

July 15, 2011

Via E-mail ([www.comments.cftc.gov](http://www.comments.cftc.gov))  
Commodity Futures Trading Commission  
David A. Stawick, Secretary  
Three Lafayette Center  
1155 21<sup>st</sup> Street NW  
Washington DC 20581

Re: “Capital Requirements and Financial Condition Reporting for Swap Dealers and Major Swap Participants,” 76 Fed. Reg. 27802 (May 12, 2011) (RIN 3038-AD54)

Dear Mr. Stawick:

I appreciate the opportunity to comment on the Commodity Futures Trading Commission’s (“Commission”) Notice of Proposed Rulemaking on capital and related reporting requirements for Swap Dealers (“Proposed Rulemaking”).<sup>1</sup> I write not as a representative of any specific group, company, exchange, or futures self regulatory organization but as a 35 year veteran of the exchange traded and cleared futures and futures options industry who is involved in some way or another with all of these categories. I wholeheartedly support the Commission’s efforts to implement those provisions of the Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)<sup>2</sup> designed to bring much needed regulation, transparency and oversight to the over-the-counter derivatives market and I greatly appreciate all of the efforts of the Commission and staff to write the definitions, rules, and regulations for the inclusion of over-the-counter (OTC) products into our industry. I believe that the financial industry, the system, and our country will be all the better because of your efforts.

I write specifically to you about the rulemaking and regulations regarding swap dealers. It has been pointed out to the commission that there is a great distinction between those persons and entities that trade *cleared* futures, options, and OTC contracts on transparent execution facilities (designated contract markets or DCM and swap execution facilities or SEF) and those who are engaging in *bilateral*

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transactions. Persons that engage in dealing with customers on a bilateral basis are engaging in a far different activity than those who are trading on platforms that monitor the activity of the executions and whose products are held by an intermediary futures commission merchant (FCM) in a central clearing party (CCP) (Intercontinental Exchange and CME's Clearport, for instance). Swap dealers that take positions as a direct counterparty should have much different regulatory standards than those who simply buy and sell in markets that are centrally cleared. In the DCM and SEF executed and centrally cleared space, the intermediary FCM bears the financial risk and the trade activity is closely monitored. As we all well know, it was bilateral transactions that caused the problems for our financial markets--not the cleared products. This point cannot be over-emphasized.

Having reminded the commission of this important distinction, I would like to point out that the activity of market making and trading on exchanges and SEF's in an electronic world today is somewhat similar to the activity of a floor trader on an exchange. What is not well known is the fact that floor brokers (FB) and floor traders (FT) (the high frequency traders of yesteryear) are required to be registered with the National Futures Association (NFA). There are no capital requirements, no specific audit requirements, and there are no complex rules surrounding the activities of FT or FB (after all, it is their money). However, as they are required to be registered they must maintain a certain level of proficiency, must maintain professional standards, and most importantly are subject to scrutiny and sanction. They are monitored and must abide by exchange rules as approved by CFTC.

It seems to me that the evolution of and, therefore, the transition of market maker trading activity has been from floor trader to mostly electronic prop trading firms, commonly called principle trading groups ("PTG"). These companies are often referred to today as high frequency traders. If indeed my observation is correct, then it would only stand to reason that the prop trading firms would be required to be registered as principle trading companies with NFA in a category that would be an extension of Floor Trader and Floor Broker registration. The principle trading companies are all members of the exchanges (if they are of any materiality at all) as are the floor traders and floor brokers. The conduct of the exchange members is closely scrutinized by the exchanges. The new registration category of "Principle Trading Company" could easily be handled by NFA. If memory serves, Cantor Fitzgerald used the floor broker registration in the 1990's for principle trading on terminals and the details of that application as approved by CFTC and NFA could be reviewed. Aside from looking forward to the envisioned swaps activity, the requirement to register would bring some current HFT firms into the registered world who are not in any way currently registered.

There are no capital requirements set by the CFTC for floor traders or floor brokers and yet this system has worked remarkably well. In the mid 1970's the primary dealers of US government debt did not want the small operators (local individual members) on the floors of the Chicago futures exchanges entering the domain of market making in futures of the government securities markets. The exchanges innovated the products, the clearing members of the exchange clearing houses provided the credit, and the local floor traders immediately were able to dramatically tighten the spread of bid and offer in debt instruments of the US government. This development made for much tighter markets, much deeper liquidity, and much greater transparency, all allowing the US government to borrow a great deal more money ...but that is another story.

What I'm proposing is the establishment of two categories of OTC traders: Swap Dealers and Professional Trading Companies. Swap dealers who have customers as counterparties should be *regulated*. Principle traders who trade only on SEF's and Designated Contract Markets should be *registered*. The distinction of the activities should be *recognized*.

I hope that my suggestion to register the principle trading companies with NFA in similar fashion to the current system for floor brokers and floor traders while regulating swap dealers is one that his helpful to you. I'm very grateful for your attention into this and for your work.

Sincerely,

Christopher K. Hehmeyer