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**Lisa M. Ledbetter**  
Vice President and Deputy General Counsel  
Legislative & Regulatory Affairs

Tel: (703) 903-3189  
Fax: (703) 903-4503  
lisa\_ledbetter@freddiemac.com

8200 Jones Branch Drive  
MS 211  
McLean, VA 22102-3110

By Comments Online process at: <http://comments.cftc.gov>

March 8, 2011

David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

Re: Notice of Proposed Rulemaking: Core Principles and Other Requirements for Swap Execution Facilities; RIN 3038-AD18

Dear Secretary Stawick:

Freddie Mac is pleased to submit these comments in response to the Notice of Proposed Rulemaking proposing new core principles and other requirements for swap execution facilities (SEFs), published by the Commodity Futures Trading Commission (the Commission) on January 7, 2011 (the Proposal)<sup>1</sup> consistent with Sections 723 and 733 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act).

Freddie Mac was chartered by Congress in 1970 with a public mission to stabilize the nation's residential mortgage markets and expand opportunities for affordable homeownership and rental housing. Our statutory mission is to provide liquidity, stability and affordability to the U.S. housing market. Freddie Mac uses swaps to hedge large-scale commercial risks on an ongoing basis. Freddie Mac currently operates under the direction of the Federal Housing Finance Agency as our Conservator.

### Summary

Freddie Mac supports the goals set forth in the Proposal to provide impartial market access, legal certainty and pre-trade price transparency for trade execution of cleared swaps. Freddie Mac is concerned, however, that the proposed methods for executing swaps permitted under the Proposal may significantly raise transaction costs, increase market risks, and have other negative consequences for the market as a whole, and for hedging parties such as Freddie Mac. In addition, we believe that, unless prohibited by the Commission, SEFs may implement rules with adverse negative effects on swap market participants.

Accordingly, Freddie Mac suggests that the Commission amend the Proposal consistent with the following recommendations, described further in our letter:

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<sup>1</sup> 76 Fed. Reg. 1214.

- The definition of “Permitted Transactions” not subject to the more restrictive execution requirements under the Proposal should be expanded to include substantially all transactions executed by an “end-user” for hedging purposes.
- No provision in any SEF rule should require the termination or other cancellation of an executed swap based solely on the failure of the swap to be cleared.
- No provision in any SEF rule should assert ownership or other rights over trade information of any transacting party other than permitted use of information for internal business purposes or regulatory compliance.

## Discussion

Freddie Mac has substantial experience in transacting both listed interest rate futures and options subject to existing Commission regulation, as well as over-the-counter (OTC) interest rate swaps that will become subject to Commission regulation under the Dodd-Frank Act. Freddie Mac uses interest rate derivatives exclusively as an end-user to hedge our interest rate risk and executes transactions exclusively with market intermediaries, including futures commission merchants (FCMs) and swap dealers. From our perspective, the Proposal could be improved by broadening the permitted execution methods and imposing certain limits on SEF rulemaking.

### a. Permitted Execution Methods

Based on Freddie Mac’s experience, we believe the fundamental differences between the futures market and the swaps market require a different approach in regulation. In the futures market, streaming quotes and central limit order books are effective for incremental transfer of risk. A hedging party can, indeed, execute trades at any of the quoted prices, but often the size of risk a party is able to transfer in any single trade is relatively small. To move a large amount of risk, market participants would need to cobble together numerous small trades. Doing so would involve a significant amount of execution risk due to the prospect of market prices moving against a transacting party before completing the entire trade. By contrast, the swaps market, as it exists today, is effective for bulk transfer of risk. In this market, carefully controlling dissemination of information about the trade is often the key to the successful transfer of risk. This is particularly important for large portfolios executing frequent hedging transactions in substantial size. Freddie Mac’s execution risk is significantly lower when it executes a large trade with a single dealer. We have expended significant efforts through the years to build relationships with dealers that make that transfer smooth and efficient and to ensure fair pricing.

In Freddie Mac’s view, a SEF framework that provides for both executable streaming quotes as well as indicative requests for quotes or voice trading between a customer and a single dealer would provide maximum benefits to the market and hedging parties. Streaming quotes would provide real time pricing information from multiple participants that could help inform a trading decision even when executing a large hedging transaction with a single dealer. A side-by-side approach would allow for enhanced price transparency to the market without compromising the need for hedging parties to control the dissemination of trade information.

Under § 37.9 of the Proposal, “Required Transactions” may only be executed on an “Order Book” or a “Request for Quote System.”<sup>2</sup> In contrast, “Permitted Transactions”<sup>3</sup> may be executed by an Order Book, Request for Quote System, “Voice-Based System” or any other system for trading permitted by the Commission. In addition, SEF rules must provide for a 15-second timing delay for execution of “customer” orders with respect to Required Transactions.

We are concerned that the proposed limits on swap execution will not permit Freddie Mac effectively to execute necessary hedge transactions. While Freddie Mac’s typical interest rate swap transaction is quite large, there is no assurance under the rule that each such transaction would be a “block trade”<sup>4</sup> permitted to be executed directly with a swap dealer in a one-to-one transaction. In addition, as noted above, Freddie Mac may be subjected to excessive market risk to the extent it is required to expose either a “block trade” or a required transaction to a minimum of five market participants to transfer the necessary risk in a single transaction through a Request for Quote System. Similarly, the execution of a trade via an Order Book may limit the size of a risk transfer transaction that may be executed at a firm price. The proposed obligation to impose a 15-second time delay on execution of a Required Transaction could further expose hedging parties, such as Freddie Mac, to additional market risk because the market could move prior to the completion of the trade. In such circumstances, Freddie Mac’s hedging opportunities could suffer if swap dealers increase prices to account for anticipated market movements or, potentially, refuse to enter into such transactions (with resulting adverse impacts on transaction liquidity and market depth). Accordingly, Freddie Mac respectfully requests that the Commission expand the definition of Permitted Transactions to include substantially all transactions executed for hedging purposes by any end-user (*i.e.*, a non-dealer) counterparty hedging economic risk.<sup>5</sup>

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<sup>2</sup> “Request for Quote System” includes a trading system or platform in which a market participant: (a) “*must submit a request for a quote... to no less than five market participants*” with bids or offers “resting” on the system taken into account and communicated to the requester with the responsive quotes; or (b) can both view real-time electronic streaming firm and indicative quotes from multiple counterparties and complete a transaction by either accepting a firm quote or transmitting a request for quote *to no less than five market participants* based upon an indicative quote and taking into account any “resting” bids or offers. Proposed § 37.9(a)(1)(ii) (emphasis added).

<sup>3</sup> “Permitted Transactions” include “block trades,” swaps not subject to the clearing and execution requirements of the Dodd-Frank Act, and “illiquid or bespoke swaps.” Proposed § 37.9(a)(1)(v). The terms “block trades” and “illiquid or bespoke swaps” are not defined in the Proposal. However, the term “block trade” is defined in the Commission’s proposed rule for real-time public reporting of swap transaction data (75 Fed. Reg. 76139, 76171; Proposed § 43.2(f)) by reference to the greater of two numerical tests based on information reported to registered swap data repositories (SDRs), and SEFs must have rules that specify the minimum size of block trades, consistent with such tests, for reporting purposes. Proposed §§ 43.5(c) and (g).

<sup>4</sup> As noted in Freddie Mac’s comment letter on the Commission’s proposed rule for real-time public reporting of swap transaction data (75 Fed. Reg. 76139), we believe the proposed definition of “block size” may establish levels for real time reporting of transactions that are far too high. See Freddie Mac Letter to David A. Stawick re: Notice of Proposed Rulemaking: Real-Time Reporting of Swap Transaction Data; RIN 3038-AD08 (Feb. 7, 2011).

<sup>5</sup> For purposes of this letter, Freddie Mac takes no position on whether it would be preferable to redefine the term “block quotes” in a manner to include all end-user hedging transactions; to include

In this regard, we recommend that the Commission permit hedging counterparties to initiate Requests for Quotes based upon indicative streaming quotes to a single dealer.

b. Limits on SEF Rulemaking

Under Proposed § 37.6, a transaction entered into on a SEF “shall not be void, voidable, subject to rescission or otherwise invalidated or rendered unenforceable” as a result of a violation by the SEF of the registration, core principles and other SEF provisions of the Commodity Exchange Act (CEA) as added by § 733 of the Dodd Frank Act. While this provision is beneficial to the market and transacting parties, we believe the Commission should strengthen this rule in one important respect. Freddie Mac is concerned that, unless prohibited by the Commission, SEFs could implement rules requiring the termination or other cancellation of an executed swap, and assessment of costs of termination or cancellation (*i.e.*, “breakage”) against one or more of the parties, based solely on the failure of the swap to be cleared. We believe that any such rule would directly contravene the requirements for legal certainty for swaps under the CEA. As amended by the Dodd Frank Act, the CEA provides that no swap transaction between eligible contract participants:

shall be void, or voidable or unenforceable, and no party to such agreement, contract or transaction shall be entitled to rescind, or recover any payment made with respect to, the agreement, contract or transaction under this section or any other provision of Federal or State law based solely on the failure of the agreement, contract, or transaction...to be cleared in accordance with section 2(h)(1).<sup>6</sup>

Accordingly, we request that the Commission amend Proposed § 37.6 to provide expressly that no provision in any SEF rule may require the termination or other cancellation of an executed swap, or assessment of cost for termination or cancellation against one or more of the transacting parties, based solely on the failure of the swap to be cleared.

Finally, under Proposed § 37.7, a SEF may not use “for business or marketing purposes” any proprietary data or personal information it collects or receives from any person for purposes of fulfilling its regulatory obligations. As is the case with Proposed § 37.6, while this provision is beneficial to the market and transacting parties, we believe the Commission also should strengthen this rule. Freddie Mac is concerned that, unless prohibited by the Commission, SEFs could implement rules under which important business, confidential, commercial or other proprietary trading or other data belonging to transacting parties such as Freddie Mac purportedly becomes the property of the SEF, an affiliate or another person, or such parties acquire other rights of use over such information, merely because the SEF is used as the execution facility for the trade. The trading patterns, historical and prospective book of business and other details of trading are highly important and commercially significant information of Freddie Mac. While Freddie Mac, and similarly situated parties, are

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such transactions as a separate category of “Permitted Transactions”; or adopt another method of including such transactions.

<sup>6</sup> See § 22(a)(4) of the CEA added by § 739 of the Dodd Frank Act (7 U.S.C. § 25(a)). As noted in our comment letter on the Commission’s proposal regarding the Process for Review of Swaps for Mandatory Clearing, unlike the statutory framework for futures, under the Dodd Frank Act, a clearing failure does not make a swap subject to the clearing requirement void *per se*. See Freddie Mac Letter to David A. Stawick re: Notice of Proposed Rulemaking: Process for Review of Swaps for Mandatory Clearing; RIN 3038-AD00 (Jan. 3, 2011).

required by the Dodd Frank Act to execute certain derivatives transactions via SEFs, the statutory scheme does not divest the ownership of such important information from the transacting parties and vest ownership or other rights of use in SEFs, their affiliates, or other parties.

Freddie Mac recognizes that SEFs must be able to collect necessary trading information and related data to perform their business functions and comply with their regulatory reporting obligations; however, any provisions that would compromise a transacting party's ownership of its own trading data would be overreaching, unnecessary and potentially impose a conflict of interest and a material anti-competitive burden on trading in conflict with the core principles for SEFs under the Dodd Frank Act.<sup>7</sup> Accordingly, Freddie Mac requests that the Commission amend Proposed § 37.7 to expressly provide that no provision in any SEF rule may assert ownership or other rights over trade information of any transacting party (other than permitted use of information for internal business purposes or regulatory compliance).

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Freddie Mac appreciates the opportunity to provide our views in response to the Proposal. Please contact me if you have any questions or would like further information.

Sincerely,



Lisa M. Ledbetter

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<sup>7</sup> CEA §§ 5h(11) and (12) added by § 733 of the Dodd Frank Act.