Via Electronic Submission: http://comments.cftc.gov

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

Re: RIN No. 3038–AD51: Customer Clearing Documentation and Timing of Acceptance for Clearing; and RIN 3038–AD51: Clearing Member Risk Management

Dear Mr. Stawick:

Arbor Research and Trading ("Arbor") appreciates the opportunity to comment on Commodity Futures Trading Commission's (the "**Commission**") proposed rules with regard to 1) timing of acceptance for clearing 2) clearing member risk management and 3) swaps execution and clearing documentation.

Arbor Research & Trading Inc. is an institutional research and brokerage firm that provides innovative research across a broad range of global fixed income, equity, currency and commodity markets. Founded in 1988 Arbor has a long history of delivering innovative, technology based products to many of the worlds largest and most influential financial institutions.

Introduction

As the CFTC has correctly asserted, trade uncertainty that may exist as a result of a time delay or 'latency' between <u>point of trade execution</u> and <u>point of trade acceptance</u> into clearing can undermine the cleared swap market's integrity and directly constrain liquidity. Moreover, any attempt to limit a swap customer's choice of dealer, counterparty, trading position with a counterparty could not only destroy confidence , but could directly undermine the swaps market's successful evolution to a systemically safer, more 'democratized' and cleared marketplace.

Arbor sees such rules as fully consistent with the fundamental tenets of the Dodd Frank Act (the "Act") and as such, supports such proposed rules with regard to timing of acceptance, clearing member risk management and documentation. Arbor respectfully requests that the Commission <u>adopt such rules in their entirety as proposed</u>; and importantly, <u>prioritize them in the final rule making process</u>.

Proposed Rule with Regard to Real Time Trade Acceptance

Arbor supports the Commission's proposed rule that calls for real time trade acceptance into clearing by the Derivatives Clearing Organization ("DCO") and it's clearing members. Such a rule requires that cleared swaps trades, be they executed on a Swap Execution Facility ("SEF"), or bilaterally, are accepted into clearing as "technologically practicable." As the CFTC correctly notes, such a time period for should be is measured "in milliseconds or seconds."

Arbor agrees that real time trade acceptance should become the cleared swap market standard, because it has been so successful in other cleared futures and cleared swaps markets.

Consider the success of the cleared futures markets in CME's Globex for treasury and Eurodollar futures. In those markets, the clearing member guarantees its customer's trade before it is executed, thus no latency exists between point of trade execution and point of trade acceptance into clearing. All trades settle immediately.

To prevent a bad trade from entering the system in a vertically integrated exchange futures environment, like Globex, the clearing member must prevent its execution. It achieves this by noticing the execution venue or executing broker to restrict or prevent the execution privileges of its customer. It works well. By the clearing member protecting itself from the bad trade, it is in essence protecting the market as a whole. Such a method could be deployed in the swaps market by SEFs working with clearing members.

Such a method also works well for bunched trades or trade allocations. Customers who allocate trades into multiple subaccounts execute the trade first via an 'omnibus account'. The clearing member immediately accepts such a trade into clearing with the expectation that allocating customer has until the end of the trading day to allocate such a trade from the omnibus account into the relevant subaccounts.

A second alternative settlement method for cleared derivative trades (executed either bilaterally or electronically) occurs today at the CME's Clearport and ICE's WebICE in the energy markets. With this solution, the trade is first executed, then submitted for clearing by the parties. Before the trade is accepted into clearing, both the clearing member for the buyer and the clearing member for the seller must acknowledge acceptance, otherwise the trade is rejected.

If the trade is rejected (in real time), breakage (the cost of executing a new trade to replace the rejected bad trade) is minimized. Thus the market convention is that the <u>bad trade is broken</u>. "Good" trade counterparties can re-enter the market quickly to execute the same trade with other solvent counterparties. In contrast, "bad" trade counterparties are restricted by their clearing firm from executing further trades.

Arbor supports both the above 'Globex' and 'Clearport' solutions for swaps because they are proven, work well and would be inexpensive alternatives for market participants to implement. Because such workflow and technology are currently utilized by clearing houses and clearing members today, they could be also ported quickly into the cleared swaps context.

Proposed Rule with Regard to Clearing Member Risk Management

Arbor supports the Commission's proposed rule with regard to clearing member risk management. Such a rule requires that clearing members 1) establish risk based limits, position size, & order size and 2) use automated means to screen their customer orders against such limits.

Arbor supports such a rule because it introduces prudent and well proven risk management techniques into the cleared swaps market that will build market confidence and encourage greater liquidity, transparency and lower processing costs.

As the Commission correctly notes, such risk management tools include the use real time customer monitors that could show open customer orders, and ‘kill buttons’ to cancel customer orders and disconnect customer execution access such that bad trades that might otherwise be rejected and never executed.

To ensure that the clearing member use such tools, it is proper that the Commission require them to protect the integrity of the market as a whole.

Such risk monitoring tools are commonplace in many futures markets and have greatly increased settlement integrity and investor confidence in those markets, since their introduction.

Arbor notes that the Commission’s own *Technology Advisory Committee* made similar recommendations in their report published March 1, 2011. In the report, the committee called for among other things, 1) Pre trade quantity limits on customer orders, 2) Pre trade price collars or ‘fat finger’ controls and 3) ‘Kill Buttons’ on execution venues for a clearing member to cancel a customer order when necessary.

Moreover, *Technology Advisory Committee* requested that the Commission impose such pre trade requirements equally to all entity types such that no ‘race to the bottom’ could occur where overall market integrity was compromised.

For these reasons, Arbor strongly endorses the Commission’s proposed rule with regard to clearing member risk management

Proposed Rule with Regard to Documentation

The Commission’s proposed rule with regard to Documentation would prohibit any market documentation that would 1) Disclose the identity of a customer’s counterparty; 2) Limit the number of counterparties with whom a customer may trade; 3) Limit the position size a customer may take with a specific counterparty; 4) Impair a customer’s access to best execution; and 5) Prevent a customer from complying with real time trade acceptance.

Arbor supports such a proposed rule because it can see no legitimate risk based reason why a clearing member, DCO or swap dealer should ever seek to restrict the *number* or *type* of counterparty with which a customer may trade. Nor does Arbor see any risk based reason why a clearing member, DCO or swap dealer should ever restrict the *trade method*, or *trade venue* on which a customer may trade, as it attempts optimal trade execution.

Moreover, Arbor can see no legitimate reason why the FCM, Dealer or MSP should ever reveal the customers original executing counterparty. Such documentation that would contravene such a rule is not required in other cleared markets.

To limit a customer's choice of dealer or execution venue (especially when it is licensed and directly regulated) would dangerously inhibit market liquidity and unnecessarily increase systemic risk in the swaps market place. As the Global Financial Crisis of 2008 has evidenced the interest rate and credit default swaps markets can never have enough liquidity.

Moreover such documentation would restrict trade which is expressly forbidden under the Dodd Frank Act. Under the Act it is well established that a DCO or a Swap Dealer (including their FCM) shall not '…adopt any rule or take any action that results in an unreasonable restraint of trade; or…impose any material anticompetitive burden." (HR 4173, p.317 & p.336).

Nor does Arbor believe such a rule is overly prescriptive. Despite possible assertions to contrary, the Commission's rule does not prevent industry participants or industry groups from drafting certain types of documentation. The rule simply ensures a proper context in which such documentation is consistent with fundamental open access tenets of the Dodd Frank Act and does not restrict a customer's right to choose.

While Arbor is normally loathe to philosophically encourage government intervention in private contracts between parties, it is well established that regulators may under certain conditions intervene to ensure orderly market activity and to protect the market participants against fraud, market manipulation, and protect against restrictions on trade.

Such authority is granted to the Commission under the Act. "The Commodity Futures Trading Commission shall adopt rules mitigation conflicts of interest in connection with the conduct of business by a swap dealer or major swap participant with a DCO, DCM or SEF that clears or trades swaps." As a consequence, Arbor sees no conflict with such a rule and thereby fully supports it.

Cost & Benefits of Such Rules

The benefits to the market of the proposed rules are significant. By the Commission's adopting of such rules it would ensure 1) the further reduction of systemic risk 2) eliminate barriers to entry to a greater pool of market makers and liquidity providers, clearing members, and execution venues, 3) enhance market depth and liquidity and 4) substantially reduce transaction costs.

These benefits far outweigh any possible costs of adoption of such rules, which would be minimal. Indeed, by compelling market adoption of workflow and systems currently deployed in other cleared markets, implementation will be cheaper and quicker.

Conclusion

Arbor supports the current proposed rules as written and recommends that the <u>Commission adopt them in their entirety</u>. Such adoption will not only ensure that the swaps market properly complies with the fundamental tenets of the Dodd Frank Act, but that it also migrates successfully to a more transparent, liquid and safer market environment where it's inherent systemic risk is mitigated through democratized central clearing.

In conclusion, Arbor respectfully requests that the Commission sets <u>these rules above all others in the final rule process</u> such that uncertainty is lifted, private capital formation can occur and the private sector can appropriately deploy its resources to ensure proper compliance.

Respectfully Submitted,

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The Hon. Gary Gensler, Commission Chairman

The Hon. Michael Dunn, Commission Commissioner

The Hon. Bart Chilton, Commission Commissioner

The Hon. Jill E. Sommers, Commission Commissioner

The Hon. Scott D. O'Malia, Commission Commissioner