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

David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties - Proposed Rulemaking (RIN 3038-AD25) (the "Proposing Release")

Dear Mr. Stawick:

We appreciate this opportunity to comment on the rules recently proposed by the Commodity Futures Trading Commission (the "Commission") under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") relating to business conduct standards for swap dealers and major swap participants (collectively referred to in this letter as "swap dealers" for ease of reference) (the "Proposed Rules"). Our comments below all specifically relate to the Proposed Rules under Section 731 of the Act regarding transactions of swap dealers with Special Entities (as defined in the Act).

As described in more detail below, we respectfully request that the Commission: (1) clarify and limit what it means for a swap dealer to "act as an advisor to a Special Entity"; (2) permit a reasonable approach to certain compliance documentation required under the Proposed Rules; and (3) seek to give appropriate effect to the limiting language in Section 731(h)(5)(A)(i) of the Act regarding the types of Special Entities to which the independent representative requirement applies in the context of transactions between a swap dealer and a Special Entity.

As a general matter, while we support the Commission's effort to provide appropriate investor protections under the authority of the Act, we are concerned that, from the perspective of those large, sophisticated Special Entities that are themselves highly knowledgeable about derivatives and derivatives markets, some of the requirements suggested by the Commission will create undue impediments to dealers transacting with them and/or will unduly increase the cost of such

transactions (*see, e.g.*, Part II.A below). This may have significant adverse effects both on the investment activities of, and financial management by, these Special Entities in their provision of critical services and retirement benefits to a broad range of U.S. citizens, and on markets in general. "Special Entity" is a broadly inclusive term that encompasses entities of widely varying sizes, sophistication levels, and experience in derivatives trading. As such, different Special Entities require significantly different levels of investor protection. We believe that the final rules can and should appropriately reflect this reality.

I. Proposed § 23.440 – Requirements for Swap Dealers Acting as Advisors to Special Entities

In Proposed Rule § 23.440, the Commission proposes to clarify what it means for a swap dealer to "act as an advisor to a Special Entity" for purposes of Section 731(h)(4)(C) of the Act. We urge the Commission to further clarify and limit what is meant by this phrase and to allow a swap dealer to rely upon a written representation received from a Special Entity to the effect that the swap dealer is not acting as an advisor to the Special Entity. At the very least, such reliance should be permitted where a Special Entity counterparty has substantial internal expertise in swaps, as reasonably determined by the swap dealer under Proposed Rule § 23.450(d).

The phrase "acts as an advisor" creates an important legal distinction, as the burdens placed by the Act on a swap dealer are much greater where the dealer acts as an advisor to a Special Entity, as opposed to a counterparty to a Special Entity. Importantly, where the swap dealer "acts as an advisor," it must act in the "best interests" of the Special Entity. The Commission's proposal has potentially broadened this key phrase beyond its statutory bounds by effectively equating the act of providing a recommendation with "acting as an advisor" (Proposed Rule § 23.440(a)).[1] "Acts as an advisor" envisions the dealer assuming a status, rather than simply performing a single act. In this regard, "acts as an advisor" intends a more formal relationship than providing advice; indeed, it would have been much easier for Congress to have said "advises" if that was what had been intended. And, providing advice is in turn a narrower category than the mere making of a recommendation. "Acting as an advisor" would seem to require some type of acknowledged agency, in which the Special Entity places trust, confidence, or reliance on the swap dealer. To be sure, such agency does not necessarily need to be spelled out in a formal contract between the swap dealer and the Special Entity, as the statute focuses on "acting," although formally documented agency relationships likely form the core of "acting as an advisor."

"Recommends" is not only a much broader concept at its center but also has the potential to be vastly expansive at its margins. Statements such as "you might consider using a derivatives contract for. . ." or "you should check out the following derivatives trade" often serve as the start of

[1] We note that the relevant language in the Act appears to implicitly acknowledge that "acting as an advisor" is distinct from making a recommendation. Section731(h)(4)(C) of the Act provides that "[a]ny swap dealer that *acts as an advisor* to a Special Entity shall make reasonable efforts to obtain such information as is necessary to make a reasonable determination that any swap *recommended* by the swap dealer...." (emphasis added).

any marketing call or email to a Special Entity by a swap dealer. While the Commission has proposed that provision of "general transaction, financial, or market information" does not constitute "acting as an advisor," unsolicited suggestions of a trade seemingly do not fit in this narrow exception. Yet, they are the means by which the marketplace operates. Financial services regulation has long acknowledged the role of sales activities in the markets for investments and financial services.[2] Furthermore, such communications serve an important informational function. Even where the prospective counterparty's last inclination would be to follow guidance of any sort from the swap dealer, such communications can indicate where the dealer might be willing to execute before negotiation and the types of trades that are being circulated in the marketplace.

Where "recommends" is substituted for "acts as an advisor," communications between swap dealers and Special Entities could likely only continue through the playing out of unnatural games such as "you called me first" or impossibly fine distinctions between general information and specific trade data. To impede the flow of marketing communications to all Special Entities as a consequence of the swap dealers' concerns about "acting as an advisor" would be a significant mistake from a policy perspective.

The Commission describes in the Proposing Release, in the context of institutional suitability requirements, the regulatory bias against clear demarcations under such tests as "acts as an advisor" in favor of facts-and-circumstances analyses.[3] However, "acts as an advisor," in its focus on the existence of a specified relationship, calls for a clear demarcation. Were the Commission to otherwise fall back on a facts-and-circumstances analysis, swap dealers should in any case be allowed to rely upon a representation received from a Special Entity, particularly an entity that the swap dealer reasonably believes to have substantial internal expertise in swaps, to the effect that the dealer is not acting as an advisor to the Special Entity.

II. Proposed § 23.450 – Requirements for Swap Dealers and Major Swap Participants Acting as Counterparties to Special Entities

A. The Commission Should Permit a Reasonable Approach to Compliance Documentation

The Commission should permit a reasonable approach to a swap dealer's documentation of its determination that a Special Entity has a qualifying independent representative. Under the Act itself, a swap dealer acting as a counterparty to a Special Entity must have a reasonable basis to

[2] Thus, the Securities Act of 1933, as amended, creates carefully crafted written disclosures to investors and the marketplace, but allows, subject to antifraud protections, oral communications between securities salespeople and potential investors once the applicable registration statement is on file.

[3] The question of what constitutes "acting as an advisor" or the provision of advice is a central question in several of the pending rulemakings under the Act, including the Securities and Exchange Commission's rulemaking to delineate who must register as a "municipal adviser" under Section 975 of the Act.

believe that the Special Entity has an independent representative that meets six criteria (seven, where the Special Entity is an ERISA plan). Proposed Rule § 23.450(c) provides three additional criteria bearing upon the representative's independence. Proposed Rule § 23.450(d) then sets forth seven further, non-exclusive factors to be considered by the dealer when relying on written representations of a Special Entity to satisfy the dealer's obligation to have a reasonable basis to believe that the Special Entity has a qualifying independent representative.

We take no issue with the intent and substance of any single criterion or factor, although we note that there are a lot of them. We observe that the sophisticated Special Entities to which we have referred in this letter normally will not face any significant issues in satisfying the criteria, despite their number. Indeed, the various criteria will serve to rigorously establish the sophistication of these Special Entities. We are concerned, however, that trade-by-trade documentation of the criteria, as well as of the fact that the swap dealer is merely acting as counterparty and not as advisor, could adversely impact the speed of trade execution for Special Entities and could needlessly turn each trade into a heavily-papered compliance exercise. We would hope that, in adopting final rules, the Commission will clarify that a swap dealer will be able to meet its burden of confirming the resources available to a Special Entity through appropriate representations provided by that entity periodically, certainly no more frequently than annually, and in all events outside of the time pressures of a particular trade. Again, we believe that such a rule of reason should apply all the more to swap dealers in their dealings with those Special Entities with substantial internal expertise in swaps. We believe that such a reasonable approach to documentation of determinations is well within the authority provided by Section 731(i) of the Act.

B. The Commission Should Seek Clarification Regarding Application of the Independent Representative Requirement to All Special Entities

We respectfully urge the Commission to revisit the question of which Special Entities are required to have an independent representative when transacting with swap dealers. In a pre-rulemaking comment,[4] we highlighted the language in Section 731(h)(5)(A)(i) of the Act that limits the independent representative requirement to certain types of governmental entities. In its Proposing Release, the Commission has responded that some of the referenced governmental entities are not in fact "Special Entities" under the Act, while other governmental entities are Special Entities under the Act but are not referenced in the relevant provisions of the Commodity Exchange Act to which the limiting language refers, and that therefore the limiting language in the statute should be ignored.[5]

We agree with the Commission's analysis of the particular reference, and acknowledge and sympathize with the interpretative challenge that the analysis presents. However, we are concerned

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[4] Letter of Christopher Klem, Ropes & Gray, LLP, September 2, 2010 (referred to in the Proposing Release and here as the "Ropes & Gray Letter").

[5] Please see the discussion at notes 106-108 of the Proposing Release.

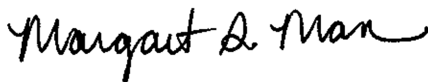
that the Commission's decision to ignore the limitation is the wrong one. It seems clear that the reference was intended by Congress to limit the independent representative requirement to a subset of governmental entities, presumably ones all included within the definition of a "Special Entity." Of course, it is not now appropriate for the Commission to go back and guess which entities were intended to be covered by the limiting language in the absence of unambiguous legislative history and conclusive evidence of a scrivener's error (and perhaps not even then). However, it seems equally inappropriate for the Commission to declare that the reference is a mistake to be ignored entirely. Indeed, the clearer case for a mistake is that the entities referenced are not all Special Entities under the Act and not that there is a limiting reference in the first place.

There are at least three other possibilities for resolving the statutory ambiguity: (i) interpreting the de facto independent representative requirement as applying to both those referenced governmental entities that are Special Entities and those that are not, (ii) interpreting the independent representative requirement to be generally inapplicable (as clearly most Special Entities were not intended to be covered in the reference), and (iii) interpreting the requirement as applying to only those referenced governmental entities that are Special Entities. To be sure, the first two of these possibilities pose their own problems of statutory interpretation,[6] and yet all three are logically more compelling than ignoring the reference altogether because it is simply unclear. In an ideal world, the Commission would affirmatively seek clarification in the form of further Congressional action to correct the apparent error, instead of defaulting to the least likely resolution (taking a statutory provision of intended narrow application and making it broadly applicable). Failing to take this step, the Commission should apply the reference so as to give greatest effect to both words and apparent intent, by preserving the reference in the statute and interpreting it to cover those included governmental entities that are Special Entities.

We appreciate the Commission's attention to these comments.

Sincerely yours,

Christopher A. Klem



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[6] The first possibility is contradicted by the lead-in to Section 731(h)(5)(A) of the Act, which expressly refers to swaps with Special Entities. The second begs the question, discussed in detail in the Ropes & Gray Letter, of whether the special rule for ERISA plans in Section 731(h)(5)(A)(i)(VII) is evidence of the mistake that the Commission now asserts or, as seems more likely, simply reflects the order in which last-minute changes were added to the Act shortly before its passage.