WMBA
AMERICAS
WHOLESALE MARKETS BROKERS' ASSOCIATION

January 14, 2013

The Honorable Gary Gensler
Chairman
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Chicago Mercantile Exchange, Inc.'s Amended Request to Adopt a New Chapter 10 and New Rule 1001 related to the Regulatory Reporting of Swap Data (IF 12-014)

Dear Chairman Gensler:

The Wholesale Market Brokers' Association, Americas ("WMBAA" or "Association")[1] appreciates the opportunity to provide specific comments to the Commodity Futures Trading Commission ("CFTC" or "Commission") related to the Chicago Mercantile Exchange Inc.'s ("CME") amended request for approval of a rule submitted pursuant to Section 40.5 of the Commission's regulations ("Rule 1001").[2]

The WMBAA is concerned that Rule 1001 will begin a slow progression toward permitted bundling of mandated regulatory services—trade execution, clearing, and swap data repository ("SDR") reporting. As trade execution platforms in over-the-counter ("OTC") markets without affiliated clearing operations, we urge the Commission to reject Rule 1001 as inconsistent with the Commission's final reporting rules, as well as the competitive marketplace envisioned by Congress in passing the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").

I. Rule 1001 Conflicts with the CFTC's Final Part 45 Rules

Part 45 Rules Empower SEF or DCM to Select SDR

The WMBAA strongly objects to Rule 1001 because it directly conflicts with the CFTC's final rules on swap data recordkeeping and reporting requirements ("Part 45 Rules"), which empower a swap

[1] The WMBAA is an independent industry body representing the largest inter-dealer brokers operating in the North American wholesale markets across a broad range of financial products. The five founding members of the group are: BGC Partners; GFI Group; ICAP; Tradition; and Tullett Prebon. The WMBAA seeks to work with Congress, regulators and key public policymakers on future regulation and oversight of OTC markets and their participants. By working with regulators to make OTC markets more efficient, robust and transparent, the WMBAA sees a major opportunity to assist in the monitoring and consequent reduction of systemic risk in the country's capital markets. For more information, please see www.wmbaa.org.

[2] Letter from Tim Elliott, Executive Director and Associate General Counsel, CME, to Office of the Secretariat, CFTC (Dec. 6, 2012), *available at* http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul120612cme001.pdf [hereinafter CME Amended Request to Adopt Rule 1001].

execution facility ("SEF") or designated contract market ("DCM") to choose the SDR to which "on facility" swap transactions are initially reported and all subsequent data related to such swap must be reported. Rule 1001 would violate the Part 45 Rules and allow the derivatives clearing organization ("DCO"), not the SEF or DCM, to select the SDR for swaps – including its own affiliated SDR.

The CFTC's final Part 45 Rules specify and require a SEF or a DCM, rather than a DCO, to report swap transaction data to a registered SDR for swaps executed on a SEF or DCM.[3] Rule 45.10(a)(1) provides that, "[a]s soon as technologically practicable after execution, the [SEF] or [DCM] shall transmit to both counterparties to the swap, and to the [DCO], if any, that will clear the swap . . . the identity of the [SDR] to which required swap creation data is reported by the [SEF] or [DCM] . . ."[4] The Commission made clear in the preamble to the final Part 45 Rules that it sought to require "the SEF or DCM to make the initial [primary economic terms] data report for swap [sic] executed on such a facility" "in order to ensure that [such data] concerning the swap is reported as soon as technologically practicable following execution."[5]

After an initial data report on a swap is made to an SDR, Rule 45.10(a)(2) specifies that "all required swap creation data and all required swap continuation data reported for the swap reported by any registered entity or counterparty shall be reported to that same [SDR]."[6] In other words, as the Commission noted in the preamble to the final rule, "in practice this [means] that the SEF or DCM would select the SDR for platform-executed swaps . . ."[7] In contrast, Rule 1001 would allow CME to require all swaps cleared on its platform to be reported to its own SDR, in direct contravention of the CFTC's clearly articulated approach.

Clearing Does Not Constitute Termination of Swap

In its amended request for approval of Rule 1001, CME claims that, "[o]nce the original swap is accepted for clearing, it will be extinguished and replaced by two resulting swaps" under the proposed Rule 1001 reporting framework: (1) "one resulting swap [would] be between CME Clearing and Party A[;]" whereas (2) "the other resulting swap [would] be between CME Clearing and Party B."[8] CME describes how "CME Clearing would send an electronic message to the SDR that received the Part 43 swap transaction and pricing data or the Part 45 creation data report for the original swap . . . that the original swap has been accepted for clearing and extinguished."[9]

This interpretation is inconsistent with the plain language of the CFTC's rules and market practice. The Part 45 Rules require the continued reporting of life cycle data, which includes novation

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[3] *See* Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2,136, 2,208 (Jan. 13, 2012).

[4] *Id.* (emphasis added). The final Part 45 rules require the reporting counterparty (*e.g.* a swap dealer or major swap participant) to make the initial report for an off-facility swap.

[5] *Id.* at 2,143.

[6] *Id.* at 2,208 (emphasis added).

[7] *Id.* at 2,143 (emphasis added).

[8] CME Amended Request to Adopt Rule 1001, at 2.

[9] *Id.*

through clearing,[10] to the same SDR throughout the life of a swap.[11] The Commission's rules are clear in that they expect reporting to an SDR to establish a complete audit trail of a swap from creation, through life cycle events, and ending with termination of the swap. The same is true with regard to addressing USI code creation with trades given codes at execution and then undergoing compression or full novation. Even in that instance, the Commission expresses a desire for continuity in SDR, noting that "where a new swap takes the place of an old swap, such as where a compression or full novation has occurred . . . a new USI will be assigned to the new swap, and the SDR to which the swap has been reported will be required to map the new USI back to the USIs of the swaps from which the new swap originated, in a manner sufficient to allow the Commission and other regulators to follow the entire history and audit trail of each affected swap."[12] CME's proposed approach would violate the Part 45 Rules, fragment swap transaction data, and frustrate the Commission's efforts to record the entirety of one swap in a single location.

Further, CME's assertion that clearing creates a "new" swap that can be reported to a new SDR would make compliance with Rule 45.10 impossible, ending the mandatory practice of reporting swaps data to one SDR. In addition to the inconsistency with existing Commission regulations, this approach would preclude the achievement of recognized public policy benefits from single-SDR reporting.[13]

CME's Claim of Inefficiencies of Reporting to Multiple SDRs is Without Merit

For similar reasons, the CME's concern regarding the obligation of DCOs to report to multiple SDRs is without merit. CME incorrectly asserts that, "[i]f the DCO reports the cleared swap data Part 45 requires to an SDR, any further reporting by Party A or Party B would be duplicative and potentially confusing."[14] The mere fact that a DCO may have to provide swap transaction data to multiple registered SDRs is not, on its own, a significant burden that outweighs the regulatory and public benefits of consolidated swap data reporting.[15] At the moment, there are only three provisionally registered SDRs. CME cannot reasonably claim that the obligation to report swaps transactions to two other SDRs (the third is its own captive SDR) is an onerous burden. As

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[10] Section 45.1 ("*Life cycle event* means any event that would result in either a change to a primary economic term of a swap or to any primary economic terms data previously reported to a swap data repository in connection with a swap. Examples of such events include, without limitation, a counterparty change resulting from an assignment or novation; a partial or full termination of the swap; a change to the end date for the swap; a change in the cash flows or rates originally reported; availability of a legal entity identifier for a swap counterparty previously identified by name or by some other identifier; or a corporate action affecting a security or securities on which the swap is based (*e.g.*, a merger, dividend, stock split, or bankruptcy).").

[11] Section 45.4.

[12] Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. at 2,159.

[13] "Roundtable participants generally endorsed the NOPR provision requiring that all swap data for a given swap must be reported to a single SDR, and no comment letters suggested changing this requirement . . . The Commission believes that important regulatory purposes of the Dodd-Frank Act would be frustrated, and that regulators' ability to see necessary information concerning swaps could be impeded, if data concerning a given swap was spread over multiple SDRs." *Id.* at 2,168.

[14] CME Amended Request to Adopt Rule 1001, at n.5.

[15] *See* Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. at 2,159.

intermediary trading facilities that do not operate clearing or SDR platforms, WMBAA member firms have long operated with connectivity to numerous clearing houses (including CME) and trade repositories, investing capital and human resources to ensure that these "pipes" are in place and highly functioning. While this arrangement may not accord with CME's apparent preference for a vertically-siloed market structure, service providers in OTC swaps markets have come to expect choice and competition in execution, clearing, and reporting.

The WMBAA supports proper implementation of the Part 45 Rules and the swap transaction data reporting regime. The Commission should reject Rule 1001 for being inconsistent with the final Part 45 Rules.

II. Rule 1001 Is Inconsistent with the Competitive Landscape Promoted by Dodd-Frank

The Commission should also reject Rule 1001 because it discriminates against service providers that specialize in only one of the three required functions for swaps transactions under Dodd-Frank: execution, clearing, and swap data repositories. Congress intended to establish a competitive landscape for DCOs, SEFs, DCMs, and SDRs. In the Part 45 Rules, the Commission declared that:

> [C]ompetition may lead SEFs and DCMs to establish connections to multiple SDRs, and result in lower SDR fees charged, not only to SEFs and DCMs for swaps executed on such facilities, but also to reporting counterparties for off-facility swaps. The Commission believes that requiring that all cleared swaps be reported only to DCOs registered as SDRs or to SDRs chosen by a DCO would create a non-level playing field for competition between DCO–SDRs and non-DCO SDRs. The Commission also believes that it would make DCOs collectively, and could in time make a single DCO–SDR, the sole recipient of data reported concerning cleared swaps.[16]

Dodd-Frank rejected the vertical silo model for the swaps market in favor of a marketplace with competitive clearing, execution, and trade reporting, ensuring that DCOs would not use their clearing function and self-regulatory organization ("SRO") authority to act in an anti-competitive manner. "Bundling" of any mandated regulatory services should be prohibited as inconsistent with statute, as implemented in CFTC regulation, and public policy considerations.

Dodd-Frank promotes the trading of swaps on a SEF or DCM and encourages competition between these entities. Competition provides market participants with the choice to select their execution venue. Just as the selection of a SEF or DCM should not be tied to a clearinghouse, market participants' choice of SDR should not be determined for them, particularly by a DCO with a captive affiliated SDR. Service providers should be forced to compete—on cost, technology, service, and other commercial factors—rather than through regulatory fiat. CME should not be allowed to ignore the letter and spirit of the law and simply use its SRO authority as a DCO to implement rule changes that eviscerate the prevailing competitive swaps landscape.

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[16] *Id.* at 2,149.

III. Rule 1001 Could Lead to Bundling of Clearing and Execution

The approval of Rule 1001 would allow the CME to restrict access to clearing for counterparties that do not wish to report to the DCO's captive affiliate SDR. CFTC approval of Rule 1001 would amount to a tacit approval of bundling of regulated services, setting the regulatory precedent for the combining of DCO and mandated regulatory services (in this case, SDR services) as "one stop shopping" in OTC markets. Such a result would run contrary to clear Congressional intent to preserve the competitive landscape that currently exists.

The logical expansion of this market structure would be to permit the combination of trade clearing services and trade execution services. WMBAA member firms operate trade execution platforms but do not operate clearing houses (or SDRs). Bundling of SEF and DCM services with DCO services would seriously disadvantage such trade execution platforms without affiliated clearing houses. If execution-only platforms cannot compete with the bundled competition, it would significantly reduce the number of service providers, further reducing market competition. The drastic reduction in market competition will reduce choices for customers and deprive market participants of the benefits of a vibrant, competitive market.

IV. Rule 1001 Could Limit Nondiscriminatory Access to Clearing

Dodd-Frank requires that DCOs must "provide for non-discriminatory clearing of a swap . . . executed bilaterally or on or through the rules of an unaffiliated designated contract market or swap execution facility." [17] Rule 1001 would impose the DCO's choice of SDR on SEFs' and DCMs' customers, jeopardizing the statutorily-mandated nondiscriminatory access to clearing provided in Dodd-Frank. The WMBAA believes that DCOs, if permitted to bundle services, will use their unique market function to restrict access in a discriminatory manner to the detriment of SEFs, DCMs, and ultimately market participants. The choice of DCO is one made by counterparties based on commercial considerations. It is not a decision made by SEFs or DCMs. Restricting access to a certain clearinghouse based on consenting to a DCO's self-reporting will artificially restrict counterparty choice. The restriction of choice should not be the product of dominant market actor expansion with regulatory support.

Rule 1001 would also allow the CME to require post-trade reporting to its own SDR as a precondition to clear swaps on its platform. This restriction will limit the ability for SEFs or DCMs to have executed trades processed in a timely manner on multiple DCOs. Imposing the selection of a certain SDR as one of the commercial terms to clearing violates Dodd-Frank's requirement that DCOs provide "non-discriminatory access" to clearing and may impose a material restraint on SEFs' and DCMs' ability to provide competitive trade execution services.[18]

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[17] Commodity Exchange Act ("CEA") § 2(h)(1)(B)(ii), as amended by Dodd-Frank, Pub. L. No. 111–203, § 723, 124 Stat. 1376, 1676 (2010).

[18] *Id.*

Conclusion

WMBAA urges the Commission to reject Rule 1001 as inconsistent with the Commission's final reporting rules, as well as the competitive marketplace envisioned by Congress in passing Dodd-Frank.

Thank you for the opportunity to express our concerns.

Sincerely,

Christopher Giancarlo
Chairman, WMBAA