



January 24, 2011

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

Re: Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers
and Major Swap Participants (CFTC RIN 3038-AC96)

Dear Mr. Stawick:

Better Markets, Inc.¹ appreciates the opportunity to comment on the above-captioned proposed rules (the "Proposed Rules") of the Commodity Futures Trading Commission ("CFTC"), the purpose of which are to establish conflicts of interest requirements for Swap Dealers ("SDs") and Major Swap Participants ("MSPs) to ensure that such persons implement adequate policies and procedures as required by provisions of the Dodd-Frank Financial Services Reform Act (the "Dodd-Frank Act").

Introduction

Because conflicts of interest have been, and continue to be, pervasive in the derivatives trading business, a series of changes to the Proposed Rules will be necessary:

- Provisions related to written and oral communications between non-research personnel and research department personnel of an SD or MSP must be clarified and made more restrictive.

¹ Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

- The disclosure requirements related to conflicts of interest and incentives involving the decision of a customer as to the trade execution and/or clearing of a derivatives transaction must be extended to conflicts of interest of affiliates; and the disclosure of such conflicts must be expanded to include the nature and amounts of interests which constitute such incentives and conflicts of interest.

The pervasiveness of conflicts of interest in the derivatives trading business was detailed in our comment on the CFTC's proposed rule on mitigation of conflicts of interest. That letter demonstrated an industry that is rife with embedded formal and informal influences that can be used to frustrate or even defeat the intent of the Dodd-Frank Act. See Better Markets, Inc. Comment Letter Dated November 17, 2010 regarding Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding Mitigation of Conflicts of Interest, a copy of which is attached hereto.

The following observation in that letter is particularly pertinent to these Proposed Rules:

If the rules addressing conflicts of interest are not sufficiently restrictive or do not effectively limit the many indirect methods of exerting influence, a marketplace characterized by anti-competitive practices will continue. The transparent, competitive, fair and risk-reducing marketplace required by the Dodd-Frank Act will not be realized. Worse yet, risk-taking will actually be encouraged as the few participants that benefit from these arrangements maximize profits in markets structured to favor them. Because of the level of risk inherent in derivatives, future failures caused by inevitable misjudgments, over-reaching and structural flaws could well be catastrophic.

The most obvious forms of incentives and conflicts of interest are (a) ownership, (b) revenue and profit interests in derivatives clearing organizations, designated contract markets and swap execution facilities, as well as in essential service providers such as index providers and (c) fee rebate arrangements. We continue to advocate a complete prohibition or very strict limitation of such incentives and conflicts of interest.

At a minimum, it is essential that customers be fully and fairly informed of these incentives and conflicts of interest, whether held directly by SDs or MSPs or held by affiliated SDs or MSPs. That means, again at a minimum, that clear, specific and comprehensive disclosure requirements are mandated.

We fully support the efforts of the CFTC in relation to conflicts of interests of SDs and MSPs and hope that these proposals are useful in the finalization of the Proposed Rules.

Regulatory Authority and Proposed Approach

The Dodd-Frank Act requires that SDs and MSPs implement conflicts of interest systems

and procedures that:

establish structural and institutional safeguards to ensure that the activities of any person within the firm relating to research or analysis of the price or market for any commodity or swap or acting in a role of providing clearing activities or making determinations as to accepting clearing customers are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of persons whose involvement in pricing, trading, or clearing activities might potentially bias their judgment or supervision and contravene the core principles of open access and the business conduct standards described in this Act....²

The CFTC points out that this provision is similar to the provision of the Sarbanes-Oxley Act of 2002,³ except that it does not expressly limit the requirement for informational partitions to only those persons who are responsible for the preparation of the substance of research reports. The CFTC has interpreted the Dodd-Frank Act provision to be intended to prevent undue influence by persons involved in pricing, trading or clearing activities on the substance of research reports that may be publically disseminated, and to prevent pre-public dissemination of any material information in the possession of a person engaged in research and analysis, or of the research report, to traders.⁴ As a result, the relevant provisions of the Proposed Rule are limited to this scope.

The Dodd-Frank Act further requires that SDs and MSPs “implement conflict-of-interest systems and procedures that... address such other issues as the Commission determines to be appropriate.”⁵ In furtherance of this requirement, the Proposed Rules address conflicts of interest in two ways:

- SDs and MSPs are prohibited from directly or indirectly interfering with or influencing affiliated members (“Affiliated Clearing Members”) of derivatives clearing organizations (“DCOs”) related to clearing and requires SDs and MSPs to create and maintain an appropriate informational partition between business trading units and Affiliated Clearing Members.⁶
- SDs and MSPs are required to implement and maintain policies and procedures that mandate disclosure to customers of material incentives or conflicts of interest regarding decisions as to the execution or clearing of a transaction.⁷

² Dodd-Frank Act, Section 731.

³ 15 U.S.C 78o-6.

⁴ Proposed Rules, Preamble, page 71392.

⁵ Dodd-Frank Act, Section 731.

⁶ Proposed Rules, Section 23.605(d).

⁷ Proposed Rules, Section 23.605(e).

Discussion of Proposed Rules

Research Analysts and Research Reports

The Proposed Rules address “written communication between non-research personnel and research department personnel concerning the content of a research report...”⁸ and “oral communication between non-research personnel and research department personnel concerning the content of a research report....”⁹ It must be made clear that any influence that results in a decision *not* to publish a report or include relevant information is also a concern. In both cases, the subject of the communication must be extended to include information that might reasonably be expected to be included in a research report.

The Proposed Rules prohibit SDs and MSPs from considering contributions to the trading business of the SD or MSP in relation to the compensation of a research analyst.¹⁰ We propose that:

- in addition to contributions to such trading business, consideration of adverse affects on such trading business must also be prohibited; and
- the trading business of affiliates must also be covered by such provisions of the Proposed Rules.

Undue Influence on Customers

The Proposed Rules require SDs and MSPs to disclose to customers incentives and conflicts of interest regarding the decision of a customer as to trade execution or clearing.¹¹ We propose that this section of the Proposed Rules be expressly extended to incentives and conflicts of interests of affiliates of the SD or MSP. In addition, we propose that “any material incentives and any material conflicts of interest” expressly include interests and conflicts regarding the provision of indices and other similar services related to trade execution and clearing.

We further propose that such disclosure include the nature of such incentives or conflicts of interest, including ***ownership interests, revenue and profit shares and fee rebates and the amounts of such ownership interests, revenue and profit shares and rebates.***

Conclusion

There can be no question, as Chairman Dodd and Chairman Lincoln stated, “Congress determined that clearing is at the heart of reform.”¹² Elimination of conflicts of interest of SDs and MSPs is critical to the proper functioning of clearing and therefore reform.

⁸ Proposed Rules, Section 23.605(c)(1)(iv)(A).

⁹ Proposed Rules, Section 23.605(c)(1)(iv)(B).

¹⁰ Proposed Rules, Section 23.605(c)(3).

¹¹ Proposed Rules, Section 23.605(e).

¹² Letter from Senators Christopher Dodd and Blanche Lincoln, respective chairs of the Senate Banking and Agricultural Committees, to Representatives Barney Frank and Collin Peterson, respective chairs of the House Financial Services and Agricultural Committees, dated June 10, 2010.

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We hope these comments are helpful in your consideration of the Proposed Rules.

Sincerely,



Dennis M. Kelleher
President & CEO

Wallace C. Turbeville
Derivatives Specialist

Better Markets, Inc.
Suite 307
1225 Eye Street, N.W.
Washington, D.C. 20005
(202) 481-8224
dkelleher@bettermarkets.com
wturbeville@bettermarkets.com

www.bettermarkets.com