February 28, 2011

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

Re: Notice of Proposed Rulemaking RIN 3038–AC96, Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants; 17 CFR Part 23

Chatham Financial Corp. ("Chatham") is pleased to respond to the request for comments by the U.S. Commodity Futures Trading Commission ("CFTC") (the "Commission") regarding its Notice of Proposed Rulemaking ("NPR") pertaining to *Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants* issued under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

Introduction

Chatham is a consulting firm that works with over one thousand companies from virtually all business sectors that utilize over-the-counter ("OTC') derivatives to manage risks they face as they carry out their day-to-day businesses. Chatham assists its clients with all facets of the hedging process, from providing hedge strategy advice, to structuring and executing hedges, to providing on-going valuations, reporting and accounting. Throughout the policy debate over regulation of the OTC derivatives market, Chatham has advocated for strong but effective regulation that is targeted toward containing systemic risk and increasing transparency.

We support the Commission in establishing a framework to reduce operational risk in the OTC derivatives market while minimizing the burden on end users which are not deemed to be swap dealers ("SD") or major swap participants ("MSP"). We seek to share a few examples where we believe the confirmation, reconciliation and portfolio compression requirements could be further refined to reduce the burden on end users in a manner that would not increase systemic risk.

Topic 1: Swap Confirmations

<u>Swap Confirmation Timing</u>
We appreciate that the Commission recognizes the need to *"…minimize the burden on those parties that will not be registered with the Commission as swap dealers or major swap participants."*[1] We also support the need to be thorough and accurate as *"…parties document the transaction in a complete and definitive written record so there is legal certainty about the*

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[1] 81521 Federal Register / Vol. 75, No. 248

terms of their agreement."[2] However, we are concerned that the short timeframes proposed for completing confirmations could work at cross-purposes to the Commission's objectives, as they would serve to rush parties in completing transaction documentation, potentially resulting in a decrease in accuracy. Further, we believe the proposed timeframes do not leave sufficient time to address common logistical considerations.

The proposed rules require financial entities to execute a confirmation by the end of the same calendar day as execution and non-financial, non-SD/MSPs must execute the confirmation by the end of the next business day after execution.[3] These timeframes would not allow for a thorough, accurate review and signature and may obligate parties to hastily issue and execute a confirmation with errors. Through our experience working with clients on thousands of swap confirmations, we've seen the need first-hand to review and verify terms for accuracy and completeness. With respect to legal documentation, accuracy should take priority over speed. This is especially true because the customized nature of OTC derivatives typically requires a combination of a system generated document and some degree of human involvement in creating and reviewing the confirmations. Resolving discrepancies that are the product of human error is thus a normal part of the transaction documentation process. Below are common situations that would prevent a confirmation from being completed within the proposed timeframes:

- **Best practices generally involve having at least one person review that the transaction details have been input into a trade-capture system correctly**. For end users that capture swap data in their own systems or a third-party system, this best practice helps ensure quality. We recognize this step adds to the time it takes to complete post-trade documentation processes, but is critical because of the customized nature of OTC derivatives and the potential for human error that can result.
- **Confirmations with legal provisions require additional time to generate and review.** Often, not all legal provisions may be part of the system generated document and therefore additional time is needed to add or modify provisions. Time is then needed for the other party to review by manually checking each term and often involving others, such as legal counsel.
- **Coordinating confirmations with legal counsel can require additional time.** It is common that confirmations are provided to internal or external counsel for review. For hedges required by a lender, lender's counsel will often review the confirmation as well. Legal review may result in comments, questions or corrections, the resolution of which could take several days or weeks. We fully recognize that the intent is to reduce the amount of time to complete a confirmation; however, without adequate time for review, end users may be deterred from involving counsel to ensure relevant legal concerns are given proper consideration.

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[2] 81520 Federal Register / Vol. 75, No. 248

[3] 81531 Federal Register/ Vol. 75, No. 248: "(3) Each swap dealer and major swap participant shall establish, maintain, and enforce written policies and procedures reasonably designed to ensure that it executes a confirmation for each swap transaction that it enters into with a counterparty that is a financial entity within the same calendar day as execution and with a counterparty that is not a swap dealer, major swap participant, or a financial entity not later than the next business day after execution."

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- **Highly customized swaps or swaps in illiquid currencies often require additional time to generate and review the confirmation.** Such situations may require specialized knowledge or multiple people to review to ensure accuracy – both with the party issuing the confirmation and the other party reviewing the confirmation.
- **Swaps may be electronically confirmed but still require a non-electronic confirmation.** For example, the economic terms of a standard plain vanilla swap may be electronically confirmed, but other legal provisions not suitable for electronic submission may require a paper confirmation.
- **Logistical timing considerations can further complicate the ability to execute a confirmation according to the proposed rules.** Swaps executed late in the business day would allow for little time under the proposed rules for one party to issue the confirmation and the other party to thoroughly review and coordinate signature. Coordination can be further complicated as end users may have a limited number of people authorized to sign confirmations. For example, completing transaction documentation while a signatory is traveling could create an unnecessary hassle. Moreover, it could require review at a time when the signatory does not have the agreed upon details at their ready disposal – an issue that could result in their failing to identify inaccurately documented terms. Lastly, swap confirmations that require coordination across time zones often require additional time to complete. A confirmation may be generated by a department in another office or country or the end user may have stakeholders in different time zones (e.g. an attorney in one time zone and the signatory in another time zone).

We propose a refinement to the framework to promote both accuracy and timely completion of confirmations while minimizing unnecessary burdens on non-SD/MSPs.

Timing for swaps that are electronically confirmed with non-SD/MSP:

- Swap details shall be submitted electronically on the same day or next business day after the swap is executed;
- The parties shall affirm, match (or otherwise agree), or respond with notice of a discrepancy within 3 business days;
- The parties shall resolve any swap discrepancies and affirm the swap within 5 business days after a discrepancy is communicated.

Timing for swaps that are not electronically confirmed with non-SD/MSP:

- A confirmation shall be issued within 1 business day after the swap is executed;
- The other party shall review and respond with notice of a discrepancy within 5 business days after they receive the confirmation;
- The parties shall execute a confirmation within 30 days to allow sufficient time to involve various stakeholders for review, revisions, and signature;
- Swaps that can be electronically confirmed, but also require a non-electronic confirmation (e.g., paper, fax, pdf, etc) shall be bound by the timing requirements for swaps that are not electronically confirmed.

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Exemption for swaps that are cleared with non-SD/MSP:

- Clearing a swap through a DCO should be deemed to satisfy the confirmation requirements under this rule.

No mandate for electronic matching

We strongly support the Commission's decision to not mandate electronic matching. While we have witnessed the benefits of electronic matching on certain trades, we believe prescribing electronic matching for all swaps could unnecessarily preclude end users from entering into a swap not yet available on matching platforms. Additionally, electronic matching could increase costs for end users depending on the platform. Though certain end users (including frequent hedgers) may deem the benefits of such platforms sufficient to justify the costs, other end users (including infrequent hedgers) may deem that the benefits of such platforms do not outweigh the costs. The rules should preserve the ability for end users to use the methods best suited to each situation.

Phase-in timing

We believe the confirmation rules should be phased-in such that non-SD/MSP end users are the last participants required to comply. As with other requirements, swaps between SD/MSPs and other SD/MSPs are more likely to pose risk and these entities are most likely to have the resources and systems to comply. End users will require a longer phase-in period of 6-12 months after the effective date of the rules to identify people, processes and systems required to comply, and to implement the processes and systems.

Topic 2: Reconciliation frequency for non-SD/MSP and the 10% rule for resolving valuation discrepancies

We understand and appreciate the benefits of portfolio reconciliation especially for swaps between SD/MSPs and other SD/MSPs. We request the Commission to refine the rules to ensure this practice does not impose undue burdens on non-SD/MSP entities.

Portfolio reconciliation frequency

We fully support the Commission's decision to not prescribe how portfolio reconciliation should be conducted for swap portfolios with non-SD/MSPs.[4] We believe this approach appropriately recognizes the ability for two parties to agree to a process while preventing undue burden on the non-SD/MSP end users.

However, we note that the rules specify timing requirements for portfolio reconciliation with non-SD/MSPs must occur: daily (500+ swaps), weekly (100-500 swaps) or quarterly (<100 swaps). Non-SD/MSP end users using swaps to hedge risk do not pose systemic risk and

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[4] 81524 Federal Register/ Vol. 75, No. 248 *"For swap portfolios with entities other than swap dealers or major swap participants, proposed § 23.502(b) would require swap dealers and major swap participants to establish written policies and procedures to perform reconciliation, but would not prescribe the manner in which the reconciliation must be performed. For example, the exchange of terms and valuations between the counterparties may consist of one party reviewing the details and valuations delivered by the other party and either affirming or objecting to such details and valuations."*

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therefore daily or weekly reconciliation is not necessary to further the core purpose of the Dodd-Frank Act. Moreover, though it may be in the interests of both parties to periodically reconcile valuation differences, these differences are insufficient to justify a regulatory mandate. In the spirit of realizing the benefits of reconciliation while reducing undue burden on end users, we propose the following:

Table 1

Number of swaps in portfolio with non-SD/MSP and with maturity dates greater than one-year from the reconciliation date[5]	**Reconciliation Frequency**
0-50	Optional (non-SD/MSP end users are exempt from reconciliation requirements)
50-100	Annually
100-500	Quarterly
500+	Weekly

<u>The 10% rule for resolving discrepancies</u>

The proposed rules require parties to reconcile discrepancies when *"the difference between the lower valuation and the higher is greater than 10%."*[6] We understand the intent of wanting to resolve discrepancies, though we believe a single percentage threshold will impose a significant burden in cases where the absolute value of the swap is small.

For example, if one party submits a swap valuation of $1,000 and the other party submits a valuation of $1200 for the same swap, the current rules would require this difference to be reconciled and documented, even though the difference in value is only $200. This situation could be common during the time period just after a swap is executed or in the period leading up to maturity. Option products with little or no value may also result in small absolute value discrepancies that could exceed the 10% threshold. The time and effort required to reconcile such differences would not be worthwhile and would distract from more meaningful issues.

<u>Phase-in timing</u>

As with other rules, we encourage the Commission to implement the reconciliation rules first for swap portfolios between one SD/MSP and another SD/MSP. Reconciliation rules for swap portfolios with non-SD/MSPs should be phased in six months to one year later to allow sufficient time to comply.

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[5] Many end users hedge short-term cash flows with a series of hedges that have short maturity dates. These short-term hedges should not inadvertently trigger a higher reconciliation frequency since these hedges do not readily lend themselves to increasing systemic risks.

[6] 81524 Federal Register/ Vol. 75, No. 248

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Topic 3: Compression for non-SD/MSP

We understand the benefit of portfolio compression exercises though we are concerned that this provision could be broadly applied to all situations where compression is not suitable. In some cases, the termination of "substantially similar transactions"[7] could be uneconomic for end users or could place an undue liquidity burden thereon. For example, if the compression results in a termination payment from the end user, the end user might need to tie up their financial/liquidity resources to make such payment. Additionally, we want to ensure that end users maintain their ability to have hedges designated under hedge accounting rules or be able to otherwise associate hedges with a specific hedged item for other purposes (e.g. reporting, audits, etc).

The Commission's explanation of the rule states the following: *"Proposed § 23.503 would not mandate portfolio compression exercises for swaps outstanding between a swap dealer or a major swap participant and counterparties that are neither swap dealers nor major swap participants."*[8] However the above sentence is then followed by *"Instead, swap dealers and major swap participants would be required to maintain written policies and procedures for periodically terminating all fully offsetting swaps and periodically engaging in compression exercises."*[9] This second sentence seems it could be inconsistent with the first.

We support the view that portfolio compression should not be mandated for end-user swaps. We believe clarification of the rule text would be helpful to ensure non-SD/MSPs may preserve any swap position that is specifically designated or otherwise associated with a hedged item and not be subject to terminate swaps or otherwise be required to participate in portfolio compression even if the swaps are able to be terminated through a portfolio compression.

Conclusion

Chatham appreciates the opportunity to comment on the confirmation, reconciliation and portfolio compression rules that will affect all participants in the swaps market. We look forward to working with the Commission to help implement rules that will strengthen the derivatives market, and, at the same time, not unduly burden end users and the larger economy.

Sincerely,

Ted McCullough
Managing Director
Chatham Financial Corp.

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[7] 81525 Federal Register/ Vol. 75, No. 248

[8] 81526 Federal Register/ Vol. 75, No. 248

[9] 81526 Federal Register/ Vol. 75, No. 248

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