Alternative Investment Management Association

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Submitted via the CFTC website

10 June 2011

Dear Chairman Gensler,

CFTC Staff Concepts and Questions Regarding Phased Implementation of Effective Dates for Final Dodd-Frank Rules

The Alternative Investment Management Association[1] (AIMA) appreciates the invitation of the Commodity Futures Trading Commission (the Commission) to comment on the CFTC Staff Concepts and Questions Regarding Phased Implementation of Effective Dates for Final Dodd-Frank Rules (the Release).

AIMA supports the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act) reforms and, in particular, those moves to meet G20 commitments around clearing and reporting of OTC derivative contracts[2]. Although, in principle, we do not seek a delay in publication of final rules or the implementation of any of the rules which the Commission is required to address, we recognise that the Dodd-Frank Act sets very tight deadlines for implementation of extremely complex rules, often in areas which have not been regulated previously. Meeting such a challenging task may not provide sufficient time for the Commission deliberations, including considerations of the input from stakeholders impacted by the future regulation. Whilst the Commission must work towards publishing final rules as soon as it can safely and sensibly do so, we believe that market participants should be given sufficient time to properly understand and prepare themselves to comply with the new regulatory requirements.

On balance, therefore, we believe that the Commission should phase in the implementation of the Dodd-Frank Act rules over time. We comment below on the specific proposed concepts which we believe the Commission should consider when deciding how and when to implement the Dodd-Frank Act rules. Following full consideration of the concepts discussed below, we would appreciate the industry being given as much clarity about the timetable for implementation as possible. The implementation timetable should be conceived in such a way as to give relevant parties sufficient time to prepare for full compliance in the most efficient manner.

[1] AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,200 corporate bodies in over 40 countries, with 11% based in the US and over 30% of AIMA members' total assets under management (AUM) managed by US investment advisers.

[2] The leaders of the G20 nations' commitment at the September 2009 summit in Pittsburgh that "All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories."

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Summary of AIMA's comments

- AIMA supports full and prompt implementation of final rules but believes that more time is necessary to ensure that rules are implemented in an appropriate manner.

- Phasing of the implementation of final rules is desirable in certain circumstances and for certain rules.

- Affected parties need time to understand the final rules, purchase or develop appropriate technology, develop policies and procedures and, where appropriate, write rulebooks before implementation of final rules.

- Open access to market infrastructure can be provided before trading and clearing obligations take effect, if the trading and clearing venues are ready to safely provide their services.

- A natural order for rule making would see entity and product definitions being provided first, followed by publication of entity registration rules, organisational requirements for entities and market infrastructure and, lastly, obligations for market end-users.

- Certain parties may be able to meet their obligations earlier than others, especially where they are already operating in the market. An industry advisory standing committee could be established to assist the Commission in this regard.

- Certain types of financial entities may be able to meet their requirements earlier than others. However, phased implementation should be limited to avoid unequal burdens among market participants and should treat financial entities by their regulatory classifications and in a similar manner to other similarly placed entities.

- Swap trading, clearing and reporting obligations and related requirements form a coherent group of rules and these should be broadly implemented at the same time.

- Position limits are a separate concern and applicable rules should be implemented when sufficient market data is gathered on each asset class.

AIMA's comments

Concept 1 – 'phased over time'

AIMA recognises that some delay is necessary to the implementation of the Dodd-Frank Act rules and phasing of the implementation of final rules in an appropriate way. However, it is unlikely to be beneficial to the market to delay implementation of all rules until all rulemaking can be completed. The Commission should, instead, consider, in respect of each of the rule-making areas, what is required of each of the affected parties and how long it will take them to reasonably comply with the final rules. We would argue against early implementation of certain rules unless such early implementation fits within a wider implementation plan that makes all proper consideration of the rules' effects.

What is a reasonable amount of time will naturally vary between entity type, the nature of a firm's business and the size of a firm. Gathering data in this regard may not be best done through requesting written comments. Rather, AIMA would propose for consideration the establishment of an implementation advisory standing committee to help the Commission devise a complete implementation plan. We are aware that the Commission

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has used such committees in the past to good effect to obtain input on a particular market area over time. An implementation advisory standing committee should comprise representatives of all affected industry sectors and end-users and should meet on a periodic basis.

Concept 2 – 'policies, procedures and rulebooks'

At the same time as the Commission is writing its final rules, many affected financial institutions are preparing to make structural and operational determinations as well as write internal policies and procedures and, in the case of market infrastructure entities, rule books to add a crucial layer of implementing detail. Institutions will be unable to finalise those determinations as well as prepare needed policies, procedures and rulebooks until the Commission publishes its final rules. Once market infrastructure entities complete their rulemaking, market participants will need time to read and understand those secondary rules ready to meet the requirements. This is particularly true in the case of derivative clearing organisations (DCOs) and designated contract markets (DCMs), which will have new requirements imposed on them under the Dodd-Frank Act in relation to clearing and trading of swaps and for swap execution facilities (SEFs), which will thus require completely new internal rulebooks. AIMA is unable to say, without further detailed consideration and conversation with other market participants, what would be a reasonable deadline for making and implementing structural and operational determinations or DCMs writing of policies, procedures and rulebooks or for complying with them. The question of what is a reasonable timeframe should be assessed by the Commission, ideally after consultation with an implementation advisory standing committee.

Concept 3 – 'open access'

Some financial entities will be subject to obligations to trade certain swaps on SEFs or DCMs and clear certain trades on DCOs. In addition, the SEFs, DCMs and DCOs will be required to offer open access to all entities, even if those entities are not obliged (or not yet obliged) to trade or clear on those venues. As the concept of a SEF is a new one and DCOs and DCMs are undergoing significant changes as a result of the Dodd-Frank Act implementation, it is important that SEFs, DCMs and DCOs are given sufficient time once the final rules are published to produce the rulebooks necessary for their operation. Once those internal rules are complete, we believe the SEFs, DCMs and DCOs should provide open access to all market end-users for their services. This should be differentiated from the obligations to use those services as, under voluntary use, market end-users can choose not to use the trading and clearing services if they are not prepared to do so. If market end-users are required to use those services for their trades, the obligations should only come in once those parties have been given sufficient time to make the necessary preparations.

Concept 4 – 'registration'

It is essential that the definitions of products and the categories of firm to whom final rules will apply are finalised before implementation of any of the other final rules. Only once the definitions are clear can firms begin to determine whether or not they will fall within the scope of those definitions and whether or not they will be required to register with the Commission. For example, while the new regulatory category of 'major swap participant' (MSP) implies a whole range of new regulatory requirements, the definition of what is a MSP is still unclear. Equally, the definition of 'swap dealer' will have its own criteria which are not yet determined.

Once those entities which are required to be registered are clearly defined and are given the opportunity to register, the implementation of transaction compliance requirements for market end-users should take effect. An example where this becomes relevant is in relation to swap position reporting, which must be carried out for each uncleared swap. Under section 729 of the Dodd-Frank Act, the obligation to make a report is imposed on

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different entities depending on the types of entities which are counterparties to the swap. If the categories of the counterparties are not clear, then it is also not clear who must file a report. This lack of clarity may lead to swaps possibly being unreported or reported in a duplicative manner.

Concept 5 – 'more time for new parties'

Some swap dealers will previously have been regulated by a prudential regulatory authority and these can, therefore, be expected to be relatively better prepared to adapt to meet new regulatory requirements. Most MSPs, by their nature, are likely to be large and active market participants in the swaps market and, thus, should be capable of preparing themselves to meet new requirements within a moderate time period. Some MSPs though may require further time to meet the requirements than other MSPs.

It does not seem to make sense to split the Swap Dealer and MSP categories into sub-categories of existing registrants and new registrants. We would suggest that all Swap Dealers and MSPs be given sufficient time to meet their requirements with common implementation dates.

Concept 6 – 'phased implementation by financial entity type'

Many of the requirements of the Dodd-Frank Act apply, broadly, to all types of financial or non-financial entities, including the clearing, trading and reporting obligations. We believe that certain financial entities should not be singled out for early implementation without a prior and thorough cost/benefit analysis. We also believe that to phase implementation by entity type is likely to (a) place disproportionate cost and burden on those firms which are required to implement early compared with other types of entity and (b) delay the benefits of the reforms more generally. Cost and burden effect is likely to be more pronounced the greater the length of time which is given for implementation of the final rules. Consequently, we urge the Commission to give careful consideration to any entity specific proposal.

Any phasing of implementation of obligations by entity type should ensure that similarly placed financial entities are treated similarly, regardless of their regulatory classification. Implementation of final rules should be planned around an evidence-based assessment of which firms may reasonably be able to comply with the obligations at the earliest opportunity.

Concept 6 notes that 'hedge funds' may be able to comply in less time than other financial entities. The Commission does not specify any empirical or other evidence to support this suggestion. We do not agree that hedge funds should be singled out in this manner and would encourage the Commission to consider evidence as to which firms may be able to comply with new requirements at an earlier opportunity (e.g., non-clearing member banks, as counterparties, may be most ready to meet new regulatory requirements). Furthermore, 'hedge fund' has proved, in the past, to be a difficult term to define and the Commission should instead, if appropriate, use the regulatory classifications of certain firms, such as commodity trading adviser (CTA), commodity pool operator (CPO) or investment adviser. Concept 6 also states that financial entities which are managing sub-accounts should be given more time than those which are not. We believe this is not a good way to consider structuring the phasing of implementation of obligations. For example, most hedge funds today will manage sub-accounts and only very few small hedge fund managers manage only a singly owned hedge fund vehicle or account. Therefore, the final rules would require only a few small hedge funds to undertake obligations first, with larger hedge fund managers being given more time to comply with obligations. In this sense, it could be argued that this consideration produces an unfair result.

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Using the criterion of whether a financial entity manages sub-accounts is not an effective tool for dividing up types of financial entity and we believe that there are other, more relevant, factors that the Commission should consider. For example, the size of the financial entity (large entities may have more resources to commit to compliance) or the range and complexity of the financial entity's business activities (complex businesses may need to comply with more rules and may, therefore, need more time to comply with requirements).

Phased implementation of final rules by type of financial entity may become complicated if too many categories are identified; we would encourage the Commission to use a simple and fair metric for phased implementation, if it is to be used per entity type, with similar treatment given to similarly placed financial entities (e.g., hedge fund managers should be treated in the same way as other types of investment advisers). An implementation advisory standing committee, if one were to be established, could advise the Commission on the appropriate lead-in times for various types of financial entity, each of which would be represented on the committee.

Concept 7 – 'non-financial entities'

Non-financial entities are likely to be less sophisticated market end-users than financial entities and, in general, we agree that the former may require more time to comply with their obligations than the latter. There are likely various ways in which non-financial entities could be sub-divided into sub-categories depending on their sophistication but for simplicity we would encourage a single category of non-financial entity with an appropriate set of compliance deadlines.

Concept 8 – 'different approaches by area of rulemaking'

To keep the implementation rules simple, we believe that the Commission should not consider too many different approaches to rulemaking and implementation for different rulemaking areas. Swap clearing, trading, reporting and confirmation, valuation and margining are all part of one long trading process for swaps in which each part is conditional and sequenced in the trading process (see below). These areas may, however, be approached differently from derivative position limits, which can be imposed at any time in the market. Such limits do not change the method by which parties trade, but instead change how large a position the parties can take in physical commodity based assets.

Concept 9 – 'conditional rule making'

Under the Dodd-Frank Act, parties that are obliged to clear a contract with a DCO must first trade that contract on a DCM or SEF (a Registered Entity). All contracts traded on a Registered Entity will be reported by the Registered Entity thereby allowing counterparties to meet their reporting obligation. For this reason, trading, clearing and reporting are intrinsically linked. The final rules in these areas, however, first require clear definitions of, for example, what is a 'swap' and which market participants are 'swap dealers' and 'MSPs'. The obligations within the rules are conditional on there being parties who are registered as 'swap dealers' or 'MSPs' and there being contracts which the Commission determines require mandatory clearing. The interlinking of these rules suggests that connected obligations should be implemented at the same time to be effective.

Concept 10 – 'access to data'

The Commission is required to set aggregate position limits 'as appropriate' on certain exempt commodity and agricultural derivative contracts. We believe that a position limit is only likely to be 'appropriate' if it takes account of empirical evidence. If set too high, the limit will not have the desired effect; if set too low it is likely

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to reduce market liquidity and interrupt proper price discovery. We have commented more extensively on this point in our letter to the Commission dated 28 March 2011.

The Commission should implement position limits, where appropriate, on a case by case basis for different specific contracts, as and when data becomes available, to meet the desired goal of those limits.

Concept 11 – 'natural sequencing'

As discussed above, the natural sequence of rulemaking is likely to start with definitions, progressing to deal with registration requirements, the writing of necessary rulebooks and then a period of time for market participants to prepare for compliance with the requirements and obligations before these become effective.

Once the Commission has considered how best to sequence each of the areas of rulemaking, it should clearly and publicly state how final rules will be sequenced with precise dates for implementation of each rule, which will allow all parties to plan out their compliance with new requirements before implementation.

Concept 12 – 'technological connectivity'

One consideration as to how to implement the rules for market infrastructure firms (DCOs, DCMs and SEFs) and market participants should be the time it will take each to put in place sufficient technology to comply with their requirements and to establish technological connectivity between market participants, trading venues, clearing providers and swap data repositories to improve efficiency. Some such infrastructure may already be in place but more (perhaps considerably more) will inevitably be needed to meet the new obligations. In our opinion, the Commission should consult extensively with affected parties and relevant service providers about the time that will be required to achieve compliance. In particular, certain solutions may not be possible until final rules are available so that the technology can be properly designed by service providers.

Concept 13 – 'phased implementation by asset class'

As discussed above, it is preferable to address appropriate position limits by looking at the different asset classes and specific contracts. Where data is available for one contract, it may be appropriate to set a limit for that contract but not for other contracts and asset classes where there is currently insufficient data. Imposing such limits by type of trading venue is likely to be preferential as existing limits on DCMs can be easily calibrated based on available information, followed by more complicated swaps, on which less is currently known, followed by other complicated asset classes and swap-equivalents. When focusing resources on ensuring that sufficient data is available, the Commission should prioritise those contracts which pose the biggest risk, trade in the greatest volume and have previously demonstrated the greatest price volatility.

The contracts (or asset classes) that are subject to the clearing and trading obligation will be selected either by the DCO and DCM/SEF or by the Commission under an own-initiative review. There is, therefore, no need to specify varying implementation timelines for the obligations in the Commission's final rules beyond a date at which contracts can begin being designated as required for clearing.

Conclusion

AIMA supports full and prompt implementation of the Dodd-Frank Act final rules, but believes that certain delays to implementation are necessary to give proper consideration to rulemaking and to allow affected parties to prepare themselves to meet the various requirements and obligations they will be newly subject to. Key to

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designing an appropriate implementation plan will be consultation with the financial services industry and the various affected parties. Also important will be publication of a sufficiently simple and clear plan that allows all parties to make necessary plans for compliance.

We thank you for this opportunity to comment on the Commission's Release and are, of course, very happy to discuss with you in greater detail any of our comments.

Yours sincerely,

Jiří Krol
Director of Government and Regulatory Affairs

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