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April 11, 2011

VIA ONLINE SUBMISSION: <http://comments.cftc.gov>

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

Re: Swap Trading Relationship Documentation Requirements for Swap
Dealers and Major Swap Participants (RIN 3038---AC96)

Dear Mr. Stawick:

We are submitting this letter in response to the request of the Commodity Futures Trading Commission (the “CFTC”) for comment on the proposed rule §23.504 (the “Proposed Rule”) of the CFTC under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). We appreciate the opportunity to comment on the Proposed Rule.

The Proposed Rule requires the written documentation of uncleared swaps entered into by a swap dealer or major swap participant and its counterparty to include written documentation in which the parties agree on the methods, procedures, rules and inputs for determining the value of

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each swap at any time from execution¹ to the termination, maturity or expiration of such swap. The valuation of each swap would be required to be based, to the maximum extent possible, on objective criteria, such as recently-executed transactions or valuations provided by independent third parties such as derivatives clearing organizations. Such methods, procedures, rules and inputs would be required to be agreed to for each swap prior to or contemporaneously with the execution of the swap and would be required to be stated with the specificity necessary to allow the swap dealer, major swap participant, counterparty, the CFTC, and any applicable prudential regulator to determine the value of the swap independently in a substantially comparable manner. The agreed methods, procedures, rules and inputs would be required to constitute a complete and independently verifiable methodology for valuing each swap entered into between the parties. Such methods, procedures and rules would be required to include alternative methods for determining the value of the swap in the event of the unavailability or other failure of any input required to value the swap, provided that the alternative methods for valuing the swap complied with the foregoing requirements (including specificity). Provided that the foregoing requirements, including the independent valuation requirement, were satisfied, a swap dealer or major swap participant would not be required to disclose to the counterparty confidential,

¹ In proposed rule §23.500, 75 FR 81530 (December 28, 2010), the CFTC defined the term "execution" to mean, with respect to a swap transaction, an agreement by the counterparties (whether orally, in writing, electronically, or otherwise) to the terms of the swap transaction that legally binds the counterparties to such terms under applicable law.

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proprietary information about any model the swap dealer or major swap participant used internally to value a swap for its own purposes.

Since the Proposed Rule requires the methods, procedures, rules and inputs (“Methods and Inputs”), and alternative methods which will be used in the event of the unavailability or other failure of any inputs required to value a swap (“Alternative Methods”), to be specific, agreed to by the parties on or prior to their execution of the swap, and documented, the concern arises that the Proposed Rule might be interpreted to require the Methods and Inputs and the Alternative Methods to be frozen when the parties enter into a swap. The Methods and Inputs and Alternative Methods agreed to when the parties executed a swap could become inappropriate at some time after the date on which the parties executed the swap, especially if there were a market failure. Instead of requiring a party to use frozen Methods and Inputs and frozen Alternative Methods, a party determining the value of a swap should be permitted to use the Methods and Inputs or Alternative Methods which such party reasonably determines in good faith are commercially reasonable and will produce the most commercially reasonable result at the time of such party’s valuation of the swap. Only by permitting a party to change the Methods and Inputs and Alternative Methods if they will not produce a commercially reasonable result can a party determine the value of a swap in unforeseen circumstances in a commercially

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reasonable manner in order to achieve the most a commercially reasonable result in such circumstances.²

Parties may modify Methods and Inputs and Alternative Methods for valuing swaps from time to time in order to make technical improvements and to reflect prevailing market conditions. If the parties were required to freeze the Methods and Inputs and Alternative Methods when the parties executed a swap, such swaps could not be valued in accordance with the improved Methods and Inputs or Alternative Methods. Swaps having substantially the same economic value inappropriately could be assigned different valuations for purposes of determining the amount of margin required to be posted or the amount payable after early termination of a swap.

The 1992 ISDA Master Agreement and the ISDA 2002 Master Agreement currently used in financial markets worldwide permit a party who is determining the value of a swap to change the Methods and Inputs or Alternative Methods previously used by such party if such Methods and Inputs or Alternative Methods no longer will achieve a commercially reasonable result. The 1992 ISDA Master Agreement provides that the “Settlement Amount” payable after the early termination of a swap may be determined by using the “Loss” method or the “Market Quotation” method. The Loss method permits the determining party to select the Methods and Inputs or

² As an analogy, in *In re Am. Home Mortg. Holdings, Inc.*, No. 07-11047, ___ F.3d ___, 2011 U.S. App. LEXIS 2992 (3rd Cir. February 16, 2011), *affg* 411 B.R. 181 (Bankr. D. Del. 2009), the United States Court of Appeals for the Third Circuit, affirming the decision of the United States Bankruptcy Court for the District of Delaware, held that for purposes of Section 562(b) of the United States Federal Bankruptcy Code, it was appropriate to determine the value of mortgage loans which were subject to a repurchase agreement by using a present discount value method when the market was dysfunctional and the mortgage loans could not be sold in the market.

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Alternative Methods which the party will use to determine its loss or gain (taking into account the cost of terminating any hedge position), provided that such party reasonably determines its loss or gain in good faith. The party may, but is not required, to determine its loss or gain by reference to quotations from leading dealers. The Market Quotation method requires the determining party to obtain quotations for a substitute swap. However, the recognition that market quotations may not produce a commercially reasonable result in all circumstances is reflected in the definition of "Settlement Amount" in Section 14 of the 1992 ISDA Master Agreement, which provides that the Settlement Amount shall be determined using the Loss method if the party making the determination reasonably believes that a market quotation would not produce a commercially reasonable result.

The Russian financial crisis in the 1990s, during which firm quotations for Russian Ruble-denominated bonds and Russian Rubles became unavailable and indicative quotations varied widely, and the resulting liquidity crisis and take-over of the hedge fund Long-Term Capital Portfolio L.P. managed by Long-Term Capital Management L.P., made clear that the Market Quotation method used to determine the value of swaps under a 1992 ISDA Master Agreement did not produce commercially reasonable results in times of market failure when quotations were unreliable. Consequently, the ISDA 2002 Master Agreement uses the "Close-out Amount" to value swaps upon early termination or to determine the amount of margin which must be posted. A party may determine the Close-out Amount by using any of a variety of Methods and Inputs

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which such party determines, at the time when the party calculates the Close-out Amount, are commercially reasonable and will produce a commercially reasonable result. In order to determine the Close-out Amount, the party determining the value of a swap is required to obtain quotations if quotations are available but may base its valuation on any and all of market quotations (either firm or indicative); relevant market data supplied by third parties, including relevant rates, prices, yields, yield curves, volatilities, spreads, correlations or other relevant market data in the relevant market; and information of such types from internal sources if that information is of the same type used by the party determining the value of the swap in the regular course of its business for the valuation of similar transactions. The party determining the value of the swap is required to consider market quotations or relevant data from third parties unless the determining party reasonably believes in good faith that such quotations or relevant market data are not readily available or would produce a result that is not commercially reasonable at that time. The ISDA 2002 Master Agreement expressly requires the party to determine the Close-out Amount in good faith and to use commercially reasonable procedures in order to produce a commercially reasonable result. Following an early termination of a swap, the party who calculated the value of the swap is required to provide the other party with a statement showing, in reasonable detail, such calculation (including any quotations, market data or information from internal sources used in making such calculations). In contrast to the 1992 ISDA Master Agreement and the ISDA 2002 Master Agreement, if the Proposed Rule were interpreted to require that the parties freeze the Methods and Inputs and Alternative Methods

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when the parties executed a swap, a party might be unable to determine the value of the swap for purposes of margin requirements and determining the amount payable after early termination of the swap in a commercially reasonable manner which would produce a commercially reasonable result.

In the CFTC's notice of proposed rulemaking containing the Proposed Rule,³ the CFTC mentioned, as the CFTC has mentioned in other notices of proposed rulemaking, that Title VII of the Dodd-Frank Act amended the Commodity Exchange Act to establish a comprehensive regulatory framework to reduce risk, increase transparency and promote market integrity within the financial system. An interpretation of the Proposed Rule which required Methods and Inputs and Alternative Methods to be frozen at the time when parties execute a swap would increase risk and reduce market integrity. Transparency can and should be achieved by disclosure of the Methods and Inputs or Alternative Methods which will be used, or which have been used, from time to time.

For the reasons expressed herein, we request that the CFTC confirm that the Proposed Rule will not be interpreted to require the Methods and Inputs and Alternative Methods to be frozen when parties execute a swap, and that, accordingly, the Methods and Inputs and Alternative Methods may be modified by the party who is determining the value of a swap if necessary to produce a

³ 76 FR 6715 at 6716 (February 8, 2011)

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commercially reasonable result, provided that the Methods and Inputs or Alternative Methods actually used are disclosed.

We thank you for the opportunity to submit this comment letter. We would be pleased to discuss with you any of the comments we have made herein. Please do not hesitate to contact Steven K. Ross (212-819-8901) if you would like to discuss these matters further.

Very truly yours,

A handwritten signature in blue ink that reads "White + Case LLP". The signature is written in a cursive, flowing style.

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