Independent Account Controller Safe Harbor for financial entities, the Commission establish further evidence justifying its concerns regarding the threat of fraudulent circumvention. The Independent Account Controller Safe Harbor has operated for decades without apparent evidence of failure or abuse. Moreover, information and control barriers are widely recognized by other regulators as effective protection against unlawful sharing of information or acting in concert. There are numerous examples of regulatory provisions that recognize the effectiveness of information barriers within financial entities;[35] one example with particularly similar objectives to those underlying the Proposed Rules is Rule 105 of Regulation M, "Short Selling in Connection with a Public Offering," intended to "protect . . . the independent pricing mechanism of the securities market so that offering prices result from the natural forces of supply and demand."[36] In 2007, the SEC amended the rule to (i) treat purchases and sales in separate accounts of a given person as separate if decisions are made separately and without coordination; and (ii) treat purchases and sales by affiliated registered investment companies, or by series of a given investment company, as separate from one another, whether or not they have separate controller procedures, because in its view concerns regarding concerted action were adequately addressed by existing regulation under the Investment Company Act.[37] Simply put, the Commission should not be concerned about coordinated action where information is not shared.

We would argue that a more efficient means of deterring fraudulent activity would be to enhance detection and enforcement remedies. For example, circumvention of position limits to manipulate markets is both a civil and a felony criminal violation of the CEA punishable by civil and criminal penalties, including imprisonment.[38] Eliminating the Independent Account Controller Safe Harbor, on the other hand, might reduce the chance of hypothetical future malfeasance, but it would do so at the cost of severely limiting extensive legitimate trading activity that poses none of the dangers that the NPR cites, with consequent harm to liquidity, hedging costs, and potentially to market stability.

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[35] For example, in interpreting Sections 13(d) and 16(a) of the Securities Exchange Act of 1934, the SEC has said that it "recognizes that certain organizational groups are comprised of many different business units that operate independently of each other. . . . The need to aggregate [would] have the effect of requiring diverse business units to share sensitive information, when it is not otherwise necessary for business purposes. . . . In those instances where . . voting and investment powers over the subject entities are exercised independently, attribution may not be required" for purposes of determining whether an person has exceeded Section 13(d) or 16(a) ownership thresholds. *See* SEC Release No. 34-3958 (Jan. 12, 1998), text accompanying notes 28-32, available at http://www.sec.gov/rules/final/34-39538.txt; *see also* Section 15(g) of the Securities Exchange Act of 1934 (requiring broker-dealers to establish procedures to prevent the misuse of material nonpublic information, generally implemented through procedures entailing information barriers).

[36] *See* SEC Release No. 34-56206 (Aug. 6, 2007), text accompanying notes 1-3, available at http://www.sec.gov/rules/final/2007/34-56206.pdf.

[37] *See id.*, text accompanying note 71; SEC Press Release 2007-120 (June 21, 2007), available at http://www.sec.gov/news/press/2007/2007-120.htm; *see also* Rules 105(b)(2) and (b)(3) of Regulation M.

[38] *See* Sections 6(c) and 13(a) of the CEA.

IV. If the Commission proceeds to adopt limits, it should consider safe harbor treatment for (1) diversified, unleveraged funds and accounts that take passive, long-only positions, and (2) registered investment companies and ERISA and similar accounts.

In determining the appropriateness of position limits as applied to different classes of traders, and how best to exercise its authority to set different limits for different classes and to "exempt, conditionally or unconditionally, any person or class of persons," the AMG would encourage the Commission to take into account the particular characteristics of different trader classes[39] and the fact that certain entities simply do not raise concerns of the type that the Commission has put forward to justify the imposition of limits. As described in the AMG Prior Letter, and in light of comments of members of Congress, we reiterate our request for (1) diversified, unleveraged funds and accounts that take passive, long-only positions, and (2) funds that are registered under the Investment Company Act (**"RICs"**) and accounts that are governed by the Employee Retirement Income Security Act (**"ERISA"**) or similar laws (referred to collectively herein as **"Benefit Plan Accounts"**).[40]

Importantly, the AMG believes that these proposed safe harbors would benefit all market participants and the goals of the Dodd-Frank Act. These funds and accounts provide a valuable service by providing small investors an efficient and low-cost means of access to commodities markets.[41] Overly expansive regulation would limit funds' and accounts' ability to use commodity derivatives, and would in effect tax them with compliance costs that, in the AMG's view, do not offer a countervailing benefit. The expected result would be more limited availability and higher cost to small investors of an important portfolio diversification tool. Further, in curtailing the size of the positions of these funds and accounts, the Proposed Rules would narrow the universe of liquidity providers available to take the other side of commercial hedgers' positions, potentially resulting in higher transaction pricing for derivatives market participants generally.

A. Diversified, unleveraged investment funds and accounts that take passive, long-only positions do not engage in the type of activity that warrant imposition of position limits.

In her December 16, 2010 letter to Chairman Gensler, Sen. Lincoln urged that, in its determination of position limits "'as appropriate' across all markets,"

> the CFTC not . . . unnecessarily disadvantage market participants that invest in diversified and unleveraged commodity indices. These investors often serve as important, collateralized sources of liquidity. At the same time, they are natural counterparties to producers who are seeking to reduce their commodity price risk.

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[39] *See* Letter from Sen. Agriculture Committee Chairman Blanche Lincoln to Hon. Gary Gensler (Dec. 16, 2010; filed Jan. 16, 2011) (the "**Lincoln Letter**"), available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27366&SearchText= ("I repeat my request again today. As it contemplates position limits, I encourage the CFTC to carefully consider how such limits may impact particular types of investment vehicles and classes of investors.")

[40] *Id.*; *see also* the Bachus/Lucas Letter, *supra* note 22.

[41] *See* the Lincoln Letter, *supra* note 39.

> In this vein, as I have said previously, it is "my expectation that the CFTC will address the soundness of prudential investing by pension funds, index funds and other institutional investors in unleveraged indices of commodities that may also serve to provide agricultural and other commodity contracts with the necessary liquidity to assist in price discovery and hedging for the commercial users of such contracts."
>
> In addition . . . diversified, unleveraged index funds are an effective way [for investors] to diversify their portfolios and hedge against inflation. Unnecessary position limits placed on mutual fund investors could limit their investment options, potentially substantially reduce market liquidity, and impede price discovery.[42]

The AMG strongly agrees with Sen. Lincoln that the sound and prudent nature of investing by diversified, unleveraged investment funds and accounts that take passive, long-only positions (collectively, **"Diversified Funds/Accounts"**) warrants differential treatment under position limits rules. As discussed in further detail in the AMG Prior Letter, we recommend that the Commission consider safe harbor treatment exempting Diversified Funds/Accounts from position limits.

Diversified Funds/Accounts invest in commodities as an asset class, generally tracking an index and measuring their positions based upon that index and investors moving in and out of the fund, rather than expressing speculative long or short views on particular commodities. More simply put, these funds and accounts provide a means for investing in commodities generally instead of a means for speculating on the performance of particular commodities. The size of the commodity derivative positions held by Diversified Funds/Accounts at any given time is largely determined by individual investors' movements into or out of the funds. Position fluctuations typically occur in relatively modest percentage changes, rather than in volatile shifts that would prompt the types of concerns that the Commission has associated with concentrated positions, as discussed above. These funds often utilize pre-determined rebalancing algorithms, which provide liquidity for commodities that have declined in value during a prior period and thus tend to invest in commodities when prices have decreased and liquidate other positions when prices have increased. Diversified Funds/Accounts typically roll over contracts from period to period, in many cases only to non-spot months, rather than actively trade in and out of markets.[43]

Diversified Funds/Accounts are distinguishable from the "massive passives" cited by Commissioner Chilton as posing price volatility concerns.[44] The "massive passives" tend to target a particular commodity type, whereas Diversified

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[42] *See* the Lincoln Letter *supra* note 39; Commissioner Dunn has also expressed similar skepticism as to the effect that index funds may have on price volatility. *See* Dunn January 13 Statement, *supra* note 3 ("Price volatility exists in markets that have substantial participation from index funds and markets that do not have any index fund participation whatsoever.")

[43] *See* AMG Prior Letter, *supra* note 2, at 6.

[44] *See, e.g.*, Speech of Commissioner Bart Chilton at Notre Dame University (Nov. 1, 2010), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/CommissionerBartChilton/opachilton-34.html.

Funds/Accounts generally seek to provide diversified exposure to commodities as an asset class, often as just a portion of a broadly diversified asset portfolio. As such, they are important long-term sources of liquidity to end-users and other physical market participants that enhance stability and price discovery in commodity swap markets.

The AMG would propose that the Diversified Fund/Account safe harbor be limited to funds and accounts that are not leveraged. As noted in the AMG Prior Letter, unleveraged funds do not present the same market pressure in the event of a forced liquidation of the fund that the Commission is concerned about,[45] and are in fact less likely to liquidate in the first place.

B. Registered investment companies and Benefit Plan Accounts are subject to regulation and oversight that significantly mitigates any risk of inappropriate or disruptive speculation.

The AMG Prior Letter discusses in detail the reasons why the AMG believes that the carefully regulated nature of RICs and Benefit Plan Accounts effectively obviates the risks of excessive speculation and market manipulation which position limits are intended to address.[46] In particular:

Limits on Leverage. RICs are severely limited in the amount of leverage they can obtain, including through the use of derivatives, by the Investment Company Act and related guidance, which requires a RIC to segregate liquid assets or hold offsetting positions on its books in an equivalent amount. [47] Benefit Plan Accounts tend to be unleveraged and, while not subject to specific prohibitions on borrowing, are required to be managed under a strict prudence standard and in a manner that diversifies investments so as to minimize the risk of large losses.[48] The AMG believes that traders that are not leveraged do not pose the risk of price destabilization in the event of a liquidation like those that have occurred in the past when highly leveraged traders have suffered losses.

Limits on Concentration. RICs and Benefit Plan Accounts are subject to requirements that tend to preclude them from taking concentrated positions in a given commodity derivative. RICs that elect to be "diversified companies" are required to meet

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[45] The Commission states in the NPR that large concentrated positions "can potentially facilitate price distortions given that the capacity of any market to absorb the establishment and liquidation of large positions in an orderly manner is related to the size of such positions relative to the market." NPR, *supra* note 1, 76 Fed. Reg. at 4755. Unleveraged funds and accounts present much less of a risk of market destabilization in the event of their liquidation than a highly leveraged fund such as the Amaranth natural gas fund.

[46] *See* AMG Prior Letter, *supra* note 2, at 7-8.

[47] Section 18(f) of the Investment Company Act; *see also* Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666 (Apr. 18, 1979); Merrill Lynch Asset Management, L.P., SEC No-Action Letter (July 2, 1992); Dreyfus Strategic Investing & Dreyfus Strategic Income, SEC No-Action Letter (June 22, 1987).

[48] Section 404(a)(1) of ERISA.

strict portfolio diversification requirements.[49] RICs that seek to maintain favorable "regulated investment company" tax status are also significantly limited in their ability to concentrate their portfolios under Subchapter M of the Internal Revenue Code of 1986.[50] In addition, RICs generally limit exposure to any single counterparty to five percent of total fund assets, in order to comply with limits under Section 12(d)(3) of the Investment Company Act.[51] ERISA, as noted above, requires fiduciaries to diversify investments so as to minimize the risk of large losses.[52]

V. Rolled positions should be grandfathered from any position limits adopted by the Commission.

Index and other funds and accounts and typically replace or "roll over" their contracts in a staggered manner, before they reach their spot months, in order to maintain position allocations in as stable a manner as possible and without causing price impacts. The AMG respectfully requests that the Commission consider extending the proposed exemption for pre-existing positions to include roll-overs of positions that were established in good faith prior to the effective date of any limit rule. If rolled positions are not grandfathered, funds and accounts could be prevented from implementing roll-overs in the most advantageous manner, and could conceivably be put in the anomalous position of having to liquidate positions to return funds to investors if pre-existing positions cannot be replaced as necessary to meet stated investment goals. This consequence would be directly at odds with the urging of Congressmen Bachus and Lucas that the Commission "use the exemptive authority granted by the [Dodd-Frank] Act to avoid establishing position limits which would force widely-held funds or firms to divest their current holdings in highly regulated products."[53]

The AMG also requests that the Commission clarify that, as stated in Proposed Rule 151.9(a) but counter to what appears to be stated in the NPR,[54] the grandfathering date for both futures and swaps would be the effective date of any position limit rule and not of the Dodd-Frank Act. For the sake of legal and operational certainty the AMG believes that it is important that any limits not affect positions taken prior to rule effectiveness, and that all derivatives contracts, swaps as well as futures, be accorded equivalent treatment.

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[49] Per Section 5(b)(1) of the Investment Company Act, diversified companies cannot invest more than five percent of total capital in any single issuer, and must invest at least 75 percent of total assets in cash and securities.

[50] *See* AMG Prior Letter, *supra* note 2, at 8.

[51] *See* AMG Prior Letter, *supra* note 2, at 7.

[52] Section 404(a)(1)(C) of ERISA.

[53] *Id.*

[54] NPR, *supra* note 1, 76 Fed. Reg. at 4763.

VI. The bona fide hedging exemption to any position limits adopted by the Commission should include economic risk mitigation.

The AMG understands from the NPR[55] that the Commission feels constrained by the statutory language of Section 737 of the Dodd-Frank Act to interpret "bona fide hedging" in a manner that precludes financial hedging. As submitted in the AMG Prior Letter,[56] we believe that this interpretation of "bona fide hedging" is not in fact mandated by Section 737 and would have harmful consequences, including hindering market participants from shifting unwanted risks to those who are willing to undertake it, particularly in light of the legislative history.

In particular, as discussed in the AMG Prior Letter, we would disagree that the omission of "normally" (as used in current Rule 1.3(z), which provides that bona fide hedging transactions "normally represent a substitute for transactions to be made . . . in a physical marketing channel") from new Section 4a(c)(2) compels a conclusion that Congress intended that financial hedging be excluded from the hedging definition. The legislative history indicates that the language emphasizing physical market transactions originated with the House Agriculture Committee's version of the Dodd-Frank Act, and was motivated by a concern that overly strict position limit rules could be injurious to agricultural and other end-users.[57] The AMG believes the "physical market" language was intended to *clarify* that physical market participants would continue to be exempt in their hedging activities, and not to exclude other types of participants from the hedging exemption. This interpretation is corroborated by the Bachus/Lucas letter, which was co-written by the Ranking Member of the House Agriculture Committee that authored the statutory bona fide hedging language, and strongly cautions against overly strict position limits.[58] Against this background we believe it is incorrect to interpret the Dodd-Frank language as requiring an interpretation that is sharply narrower than the common understanding of "hedging" which, per the Commission's current interpretation "would include . . . asset/liability risk management, security portfolio risk, etc."[59]

If the Commission determines that it is unable to continue to interpret "bona fide hedging" in this manner, we would respectfully request that it consider: (a) using its exemptive authority under CEA § 4a(a)(7) to exempt hedging transactions determined by the Commission to be economically appropriate to the reduction of risks in the conduct of a market participant's enterprise; and (b) interpreting netting in a more flexible manner that would take broader forms of offsetting, risk-reducing positions into account. The CEA makes clear that position limits are not to be applied to positions that are not

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[55] NPR, *supra* note 1, 76 Fed. Reg. at 4761.

[56] *See* AMG Prior Letter, *supra* note 2, at 10-11.

[57] *See* AMG Prior Letter, *supra* note 2, note 26 and accompanying text.

[58] Bachus/Lucas Letter, *supra* note 22.

[59] *See* CFTC Form 40, Part B, Item 3 and Schedule 1.

speculative, and we would encourage the Commission to treat financially hedged positions in a manner that is consistent with the CEA's intent.[60]

The AMG further believes that the Proposed Rules create excessive procedural and notification burdens for traders that enter into exempt bona fide hedges. Notwithstanding that the Proposed Rules limit permitted hedges to very specific transactions and positions,[61] exempt treatment is conditioned on participants' filing detailed reports with the Commission for each position, *and for each day* that such position is maintained and the bona fide hedge exemption is relied on. The AMG is concerned that the sheer burden of complying with this requirement, together with the related proposed administrative requirements of the bona fide hedging exemption, could deter participants from taking hedge positions. We believe such a result would be at odds with CEA Sec. 4a(c)(1) which, in prohibiting the Commission from applying limits to bona fide hedging transactions, indicates Congress's intent that position limits not inhibit market participants from engaging in bona fide hedging.

VII. A "position points" regime should not be implemented without a formal rulemaking process.

The AMG is also concerned about the "position points" regime that was suggested by Commissioner Chilton at the Commission's December 16, 2010 public meeting and by Chairman Gensler in his statement in support of the NPR.[62] Under this regime, the Commission may monitor trading positions larger than a pre-established "position point" and "use all available authorities" to require the reduction of certain of these positions. We note that there has been no public notice or comment period in connection with this proposal. Any "position points" regime, including any required reduction of significant positions, should not be implemented without a formal rulemaking process, or otherwise risk violating the Administrative Procedures Act.[63]

There is a significant lack of clarity as to what the position points directive will entail, how it would be implemented and its potential effects on market participants. It is unclear at this point what the Commission's intended course of action would be if it believed a trader's position was too large. The AMG is supportive of the Commission's efforts to survey the size of commodities markets, however, to our knowledge, taking action against participants with large positions would exceed the boundaries of the

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[60] Limiting hedging in the manner set forth in the Proposed Rules would not serve any of the enumerated purposes of position limits as it would limit activity that is not speculative or manipulative. *See supra* note 4.

[61] *See* Proposed Rule 151.5(a)(2).

[62] *See* Commissioner Bart Chilton, "Position Points" (Dec. 16, 2010), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/chiltonstatement121610.html; Commissioner Bart Chilton, Statement Regarding Position Limits and Interim Position Points (Jan. 4, 2011), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/chiltonstatement010411.html; Chairman Gary Gensler, Statement on Support of the Dodd-Frank Rulemaking of Chairman Gary Gensler (Jan. 13, 2011), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/genslerstatement011311b.html.

[63] As Commissioner O'Malia states, "the new 'position points' directive operates as a Trojan horse by attempting to articulate a requirement of general applicability without providing an opportunity for public notice and comment." O'Malia January 13 Statement, *supra* note 7.

Commission's current authority. Accordingly, we request that the Commission's efforts in this area be limited to market surveillance only, unless a "position points" regime is otherwise adopted through a formal rulemaking process allowing for public notice and comment.

* * *

The AMG thanks the CFTC for the opportunity to comment on proposed rulemaking concerning position limits. The AMG would welcome the opportunity to further discuss our comments with you. Should you have any questions, please do not hesitate to call the undersigned at 212-313-1389.

Sincerely,

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

sifma

Invested in America

March 8, 2011

COMMENT

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

Re: Core Principles and Other Requirements for Swap Execution Facilities (RIN 3038-AD18)

Dear Mr. Stawick:

The Asset Management Group (the "**AMG**") of the Securities Industry and Financial Markets Association ("**SIFMA**") writes in response to the Notice of Proposed Rulemaking (the "**CFTC Release**"), published by the Commodity Futures Trading Commission (the "**CFTC**") on January 7, 2011, regarding the CFTC's proposed rule (the "**CFTC Proposed Rule**") relating to core principles and other requirements for swap execution facilities ("**SEFs**").[1] The AMG previously provided the CFTC and the Securities and Exchange Commission (the "**SEC**" and, together with the CFTC, the "**Commissions**") with its views on SEF requirements in a pre-comment letter dated November 24, 2010[2] and on block trading definitions and reporting issues in a comment letter dated February 7, 2011.[3]

The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, state and local government pension funds, endowments, ERISA funds, 401(k) and similar types of retirement funds and private funds such as hedge funds and private equity funds. In their role as asset managers, AMG member firms, on behalf of their clients, engage in transactions, including transactions for hedging and risk management purposes, that are classified as "swaps" or "security-based swaps" ("**SB swaps**" and, together with CFTC-regulated

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[1] Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1,214 (proposed January 7, 2011) (adding 17 CFR Pt. 37).

[2] *See* November 24, 2010 AMG Comment Letter, *available at* http://www.sec.gov/comments/df-title-vii/mandatory-facilities/mandatoryfacilities-23.pdf.

[3] *See* February 7, 2011 AMG Comment Letter, *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27614&SearchText.

"swaps," "**Swaps**") under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**").

This letter provides the AMG's comments with respect to the CFTC Proposed Rule, including the following points: (i) the comment period for the CFTC Release should remain open during the comment period for the SEC's Notice of Proposed Rulemaking (the "**SEC Release**")[4] relating to security-based swap execution facilities ("**SB SEFs**"); (ii) the CFTC should adopt a more flexible approach to permissible forms of trade execution, particularly with respect to request for quote ("**RFQ**") systems; (iii) the allowable execution methods for Permitted Transactions generally should not be restricted; (iv) the "available to trade" determination should be made by the CFTC and subject to a specific prescribed set of objective criteria; (v) the rules and amendments self-certified by SEFs should be preceded by robust opportunities for public comment; (vi) the CFTC should require SEFs to establish policies and procedures to prevent any terms of a swap from being modified without the express consent of the counterparties; (vii) the reach and scope of SEFs' information gathering, examination and enforcement authority with respect to market participants should be curtailed; (viii) certain packaged swap transactions should be exempt from mandatory execution on a SEF; and (ix) the relationship between the confirmation requirements embedded in the CFTC Proposed Rule and the CFTC's separate Confirmation, Reconciliation and Portfolio Compression Rule Proposal should be clarified.

The comment period for the CFTC Release should remain open during the comment period for the SEC Release relating to SB SEFs to promote consistent rulemaking.

Coordination between the CFTC and the SEC, and harmonization of their respective rules, is essential to carrying out the goals of Dodd-Frank in a way that is workable for the Swap markets. In a proposal parallel to the CFTC Release, the SEC published a proposed rule on SB SEFs on February 28, 2011, with a comment period scheduled to close on April 4, 2011, nearly one month after the expiration of the CFTC comment period. Because of the similarities between swaps and SB swaps in the marketplace and their common statutory mandate under Title VII, and because of the discrepancies between the CFTC and SEC Proposed Rules discussed below, the AMG believes that the CFTC should leave open its comment period under the CFTC Proposed Rule until the close of the SEC comment period.

In a letter from Congressman Barney Frank to Chairpersons Mary Schapiro and Gary Gensler, Congressman Frank recently stressed the need for such harmonization and coordination between the Commissions for Dodd-Frank rulemaking.[5] Congressman Frank specifically expressed a concern regarding unnecessary differences between the Commissions' rules, which would "drive up the cost of implementation, without

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[4] Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10,948 (proposed February 28, 2011) (amending 17 CFR Pts. 240, 242 and 249).

[5] Letter from Barney Frank, Ranking Member, H.R. Comm. on Fin. Servs., to Hon. Mary L. Schapiro, Chairman, Sec. Exch. Comm'n, and Hon. Gary Gensler, Chairman, Comm. Fut. Trade Comm'n (Feb. 18, 2011).

improving the regulatory structure."[6] The letter cited discrepancies in the approaches taken by the CFTC Proposed Rule for SEFs and the SEC-proposed rule (the "**SEC Proposed Rule**" and, together with the CFTC Proposed Rule, the "**CFTC and SEC Proposed Rules**") for SB SEFs with respect to RFQ systems, voice brokerage systems and the treatment of block trades.[7] Congressman Frank surmised that, although there are differences between the existing equity and futures markets, those differences do not justify differing treatment between swaps, on the one hand, and SB swaps, on the other.[8] Recognizing that swaps and SB swaps "are very different products than those currently traded in the highly-evolved equities and futures markets," Congressman Frank suggested that the rules for trading swaps and SB swaps should not be based on the equities and futures markets or differences in those markets.[9] Moreover, the letter urges the Commissions to "reconcile and coordinate those differences" with the goal of "maintain[ing] liquidity and stability in these new markets and reduc[ing] costs."[10]

Congressman Frank's concerns are consistent with President Barack Obama's recent Executive Order, in which he requested that federal agencies undertake greater coordination to avoid redundant, inconsistent or overlapping regulations.[11] Similarly, in a speech Commissioner Sommers delivered to the Institution of International Bankers, Commissioner Sommers voiced her "concern[] that the CFTC is moving out of step in time, substance, or both with the SEC and the rest of the world in implementing trade execution requirements for standardized swaps."[12]

In its initial review of the SEC Proposed Rule, the AMG has noticed significant disparities between the Commissions' Proposed Rules in areas beyond those highlighted by Congressman Frank. For example, as further discussed below, the Commissions take different approaches to the question of who determines whether a Swap has been "made available to trade," – i.e., the SEF or SB SEF or the relevant Commission – and very different approaches to what constitutes an acceptable RFQ system. Given our concerns

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[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *Id.*

[11] *See* Executive Order, "Improving Regulation and Regulatory Review" (Jan. 18, 2011) (recognizing that, generally speaking for all regulatory agencies, "[s]ome sectors and industries face a significant number of regulatory requirements, some of which may be redundant, inconsistent, or overlapping" and "[g]reater coordination across agencies could reduce these requirements, thus reducing costs and simplifying and harmonizing rules"). Although the Executive Order is not binding on the CFTC, its principles would still seem highly relevant to the CFTC coordinating with the SEC on rulemaking related to swaps and SB swaps.

[12] *See* Commissioner Jill E. Sommers, Remarks before the Institute of Int'l Bankers, Annual Washington Conference (Mar. 7, 2011) (the "**IIB Speech**"), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opasommers-13.html.

regarding the significant discrepancies between the CFTC and SEC Proposed Rules, the AMG requests that the CFTC keep the comment period for the CFTC Release open until at least April 4, 2011 to allow market participants time to provide, and both Commissions sufficient time to consider, public comments on the CFTC and SEC Proposed Rules. Accordingly, the AMG requests that the CFTC exercise its discretion to review meaningful market participant comments that are filed prior to the expiration of the SEC comment period.

The CFTC should adopt a more flexible approach to permissible forms of trade execution.

As explained in our November 24, 2010 letter, the AMG believes that flexibility in trading methods is necessary to achieve the two Congressional goals of promoting pre-trade price transparency and the trading of swaps and SB swaps on SEFs and SB SEFs.[13] In particular, the AMG believes that the CFTC should not restrict permissible SEF execution methods for Required Transactions (as defined in CFTC Proposed Rule 37.9(a)(iv)) to just RFQs and central limit order book systems ("**Order Books**"). A preferable approach, like the one proposed by the SEC, would leave open numerous acceptable execution methods for transactions, subject to certain principles, guidelines and minimum objective criteria.[14] Such an approach will allow appropriate execution methods to grow and develop with the evolving swap markets.

At a minimum, the statutory definitions of "swap execution facility" and "security-based swap execution facility" should be read to include highly flexible RFQ systems that ***allow***, but do not require, multiple liquidity seekers to individually request quotes from multiple liquidity providers. The AMG believes that, unlike the SEC, the CFTC has taken an overly restrictive, and what the AMG believes to be impractical, view of the "multiple-to-multiple" statutory requirement. Specifically, the CFTC Proposed Rule's imposition of a five-market participant requirement, a minimum 15-second delay and a requirement for RFQ requesters to "take into account" bids or offers resting on the trading system or platform will restrict, rather than promote, liquidity and pre-trade price transparency. These restrictions will dilute the effectiveness of an RFQ execution model to the point where it no longer resembles what is commonly known as an RFQ system today. Thus, the AMG recommends that the CFTC eliminate all three of these restrictive requirements since they (i) are not required by the statute, (ii) do not further Dodd-

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[13] *See* November 24, 2010 AMG Letter, *supra* n.2 at 1-2; CEA Section 5H(e).

[14] *See* SEC Release at 10,953 (stating

> rather than proposing a rule that would establish a prescribed configuration for SB SEFs that would meet the statutory definition of SB SEF, the Commission proposes to provide baseline principles interpreting the definition of SB SEF, consistent with the requirements of the Exchange Act, as amended by the Dodd-Frank Act, which any entity would need to be able to meet to register as a SB SEF. Such an approach is designed to allow flexibility to those trading venues that seek to register with the Commission as a SB SEF and to permit the continued development of organized markets for the trading of SB swaps. This more flexible approach also would allow the Commission to monitor the market for SB swaps and propose adjustments, as necessary, to any interpretation that it may adopt as this market sector continues to evolve).

Frank's two goals of promoting price transparency and trading of swaps on SEFs and (iii) will likely raise costs for end users.

The CFTC should eliminate the requirement that RFQs be transmitted to five or more market participants which is likely to result in increased costs for end users.

The AMG respectfully recommends that the CFTC eliminate the five-market participant requirement from its definition of RFQs.[15] Dodd-Frank amended the Commodity Exchange Act ("**CEA**") to require that multiple participants on a SEF "***have the ability*** to execute or trade swaps by accepting bids and offers made by multiple participants."[16] The AMG believes that the SEC more closely adhered to congressional intent by interpreting the statutory requirement as requiring that a SEF merely ***allow for*** market participants to disseminate an RFQ to "one or more dealers."[17] Likewise, Commissioner Sommers, in her IIB Speech, recognized the disparity between the SEC and CFTC Proposed Rules whereby the SEC "would allow [RFQs] to be sent to a single dealer, or to multiple dealers depending on the end-user's preference [while] [t]he proposal issued by the CFTC would require RFQs to be sent to at least five dealers."[18] Commissioner Sommers has expressed her disagreement with the CFTC Proposed Rule's approach to RFQ requirements in both her dissent to the CFTC Proposed Rule and in the IIB Speech.[19]

In addition to a lack of statutory support for a five-market participant requirement, the AMG sees several practical difficulties with this requirement. First, as the AMG explained in detail in connection with narrow block trading exceptions in its letters dated November 24, 2010[20] and February 7, 2011, a minimum five-market participant requirement will result in significantly more expensive hedging to the original counterparty – i.e., end users – due to the signaling of trading strategies to the market, whether or not the trade is a block trade.[21] Requiring the dissemination of an RFQ to a

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[15] The CFTC Proposed Rule provides for execution through an RFQ system: (i) that allows for a market participant to transmit an RFQ "to no less than five market participants, to which all such market participants may respond"; (ii) that allows for an RFQ (with the same five-market-participant requirement) as a potential response in a trading system that allows for "real-time electronic streaming quotes, both firm and indicative, from multiple potential counterparties on a centralized electronic screen"; or (iii) by "[a]ny such other trading system or platform as may be determined by the [CFTC]." *See* CFTC Proposed Rule 37.9(a)(ii).

[16] CEA Section 1a(51) (emphasis added).

[17] *See* SEC Release at 10,951 n.27.

[18] *See* IIB Speech, *supra* n.12.

[19] *See* Commissioner Jill E. Sommers's Dissent, CFTC Release at 1,259; *see also* IIB Speech, *supra* n.12.

[20] *See* the November 24, 2010 AMG Comment Letter, *supra* n.2 at 3-5 (stating that the problems of a winner's curse and "front running" arise when there are narrow block trading definitions and "more generally in a trade execution platform that offers RFQ").

[21] *See* the February 7, 2011 AMG Comment Letter, *supra* n.3 at 3-4. The AMG believes that the CFTC real-time reporting block trading definitions are extremely narrow. If the CFTC adopts its proposed definition of block trades, a large number of trades will not qualify for delayed (...continued)

minimum of five market participants could cause the dealer to pay a higher price for, or lose entirely, the second side of the transaction because other opportunistic traders may be able to "front run" the second side of the transaction based on information provided by the initial RFQ. This issue is further exacerbated by the proposed 15-second minimum delay requirement, discussed below. End users, including clients of the AMG's member firms, will likely be forced to bear this cost, as dealers may pass this cost along in the form of a wider bid-ask spread.

Second, the CFTC Proposed Rule's five-market participant requirement could hinder the development of a robust exchange-traded swap market because, for certain less liquid and low-volume swap instruments, there may not be five potential liquidity providers to receive the RFQ. Even for transactions where there are five potential liquidity providers, certain types of customers may face restrictions that disallow transactions with some or most of these market participants. For example, absent an exemption, ERISA accounts generally are prohibited from transacting with affiliated dealers.

Third, managers should retain the right to transact with the counterparties of their choice without the imposition of artificial requirements to reach out to any minimum number of potential counterparties. Asset managers choose dealers based on a combination of factors and for a variety of business reasons, including rebates, best execution and concentration limits. In addition, some customers impose upon their asset managers "single-dealer guidelines," which require that trades be executed only with specific dealers. For example, many customers participate in commission recapture programs with specific dealers through which they receive rebates based on the percentage of trades they execute through those dealers, and accordingly, may get better overall pricing when trading with those dealers. In other cases, clients have directed brokerage agreements whereby asset managers are permitted to execute transactions only through a single dealer. Asset managers should retain the freedom to select which dealers to transact with.

Finally, the credit risk of potential counterparties is also a concern to AMG members. Despite the fact that Required Transactions will be subject to mandatory clearing, many customers of AMG member firms are still concerned about the credit risk of their dealers, particularly as it is uncertain what would happen when a designated clearing organization ("**DCO**") rejects a swap transaction subject to mandatory clearing.

In sum, because of the lack of statutory support for the CFTC's interpretation of the multiple-to-multiple requirement and the practical problems that will result from such a narrow reading, the AMG believes that market participants should, at a minimum, be able to assess the best interests of clients in seeking the best possible price, including how many dealers receive RFQs. The AMG strongly believes that the statutory mandate is

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(continued...)

real-time reporting rules and will be forced onto SEFs for execution. If these trades are not treated as a block, requiring the submission of an RFQ to a minimum of five participants (and subjecting them to a 15-second pause) will only exacerbate information leakage and the other problems described in the AMG letter.

satisfied by a SEF offering market participants the ability to communicate an RFQ to more than one market participant if they so choose.[22]

The minimum 15-second timing delay requirement should be eliminated because any imposed minimum pause requirement may result in increased costs to clients of the AMG's member firms.

The AMG believes that the CFTC Proposed Rule's 15-second minimum delay requirement should be eliminated. Under the CFTC Proposed Rule, the SEF must require that "***traders*** who have the ability to execute against a customer's order or to execute two customers against each be subject to a 15-second timing delay between the entry of those two orders . . . before the second side of the potential transaction (whether for the trader's own account or for a second customer), is submitted for execution."[23] The CFTC Release states the purpose of this requirement is to "'show[]' other market participants the terms of a request for quote from its customer, and provid[e] other market participants the *opportunity to join in the trade.*"[24]

Requiring a minimum delay creates ambiguity in numerous scenarios, which the CFTC would need to identify and address in its final rulemaking. It is unclear whether the proposed 15-second delay was intended to apply to RFQs.[25] If the 15-second rule applies, must the requester keep the RFQ open for 15 seconds even if the market moves? If so, the AMG questions why this would be necessary as firm quotes that are posted on an Order Book or transmitted in response to an RFQ would already be exposed to the market and robust pre-trade price transparency.

As explained above in the context of the five-market participant requirement – and in the previous AMG letters referenced in that subsection – the AMG believes that this requirement will have significant negative effects on end users of Swaps. During the proposed 15-second pause after a broker or dealer enters the first side of a transaction, there is a possibility that the market will move against the original counterparty, as opportunistic third-party market participants can act in the marketplace on the basis of the information signaled by one-sided trade information. This will result in significantly more expensive hedging to the original counterparty. Consequently, initial transaction costs will increase as initial bids and offers are adjusted to pass along these costs. Ultimately, these increased costs could be borne by buy-side users and, consequently, discourage them from transacting in swaps on SEFs. The AMG does not see adequate justification for the 15-second delay – particularly in the case of RFQs and Order Books that are already exposed to the market and subject to pre-trade price transparency – to

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[22] The AMG also requests clarification of whether the CFTC Proposed Rule allows market participants to inform certain dealers of their intent to put out an RFQ, provided that the requester satisfies the other requirements for an RFQ.

[23] CFTC Proposed Rule 37.9(b)(3) (emphasis added).

[24] *See* CFTC Release at 1,220 (emphasis added).

[25] The CFTC Proposed Rule is unclear whether the minimum 15-second pause requirement applies to every transaction or only to prearranged transactions. The AMG believes that the CFTC Proposed Rule is intended to apply only to prearranged trades; however, the CFTC Proposed Rule could be read more broadly without clarification.

offset the risk that the market moves against the requester in the intervening 15 seconds (or within any minimum imposed pause).

Besides the potential for significant increased costs for end users, the CFTC Proposed Rule is unclear as to ***whom*** the delay applies. The CFTC Release states that this pause would be "applicable to traders such as brokers" and also states that "[u]nder the proposal, a broker would have to provide a minimum pause . . . ."[26] It is unclear whether the term "traders" is intended to apply more broadly than to just dealers. The AMG believes that the proposed minimum delay requirement is intended to only apply to dealers executing orders on behalf of clients, and, if the CFTC does not eliminate the minimum delay requirement entirely, at a minimum, the CFTC should clarify that this delay requirement does not apply to trades executed by asset managers on behalf of their clients that may inadvertently cross each other on a SEF.[27]

Finally, the AMG believes that this requirement is inconsistent with Congress's desire to promote trading on SEFs and SB SEFs. As with the five-market participant requirement, Dodd-Frank does not mandate a minimum delay requirement, and the SEC has not imposed any parallel requirement in its Proposed Rule. The AMG believes that a 15-second delay requirement is overly prescriptive, punitive and arbitrary. Therefore, the AMG strongly encourages the CFTC to strike the minimum delay requirement from the final rule and instead leave it to market participants to set their own time limits on quotes.

The CFTC should eliminate the requirement for market participants to "take into account" bids or offers resting on the trading system or platform.

The AMG believes that the CFTC Proposed Rule's requirement for market participants to "take into account" resting bids or offers should be eliminated. The CFTC Proposed Rule requires respondents to an RFQ to communicate such resting bids and offers when providing a responsive quote to allow the requester to take into account "[a]ny bids or offers resting on the trading system or platform pertaining to the same instrument."[28] The CFTC Proposed Rule also requires resting bids and offers to be taken

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[26] *See* CFTC Release at 1,220.

[27] Specifically, AMG members do not believe that any minimum pause requirement should apply towards asset managers. AMG members are concerned for the situation where a single asset manager, trading on behalf of separate clients, inadvertently matches or crosses the trades before satisfying an imposed minimum pause requirement. In this situation, the asset manager should not be deemed as violating the minimum pause requirement, especially as such trades may be subject to best-execution standards, specified asset allocations and/or concentration limits. AMG believes little is achieved by applying a minimum pause requirement on an asset manager.

[28] CFTC Proposed Rule 37.9(a)(ii)(A) (stating that one permissible RFQ is

> [a] trading system or platform in which a market participant must transmit a request for a quote to buy or sell a specific instrument to no less than five market participants in the trading system or platform, to which all such market participants may respond. Any bids or offers resting on the trading system or platform pertaining to the same instrument must be taken into account and communicated to the requester along with the responsive quotes).

into account by a person submitting an RFQ based upon an indicative real-time electronic streaming quote.[29]

If this requirement were not removed for RFQs, the CFTC Proposed Rule would need to be clarified and amended significantly to be workable. First, under either of the permissible uses of RFQ mentioned above, the CFTC Proposed Rule does not provide guidance as to ***how*** the requester "takes into account" these resting bids and offers.[30] As discussed above, there are many considerations, other than pricing, that enter into the calculus of selecting a market participant with which to transact. This decision should be left solely, and with unfettered discretion, to market participants. Second, the AMG believes that the SEF should inform the RFQ requester of the relevant resting bids and offers but that the information sharing should be one-way. The SEF should not inform the providers of resting bids and offers of the other relevant RFQs; otherwise, the RFQ system would be subject to market abuse by opportunistic third parties seeking market information. This would also open up RFQs beyond the minimum number of required participants and make the RFQ system resemble an Order Book, which would be inappropriate for certain swaps.

The AMG is also concerned about the potential for market abuse with respect to third parties that have merely provided indicative bids or offers. The concern is that market participants providing only indicative prices (and potentially misleading information) could be on a "fishing expedition" which would distort the market, as opposed to seeking executable trades. Market participants always have the right to contact a dealer directly to ask for indicative prices, so including them is unnecessary and confusing. Accordingly, the CFTC should clarify that "resting bids and offers" do not include indicative prices.

Thus, the AMG encourages the CFTC to adopt Commissioner Sommers's alternative language to the CFTC Proposed Rule, which would eliminate this requirement as it pertains to market participants responding to an RFQ.[31] The AMG also suggests

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[29] CFTC Proposed Rule 37.9(a)(ii)(B)(1)–(2) (stating that another permissible RFQ is where

> multiple market participants must have the ability to [v]iew real-time electronic streaming quotes and [h]ave the option to complete a transaction by (i) [a]ccepting a firm streaming quote, or (ii) [t]ransmitting an [RFQ] to no less than five market participants, based upon an indicative streaming quote, taking into account any resting bids or offers that have been communicated to the requester along with any responsive quotes).

[30] The AMG assumes that if "resting bids and offers" will be required to be taken into account by the requester, this requirement would only apply to bids and offers of the same size as the underlying swap that the RFQ was put out on.

[31] *See* Statement of Commissioner Sommers, CFTC Release at 1259 (stating that one of the RFQ execution methods should include

> [a] trading system or platform in which a market participant transmits a request for a quote to buy or sell a specific instrument to more than one potential counterparty. Upon receipt of responsive quotes from any of the potential counterparties, the

(...continued)

eliminating the response requirement when made by a requesting market participant who sent an RFQ based upon an indicative real-time electronic streaming quote. Eliminating the requirement for an RFQ submitter to take into account resting bids and offers would also make the CFTC Proposed Rule consistent with the SEC Proposed Rule. The AMG believes that the "taking into account" requirement serves only to introduce uncertainty into the Swap markets.

The CFTC Proposed Rule should not place any limit on the available execution methods on SEFs for Permitted Transactions that market participants voluntarily choose to execute on a SEF.

CFTC Proposed Rule 37.9(a) defines "Permitted Transactions" as block trades, swaps not subject to mandatory clearing and execution requirements and illiquid or bespoke swaps.[32] CFTC Proposed Rule 37.9(c) limits the execution of these transactions to an Order Book, RFQ, a voice-based system or any system for trading which the CFTC may permit.[33] The AMG believes that the CFTC should not limit execution modalities available to market participants who voluntarily choose to execute Permitted Transactions on a SEF. No statutory basis exists in Dodd-Frank for regulatory execution requirements for Permitted Transactions since Dodd-Frank amended the CEA to explicitly state that "[f]or all swaps that are not required to be executed through a [SEF] . . . such trades may be executed through ***any other available means*** of interstate commerce."[34] If parties choose to execute a Permitted Transaction on a SEF, the final rule should not impose any restrictions on allowable execution methods on SEFs besides the general requirement that the execution methods must meet the requirements of the core principles applicable to all SEFs. In addition, the CFTC should clarify that only the core principles applicable to all SEFs will apply to Permitted Transactions executed on a SEF.

The determination of "available to trade" should be made by the CFTC, and not SEFs, based on well-defined, objective criteria.

Under Dodd-Frank, Swap counterparties must execute all transactions subject to mandatory clearing on a DCM or a SEF (or SB SEF) unless no DCM or SEF (or SB SEF) "makes the [S]wap available to trade."[35] The CFTC Proposed Rule delegates to SEFs the responsibility of deciding whether a swap has been made available to trade. In exercising this power, SEFs must make, and electronically submit to the CFTC, annual assessments of which swaps it considers available for trading. This assessment may consider factors

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(continued...)

original requester may accept a responsive quote and complete a transaction with any one of the responsive counterparties.)

[32] CFTC Proposed Rule 37.9(a).

[33] CFTC Proposed Rule 37.9(c).

[34] CEA Section 5H(d)(2) (emphasis added).

[35] *See* CEA Section 2(h)(8).

that the CFTC may deem relevant. The two examples of such factors included in the CFTC Proposed Rule are "frequency of transactions" and "open interest."[36]

The effect of a Swap being made available for trading is far-reaching. Under the statute, once any SEF or SB SEF determines that a Swap has been made available to trade, all SEFs and SB SEFs must treat the Swap and any economic equivalents of that Swap as being made available for trading, and that Swap transaction and its economic equivalents may no longer be executed in a bilateral transaction away from the SEF or SB SEF. Under the CFTC Proposed Rule, this limits the execution methods for that swap to those deemed appropriate for Required Transactions.[37]

SEFs and SB SEFs may find it in their interest to prematurely make Swaps available for trading, which would limit the flexibility of market participants entering into such Swap transactions. Specifically, a SEF or SB SEF may have an incentive to make a Swap available for trading to create liquidity on its trading platform or to limit liquidity in Swaps where they may benefit from execution methods that are only available for Permitted Transactions.[38]

The SEC Release recognizes that granting SB SEFs the discretion to determine which SB swaps are available for trading carries significant consequences. A determination by one SB SEF that an SB swap has been made available to trade means that the SB swap may no longer trade over-the-counter, "making the determination of what it means for an SB swap to be 'made available to trade,' as well as the decision as to who makes such a determination, central to the implementation of [Dodd-Frank]."[39] Thus, the SEC Release recognizes that a determination by a single SB SEF "could have unintended consequences for the trading of such SB swap."[40] With these unintended consequences in mind, the SEC Proposed Rule requires that this decision be made by the SEC rather than by one or a group of SB SEFs pursuant to objective measures to be established in future rulemaking.

The AMG believes that the SEC has adopted the appropriate approach and urges the CFTC to implement a similar rule whereby the determination of when a swap has become available to trade is made by the CFTC and not a SEF or group of SEFs. In lieu of the two somewhat vague and nonexclusive factors currently proposed by the CFTC (i.e., frequency of transactions and open interest), the AMG recommends that the final rule specify a set of exclusive objective factors, such as: minimum frequency of trading, minimum number of market participants actively trading a transaction and minimum transaction sizes. Imposing minimum thresholds, with the goal of measuring the liquidity

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[36] *See* CFTC Proposed Rule 37.10.

[37] *Compare* CFTC Proposed Rule 37.9(c) (allowing for Permitted Transactions to be executed "by an Order Book, Request for Quote System, a Voice-Based System, or any such other system for trading as may be permitted by the Commission") *with* CFTC Proposed Rule 37.9(b) (limiting Required Transaction execution to "an Order Book or a Request for Quote System").

[38] *See Id.*

[39] SEC Release at 10,968.

[40] *See* SEC Release at 10,969.

of a particular swap, upon the "available to trade" determination is necessary since products that trade in very small or insignificant notional sizes do not warrant mandatory SEF execution. In addition, because these factors measure the relative liquidity of a particular swap, these tests should not be done on a one-time annual basis – as the CFTC Proposed Rule seems to suggest by requiring the submission of annual assessments only – but repeatedly to make sure that the product continues to meet the applicable thresholds.

The AMG has several related concerns. First, the AMG is concerned about the CFTC Proposed Rule's lack of a notification system to inform market participants when a swap has become available to trade on a SEF. Without such a system, market participants may not know to cease over-the-counter transactions in these swaps, stifling compliance with applicable rules. Second, the AMG requests clarification on how quickly other SEFs must make a swap available after one SEF determines that a swap has been made available for trading. Third, it is unclear what happens if a SEF cannot support a product that has been made available for trading on a separate SEF. Lastly, market participants will need to understand how quickly they must comply with the SEF execution requirement.

The AMG also believes that, as a matter of sequencing and implementation, the CFTC should not allow any swaps to be considered available for trading (thereby limiting the permissible execution methods for these swaps to those allowed for Required Transactions) until appropriate information has become available to make the liquidity determinations described above.

Because registered entities may self-certify rules and amendments under Dodd-Frank, the CFTC should promulgate rules that maximize the opportunity for public input regarding such rules, amendments and user agreements.

Dodd-Frank amended the CEA to implement a new framework for self-certification and approval procedures for new products, rules and amendments submitted to the CFTC by registered entities, such as SEFs.[41] After such a submission, the new rule or amendment becomes effective within ten business days after the CFTC receives the self-certified rule or amendment.[42] The CFTC may stay the certification under certain limited circumstances,[43] which would trigger a review period of up to 90 days from the date of the notification of the stay, including a 30-day public comment period.[44] Dodd-

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[41] *See* CEA Section 5c(c) *and* Provisions Common to Registered Entities, 75 Fed. Reg. 67,282 (proposed November 2, 2011) (amending 17 CFR Pt. 40) (implementing the amended procedures for self-certification of rules mandated by Section 745 of Dodd-Frank, which amended Section 5c(c) of the CEA, by codifying amended self-certification procedures in Proposed Rule 40.6).

[42] *Id.*

[43] *Id.* (CFTC Proposed Rule 40.6(c)(1) would stay the certification of a rule if the CFTC determines that the new rule or amendment raised one of three issues, including: if the rule or amendment "present[s] novel or complex issues that require additional time to analyze, the rule is accompanied by an inadequate explanation or the rule is potentially inconsistent with the Act or the Commission's regulations thereunder.").

[44] *Id.* at 40.6(c)(1)-(2).

Frank also amended the CEA to give the CFTC broad regulatory powers with respect to the trading of swaps, including the ability to promulgate rules that define the swaps that can be executed on a SEF and expansive authority over SEFs in general.[45]

The AMG believes that the rules and amendments that a small number of SEFs and SB SEFS will promulgate through self-certification will affect the Swap market to the same degree as many of the CFTC and SEC Proposed Rules themselves. Recognizing the importance of public comment to the development of swap markets, the CFTC and SEC have both made it a priority thus far to request, procure and analyze closely market participant opinions. The AMG believes that the same level of review is necessary for SEF and SB SEF rules and amendments. Thus, the AMG requests that the CFTC utilize its authority to implement robust opportunities for public comment with respect to SEF rules and amendments by implementing the three requirements described below.

First, the AMG recommends that the final rule revise the SEF self-certification submission process to require that SEFs: notify the public of any intent to self-certify a rule or amendment; provide this notice a reasonable amount of time before the submission of self-certification to the CFTC; include in a self-certification submission any and all objections voiced by market participants; and, finally, expand the circumstances under which the CFTC may issue a stay of the SEF rule or amendment to include on the basis of any material market participant objections provided in the self-certification submission. These requirements would supplement the stay requirements and procedures under the CFTC Proposed Rule for Provisions Common to Registered Entities.

Second, as a means of establishing compliance with SEF Core Principle 13 – Financial Resources, each SEF should be required to submit to the CFTC and make available for public comment evidence demonstrating that the SEF will have in place sufficient legal, business and technological resources (including appropriate systems, policies and procedures and adequate personnel) to process user applications and accommodate the transactional flow of the numbers of market participants that it reasonably estimates will become users of the SEF over time. If SEFs are not fully equipped to handle all potential users, asset managers and their clients with relatively small market shares could be disadvantaged. Inadequate or materially delayed access to SEFs – when execution on SEFs is mandatory – could lead to significant pricing distortions and market disruptions in the relevant swap markets and would be contrary to the statutory goal of promoting the trading of swaps on SEFs.[46]

Finally, the CFTC should require SEFs to submit for public comment prior to self-certification the forms of user agreements, all terms to be incorporated into such user agreements and all business and technological requirements for market participants. Market participants should have an opportunity to comment on these user agreements and will need sufficient time to understand the related business and technological requirements for trading on a SEF before being bound by a SEF's terms.

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[45] *See, e.g.*, CEA Sections 5h(d) and 5c(c)(5)(C)(iii).

[46] *See* November 24, 2010 AMG Letter, *supra* fn.2 at 1-2; CEA Section 5H(e).

The CFTC should require SEFs to establish policies and procedures reasonably designed to prevent any provision in a valid swap transaction from being invalidated or modified without the express consent of the counterparties.

The AMG believes that there are no circumstances under which a swap transaction should be modified or cancelled by a SEF without express consent from the counterparties at the time of such modification or cancellation. Accordingly, the AMG believes the CFTC should require SEFs to establish policies and procedures reasonably designed to prevent any provision in a valid swap from being invalidated or modified as a result of being executed on, or otherwise processed by, a SEF. The AMG would find it unacceptable for a SEF to seek to reserve in its standard user agreements the power to unilaterally modify or cancel the terms of validly executed swaps, for example, through a provision that each SEF user is deemed to have accepted any modifications made to the terms of their swaps executed on the SEF, so long as the SEF gives notice of the change in terms. Accordingly, the AMG believes the Commissions should require SEFs to establish policies and procedures reasonably designed to prevent any provision in a valid swap transaction from being invalidated or modified through the utilization of, or execution on, a SEF without the express consent of the counterparties given at the time of the modification or cancelation.

Express consent of both counterparties should be required for modification or invalidation even when the terms of an agreement or confirmation contain errors. However, the CFTC Proposed Rule would allow a SEF to "adjust trade prices or cancel trades when necessary to mitigate market disrupting events caused by malfunctions in its electronic trading platform(s) or errors in orders submitted by members and market participants."[47] Instead, the final rule should clarify that such transactions must be preserved and only canceled or modified with the consent of the counterparties. If the parties so choose, they themselves can agree to cancel the transaction and re-enter into a swap that conforms with the requirements for the Required Transaction. This clarification is essential to facilitate certainty and promote confidence in the swap markets.

Finally, if the counterparties give the SEF express consent to adjust the terms of a cleared swap, then it is imperative that the relevant entities involved in clearing – along with executing brokers, DCMs and middleware platforms – make the appropriate adjustments as well.

The reach and scope of SEFs' information gathering, examination and enforcement authority under the CFTC Proposed Rule is overly broad and should be curtailed.

The AMG is concerned with the CFTC Proposed Rule's ambiguous use of the terms "participants," "market participants" and "members" when discussing the entities SEFs must regulate, collect information from, monitor and, in certain situations, discipline. In the CFTC Proposed Rule, SEF regulatory authority is said to apply not only to swap dealers who execute the transactions, but also to market participants generally. For example, the CFTC Proposed Rule would require a SEF to "have rules that allow it to collect information on a routine basis, allow for the collection of non-

[47] CFTC Proposed Rule 37.202(e).

routine data from its ***participants***, and allow for its examination of books and records kept by the traders on its facility."[48] If these duties are interpreted broadly to apply to customers of dealers, asset managers and their clients will be subjected to onerous reporting and regulatory requirements of multiple SEFs.

Under CFTC-regulated futures trading today, examination of books and records and audits is limited solely to registered entities, such as futures commission merchants ("**FCMs**"). Furthermore, if the FCM is a member of more than one exchange, it is subject to examination and audit only by a single self-regulatory organization – either the National Futures Association ("**NFA**") or the FCM's Designated Self-Regulatory Organization ("**DSRO**"). Neither the NFA nor a DSRO has the authority to conduct audits or examinations of the FCM's customers.

The AMG recommends that the CFTC clearly define which entities the SEF must regulate, as the SEC has done in its proposed rule, so as not to result in too expansive an interpretation. The SEC Proposed Rule clearly defines the term "participant" as a person that is permitted to directly effect transactions on an SB SEF.[49] The AMG requests clarification that the regulatory reach of SEFs will not extend beyond the entities that actually execute the transactions on the SEF.[50]

In addition, the CFTC Proposed Rule requires SEFs to establish and enforce rules to collect and evaluate data regarding, among other things: an individual trader's market activity on an ongoing basis, swap terms and conditions, the adequacy of deliverable supply and non-routine information contained in the books and records of traders.[51] This broad authority to acquire information is granted throughout the CFTC Proposed Rule, in connection with topics such as Monitoring of Trading and Trade Processing, Ability to Obtain Information and Access Requirements.[52] Recognizing that providing information to SEFs and their affiliates has associated risks, the CFTC has proposed Rule 37.7, which prohibits the use "for business or marketing purposes [of] any ***proprietary data*** or personal information it collects or receives . . . for the purpose of fulfilling its regulatory obligations."[53] Even with this protection, the AMG believes that it is inappropriate for

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[48] CFTC Proposed Rule 37.502 (emphasis added); *see also*, examples *supra* text surrounding n.51.

[49] SEC Proposed Rule 242.800. The SEC Proposed Rule also defines the terms "person associated with a participant" and "related person."

[50] In the case of introducing brokers and sponsored entities, the CFTC's rulemaking should make clear that the SEF's regulatory authority only covers these entities and does not extend to the next level of participants.

[51] CFTC Proposed Rule 37.401(a), 37.402(a)(1), 37.402(a)(2) and 37.502.

[52] *See, e.g.*, CFTC Proposed Rule 37.202 (stating that "[a] [SEF] must have arrangements and resources for effective enforcement of its rules. Such arrangements must include the authority to collect information and documents on both a routine and nonroutine basis, including the authority to examine books and records kept by the [SEF's] members ***and by market participants.***") (emphasis added).

[53] See CFTC Proposed Rule 37.7 (emphasis added).

SEFs to access this information at all. The term "proprietary data" is too narrow to adequately protect trading information that SEFs could obtain. Even if the definition were appropriately expanded, the AMG believes there is risk that proprietary information could be improperly disclosed, and it would be impractical to sufficiently monitor a SEF's proper use of this information. The CFTC Proposed Rule also allows SEFs to share this information with SEF members, other SEFs and DCMs. The information shared in this process could inadvertently be leaked to, or improperly obtained by, third parties.

The CFTC final rules should contain exceptions from mandatory execution on a SEF for certain packaged swap transactions.

Some AMG members engage in "packaged" or "combination" Swap transactions which combine into a single transaction two or more component transactions. These components can consist of other Swaps, futures, cash market transactions or other financial instruments. Because the pricing and economic rationale of the packaged Swap transaction depends on the pricing of its components, such packaged Swap transactions have unique pricing, trading and credit characteristics.

Requiring a swap component of such a transaction to be executed on a SEF because that component, when traded independently, is available for trading on a SEF would impair the viability of the packaged swap transaction. Decoupling the packaged swap transaction and requiring it to be executed on a SEF may not reflect the true price of the packaged instrument and does not promote accurate pricing information to market participants trading such instruments. Similarly, the AMG believes that the entire combination instrument should be excluded from the SEF execution requirement. When asset managers execute packaged swap transactions on behalf of their clients, they seek the best price on the overall transaction, and not just looking at its component parts. Similarly, the SEF rules should look at these packaged products on the basis of the overall transaction, and not its component parts.

This is especially true where certain packaged Swap transactions are already subject to, and governed by, DCM regulations. For example, some AMG members may engage in Exchange for Risk ("**EFR**") or Exchange for Physical ("**EFP**") trades involving a future and a swap. Current CFTC rules exempt these packaged transactions from mandatory execution on DCMs, so long as the transactions meet special exchange rules[54] that allow them to be executed off-exchange, such as a block trade. It would be inconsistent for the CFTC to allow these transactions to be executed off the futures exchange but not off SEFs. The AMG believes that the final CFTC rules should explicitly exempt packaged swap transactions from the SEF trade execution requirements.

The AMG is uncertain of how certain of the CFTC Proposed Rule provisions relate to the separate CFTC Confirmation, Reconciliation and Portfolio Compression Proposal.

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[54] *See, e.g.*, Market Regulation Advisory Notice, RA1006-5, CME, CBOT, NYMEX & COMEX Rule 538 (June 11, 2010), http://www.cmegroup.com/rulebook/files/RA1006-5.pdf.

This CFTC Proposed Rule requires that executed swap transactions include written documentation memorializing all the terms of the transaction that legally supersede any previous agreement, and this must take place at the time of execution.[55] The AMG is unsure of whether this requirement applies to an executing dealer and what the relationship is between this provision and the provisions in the CFTC's Confirmation, Reconciliation and Portfolio Compression Rule Proposal.[56] Thus, the AMG requests that the CFTC clarify how the rules will operate together when they become effective.

[55] CFTC Proposed Rule 37.6(b).

[56] *See* Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. 81,519 (proposed December 28, 2010) (adding 17 CFR Pt. 23); *see also* February 7, 2011 AMG Comment Letter, *available at* http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission18_011811-7.pdf.

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The AMG thanks the CFTC for the opportunity to comment on proposed rulemaking concerning the core principles and other requirements for swap execution facilities under Title VII. The AMG would welcome the opportunity to further discuss our comments with you. Should you have any questions, please do not hesitate to call the undersigned at 212-313-1389.

Respectfully submitted,

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