ISDA | Safe, Efficient Markets

April 8, 2011

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

Re: Notice of Proposed Rulemaking: Requirements for Processing, Clearing, and Transfer of Customer Positions (RIN 3038—AC98)

Dear Mr. Stawick:

The International Swaps and Derivatives Association, Inc. ("**ISDA**") appreciates the opportunity to comment on the notice of proposed rulemaking (the "**NPR**"), promulgated by the Commodity Futures Trading Commission (the "**Commission**") pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**"), setting forth proposed regulations ("**Proposed Regulations**") intended to: (i) establish a timeframe for a swap dealer ("**SD**"), major swap participant ("**MSP**"), futures commission merchant ("**FCM**"), swap execution facility ("**SEF**") and designated contract market ("**DCM**") to submit contracts, agreements, or transactions to a derivatives clearing organization ("**DCO**") for clearing; (ii) facilitate the prompt and efficient processing of all contracts, agreements, and transactions submitted for clearing; (iii) require SEF and DCM coordination with DCOs in the development of rules and procedures to facilitate clearing; and (iv) require a DCO, upon customer request, to promptly transfer customer positions and related funds from one clearing member to another, without requiring the close-out and re-booking of the positions. As noted in the NPR, the Commission intends the Proposed Regulations to supplement certain other proposed regulations that were previously disseminated by the Commission.[1]

ISDA was chartered in 1985 and has 800 member institutions from 54 countries on six continents. Our members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end-users that rely on over-the-counter derivatives to manage efficiently the risks inherent in their core economic activities.

[1] *See, e.g.,* 76 FR 6715, Feb. 8, 2011 ("Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants") ("**Swap Documentation NPR**"); 76 FR 3698, Jan. 20, 2011 ("Risk Management Requirements for Derivatives Clearing Organizations") ("**DCO Risk Management NPR**"); 76 FR 1214, Jan. 7, 2011 ("Core Principles and Other Requirements for Swap Execution Facilities") ("**SEF Core Principles NPR**"); 75 FR 81519, Dec. 28, 2010 ("Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants") ("**Confirmation NPR**"); 75 FR 80572, Dec. 22, 2010 ("Core Principles and Other Requirements for Designated Contract Markets") ("**DCM Core Principles NPR**").

International Swaps and Derivatives Association, Inc.
1101 Pennsylvania Avenue, Suite 600
Washington, DC 20004
P 202 756 2980 **F** 202 756 0271
www.isda.org

NEW YORK WASHINGTON
LONDON BRUSSELS
HONG KONG SINGAPORE
TOKYO

Since its inception, ISDA has pioneered efforts to identify and reduce the sources of risk in the derivatives and risk management business through documentation that is the recognized standard throughout the global market, legal opinions that facilitate enforceability of agreements, the development of sound risk management practices, and advancing the understanding and treatment of derivatives and risk management from public policy and regulatory capital perspectives.

ISDA respectfully submits the following comments in response to the Proposed Regulations.

A. Proposed § 23.506—SD and MSP Submission of Swaps for Processing and Clearing

(i) Swap Processing

ISDA supports the Commission's prudent judgment that SDs and MSPs, coordinating with their DCOs, should be free to select the manner by which they must route their swaps to DCOs and provide for prompt and efficient processing. However, assuming cleared trades must go through a clearing member to the DCO, it is not apparent what proposed § 23.506(a) adds to the already proposed § 39.12(a)(3) requirement that clearing members have adequate operational capacity to meet obligations arising from their participation in DCOs. Market participants have for some time been developing industry standards for the prompt and efficient processing of cleared swap transactions, beginning with the original trading parties and proceeding through clearing members (and appropriate credit and other controls) to the clearinghouse. ISDA would urge the Commission to study these standards and defer to them wherever possible. Certainly, the Commission would be wise to avoid encouraging segmented specification of standards that may defeat prudent, coordinated transaction processing.

Perhaps because of the conceptual segmentation of the clearing process that the Commission has used to organize its proposed regulations, it is sometimes difficult (as is the case in these Proposed Regulations) to discern the important intermediary role of the clearing member. The clearing member is typically responsible for maintaining credit controls and collecting the margin that protects the clearinghouse. The clearing member provides other valuable user interface functions. We urge the Commission throughout this regulatory effort to remember that the clearing member, though subject itself to the rules of various market utilities, has a gatekeeper role in enforcing those rules and prudential standards generally.

(ii) Swap Clearing

Under proposed § 23.506(b)(1), an SD or MSP would be required to submit a swap that is not executed on a SEF or DCM, but is subject to a clearing mandate under section 2(h)(1) of the Commodity Exchange Act ("**CEA**") (and has not been electively excepted from mandatory clearing by an end-user under section 2(h)(7) of the CEA), to a DCO for clearing as soon as technologically practicable following execution of the swap, but in no event later than the close of business on the day of execution.

In ISDA's view, submission of such swaps for clearing on the same day as execution is desirable, but is not yet consistently achievable across the market, whether "technologically"

or otherwise. The ability to comply with a "same day" directive would be highly dependent on the time of execution, nature of the transaction, nature of the counterparties and the uniform availability of adequate technology. Even a next business day cut-off may be problematical in some circumstances. For example, some cleared swaps may be required to pass through an affirmation platform after trade and before submission, and submission would not be directly to a DCO, but would be through clearing members. Clearing members, to protect themselves and the DCO, add an important element of risk control to the clearing process and any clearing timeline must take account of the need to have them screen trades for compliance with their own standards and DCO standards (and reject trades that are beyond credit limits or otherwise unacceptable). These post-trade processes promote accuracy and certainty, but may require additional time. This is even more the case if a party to the trade does not have both the expertise and the technological support available to an SD or MSP.

Prompt submission for clearing promotes trade and margin processing efficiency, and timely risk counterparty certainty. ISDA is concerned, however, that premature enforcement of mandatory "same day" submission may invite error. As previously conveyed to the Commission in our comment letter, dated February 28, 2011 ("**Confirmation Letter**"),[2] in response to the Confirmation NPR, ISDA is concerned that aggressive time frames (same day or substantially less) like those embodied in proposed § 23.506(b) may have numerous unintended consequences, not least of which is that proposed § 23.506(b) may actually increase systemic risk by forcing market participants to focus on speed at the expense of accuracy. Although regulations may promote aspirational goals, we suggest that regulations should distinguish clearly between the aspirational and the mandatory, and should allow the necessary developmental steps before the aspirational becomes mandatory.

The need of asset managers and others acting in an agency capacity to have adequate time to allocate transactions in good order to their principals is a particularly striking example of the general need to allow time to all the market processes now being reduced to rule. To mechanically disenfranchise such an important user group would be to court the failure of the cleared market.

Accordingly, ISDA would instead propose that an "as soon as reasonably practicable" standard would be most appropriate, as it would give apposite weight to the evolution of markets and transactions, as well as the potential negative consequences of fixed deadlines. Such a standard would also avoid use of the phrase "technologically practicable," which we believe is unclear and, given that what may be "technologically practicable" for the largest SD may be different from what is "technologically practicable" for another, potentially inconsistent in application. We also suggest that any rule make plain that missing a submission deadline, be it firm or flexible, would not threaten the enforceability of the transaction.

As also emphasized in the Confirmation Letter, ISDA is concerned about the "one size fits all" nature of certain regulations, now including proposed § 23.506(b), which lacks sufficient flexibility to account for differences between asset classes or between products within asset

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[2] *See* ISDA's comment letter, dated February 28, 2011, in response to the Commission's notice of proposed rulemaking "Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Participants" (75 FR 81519, Dec. 28, 2010).

classes. Rules governing interest rate swaps, for example, may have good reason to be different from rules for energy transactions.

Where a swap is not subject to a clearing mandate, but the counterparties have nevertheless elected to clear the swap, proposed § 23.506(b)(2) would require an SD or MSP to submit the swap for clearing not later than the next business day after execution of the swap or the agreement to clear, if later than execution. The drafting of this provision is unclear. We do not interpret proposed § 23.506(b)(2) as limiting the ability of the parties to a swap transaction to agree to submit that transaction for clearing at some date in the future. Consequently, we construe proposed § 23.506(b)(2) as simply imposing a one business day "grace period" from the agreed date on which the parties *intend* to submit a transaction for clearing. Where parties voluntarily elect to submit a swap for clearing, all aspects of that election should be left to the parties to determine contractually. Obviously, limiting the flexibility of parties voluntarily seeking to clear will only create disincentives to such voluntarism, including confusion and potential legal uncertainty.

B. Proposed § 39.12—Acceptance and Clearing of Swaps by a DCO

(i) Proposed § 39.12(b)(2)

The Proposed Regulations would revise the previously-proposed § 39.12(b)(2) to clarify that a DCO must adopt rules to establish templates for the terms and conditions of swaps that it will clear. As an initial matter, the word "template" by itself has no clear meaning. We assume that this refers to the contract specifications currently used by a variety of futures facilities, but we would ask the Commission to clarify. Provided this interpretation is accurate, we note that the development of specific templates for swap transactions is a mixed business/technological project that requires significant discussion involving each DCO and its market participants. The Commission's regulations should guide the meaning of "template" to achieve as much individual transactional variability as possible within the transaction or range of transactions that a template may cover. The precision of product definition previously recommended by ISDA to the Commission[3] should be reflected in transaction templates that will, with even greater precision, allow for expression of permitted transactional nuances and precisely define the boundaries of what is to be cleared and what is not to be cleared.

(ii) Proposed § 39.12(b)(4)

Newly proposed § 39.12(b)(4) would prohibit a DCO from refusing to clear a product where neither party to the original contract, agreement, or transaction is a clearing member, although parties that are not clearing members would still have to submit their bilateral trades for clearing through a clearing member of the DCO.

ISDA believes that rules on clearing access at the inception of the market should be principles-based and aspirational. In mature DCOs, rules barring trades that don't involve a clearing member as a party are inappropriate. Developmental DCOs may well need, however, to roll out

[3] *See* ISDA's comment letter, dated December 22, 2010, in response to the Commission's notice of proposed rulemaking "Process for Review of Swaps for Mandatory Clearing" (75 FR 67277, Nov. 2, 2010).

products and procedures in a contained way, perhaps using the skills and experiences of their members. Initial decisions on which market constituencies should have access to clearing must be the subject of legitimate, reasoned decision-making by each DCO with regard to its ability to properly serve each constituency and each constituency's readiness to participate in a cleared market. Proposed § 39.12(b)(4), which would prohibit a DCO from refusing to clear a product where neither party to the original contract, agreement, or transaction is a clearing member, should be replaced with a rule permitting a weighing of factors relevant to types of parties by each DCO, ranging from, for example, operational sophistication, to systems readiness to the DCO's own rulebook completion, in deciding clearinghouse access. In making this assertion, we assume that any party submitting a swap transaction in this context must be one that is able to comply with clearinghouse standards, including most importantly, credit standards as applied through a clearing member. Ultimately, of course, the DCO must have the ability (exercised through its clearing members) to accept any transaction on its own terms, ranging from credit limits to its own rules, all as subject to Commission requirements.

(iii) Proposed § 39.12(b)(5)

The Proposed Regulations would expand on the previously-proposed § 39.12(b)(5) by clarifying that, in establishing product templates under its rules, the DCO is required to select other terms and conditions in addition to unit size, such as termination or maturity period, settlement features, and cash flow conventions, to facilitate price transparency (in addition to liquidity, open access, and risk management). ISDA fully supports the goals identified by the Commission, and urges the Commission to fully encourage product variety and product usefulness. ISDA observes, however, that "unit size" is not a meaningful concept in swap transactions. Unlike the futures market, where contract size is quite standardized, a prominent characteristic of the swap market is that the only meaningful size limit is the smallest unit of relevant currency or relevant underlying. As a result, the Commission should avoid focusing on "unit size" and should instead articulate its ultimate objectives, as it has, leaving DCOs with the discretion to set suitable terms and conditions to further those objectives.

(iv) Proposed § 39.12(b)(7)

Proposed paragraph (i) would require a DCO to coordinate with each SEF and DCM that lists for trading a product that is cleared by that DCO in developing rules and procedures to facilitate prompt and efficient processing of all contracts, agreements, and transactions submitted to the DCO for clearing. ISDA would suggest that processing should be "accurate," in addition to "prompt and efficient," but more broadly, as noted above, ISDA's view is that regulations should be principles-based and aspirational to permit an appropriate phase-in of standards as the cleared markets grow in capability.

Proposed paragraph (ii) would require a DCO to have rules that provide that the DCO will accept for clearing, immediately upon execution, all contracts, agreements, and transactions that are listed for clearing by the DCO and (A) that are entered into on or subject to the rules of a SEF or DCM; (B) for which the executing parties have clearing arrangements in place with clearing members of the DCO; and (C) for which the executing parties identify the DCO as the intended clearinghouse. Proposed paragraph (iii), which governs swaps subject to mandatory clearing,

would require a DCO to have rules that provide that the DCO will accept for clearing, upon submission, all contracts, agreements, and transactions that are listed for clearing by the DCO and (A) that are not executed on or subject to the rules of a SEF or DCM; (B) that are subject to mandatory clearing pursuant to section 2(h) of the CEA; (C) that are submitted by the parties to the DCO, in accordance with proposed § 23.506; (D) for which the executing parties have clearing arrangements in place with clearing members of the DCO; and (E) for which the executing parties identify the DCO as the intended clearinghouse.

The concepts of acceptance "immediately upon execution" and "upon submission" as used in proposed paragraphs (ii) and (iii), respectively, have no precise meaning. We suggest that "as soon as reasonably practicable" is a more clear-cut measure in both of these provisions. Similarly, for the reasons discussed above, proposed paragraph (iv), which would require "day of submission" clearing of swaps not executed on or subject to the rules of a SEF or DCM and not subject to mandatory clearing, sets forth a timetable that may be unworkable in practice. The ability to comply with such a mandate is highly dependent on factors such as the time of submission, type of trade, *etc*. More fundamentally, however, DCOs should be obliged to clear only when transactions and parties are in compliance with DCO rules, including appropriate credit controls administered by the clearing brokers. Proposed paragraphs (ii), (iii) and (iv) fail to afford DCOs this latitude.

Proposed paragraph (v) would require that DCOs accepting a swap for clearing receive from the counterparties a definitive written record of the terms of their agreement ("written documentation that memorializes all of the terms of the transaction and legally supersedes any previous agreement"). As noted in the NPR, the Commission has in other regulations defined a swap confirmation as the consummation (electronically or otherwise) of legally binding documentation (electronic or otherwise) that memorializes the agreement of the counterparties to all of the terms of a swap. As we noted in the Confirmation Letter, the clearing of trades through DCOs produces an authoritative record in and through the clearinghouse. We therefore asked the Commission in the Confirmation Letter to recognize that clearing a swap through a DCO would be deemed to satisfy any confirmation requirement, but we did not contemplate that this would in fact be required of *the parties before* they take their transaction to the DCO. As currently constituted, it is not clear what efficiencies proposed paragraph (v) achieves for the parties in confirming through a DCO. Accordingly, we again urge the Commission to be less prescriptive in this context and recognize that the act of clearing a swap transaction through a DCO *in and of itself* should produce a definitive written record, tailored to the particular category of swap transaction by the DCO and its market constituency, that fulfills the Commission's objective of facilitating the timely processing and confirmation of swaps not executed on a SEF or a DCM.

(v) Proposed §§ 37.702 and 38.601

The Proposed Regulations supplement previously-proposed §§ 37.702(b) and 38.601 by requiring SEFs and DCMs, respectively, to coordinate with each DCO to which either such entity submits transactions for clearing in the development of rules and procedures to facilitate prompt and efficient transaction processing in accordance with proposed § 39.12(b)(7). ISDA applauds this proposal. Coordination among the parties subject to the Commission's new swap jurisdiction is critical to ensuring that the rulemaking process is effective without disrupting the

swap markets. In order to facilitate the "coordination" of processing, ISDA again advocates the adoption of Financial Products Markup Language ("**FpML**"), an existing standard managed by ISDA that is used between participating companies for communicating OTC transaction details, within companies for the purpose of internal sharing of OTC transaction information and between participating companies and outside firms offering services related to OTC transactions.[4]

C. Proposed § 39.15—Transfer of Customer Positions and Related Funds

Proposed § 39.15(d) would require a DCO to have rules providing that, upon the request of a customer and subject to the consent of the receiving clearing member, the DCO will promptly transfer all or a portion of such customer's portfolio of positions and related funds from the carrying clearing member of the DCO to another clearing member of the DCO, without requiring the close-out and re-booking of the positions prior to the requested transfer.

ISDA commends the Commission for exercising restraint in not imposing a specific time frame in proposed § 39.15(d). ISDA is concerned, however, that due to certain fundamental differences between futures and swaps (for example, fundamental transaction variability), futures industry experience, which the Commission discusses in the NPR, is not necessarily a meaningful reference point in this context. Any transfer rule must provide that a party seeking transfer not be in default to its existing clearing member. Transfer must take account of any cross-cleared or cross-margined transactions[5] and in the case where only a portion of a customer's portfolio is transferred, clearing members must have the ability to condition the transfer on the posting of additional margin by the customer. Transfer rules, particularly as they relate to the posting of margin, must similarly account for potential offsets between swap and security-based swap positions. Thus, ISDA urges the Commission and the Securities and Exchange Commission to ensure that their respective regulations are harmonized as far as possible. There is an important role for the Commission to play in carefully promoting aspirational goals, while promulgating mandatory requirements that take account of current swap market circumstances. We think that the Commission's efforts to create consistency in transfer procedures and timing will inevitably be supported by the competitive pressures on DCOs to provide what customers will want.

In sum, clearing members should have the right to decline a transfer of a customer's portfolio, in the case of the transferee clearing member, as it would any new position, and in the case of the transferor clearing member, to the extent that transfer would impose material cost or increased risk upon it (including, without limitation, credit or other risks inherent in any resulting portfolio imbalance).

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[4] *See* ISDA's comment letter, dated November 12, 2010, in response to the Commission's "Interim Final Rule for Reporting Pre-Enactment Swap Transactions" (75 FR 63080, Oct. 14, 2010).

[5] ISDA advocates offsets across clearinghouses and across cleared and uncleared transactions to the full extent supported by law (including insolvency law) and regulation.

ISDA appreciates the opportunity to provide its comments on the Proposed Regulations and looks forward to working with the Commission as the rulemaking process continues. Please feel free to contact me or ISDA's staff at your convenience.

Sincerely,

Robert Pickel
Executive Vice Chairman
ISDA