MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

July 22, 2011

Via Electronic Submission: http://comments.cftc.gov
http://www.sec.gov/rules/proposed.shtml

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

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: RIN No. 3038-AD46; RIN No. 3235-AL14: Further Definitions of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping.

Dear Mr. Stawick and Ms. Murphy:

Managed Funds Association ("**MFA**")[1] appreciates the opportunity to provide comments on the rules proposed jointly by the Commodity Futures Trading Commission (the "**CFTC**") and the Securities and Exchange Commission (the "**SEC**") (together, the "**Commissions**") regarding their proposed rule and interpretive guidance on the further definitions of the terms "Swap," "Security-Based Swap," and "Security-Based Swap Agreements"[2] (the "**Proposed Rule**") under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**").[3]

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $2.0 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

[2] Joint Proposed Rule; Proposed Interpretations "Further Definitions of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping," 76 Fed. Reg. 29818, May 23, 2011 (the "**Proposing Release**"**)**, available at http://www.cftc.gov/ucm/groups/public/@federalregister/documents/file/2011-11008a.pdf).

[3] Pub. L. 111-203, 124 Stat. 1376 (2010).

I. General and Summary

As the Commissions noted in the Proposing Release,[4] the definition of these important terms under Dodd-Frank will significantly affect the evolving markets for swaps and security-based swaps (together, "**Swaps**") and the conduct of participants in these markets. MFA emphasizes that it supports the Commissions' general approach to the definitions as set forth in the Proposed Rule. We submit this comment letter to request further guidance on certain aspects of the Proposed Rule, particularly the manner in which the Forward Contract Exclusion will apply to the commodities covered by the 1993 Energy Exemption. We also respectfully urge the Commissions to exclude from the definition of Swaps all loan participations. Our comments are intended to assist the Commissions in adopting a final rule that captures only the specific market participants intended, taking into account reasonable projections in market activity and growth. We believe that small changes and clarifications will create a more pointed regulation, consistent with the Commissions' goal of monitoring and overseeing OTC derivatives markets and entities that could pose systemic risk to the United States financial markets.

II. Forward Contract Exclusion

We strongly support the CFTC's consistent interpretation of the Forward Contract Exclusion and its treatment of the book-out contracts prevalent in certain commodities markets. We also write to request clarification about the CFTC's proposed withdrawal of the Energy Exemption, particularly the implications of this action for market participants.

A. Support for the CFTC's Interpretation of the Exclusion

We write to express our support for the Commissions' analysis of the Forward Contract Exclusion. Section 721(a) of Dodd-Frank excludes "any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled," from the definition of swaps. Congress explicitly excluded forward contracts from the additional regulations imposed by Dodd-Frank because these transactions do not subject the market to the kind of risk Dodd-Frank aimed to alleviate. According to the Proposing Release, the CFTC reads the "intended to be physically settled" language to require that the Commissions consider evidence of an intent to deliver a physical commodity in the analysis of whether a particular contract meets the definition of a forward contract exempt from Dodd-Frank. We believe that the CFTC's interpretation of forward contracts is in line with settled legal understandings and creates valuable consistency among the Commissions' diverse regulatory efforts.

The Proposing Release also provides clarification regarding the treatment of "book-out" transactions and we strongly support the CFTC's interpretation of this issue. The parties in a commodity deal sometimes enter into book-outs in addition to their main contract. Book-outs allow either party to terminate and forego delivery on the main contract, in favor of a negotiated payment-of-differences. According to the CFTC's 1990 Brent Interpretation, at any point in the

[4] 76 Fed. Reg. at 80175.

chain, one of the parties could refuse to enter into a new contract to book-out the transaction and instead insist upon delivery pursuant to the parties' obligations under their original contract. [5] According to the Proposing Release, "the principles underlying the Brent Interpretation similarly should apply to the forward contract exclusion from the swap definition with respect to nonfinancial commodities." Under Dodd-Frank, "book-out" transactions will qualify for the forward exclusion for market participants that regularly make or take delivery of non-financial commodities in the ordinary course of their business, so long as the book-out transaction is effectuated through a subsequent, separately negotiated agreement. We believe that the CFTC acts prudently in extending the rationale of the Brent Interpretation to cover forward contracts exempt from Dodd-Frank.

B. Proposed Withdrawal of the 1993 Energy Exemption

We also write to request clarification on the application of the forward contract exclusion to certain energy commodities. In 1993, the CFTC issued an order exempting certain energy contracts from regulation under the Commodity Exchange Act (the "**CEA**") by extending the Brent Interpretation to cover energy commodities other than oil (the "**1993 Energy Exemption**"). Under the Proposed Rules, the CFTC would withdraw the 1993 Energy Exemption because the "book-out provisions of the Brent Interpretation similarly should apply to the forward contract exclusion from the swap definition for nonfinancial commodities." However, the Proposing Release does not explain the rationale for withdrawing the 1993 Energy Exemption or the possible consequences for energy market participants. We are concerned that removing the Energy Exemption will have unintended adverse consequences on the market for energy commodities and we request clarification that the withdrawal of the 1993 Energy Exemption will not harm market participants that relied on the 1993 Energy Exemption in the past. Therefore, we seek confirmation that despite the withdrawal of the 1993 Energy Exemption, market participants will be permitted to rely on the Brent Interpretation, as it was expanded by the 1993 Energy Exemption, particularly as it relates to alternative delivery procedures.[6]

III. Loan Participations

The Proposing Release contains interpretive guidance on the treatment of loan participations. A loan participation will not qualify as a Swap when the purchaser acquires: (i) a current or future direct or indirect ownership interest in the underlying loan; and (ii) a beneficial ownership interest in the underlying loan (a so-called "true participation"). The Commissions will also exclude from the definition of a Swap a loan participation that is regulated as a security under the federal securities laws or identified banking products under section 403(a) of the Legal

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[5] Statutory Interpretation Concerning Forward Transactions, 55 FR 39188, Sept. 25, 1990.

[6] While the Brent Interpretation was limited to forward transactions that did not result in physical delivery due to cancellation or netting of the physical delivery obligation between parties (i.e., book-outs), the 1993 Energy Exemption applied to a broader range of transactions that did not result in actual physical delivery of the commodity, including transactions that were settled by the parties other than through physical delivery.

Certainty for Bank Products Act of 2000,[7] as amended by Dodd-Frank. We respectfully urge the Commissions to ensure that *all* loan participations fall outside the scope of the definition of a Swap. We believe that defining any loan participations as a Swap could disrupt, or even destroy, the market for these agreements, and harm loan markets.

A. LSTA-Style and LMA-Style Loan Participations Should Be Treated Alike

In both the U.S. and Europe, "participation agreements," alongside "assignment and assumption agreements," are used to transfer the economic benefits and risks of a bank loan from a seller (the "**grantor**") to a buyer (the "**participant**"). In the U.S, participation agreements are often modeled on templates published by The Loan Syndications & Trading Association (the "**LSTA**") based in New York. In Europe (and often Asia), participation agreements are modeled on templates published by the London-based Loan Market Association (the "**LMA**"). Under both LSTA- and LMA-style participation agreements, the grantor remains the "lender of record" under the loan agreement, and passes to the participant all loan payments received by the grantor. Under both forms of participation agreement, a participant is often entitled to direct the grantor's acts and decisions as a lender under the loan agreement. An LSTA-style participation provides for the sale of the underlying loan by the grantor and a purchase by the participant, which is "intended to effect a 'true sale' of the loan from the grantor to the participant and put the participant's beneficial ownership interest in the loan beyond the reach of the grantor's bankruptcy estate."[8] On the other hand, an LMA-style participation does not effect a "true sale" of the loan, but rather "creates a current debtor-creditor relationship between the grantor and the participant under which a future ownership interest is conveyed."[9]

As discussed above, the Proposing Release notes that the Commissions will not include within the definition of swap or security-based swap loan participations in which the purchaser acquires: (i) a current or future direct or indirect ownership interest in the underlying loan; and (ii) a beneficial ownership interest in the underlying loan (a so-called "true participation"). Therefore, LSTA-style participations would not be defined as swaps or security-based swaps. However, the Proposing Release notes that "The grantor of an LMA-style participation does not grant an ownership interest in the loan to the participant."[10] As a result, it is unclear whether LMA-style participations would be treated as "true participations." We write to urge the Commissions to treat these two types of loan participations alike under the new rules and we strongly urge the Commissions to ensure that neither LSTA-style nor LMA-style loan participations are defined as Swaps.

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[7] 7 U.S.C. 27a(a).

[8] 76 Fed. Reg. 29834 (May 23, 2011), quoting the letter from R. Bram Smith, Executive Director, The Loan Syndications and Trading Association, Jan. 25, 2011 (the "January LSTA Letter).

[9] *Id*., quoting the January LSTA Letter and the letter from Elliot Ganz, General Counsel, The Loan Syndications and Trading Association, Mar. 1, 2011.

[10] *Id*., at footnote 113, citing Jon Kibbe, Julia Lu and Carl Winkworth, Richards Kibbe & Orbe, LLP, "Dodd-Frank Crosses the Pond: Unintended Consequences for LMA–Style Loan Participations?" 3 (Nov. 12, 2010) ("The grantor of an LMA-style participation does not grant an ownership interest in the loan to the participant.").

B. Proposed Interpretative Guidance on Loan Participations

We believe there are two central features of all loan participations that provide a clear standard to distinguish them from other financial products, such as loan total return swaps, and these features should form the basis of the Commissions' guidance as to what constitutes a loan participation. First, a central feature of a loan participation is the grantor's actual ownership of the underlying loan. A grantor of a loan participation must represent to the participant that it owns the loan that is subject to the participation. However, under a loan total return swap, the total return receiver must acknowledge that the total return payer has no obligation to own the reference loan.

Second, the participant under a loan participation agreement pays the full purchase price for the loan on the transaction closing date. The grantor does not extend financing to the participant and the participant does not lever its purchase by posting collateral to secure a future obligation to pay the full purchase price. However, a loan total return swap is designed to allow the total return receiver to gain synthetic exposure to the reference loan on a levered basis, and is not used as a loan transfer mechanism.

These features illustrate that loan participations and loan total return swaps are economically and legally distinct structures, and serve entirely different functions in the loan market. To ensure that loan participations are not captured within the definition of Swap, we believe that the Commissions should adopt the following interpretive guidance drafted by the LMA that is supported by the LSTA, to ensure that the loan participations would not fall under the definition of Swap.[11] Under the proposed guidance, the definition of Swap would not include loan participations in which:

(i) the purchaser is acquiring a current or future direct or indirect ownership interest in the related loan or commitment; and

(ii) the agreement pursuant to which the purchaser is acquiring such an interest:

(a) is a participation agreement that is, or any similar agreement of a type that has been, is presently, or in the future becomes, customarily entered into in the primary or secondary loan markets;

(b) requires the grantor to represent that it is a lender under, or a participant or sub-participant in, the loan or commitment;

(c) provides that the participant is entitled to receive from the grantor all of the economic benefit of the whole or part of a loan or commitment to the extent of payments received by the grantor in respect of such loan or commitment; and

[11] *See* letter from Clare Dawson, Managing Director, The Loan Market Association, July 22, 2011.

(d) requires that 100% of the purchase price calculated with respect to the loan or commitment is paid on the settlement date.

We believe that the proposed interpretation would protect loan participations from being defined as a Swap, while ensuring that financial products that do not meet the above-defined criteria could be considered a Swap, depending on the nature of that product. The failure to provide proper guidance as to what constitutes a loan participation would inadvertently force certain forms of loan participations to be treated as a Swap, adversely impacting the entire loan participation market. We believe that this proposed interpretative guidance would avoid such an outcome.

C. Defining LMA-Style Loan Participations as Security-Based Swaps Will Have a Negative Impact on the Market

Defining loan participations as a Swap will subject these agreements to significant regulatory requirements and will adversely impact the loan markets. If LMA loan participations are defined as security-based swaps, they would fall under the Dodd-Frank requirements of central clearing and exchange trading, and market participants that enter into these loan participations would be subject to capital, margin, reporting, recordkeeping and business conduct requirements. The "sale" of a security-based swap, which includes entering into, terminating, amending or transferring the security-based swap, will be subject to the registration requirements of Section 5 of the Securities Act of 1933 (the "**Securities Act**"), unless both counterparties are "eligible contract participants" as defined in the CEA. If applied to LMA-style participations, these rules would be extremely disruptive to the market. The expense and administrative burden of ensuring compliance could result in a large number of market participants exiting the market entirely. It would also remove flexibility for lenders and raise the barrier to entry for new investors.

Furthermore, if LMA loan participations are security-based swaps, they will be defined as "securities" under the Securities Act and the Securities Exchange Act of 1934 (the "**Exchange Act**") and would be subject to the requirements of Section 10(b) of the Exchange Act and related new provisions added by Dodd-Frank, including the new Section 9(j) of the Exchange Act. As a result of these provisions, parties to LMA loan participations would be prohibited from entering into a participation while in possession of material non-public information without first disclosing that information to the counterparty or confirming that the counterparty has access to the same information. Since the European loan market is largely a "private" market, with very little public information about borrowers or their loan agreements, it is difficult to conceive, at this time, how parties could transact in loans based on public information only, except in the rare case where adequate information is publicly available. As a result, parties would be forced to publicly trade LMA-style participations to avoid antifraud liabilities under Dodd-Frank, which would hinder a borrower's ability to raise capital in the loan markets. Defining a loan participation as a security-based swap would also impact European borrowers' disclosure obligations in the capital markets and the liabilities of loan arrangers in the syndication process.

These changes would likely send a wave of negative economic feedback into the U.S. loan markets.

Without clarification from the Commissions that LMA-style participations are not security-based swaps, the burden of this regulatory scheme would effectively prohibit the use of the loan participation as an alternative transfer structure, and the syndicated loan market would need to move towards settlement by assignment only. This would remove flexibility in trade settlement, lead to protracted settlement times, and potentially freeze participants out of the market.

D. Extraterritorial Impact

In both the United States and Europe, loan participations are an alternative form of transfer structure to the conventional loan assignment and serve essentially the same function in the market. Loan assignments are not, however, covered by Dodd-Frank and it therefore seems illogical that Title VII of Dodd-Frank would regulate loan participations, but not loan assignments.

We also believe that the impact imposed on European investors by Dodd-Frank, if LMA-style participations were defined as security-based swaps, would have a detrimental effect on liquidity in the U.S. market. European banks and institutional investors enter into participations with U.S. domiciled counterparties as readily as they do with non-U.S. counterparties (and vice versa). The syndicated loan market, of which participations are a vital component, is very much an integrated global market and therefore we stress that regulating loan participations as security-based swaps would have a damaging effect on the loan markets and all investors in the loan markets, thereby hindering a borrower's ability to raise capital in the loan markets.

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MFA thanks the Commissions for the opportunity to provide comments regarding the Proposed Rule. Please do not hesitate to contact Jennifer Han or the undersigned at (202) 730-2600 with any questions the Commissions or their staff might have regarding this letter.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director, General Counsel

cc: The Hon. Mary Schapiro, SEC Chairman
The Hon. Kathleen L. Casey, SEC Commissioner
The Hon. Elisse B. Walter, SEC Commissioner
The Hon. Luis A. Aguilar, SEC Commissioner
The Hon. Troy A. Paredes, SEC Commissioner

The Hon. Gary Gensler, CFTC Chairman
The Hon. Michael Dunn, CFTC Commissioner
The Hon. Bart Chilton, CFTC Commissioner
The Hon. Jill E. Sommers, CFTC Commissioner
The Hon. Scott D. O'Malia, CFTC Commissioner