



June 2, 2010

Mr. David A. Stawick  
Secretary  
U.S. Commodity Futures Trading Commission  
Three Lafayette Centre, 1155 21<sup>st</sup> Street, N.W.  
Washington, D.C. 20581

Ms. Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

Re: Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest (RIN 3038-AD01); Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant,” and “Eligible Contract Participant,” (RIN 3235-AK65); Swap Data Repositories (RIN 3038-AD20); Real-Time Public Reporting of Swap Transaction Data (RIN 3038-AD08); Core Principles and Other Requirements for Swap Execution Facilities (RIN 3038-AD18); Registration and Regulation of Security-Based Swap Execution Facilities (RIN 3235-AK93); Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges With Respect to Security-Based Swaps Under Regulation MC (RIN 3235-AK74); Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information (RIN 3235-AK 80)

Dear Mr. Stawick and Ms. Murphy:

The Association of Institutional INVESTORS (the “Association”) appreciates the opportunity to provide additional comments<sup>1</sup> related to several rulemakings proposed by the Commodity Futures Trading Commission (“CFTC”) and the Securities and Exchange Commission (“SEC” and together with the CFTC, the “Commissions”) under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).<sup>2</sup> The Association supports the efforts of the Commissioners and staff to advance the goals of increasing market transparency without reducing liquidity and mitigating systemic risk while protecting open market access for all participants. Further, we believe early, open, and universal access to new market facilities with balanced, practical, and prudent phasing of mandates for conversion of specific classes of participants and instruments will advance the overall goals of the Commissions’ efforts.

## **I. OVERVIEW OF THE ASSOCIATION OF INSTITUTIONAL INVESTORS**

The Association of Institutional INVESTORS is an association of some of the oldest, largest, and most trusted investment advisers in the United States. Our clients are primarily institutional investment entities that serve the interests of individual investors through public and private pension plans, foundations, and registered investment companies. Collectively, our member firms manage ERISA pension, 401(k), mutual fund, and personal investments on behalf of more than 100 million

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<sup>1</sup> See Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 25,274 (May 4, 2011).

<sup>2</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

American workers and retirees. Our clients rely on us to prudently manage participants' retirements, savings, and investments. This reliance is built, in part, upon the fiduciary duty owed to these organizations and individuals. We recognize the significance of this role, and our comments are intended to reflect not just the concerns of the Association, but also the concerns of the companies, labor unions, municipalities, families, and individuals we ultimately serve.

Open, transparent, liquid, and efficient swaps markets that provide a level playing field for all participants, from the largest hedge funds to the smallest corporate, union, or municipal pension plans are critically important to our institutional investor clients. Tens of thousands of institutional investors utilize derivatives products to manage risk, match income to liabilities, efficiently access capital markets, and implement strategies designed to meet their individualized needs. The current and future retirements of millions of Americans are more secure through their advisers' use of derivatives to manage risk or gain customized access to specific asset classes.

## II. OUR PERSPECTIVE

The Association appreciates the Commissions' efforts to ensure the rulemaking process is transparent and that all entities are protected by the proposed rules. We believe that all highly regulated institutional investors should have fair and open access to transparent, vibrant, and liquid markets without additional costs or greater risks. If the regulatory burden is too great for small institutional investors to comply with, or if participation in the marketplace becomes too cost prohibitive, the new regulations could reduce access to the tools a large number of fund and ERISA plans need to meet their fiduciary obligations to diversify investments. Without a diversified portfolio including derivatives products, the pensions for millions of retirees would be less secure and companies, unions, and municipalities may be required to maintain greater reserves to reflect the increased volatility of their accounts.

Furthermore, the Association requests that all final rules ensure that institutional investors have a voice and access as the industry creates these new market infrastructures. Although, as discussed in greater detail below, we agree with a phased-in approach for mandated compliance with new requirements, we support the CFTC's assertion that clearinghouses and trading platforms must provide for client clearing and access *at the same time* for all participants who wish to use the platform.<sup>3</sup> Every participant is highly vested in ensuring the safety and soundness of financial markets, and it is important that various, sometimes disparate, perspectives be given adequate consideration at every level. By encouraging equal access for institutional investors, at the outset, in the development of new market infrastructures, conflicts of interest will be mitigated and transparency will be facilitated by ensuring a level playing field among market participants.<sup>4</sup>

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<sup>3</sup> See [CFTC Staff Concepts and Questions Regarding Phased Implementation of Effective Dates for Final Dodd-Frank Rules](http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/staffconcepts050211.pdf) available at: <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/staffconcepts050211.pdf>.

<sup>4</sup> For example, once clearing rules are implemented, the majority of institutional investors will clear most trades through derivatives clearing organizations ("DCOs"). However, under the proposed rule, customer participants will likely not have a voice on both the Board of Directors and the governance committee at the DCO, but rather one or the other. This voice will also be small; the CFTC is proposing only requiring ten percent of the Board or Committee to be customers of the DCO. By marginalizing the voice of an important group of market participants, the important considerations they bring to the table regarding the safety and soundness of the financial system will be minimized. While customer participants may not contribute to the DCO default fund, they are highly vested in ensuring the continued operations of DCOs, and can be substantially impacted if a DCO improperly measures risk.

### III. DISCUSSION OF PROPOSED REGULATIONS

#### A. Implementation of Dodd-Frank Act Rulemakings

The Association supports the Dodd-Frank Act's objectives of transparency and risk reduction for the derivatives markets, and appreciates the Commissions' thoughtful efforts to implement the numerous rulemakings mandated by the Dodd-Frank Act. While the Association plans to submit a formal comment letter focusing on a proposed timeline for implementing the Dodd-Frank Act, the Association wishes to make a few points related to implementation in advance of that comment letter.

We agree with the concepts enumerated in the CFTC Staff Concepts and Questions Regarding Phased Implementation of Effective Dates for Final Dodd-Frank Rules,<sup>5</sup> released prior to the roundtable hosted by the CFTC and the SEC on May 3 and May 4, 2011. In particular, the Association agrees with the CFTC that a phased-in implementation approach is essential to ensuring minimal market disruption and optimal risk reduction.<sup>6</sup> We believe that market infrastructure must be in place prior to requiring market participant compliance. The Association supports the CFTC's conclusion that many non-swap dealer or major swap participant ("MSP") financial entities may need more time to comply with the new regulatory requirements than swap dealers or MSPs.<sup>7</sup> We also agree that the phasing process should not limit immediate access to new infrastructure, and believe that our clients must be able to utilize this new infrastructure, if they so choose, as early as any other market participant.<sup>8</sup>

Perhaps most importantly (and discussed more extensively below), the Association agrees that some Dodd-Frank Act proposed rules should be based on an analysis of data the CFTC has not yet collected.<sup>9</sup> In particular, we believe that rulemakings related to block trades and position limits should be guided by data the CFTC will soon begin collecting from swap data repositories ("SDRs").

The Association believes that it may take up to two years to implement the final rulemakings once they are released, due in large part to the substantial efforts required to conduct the renegotiation of tens of thousands of contracts between clients and counterparties. There is potential for a "bottle-neck" both in the document negotiation process and in moving to clearing. The bandwidth available for the parties to negotiate the new required contract terms simply has practical limitations. Likewise, it may be impractical for all entities to begin clearing at the same time.<sup>10</sup> Currently, ISDA

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<sup>5</sup> See CFTC Staff Concepts and Questions Regarding Phased Implementation of Effective Dates for Final Dodd-Frank Rules.

<sup>6</sup> See *Id.*

<sup>7</sup> See *Id.*

<sup>8</sup> See *Id.*

<sup>9</sup> See *Id.*

<sup>10</sup> There is also concern among asset managers that it may be difficult or even impossible to process accounts at swap clearinghouses overwhelmed with an influx of documentation and applications. See the comment letter submitted by SIFMA, together with the Futures Industry Association ("FIA"), the International Swaps and Derivatives Association ("ISDA") and the Financial Services Forum regarding the phase-in schedule for Title VII (May 4, 2011), available at: <http://www.futuresindustry.org/downloads/TitleVII-ImplementationLetter.pdf>.

agreement negotiations take up to a year to complete for certain of our clients. To renegotiate each of our clients' contracts could take just as long. In order to speed up these negotiations and the implementation process, it would be helpful for certain categories of terms to be included in the documents. We recommend the agreements to be similar to the ISDA master agreement and schedule. While we firmly believe it is important that our clients have the ability to negotiate, negotiations could take longer unless a comprehensive template serves as a starting point for discussions.

## **B. Block Trade Sizes and Reporting Requirements**

To date, the marketplace has not seen sufficient collection and analysis of swap trading data on which to base determinations regarding block trade size thresholds. We believe that the CFTC might be best served by considering sequencing implementation of the reporting rules, first implementing Parts 45 and 49, the proposed rules on SDRs.<sup>11</sup> Then, after the CFTC has collected and analyzed sufficient data to study the market, the CFTC may effectively implement block trading and real-time reporting requirements.<sup>12</sup> By first implementing the SDR reporting requirements and collecting data prior to implementing final rules related to block trading, the CFTC can analyze the data and determine the correct block size thresholds so that disclosure of the trades does not impact liquidity, while also providing the market with sufficient time to prepare clients for implementation.

If the final rules set block trade sizes too high, the benefits of doing a large trade may be negated, and costs will ultimately be increased for institutional investors. Among the greatest consequences to block trading sizes being set too high is the potential for reduction of liquidity. High block trading sizes will require additional trades to be executed through swap execution facilities ("SEFs"), which will limit liquidity and, under the CFTC's proposed rules, limit modes of execution, constraining the facilities from executing transactions in a manner that fosters the formation of liquidity.<sup>13</sup>

To avoid these problems, the Association requests the CFTC collect market data for one year prior to implementing any rulemakings related to block trades. In the alternative, should the CFTC determine that it is unfeasible to wait for this data collection, the Association requests that the CFTC initially set block trade sizes low, and from this starting point begin to collect data to determine an appropriate block trade size.<sup>14</sup> Without adequate market data, there is the possibility that block

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<sup>11</sup> See Swap Data Repositories, 75 Fed. Reg. 80,898 (Dec. 24, 2010) and Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. 76,574 (Dec. 8, 2010).

<sup>12</sup> See Real-Time Reporting of Swap Transaction Data, 75 Fed. Reg. 76,930 (Dec. 10, 2010). The Association notes that SIFMA AMG also agrees that the CFTC should sequence implementation of the real-time reporting rules after the SDR rules in order to collect sufficient information to set block thresholds and time delays. See SIFMA AMG's February 7, 2011 comment letter submitted in response to the CFTC's proposed rules on "Real Time Public Reporting of Swap Transaction Data," "Swap Data Recordkeeping and Reporting," and "Swap Data Repositories," available at: <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27614&SearchText=>.

<sup>13</sup> See Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1214, at 1220 (Jan. 7, 2011).

<sup>14</sup> For additional discussion regarding setting block trading sizes low and collecting data prior to determining appropriate block trading sizes, please refer to Vanguard's comment letter submitted on February 7, 2011, in response to the CFTC's proposed rules "Swap Data Recordkeeping and Reporting Requirements" and "Real-Time Public Reporting of Swap Transaction Data," available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27596&SearchText=>.

trading sizes will be set artificially high in the short term, causing greater, potentially negative, impacts on the marketplace.

For these reasons, the Association hopes that during the first year of calculating block size thresholds, the CFTC will be sensitive to tailoring thresholds to the specific liquidity characteristics of products to ensure that the calculations do not yield unnaturally high results. The Association has considered appropriate thresholds for interest rate swaps, products whose trading characteristics are particularly well understood by our members, and believes it would be appropriate for block trading thresholds for interest rate swaps to be set on a sliding scale, based on tenor. For example, the following limits could be utilized for interest rate swaps: For 0-5 year interest rate swaps, it may be appropriate to set the limit at approximately \$100 million. For 5-10 year interest rate swaps, the threshold might be approximately \$50 million and for 10-30 year interest rate swaps, the appropriate threshold could be approximately \$25 million. These thresholds should ensure liquidity and avoid the potential for “front-running” in the market. Then, after a sufficient amount of data has been collected and the appropriateness of the CFTC’s proposed block trading calculation methods can be determined, a new system may be feasible.

The Association is also concerned about the request for quote (“RFQ”) process, which requires that a request be sent to five or more market makers. If asset managers are required to go to five market makers prior to making a deal on behalf of our clients, each of those market makers will know that four others are also being approached about the same deal. Such a situation increases the potential for information leakage and “front-running” and makes it likely that the price of the instrument will move against our clients because each of the other four dealers is tipped off that the trade will occur.<sup>15</sup> If the final rules promote “front-running” practices, the benefits of doing a large trade may be negated, increasing the costs for institutional investors. Currently, large trading blocks are not constrained by a market size consideration because dealers are willing to blend the redistribution of the trade among other market flows and spread risk among their networks over a period of time. Ultimately, these changes will likely drive up costs for the end investor.

To address this issue, the Association suggests a “one or more” approach to the RFQ model. This approach would resolve the concerns about diminished liquidity and reduce the potential for “front-running.” The proposed five-request minimum is both arbitrary and prescriptive. We believe that advisers to institutional investors, given their legal and fiduciary duties, are best suited for determining the appropriate number of participants in which to send a request. We would encourage the CFTC to look to the SEC’s proposal as support for a “one or more” RFQ model.<sup>16</sup>

### **C. Legal Entity Identifier/Unique Counterparty Identifier**

The Association supports the efforts of the Commissions and other regulators to create a single coordinated legal entity identifier (“LEI”) system for identification of entities. We believe this

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<sup>15</sup> The Association notes that SIFMA AMG also agrees that there are practical difficulties with the five quote requirement that will ultimately increase the costs for institutional investors. *See* SIFMA AMG’s March 8, 2011 comment letter submitted in response to the CFTC’s proposed rule “Core Principles and Other Requirements for Swap Execution Facilities,” *available at*:

<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=31341&SearchText=>

<sup>16</sup> *See* Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10,948 (Feb. 28, 2011).

system is key to the rulemaking process because it provides the Commissions with the ability to view the marketplace as a whole and understand the full activities of market participants.

As the Commissions work with the industry to develop a LEI system, the Association believes there are certain complexities that must be considered. Harmonization of systems is among our top concerns. We request that the CFTC consider the LEI system when issuing requirements for the SDR unique counterparty identifier (“UCI”) system. Substantial work will be required to harmonize the connectivity and software requirements among market participants when finalizing the LEI/UCI system rules. As it appears unlikely that the LEI system will be complete in time for the launch of SDRs, a UCI system will be needed as a stopgap until this system is created. By considering the needs of both systems simultaneously, the industry will only have to initiate one process.<sup>17</sup> Further, we believe it is essential that there is a global consensus for an international LEI system. Without international harmonization regarding LEIs, it will be virtually impossible for the CFTC to get a full picture of entities’ positions, leading to reduced transparency and frustrating the CFTC’s oversight efforts.<sup>18</sup> In addition, duplicative and burdensome reporting requirements may further encourage businesses to move to foreign markets.

Regarding investment trusts, we also believe that each series or portfolio within each trust should be given its own LEI/UCI number to address possible confusion between series or portfolios within the same trust. Each portfolio is distinct with its own separate assets and liabilities.

Perhaps most important to the Association, the LEI/UCI system must consider privacy issues surrounding asset managers and the division of one legal entity’s assets among several asset managers. A typical institutional investor has a number of different institutional investment advisers managing different sleeves of the institutional investors’ funds. Although the LEI system is meant to provide the CFTC with complete data on the legal entity, it is important to the buy-side industry for the identity and specifics regarding funding invested with various asset managers to remain private. The Association supports efforts by DTCC and others in their work to create a system whereby the total of the information “rolls-up” in some form to the same LEI, while permitting anonymity among asset managers and their clients regarding specific investments.

#### **D. Definition of Major Swap Participant and Major Swap Participant Testing**

The Association supports limiting the definition of MSP to those entities that “pose a *high degree* of risk to the U.S. financial system generally.”<sup>19</sup> The Commissions have informally indicated that the

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<sup>17</sup> Several agencies including the CFTC and SEC, are working to create data identification system regulations. The Association joins with other groups, including SIFMA AMG, in asking for coordinated efforts between regulators to create a single, coherent approach to entity identification. See SIFMA AMG’s February 7, 2011 comment letter submitted in response to the CFTC’s proposed rule “Real Time Public Reporting of Swap Transaction Data,” “Swap Data Recordkeeping and Reporting,” and “Swap Data Repositories.”

<sup>18</sup> The Depository Trust & Clearing Corporation (DTCC) has stated that the UCI system is necessary in order for regulators to accurately track exposures between counterparties to swaps. See DTCC’s February 7, 2011 comment letter submitted in response to the CFTC’s proposed rule “Swap Data Recordkeeping and Reporting Requirements,” available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27621&SearchText=>.

<sup>19</sup> See Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant,” and “Eligible Contract Participant,” 75 Fed. Reg. 80,174 at 80,185 (Dec. 21, 2010). (italics added).

definition of MSP should be limited to a select few entities that pose systemic risk.<sup>20</sup> The Association supports this interpretation, and agrees with the Commissions that the MSP definition should not apply to asset managers or investment advisers trading on behalf of clients, but rather “apply to the entities that actually ‘maintain’ substantial positions in swaps or security-based swaps.”<sup>21</sup> We believe that it was not the intent of Congress to include entities such as investment advisers under the MSP definition, and we encourage the Commissions to explicitly recognize this in the final rule. Moreover, our highly regulated clients, such as RICs and ERISA and government benefit plans, do not pose the types of risks responsible for the recent financial crisis.<sup>22</sup>

Further, the Association believes that absent an exemption from MSP status or a safe harbor from daily testing requirements, many entities with swap activities that will never present a high degree of risk to the U.S. financial system will be forced to perform the proposed MSP tests daily. Many of our clients’ swaps are fully collateralized and/or use netting agreements, virtually ensuring the test results will never approach the MSP thresholds. Upon implementation of final rules on clearing, most standard swaps will also be centrally cleared, making it even less likely that market participants that use these instruments could reach the uncleared, uncollateralized levels necessary to fall under the definition of MSP. Although the Commissions may not have intended to make all entities perform these onerous tests daily, there is confusion in the marketplace regarding which entities are subject to these testing requirements and how often the tests must be performed.

To mitigate concerns about unnecessary testing requirements, and the associated costs, the Association requests that the Commissions provide a reasonable safe harbor stating that unless swap activity nears the mandated thresholds, performance of daily calculations is not required for the purposes of the test. To clarify the testing responsibility, we recommend that an entity need not perform MSP calculations with respect to an individual major swaps category unless an entity has a swaps portfolio with a gross notional amount equal to or greater than the applicable exposure threshold for such category. Once such entity’s swaps portfolio has such a gross notional amount, it need only perform a monthly performance test until such time as the calculations yield a result equal to or greater than 50% of the applicable threshold, at which point these calculations must be performed on a daily basis.<sup>23</sup>

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<sup>20</sup> For example, in testimony before the House Agriculture Committee, CFTC Chairman Gary Gensler stated that, “the major swap participant category is very clearly limited only to those non-swap dealer entities that have risk large enough to pose a threat to the U.S. financial system.” Chairman Gensler added that the category of MSPs will include only a “handful of entities.” Chairman Gensler’s testimony before the House Agriculture Committee (May 31, 2011), *available at*: <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-76.html>.

<sup>21</sup> See Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant,” and “Eligible Contract Participant,” 75 Fed. Reg. 80,174 at 80,201.

<sup>22</sup> See Fidelity’s comment letter submitted in response to the SEC and CFTC joint proposed rule “Further Definition of ‘Swap Dealer,’ ‘Security-Based Swap Dealer,’ ‘Major Swap Participant,’ ‘Major Security-Based Swap Participant,’ and ‘Eligible Contract Participant,’” (Feb. 22, 2011), *available at* <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27838&SearchText=>.

<sup>23</sup> For additional information on calculations for the safe harbor, please refer to Vanguard’s comment letter submitted in response to the SEC and CFTC joint proposed rule “Further Definition of ‘Swap Dealer,’ ‘Security-Based Swap Dealer,’ ‘Major Swap Participant,’ ‘Major Security-Based Swap Participant,’ and ‘Eligible Contract Participant,’” (Feb. 22, 2011), *available at* [://comments.cftc.gov/PublicComments/ViewComment.aspx?id=28000&SearchText=](http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=28000&SearchText=).

### III. CONCLUSION

The Association recognizes the challenges of the Commissions' and staff's efforts to increase market transparency without reducing liquidity and to mitigate systemic risk while protecting open market access for all participants. Further, we support early, open, and universal access to new market facilities supported by balanced, practical, and prudent phasing of mandates for conversion of specific classes of participants and activities. The Association thanks the Commissions for the opportunity to comment on these proposed rules. Please feel free to contact me with any questions you may have on our comments at [jgidman@loomissayles.com](mailto:jgidman@loomissayles.com) or (617) 748-1748.

On behalf of the Association of  
Institutional INVESTORS,

A handwritten signature in black ink, appearing to read "John R. Gidman". The signature is written in a cursive style with a long, sweeping underline.

John R. Gidman

cc: Gary Gensler, Chairman, Commodity Futures Trading Commission  
Mary Schapiro, Chairman, Securities and Exchange Commission  
Michael Dunn, Commissioner, Commodity Futures Trading Commission  
Bart Chilton, Commissioner, Commodity Futures Trading Commission  
Jill Sommers, Commissioner, Commodity Futures Trading Commission  
Scott O'Malia, Commissioner, Commodity Futures Trading Commission  
Luis Aguilar, Commissioner, Securities and Exchange Commission  
Kathleen Casey, Commissioner, Securities and Exchange Commission  
Troy Paredes, Commissioner, Securities and Exchange Commission  
Elisse Walter, Commissioner, Securities and Exchange Commission