



STATE STREET.

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

via e-mail: dcodcmsefGovernance@cftc.gov

Re: Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest (RIN 3038-AD01)

Dear Mr. Stawick:

State Street Corporation¹ (together with its subsidiaries, “**State Street**”) thanks the Commodity Futures Trading Commission (“**CFTC**”) for the opportunity to comment on the CFTC’s proposed rulemaking to mitigate conflicts of interests for derivatives clearing organizations (“**DCOs**”), designated contract markets (“**DCMs**”) and swap execution facilities (“**SEFs**”) under Section 726 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank**”).² State Street believes that the Proposed Rule’s ownership and voting limit waiver process for DCOs should be extended to DCMs and SEFs.

¹ With over \$20 trillion of assets under custody and administration and \$1.9 trillion of assets under management at September 30, 2010, State Street is a leading specialist in meeting the needs of institutional investors worldwide. Our customers include mutual funds, collective investment funds and other investment pools, corporate and public retirement plans, insurance companies, foundations, endowments and investment managers. Including the United States, we operate in 25 countries and more than 100 geographic markets worldwide. We conduct our business primarily through our principal banking subsidiary, State Street Bank and Trust Company, which traces its beginnings to the founding of the Union Bank in 1792. State Street Bank’s current charter was authorized by a special act of the Massachusetts Legislature in 1891, and its present name was adopted in 1960.

² 75 Fed. Reg. 63,732 (Oct. 18, 2010).

Section 726 of Dodd-Frank requires the CFTC to adopt rules to mitigate the conflicts of interests faced by DCOs, DCMs and SEFs. These rules may, but are not required to, include limits on control or voting rights. The CFTC's proposed rule under Section 726 (the "**Proposed Rule**") would impose governance and ownership requirements on DCOs, DCMs and SEFs. The ownership requirements would limit individual members to a 20% ownership and voting interest in any particular DCM or SEF.³ DCOs would choose between a (i) a 40% aggregate ownership and voting limit by "enumerated entities"⁴ and a 20% individual limit; or (ii) no aggregate ownership or voting limit for "enumerated entities" if no member of the DCO has more than a 5% ownership or voting stake.

Under the Proposed Rules, DCOs would be allowed to apply for a waiver of the ownership and voting limits. The proposed waiver process reflects the CFTC's belief "that there may be circumstances where the imposition of rigid limitations on ownership or voting rights may not be appropriate for certain DCO ownership structures."⁵ The CFTC may provide such a waiver for a "reasonable period of time" if it finds the ownership or voting rights limitations are not necessary or appropriate to:

- improve the governance of the DCO;
- mitigate systemic risk;
- promote competition;
- mitigate conflicts of interest in connection with a swap dealer's or major swap participant's conduct of business with the DCO with respect to fair and open access and participation and product eligibility; and
- otherwise accomplish the purposes of the Act.

The Proposed Rule does not extend the possibility of ownership and voting limit waivers to DCMs or SEFs. However, in connection with the ownership and voting limits for DCMs and SEFs, the CFTC asks whether a waiver process for DCMs and SEFs would be appropriate.

State Street believes that DCMs and SEFs should similarly be able to petition the CFTC for a waiver of any adopted ownership and voting rights limits. The logic for a DCO waiver extends to DCMs and SEFs: different DCMs and SEFs face different conflict of interests concerns, and therefore subjecting all DCMs and SEFs to rigid ownership and voting limits may not best effectuate the purposes of Dodd-Frank in every case. A waiver process allows the CFTC to examine DCMs and SEFs on a case-by-case

³ We understand "members" of a DCM or SEF to be those entities that directly execute trades on the DCM or SEF. We believe the CFTC should look to the definition of "member" in Section 1a(34) of the Commodity Exchange Act as guidance for how the term should be used under Dodd-Frank.

⁴ The "enumerated entities" are (i) Bank holding companies with over \$50,000,000,000 in total consolidated assets; (ii) a nonbank financial company supervised by the Board of Governors of the Federal Reserve System; (iii) an affiliate of (i) or (ii); (iv) a swap dealer; (v) a major swap participant; or (vi) an associated person of (iv) or (v).

⁵ 75 Fed. Reg. at 63,744.

basis to determine how best to manage the tradeoff between avoiding conflicts of interests and maintaining dynamic, competitive DCMs and SEFs, which the CFTC has stressed as an important goal.⁶ For example, the relative benefits of competition may justify a waiver for DCMs and SEFs that list highly liquid foreign exchange contracts,⁷ for which there are few conflict of interest concerns, but not for start-up DCMs and SEFs that will trade illiquid CDS contracts.

Waivers may be justified for DCMs and SEFs on which highly standardized swaps are traded and for which multiple DCMs and SEFs exist. In such a case, if conflicts of interest were to develop with respect to a particular platform, market participants would be able to respond rapidly by moving their trading activity to other platforms. Similarly, waivers may be justified where the market participants are very sophisticated entities able to rapidly determine when conflicts of interests arise and respond appropriately.

Waivers may also be justified for existing liquidity-enhancing DCMs and SEFs that have proven to function well without evidencing conflict of interest concerns. Imposing restrictive ownership and voting limits on these DCMs and SEFs will disrupt existing markets as owners either stop transacting on the facility, which would damage liquidity, or divest their ownership interest, which could lead to operational uncertainty and disruptions. These unnecessary disruptions would discourage the continued growth of successful systems in mature markets that vigorously compete for market share.

Alternatively, time-limited waivers could be used to encourage the growth of DCMs and SEFs in products for which robust trading platforms do not currently exist. In many cases, the only investors with sufficient capital and expertise to launch a successful DCM or SEF may be the entities with the significant volume of transactions needed to generate sufficient liquidity to make the DCM or SEF a success. To encourage these investors to form DCMs and SEFs either alone or in small groups, the CFTC may choose to allow them to be members of the DCM or SEF while owning more than 20% of the DCM or SEF. The CFTC could allow the time-limited waiver to expire when conflict of interest concerns begin to outweigh the need to encourage initial investments and liquidity, and the venture has had the opportunity to show its worth and draw outside investors.

As a condition of any waiver, the CFTC could choose to limit the amount of trading by a member-owner of a DCM or SEF. For example, the CFTC's final rules could allow the CFTC to limit a member of a DCM or SEF that owns more than 20% of that DCM or SEF to, on a rolling basis for four of the previous six months, an average daily trading volume of 20% of the aggregate average swap and forward volume on that

⁶ In proposing aggregate ownership and voting limits for DCOs but not for DCMs or SEFs, the CFTC states that "the Commission believes that the benefits of sustained competition between new DCMs and SEFs outweigh the incremental benefit of better governance through limitations on the aggregate influence of the enumerated entities." 75 Fed. Reg. at 63,745.

⁷ State Street believes the highly-liquid, short-term and well-supervised nature of the foreign exchange swap and forward markets should lead the Secretary of the Treasury to make the necessary determinations to exempt foreign exchange swaps and forwards from the definition of "swap." State Street intends to convey our support for an exemption directly to the Treasury Department.

DCM or SEF.⁸ This would address fair access and transparency concerns regarding the DCM or SEF, and the fear that a wholly owned DCM or SEF would be designed to preserve bilateral trading by the owner-member. It also would allow varying ownership structures to exist. In addition, the CFTC would retain the ability to revoke the waiver if the abuses that Dodd-Frank seeks to address arise.

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State Street appreciates the opportunity to provide the CFTC with its views on the Proposed Rule. Please feel free to contact me at 617.664.1783.

Sincerely,



David C. Phelan

cc: Jeffrey N. Carp, State Street Corporation, EVP and Chief Legal Officer
Stefan M. Gavell, State Street Corporation, EVP and Head of Regulatory and Industry Affairs

⁸ See Regulation ATS Rule 301(b)(3)(i)(B).