CIEBA

The Committee on Investment of Employee Benefit Assets

September 30, 2011

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

Re: RIN 3038-AD51/Customer Clearing Documentation and Timing of Acceptance for Clearing

Dear Mr. Stawick:

The Committee on Investment of Employee Benefit Assets ("CIEBA") appreciates this opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission") regarding the recently released notice of proposed rulemaking and request for comments ("NPR") concerning customer clearing documentation and the implementation of the related statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which amends the Commodity Exchange Act (the "CEA").

CIEBA represents more than 100 of the country's largest pension funds. Its members manage more than $1.4 trillion of defined benefit and defined contribution plan assets on behalf of 17 million plan participants and beneficiaries. CIEBA members are the senior corporate financial officers who individually manage and administer ERISA-governed corporate retirement plan assets.

In the NPR, the Commission has proposed rules that would, among other things, prohibit arrangements that disclose to a customer's future commission merchant ("FCM"), swap dealer or designated clearing organization ("DCO") the customer's counterparty with respect to a swap, or limit the number of a customer's potential counterparties or restrict the size of a customer's position with any counterparty. The NPR also proposes rules that require that trades be accepted or rejected for clearing " as quickly as would be technologically practicable if fully automated systems were used" ("Real Time"). We endorse the Commission's continuing efforts to protect the integrity of the cleared swaps market and strongly support the rules proposed by the NPR. Given the emphasis that Dodd-Frank has placed on the elimination of systemic risk through central clearing, it is imperative that pension plans and other customers have open access to clearing without any anti-competitive restrictions. The proposed rules will help ensure meaningful competition between swap dealers, increase the likelihood that trades will be executed on the best terms available and protect anonymity in the cleared swap market. We therefore strongly urge the Commission to adopt the rules proposed in the NPR.

I. Background

We are very pleased that the Commission addressed potential swap documentation concerns by issuing the NPR, which would prohibit anti-competitive arrangements in connection with clearing, such as FCMs restricting the swap position a customer may have with a specific swap dealer. The recent turmoil in the markets has resulted in a smaller number of swap dealers and FCMs who have a correspondingly high concentration of market power. As clearing will shortly be mandatory for many swaps, the protection of customers in the face of such market power and ensuring open access to clearing will become ever more important, which is why we strongly support the NPR and the Commission's efforts on behalf of swap customers.

In the NPR, the Commission sought comments on what effect the new rules would have on open access to clearing and if the proposals would increase risk to various market participants. We strongly believe that these rules would have a beneficial impact on access to clearing, will not increase costs and that due to the ability of FCMs to set limits on their clients' swap positions no additional risk would be imposed.

II. We endorse the Commission's prompt action to protect pension plans and other buy-side firms

We strongly support the Commission for the NPR, which will prohibit anti-competitive documentation and provide pension plans greater choice of counterparties. In addition, we urge the Commission to continue to review documentation proposed by swap dealers and dealer-dominated trade groups to ensure that such documentation is in the public interest and consistent with the objectives of Dodd-Frank. The Commission has an important role in protecting the public interest, which necessarily involves reviewing swap documentation that could be harmful to the interests of the public. Without the Commission's action swap dealers and dealer-dominated trade groups will dominate the development of documentation to the potential detriment of pension plans and other market participants.

III. The proposed rules will increase open access to clearing

A. The NPR will prohibit swap dealers from limiting pension plans' choice of counterparties and restraining trade

By prohibiting the disclosure to the FCM of a customer's counterparty and prohibiting restrictions on the number of, or the amount of positions with, specific counterparties, the Commission has ensured that pension plans will have a greater choice of swap counterparties. Many FCMs have affiliated swap dealers and could potentially prefer their affiliated swap dealers, while other swap dealers could be disfavored by means of artificially low limits. This could restrict a pension plan's choice of swap counterparties, as they may effectively be prohibited from entering into cleared swaps with certain swap dealers.

The rules proposed in the NPR would explicitly prohibit any FCM from restricting the size of the position, apart from an overall credit limit, that a pension plan can take with any swap dealer or any other counterparty. This will allow pension plans to use any counterparty they consider appropriate, eliminating restraints on trade and giving pension plans more choices. This will also result in a wider diffusion of swaps instead of restricting them to a smaller number of parties, which will increase market stability. Currently, the high concentration of swap dealers permits them to dominate the market and the industry trade groups that develop swap documentation.

For instance, in the absence of the NPR, pension plans would likely be required to enter into agreements such as the FIA-ISDA Cleared Derivatives Execution Agreement and the triparty annex thereto (the "Annex") with FCMs, which could restrict their ability to enter into trades with certain counterparties. The proposed rules in the NPR will ensure that such anti-competitive agreements that restrict market choice will not be forced upon pension plans.

B. <u>The NPR will result in more competition among swap dealers which will allow pension plans to obtain best pricing</u>

If FCMs are able to impose artificial limits on positions with non-affiliated swap dealers, pension plans will have a smaller pool of swap counterparties to trade with. This would therefore reduce competition among swap dealers, and there are currently relatively few swap dealers in the market in any event. Competition among swap dealers and the removal of artificial barriers to entry will result in better execution for pension plans (both in terms of tighter bid-ask spreads on execution and with respect to FCM clearing fees) and will improve pension plans' ability to obtain best pricing. The prohibition on anti-competitive arrangements will also remove barriers to entry for new swap dealers and FCMs, which will increase the market's liquidity and de-couple execution and clearing services, creating a more efficient market. The NPR would therefore result in wider competition among swap dealers, which would benefit both retirees who entrust their savings to pension plans and will allow other customers to conduct their hedging and risk-mitigation activities on more economic and efficient terms.

C. <u>The NPR will protect anonymity in clearing ensuring that all participants are treated equally</u>

Anonymity, as between a customer's FCM and the customer's counterparty, is one of the hallmarks of clearing because it ensures that all market participants are treated equally regardless of their market power. Swap documentation provisions that reduce this anonymity by allowing FCMs (and through them, potentially their swap dealer affiliates) to determine the ultimate counterparty of a pension plan's trade could lead to potential abuses due to the concentration of information among swap dealers and FCMs. We therefore strongly support the NPR's requirement that anonymity be preserved, which will allow all parties access to clearing on an equal footing.

D. The NPR will ensure that potentially harmful or anti-competitive documentation will not become mandatory

Although certain swap dealers and FCMs have claimed that swap documentation produced by dealer-dominated trade groups will be optional, there is a risk that such documentation will effectively be required for market participants such as pension plans. Because clearing for many types of swaps will soon be mandatory, pension plans will need to agree to clearing documentation with FCMs in order to enter into swaps. Given cost and time constraints, swap participants such as pension plans are generally effectively required to use trade group documentation. Historically, this documentation has tended to favor dealers at the expense of other market participants. Although some of the largest buy-side swap participants are able to negotiate special terms, buy-side participants with lower volumes have less leverage and may be unable to negotiate changes to documentation developed by dealer-dominated trade groups. Due to the market power of swap dealers and the largest buy-side participants, such documentation may become standard and swap dealers will likely use their market power to ensure that provisions allowing them to eliminate anonymity or to limit the number of a pension plan's counterparties, such as the Annex, will become effectively mandatory. Therefore, the NPR's prohibition of such provisions is important and necessary to ensure open access for clearing.

E. Real Time clearing will increase the efficiency and certainty of the swap market

We strongly endorse the Commission's proposed Real Time standard for clearing, which will reduce systemic instability by minimizing the window of counterparty risk between the execution and clearing of a swap. This will, in turn, significantly improve clearing access for smaller participants, particularly in times of market turmoil, because Real Time acceptance will ensure that counterparties are willing to trade with all customers. Real Time clearing will also provide market certainty, as the immediate knowledge that a trade has been rejected for clearing means that less damage would be suffered by either party with respect to such transaction.

IV. The proposed rules will not decrease open access to clearing

A. "Back-up" arrangements to clearing are unnecessary

Swap dealer dominated trade groups have claimed that the arrangements prohibited by the NPR are necessary to promote efficient clearing. We do not believe this is a legitimate claim. For instance, sell-side firms argue that knowing the pension plan's counterparty will ensure that counterparties have "back-up" provisions so that trades that fail to be cleared can be executed bilaterally. However, trades that are intended to be cleared are fundamentally different from bilateral transactions. In a bilateral trade, a pension plan would need to consider counterparty risk as well as individual negotiation of specific provisions that depend on the potential counterparty. This is not true of cleared trades, which are entered into with the DCO and contain generally standardized terms. In addition, the Dodd-Frank Act provides that cleared and bilateral trades will be subject to different capital and margin rules, which will vary depending on the type of swap that the parties wish to enter into. Therefore, it is extremely unlikely that pension plans will agree to enter into a bilateral trade on exactly the same terms as a trade that failed to clear, as they would need to consider counterparty risk, the effect of different capital and margin rules as well other fact specific terms. Since this would involve a significant negotiation (as currently occurs in the bilateral swap market), pension plans would not preemptively agree to convert a trade that failed to clear into a bilateral arrangement unless forced to do so by swap dealer developed documentation.

In addition, under the NPR, the determination as to whether a trade will be cleared must be made in Real Time, so any timing gap between a trade being executed and the determination that the trade cannot clear will be very short. This in turn eliminates the need for "backup" arrangements because, as in other cleared derivatives markets, the parties will know immediately if the swap does not clear. If this is the case, there would be no trade, so the parties can immediately seek to source the swap with other counterparties and would not need any back-up arrangements.

B. The proposed rules will not increase the cost of clearing

The benefits of the NPR described in this letter will not cause an increase in the cost of clearing. DCOs and FCMs already have systems in place in other cleared derivative markets that provide for real time clearing without any arrangements that are prohibited by the NPR. These systems can be adapted for the types of derivatives that will soon be subject to mandatory clearing without importing unnecessary documentation from the over-the-counter swap market. As the industry is already making some investments to provide for Real Time clearing, the proposed rules will provide regulatory certainty and ensure an efficient allocation of resources by DCOs and FCMs. In addition, certain arrangements prohibited by the NPR, such as the Annex, would require each swap customer to negotiate documentation with multiple parties, which incurs substantial legal and operational costs. This burden would likely fall on swap customers (and be particularly onerous for multi-account pension plan managers), so the NPR's prohibition of such arrangements would lower clearing costs.

Some of the arrangements prohibited by the NPR would require significant changes to the clearing systems currently used for derivatives. For instance, the limits on customer positions with counterparties that may be imposed by the Annex is incompatible with Real Time clearing, and would necessitate a significantly redesigned clearing architecture. Investing time and funds to make such prohibited arrangements compatible with the existing clearing mechanics would be an unnecessary waste of resources and increase the cost of clearing.

V. The proposed rules will not increase risk to DCOs, FCMs or swap dealers

Some FCMs have argued that if the rules proposed by the NPR are adopted, they will be subject to greater risk because they will be unable to set limits on pension plan trades with certain unaffiliated swap dealers (or other counterparties). We disagree with this assessment. The counterparty to each pension plan's cleared swap will be the DCO (through the agency of the FCM), so the FCM will not be exposed to the credit risk of the pension plan's swap dealer, since trades will clear in Real Time. Therefore, there is no need for an FCM to monitor which swap dealer has executed its pension plan customer's trade. In addition, nothing in the NPR prevents FCMs from setting overall limits on customers' positions and thereby managing the FCM's overall exposure to one client. Doing so will enable the FCM to control risks without setting limits on a customer's trades with specific swap dealers.

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We thank the Commission for the opportunity to comment on its NPR on customer clearing documentation and timing of acceptance for clearing. If you need additional information, please contact CIEBA's Executive Director Deborah Forbes at 301-961-8677 or at dforbes@afponline.org.

THE COMMITTEE ON INVESTMENT OF EMPLOYEE BENEFIT ASSETS