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

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**Via Electronic Submission:** http://comments.cftc.gov

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

**Re: RIN No. 3038–AD51: Customer Clearing Documentation and Timing of Acceptance for Clearing; and RIN No. 3038–AD51: Clearing Member Risk Management**

Dear Mr. Stawick:

Managed Funds Association[1] appreciates the opportunity to provide comments on the Commodity Futures Trading Commission's (the "**Commission**") proposed rules on customer clearing documentation (the "**Proposed Documentation Rules**") and timing of acceptance for clearing (the "**Proposed Timing Rules**"),[2] as well as the Commission's proposed rules on clearing member risk management (the "**Proposed Clearing Member Risk Management Rules**", and together with the Proposed Documentation Rules and the Proposed Timing Rules, the "**Proposed Rules**"),[3] under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").[4] We strongly support the Proposed Rules and believe that they are a critical step towards addressing the comments raised by MFA in our comment letter to the

[1] The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

[2] Commission Notice of Proposed Rulemaking on "Customer Clearing Documentation and Timing of Acceptance for Clearing", 76 Fed. Reg. 45730 (Aug. 1, 2011) (the "**Proposing Release**"), available at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-19365a.pdf.

[3] Commission Notice of Proposed Rulemaking on "Clearing Member Risk Management", 76 Fed. Reg. 45724 (Aug. 1, 2011), available at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-19362a.pdf.

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

Commission on its proposed "Requirements for Processing, Clearing, and Transfer of Customer Positions".[5] We encourage the Commission to adopt final rules in the form proposed, with the suggested clarifications discussed in Section V below.

## I. Summary

MFA applauds the Commission for developing and issuing the Proposed Rules, as we believe they are essential to achieving the fundamental objectives of the Dodd-Frank Act: open access to competitive and efficient markets, promotion of greater central clearing of swaps and the reduction of systemic risk.[6]

In particular, we appreciate the Commission's efforts through the Proposed Rules to ensure real-time clearing of trades, reduce counterparty credit risk and prohibit anti-competitive activities, which will benefit all market participants, especially smaller market participants and alternative liquidity providers that would have otherwise encountered barriers to entry.[7] In addition, the Proposed Rules will ensure that market participants develop appropriate systems to facilitate clearing in real time, rather than diverting resources to systems that would impose additional and unnecessary credit sub-limits, thereby fragmenting liquidity, delaying the acceptance of trades for clearing or raising material barriers to access to clearing.

Finally, we agree with the Commission that the Proposed Rules would not prohibit the use of industry-developed documentation, but rather would protect market participants from trilateral clearing agreements or other arrangements that would undermine the fundamental objectives of the Dodd-Frank Act mentioned above. Some market participants have suggested that the Proposed Rules are unnecessary and would supplant industry-developed agreements. To the contrary, we believe that the Proposed Rules are essential to creating a clear framework for the industry to develop systems and arrangements that are consistent with the aforementioned fundamental objectives of the Dodd-Frank Act.

## II. MFA Supports the Proposed Rules

The Proposed Documentation Rules would prevent futures commission merchants ("**FCMs**"), swap dealers ("**SDs**") and major swap participants ("**MSPs**") from requiring customers to enter into agreements that would limit the number of counterparties a customer may trade with, restrict the size of a trade a customer may enter into with any individual counterparty

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[5] *See* MFA's comments on the Commission's Notice of Proposed Rulemaking on "Requirements for Processing, Clearing, and Transfer of Customer Positions", 76 Fed. Reg. 13101 (Mar. 10, 2011) (the "**Proposed Customer Positions Rules**") filed with the Commission on April 11, 2011, available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=35520&SearchText= (the "**MFA April Letter**").

[6] 76 Fed. Reg. 45731.

[7] As discussed below, the concentration of transaction flows in current non-cleared swap markets among the largest dealers makes it difficult for smaller dealers to provide competitive pricing to customers and for smaller customers to receive competitive pricing options.

(aside from its overall credit limit), impair a customer's access to execution on terms that have a reasonable relationship to the best terms available, or compromise the anonymity of a customer's executing counterparty.[8] MFA strongly supports the Proposed Documentation Rules because, as we requested of the Commission in the MFA April Letter, these rules will prohibit documentation that would: (1) impose anti-competitive restrictions; (2) impair access to competitive liquidity and best execution; and (3) compromise anonymity.[9]

Depending on the type of trade, the Proposed Timing Rules would require a derivatives clearing organization ("**DCO**") or a clearing member to accept or reject each trade submitted for clearing "as quickly as would be technologically practicable if fully automated systems were used".[10] In the MFA April Letter, MFA urged the Commission to clarify through rulemaking that a DCO or clearing member must immediately accept or reject a trade upon submission for clearing, regardless of whether or not a trade is subject to mandatory clearing and regardless of the mode of trade execution, and immediately communicate its acceptance or rejection of the trade back to the counterparties to the trade.[11] As the Commission states in the Proposing Release, "[i]f a DCO lists a product for clearing, it should be able to process it regardless of whether clearing is mandatory or voluntary." We, therefore, strongly agree with the Commission requiring a clearing member and a DCO to accept or reject a trade as quickly as would be technologically practicable, *regardless of the venue in which the trade was executed or the mode of execution*, including trades that are executed through bilateral negotiation, whether through or outside of an electronic platform.

The Proposed Clearing Member Risk Management Rules would, among other things, require SDs, MSPs and FCMs that are clearing members to establish credit and market risk-based limits based on position size, order size, margin requirements or similar factors and use automated means to screen orders for compliance with the risk-based limits.[12] MFA is very supportive of these proposed rules given that customer trades must be examined to ensure they are within limits set by the customer's clearing member before they can be cleared. Regardless of where the screening occurs (*e.g.*, at the DCO against customer limits set by the FCM or through a message exchange between the DCO and the FCM), it is essential that FCMs provide automated means for such screening. Automated approaches are an established practice in existing cleared derivatives markets and are necessary to facilitate real-time acceptance or

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8 Sections 1.72 and 23.608 of the Proposed Documentation Rules.

In this context, "anonymity" means that a customer's clearing member does not know the identity of a customer's counterparty, as is the norm in other cleared derivatives markets. A customer may know the identity of its counterparty, for example in executing a block trade, but, as set out in the text further, there is no reason for the customer's clearing member to know, or have an influence on, the customer's counterparty.

9 *See* MFA April Letter at 10-11.

10 Sections 39.12(b)(7)(B) and 23.610 of the Proposed Timing Rules.

11 *Id.*

12 Sections 1.73 and 23.609 of the Proposed Clearing Member Risk Management Rules.

rejection by a DCO and thereby eliminate counterparty credit exposure.[13] Given that automation is also essential to allow cleared markets to function at scale and a number of existing clearing members have this capability for cleared over-the-counter ("**OTC**") derivatives today because automation is the norm in other cleared derivatives markets, we believe that the Proposed Rules provide certainty to the marketplace and will facilitate the transition to real-time clearing by market participants that have not yet developed systems and procedures for real-time clearing. Therefore, we believe that it is critical that the Commission require clearing members to use automated means to screen orders to ensure that they meet the real-time clearing requirement.

## III. Proposed Rules Are Required and Necessary

### 1. Advance Core Goals of the Dodd-Frank Act

According to the Proposing Release:

> A fundamental premise of the Dodd-Frank Act is that the use of properly regulated central clearing can reduce systemic risk. Another tenet of the Dodd-Frank Act is that open access to clearing by market participants will increase market transparency and promote market efficiency by enabling market participants to reduce counterparty risk and by facilitating offset of open positions.[14]

The Proposed Rules will reduce systemic risk and create competitive, efficient and transparent markets as called for by the Dodd-Frank Act. Specifically, providing open access to real-time clearing of trades will promote market efficiency by enabling market participants to reduce their counterparty credit risk without delay and by ensuring unfettered access to the broadest range of executing counterparties, deepest liquidity and competitive pricing. In addition, real-time clearing is essential to market transparency because the absence of immediate clearing certainty compromises the quality of post-trade transparency reporting, and real-time clearing provides a necessary foundation for electronic trading, particularly open, transparent, anonymous, limit order book trading as in listed futures or equity options.

### 2. Required by the Dodd-Frank Act

MFA believes that the Proposed Rules are required by the Dodd-Frank Act, which: (1) expressly requires the Commission to adopt rules governing documentation standards for

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[13] MFA agrees with the Commission's assessment that the "least efficient" method for effecting such checks on a customer's credit limit is for the "DCO to send a message to the clearing member for each trade requesting acceptance or rejection". Nonetheless, some DCOs may adopt such an approach.

[14] *Id*. at 45731.

swap dealers and MSPs;[15] (2) explicitly prohibits practices that impose an unreasonable restraint on trade or material anticompetitive burden on trading or clearing;[16] and (3) requires SDs and MSPs to develop conflict-of-interest safeguards (*e.g.*, informational barriers) with regard to affiliate clearing functions.[17] Without the framework created by the Proposed Rules, we are concerned that, as discussed in the MFA April Letter, counterparties could impose certain forms of customer clearing and execution documentation on their customers that would undermine market integrity. In particular, such documentation could create barriers to real-time clearing and execution of transactions on the best terms that are reasonably available,[18] by limiting the range of executing counterparties or even individual transactions available to buy-side market participants.[19] Such restrictive customer clearing agreements would have the further adverse impact of limiting the ability of alternative liquidity providers to serve the swap markets, as these agreements would inhibit their ability to trade with a substantial portion of buy-side market participants. As a result, the agreements would hamper alternative liquidity providers' ability to offer competitive liquidity, and thereby, restrict execution of customer transactions on terms that have a reasonable relationship to the best terms available for *all* market participants.

### 3. Incentivize Real-Time Clearing and Eliminate Counterparty Credit Risk

MFA strongly supports the Proposed Rules because they incentivize and facilitate real-time clearing, which will bring added efficiency, liquidity and stability to the swap markets. Real-time clearing provides counterparties with immediate certainty as to whether or not the trade has cleared and eliminates bilateral counterparty credit risk, as the counterparties immediately after clearing face the DCO and not each other. As a result, as discussed in the MFA April Letter, real-time clearing allows customers to transact with any eligible counterparty without the need for execution documentation (regardless of whether such documentation is developed between individual counterparties or through an industry-led process), credit

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[15] Section 731 of the Dodd-Frank Act adds new section 4s(i)(2) to the Commodity Exchange Act that states "[t]he Commission shall adopt rules governing documentation standards for swap dealers and major swap participants".

[16] Sections 725(c) and 731 of the Dodd-Frank Act prohibit DCOs and SDs, respectively, from "adopt[ing] any process or tak[ing] any action that results in any unreasonable restraint of trade" or "impos[ing] any material anticompetitive burden on trading or clearing".

[17] Section 731 of the Dodd-Frank Act also requires SDs and MSPs to develop additional partitions between persons "acting in a role of providing clearing activities or making determinations as to accepting clearing customers" from persons involved in "pricing, trading or clearing activities".

[18] Under the Commission's proposed rules on business conduct standards, with respect to any swap that is available for trading on a designated contract market ("**DCM**") or swap execution facility ("**SEF**"), SDs would be required to execute the swap on terms that have a "reasonable relationship" to the best terms available. The swap execution standards would apply to all Commission registrants executing customer orders for swaps made available for trading on a DCM or SEF, whether execution occurs on or through a DCM, SEF or bilaterally. *See* Commission Notice of Proposed Rulemaking on "Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties", 75 Fed. Reg. 80648 (Dec. 22, 2010), available at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-31588a.pdf.

[19] *See* MFA April Letter at 9-10.

intermediation, or other credit arrangements.[20] Such execution flexibility has long existed in a wide range of established cleared derivatives markets, including energy swaps cleared through Chicago Mercantile Exchange ("**CME**") ClearPort or Intercontinental Exchange ("**ICE**"), futures cleared through **CME**, and equity derivatives cleared through the Options Clearing Corporation.[21] This arrangement has allowed customers to transact with the widest range of execution counterparties, enhancing price competition and access to liquidity, while mitigating interconnectedness in the markets, and reducing systemic risk. Therefore, we strongly urge the Commission to adopt the Proposed Rules to ensure that all cleared derivatives markets will operate in the same manner.

### 4. Protect Anonymity in the Market

Real-time clearing also protects the anonymity of a customer's executing counterparties because the clearing member faces only its customer and the DCO once the trade clears, and does not interact with its customer's executing counterparties. The Proposed Documentation Rules would preserve this anonymity by prohibiting any arrangement that would require disclosure of a customer's original executing counterparty.[22] Anonymity is vital to creating an open, efficient, level, competitive playing field in the swaps market by prohibiting a clearing member from:

(i) exerting influence on, or otherwise restricting, a customer's choice of executing counterparties;

(ii) making biased or anticompetitive decisions with respect to the allocation, administration, or adjustment of its customers' execution sub-limits across executing counterparties;

(iii) sharing information with an SD affiliate about its customers' executing counterparties; or

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[20] *See* MFA April Letter at 10.

[21] The introduction of real-time clearing through the CME ClearPort facility for energy swaps in 2002 is credited with saving the energy markets following the collapse of Enron because real-time clearing eliminates counterparty credit immediately following execution, allowing all market participants to transact securely with all other market participants. *See* "The Tipping Point: OTC Energy Clearing Takes Off", Futures Industry Magazine, January/February 2005, available at: http://www.futuresindustry.org/fi-magazine-home.asp?v=p&a=1010. The CME ClearPort model utilizes immediate post-execution acceptance for clearing, and thus, substantial volumes of transactions in the energy markets are conducted by voice or through other bilaterally negotiated means, immediately submitted for clearing and then immediately accepted for clearing. Furthermore, there is no execution documentation required since clearing acceptance is confirmed *immediately* after execution. CME ClearPort therefore demonstrates that real-time clearing is feasible for transactions that are executed off-exchange, while CME Globex and ICE Energy demonstrate models that allow for pre-execution clearing certainty in support of full central limit order book execution.

[22] *See* Footnote 8.

(iv) inappropriately signaling to the market information about the customer by using designation or other similar notices[23] to a customer's executing counterparties to adjust such customer's limit upward or downward.

The Commission's proposed rule barring SDs' exertion of influence over affiliate clearing functions underscores the Commission's awareness of the potential for such control to pressure clearing customers to execute with their clearing members' affiliated SDs to the detriment of fair competition.[24] We submit, as detailed in the MFA April Letter, that the trilateral documentation arrangement is highly susceptible to such conflicts of interest in that it would shift execution either to a clearing member's SD affiliate or, due to the burden of having to negotiate extensive documentation and administer execution sub-limits, a limited number of the largest SDs.[25]

### 5. Best Solution for Smaller Market Participants

MFA strongly disagrees with the notion, raised at the Commission open meeting to adopt the Proposed Rules (the "**Open Meeting**"),[26] that the Proposed Documentation Rules would hinder access to clearing for smaller market participants. To the contrary, trilateral clearing agreements hinder access for smaller customers, since their clearing members retain the unilateral right to reduce their customer's credit limit at any time. Clearing members are particularly likely to reduce such limits in times when there is high market volatility or distressed conditions. Such periods of stress are precisely when a smaller customer needs the full use of its overall limit. Trilateral agreements fragment those limits by subjecting a customer to a separate, smaller limit for each of the customer's executing counterparties, which reduces a smaller participant's trading options, when compared to its larger, single credit limit. These harmful constraints on a customer's market access, range of execution counterparties and ability to execute up to its full limit outweigh any benefit of having a clearing member provisionally guarantee clearing capacity. For these reasons, market participants have never used trilateral agreements in other cleared derivatives markets, but, instead, have relied on automated, real-time clearing through robust and centralized technology, allowing smaller customers ready access to markets.

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[23] A "designation notice" is a notice of credit sub-limits, or a change therein, as used in the prime brokerage context and market participants would use it in conjunction with the FIA-ISDA Cleared Derivatives Execution Agreement's trilateral annexes.

[24] *See* Commission Notice of Proposed Rulemaking on "Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants", 75 Fed. Reg. 71391 (Nov. 23, 2010), available at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-29006a.pdf.

[25] *See* MFA April Letter at 9-10.

[26] Open Meeting on Three Final Rule Proposals and Two Proposed Rules under the Dodd-Frank Act, Commodity Futures Trading Commission, July 19, 2011. Available at: http://www.cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank071911.

Real-time clearing benefits smaller customers by eliminating the window of counterparty credit risk that might otherwise prevent counterparties from entering into transactions with smaller, and potentially less creditworthy, customers. Therefore, the Proposed Rules will eliminate the barrier to entry to the markets for smaller customers whose creditworthiness might otherwise exclude them, and will ensure that customers can transact freely with all counterparties in order to manage their risk, including the counterparties offering the most competitive pricing.

### 6. Not Overly Prescriptive

During the Open Meeting, certain Commissioners raised questions as to whether the Proposed Documentation Rules were overly prescriptive. MFA submits that the Proposed Documentation Rules are not overly prescriptive. In fact, rather than being prescriptive about the form and substance of customer clearing documentation, the Proposed Documentation Rules lay out five principles by which such documentation must abide.[27] These principles support the fundamental tenets of the Dodd-Frank Act and embody free market standards such as the preservation of counterparty choice and anonymity. The Proposed Documentation Rules contain the proper level of specificity, because they set clear standards for documentation as required by Section 731 of the Dodd-Frank Act, which will eliminate legal uncertainty and help market participants implement Dodd-Frank Act-compliant clearing arrangements.[28] The Proposed Documentation Rules would not prevent market participants and/or industry associations from developing legal agreements, including bilateral execution arrangements, that remain consistent with these principles.

### 7. Consistent with Current Market Practice and Developing Solutions

Absent the Proposed Rules, there is a material risk that there would be delays and compromises to access to clearing, as market participants would divert significant industry resources toward negotiating unnecessary documentation and developing internal systems to manage a layer of trilateral credit intermediation. The new regulatory regime for swaps will require enhancements to market participants' systems and infrastructure, including middle-office and back-office capability to process and clear swap transactions. Fortunately, these developments have been underway for considerable time and can be integrated with currently available, real-time OTC derivatives clearing models. As noted in the Proposing Release, real-time clearing will necessarily require coordination between DCMs, FCMs, SDs and MSPs "in order to design and implement a system to clear transactions" and "will likely require capital investment and personnel hours in some instances".[29] To that end, MFA believes that the Proposed Rules will ensure that market participants that have not already done so will devote

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[27] *See* Section II for a discussion of the five principles of the Proposed Documentation Rules.

[28] Section 731 *requires* the Commission to adopt rules governing the documentation standards for swap dealers.

[29] 76 Fed. Reg. 45763. However, the Commission believes, correctly in our view, that DCOs and clearing members may already be using procedures that comply with the proposed standard.

their resources toward forward-looking investments that will facilitate acceptance of trades for clearing in real time and reduce systemic risk.

Some market participants have suggested that the Proposed Rules overreach by voiding a "voluntary" or "optional" agreement that reflects full industry consensus. However, the Futures Industry Association ("**FIA**") and the International Swaps and Derivatives Association, Inc. ("**ISDA**") did not publish the FIA/ISDA Cleared Derivatives Execution Agreement (the "**FIA/ISDA Agreement**") as an agreement developed with the full consensus of all affected, industry, market participants, but rather as a working draft for additional industry consideration. Moreover, in the Memorandum to the FIA/ISDA Agreement, FIA and ISDA recognized that "in time, many of the provisions in the Agreement will almost certainly be superseded by the rules of the Commodity Futures Trading Commission".[30]

Given that MFA as well as a number of market participants and other industry associations did not have the opportunity to propose clarifications or substantive changes to the FIA/ISDA Agreement prior to its publication and given the industry's recognition of future Commission rulemakings superseding the FIA/ISDA Agreement, MFA does not believe that the Commission should view the Proposed Rules as supplanting an industry solution. Rather, since the Proposed Rules would prevent the broad imposition of a scheme that would substantially limit customers' access to clearing and competitive pricing, we believe the Proposed Rules are neither overly prescriptive nor outside the scope of the Commission's purview, but rather industry-specific market governance that is core to the Commission's mission under the Dodd-Frank Act.

### 8. Do Not Compromise FCM Risk Management

At the Open Meeting, one Commissioner asked if trilateral agreements would help FCMs manage their exposure to their clearing customers and if the Proposed Rules would impair clearing members' risk management procedures. We believe that trilateral agreements would not provide any additional protection to an FCM, as FCMs already closely monitor the unitary limits provided to each customer and are free to reduce those limits at any time and/or to reject customer trades that would breach them. From an operational standpoint, it is more efficient for an FCM to manage each customer against one overall limit, as FCMs otherwise do not manage any counterparty-specific sub-limits for customers and we do not believe that they have developed systems to do so.

Furthermore, the creation of sub-limits will be especially harmful to customers and FCMs during periods of market stress, by introducing significant operational risk with systemic implications. During such periods, an FCM that wanted to reduce the limits of one or more of its customers would have to issue an unknown number of designation notices to its customers' executing counterparties to manage effectively its outward exposure of potential clearing commitments, instead of simply reducing its customers' limit directly. Therefore, MFA does not

[30] Memorandum, FIA-ISDA Cleared Derivatives Execution Agreement, at p. 1 (June 14, 2011).

believe that the Proposed Rules will compromise an FCM's ability to manage and mitigate its customers' risk of exceeding their credit limits. To the contrary, the Proposed Rules will both simplify credit limit management and eliminate the risk of trade breakage through real-time clearing, reducing the exposure of FCMs to customer credit risk.

### 9. Essential to Promote SEFs

A stated goal of the Dodd-Frank Act is to "promote the trading of swaps on swap execution facilities."[31] Clearing certainty, whether provided pre-execution or immediately post-execution, will allow all market participants to trade with confidence on SEFs. But the development of highly-functioning and effective SEFs will suffer if there is not real-time clearing and if execution documentation arrangements limit customers' ability to freely transact with a range of counterparties up to their full credit limit.

## IV. Proposed Rules Will Support Post-Execution Allocations of Trades to Multiple Funds

As noted in the MFA April Letter, certain investment managers, including members of MFA, regularly engage in a post-trade process to allocate a single "bunched" or "bundled" trade among multiple funds. This allocation process enables fund managers to seize opportunities and secure the best price for their funds, and to manage situations where only a partial fill of an order is available. We understand, based on industry discussions, that from the DCO's perspective there is no practical difference in processing this type of trade compared to other trades. Therefore, a DCO and its participating clearing members should be able to comply with the Proposed Timing Rules in circumstances where an investment manager is allocating, after execution, portions of a cleared trade: (a) pursuant to a separate agreement with its clearing member or (b) to multiple clearing members as part of a separate allocation process. Thus, such trades can be accepted for clearing immediately and clearing does not have to be delayed while the investment manager conducts the allocation process.

Arrangements between clearing members and investment managers who manage multiple funds are long established in other markets, such as the futures market, and provide the model for clearing certainty, followed by post-trade allocation, for cleared OTC derivatives.[32] These "standby" clearing arrangements are important to investment managers who allocate bunched trades across multiple funds or accounts, since they allow the bunched trades to be immediately accepted for clearing, ensure access to the widest range of counterparties and fulfill the investment manager's duty to secure best available execution on behalf of its client funds.

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[31] Section 733 of the Dodd-Frank Act.

[32] Upon execution, a clearing member serves as a "standby" clearer for the entirety of a portfolio manager's bunched trade. The standby clearer effectively guarantees to the DCO that the bunched trade will clear, thereby allowing the DCO to accept the trade immediately for clearing. Then, as allocation instructions are provided by the customer (typically within a two-hour window), the bunched trade is divided up and cleared to the accounts of the individual funds. This solution functions equally well when all the accounts use the same clearing member or a range of clearing members.

Furthermore, a standby clearing arrangement that allows pre-execution clearing certainty of the bunched trade is an essential condition for a multi-fund complex to access anonymous central limit order book markets. As noted, a central limit order book cannot function with a window of uncertainty between execution and clearing. Accordingly, without the standby arrangement, a multi-fund complex would not be able to execute bunched trades in central limit order book markets, and instead would only be able to execute individual trades for each of its accounts.

Finally, for investment managers who manage a large number of accounts, having to enter into execution documentation with each trading counterparty on behalf of each individual account would create a prohibitive documentary burden to their access to cleared markets. The standby clearing arrangement, which enables real-time clearing, eliminates any need for bilateral credit arrangements to cover the period between execution and allocation for clearing to the individual fund accounts. Therefore, we believe that the Proposed Rules will enhance (rather than limit) the ability of investment managers to allocate bunched trades across multiple funds or accounts.

## V. Clarification of Proposed Rules

MFA believes that the Proposed Rules will play a crucial role in the development of open access to competitive and efficient swap markets, and the reduction of systemic risk through real-time clearing. We strongly urge the Commission to adopt the Proposed Rules without change to their current form.

In the MFA April Letter, we noted a few items in connection with the Proposed Customer Positions Rules that would benefit from clarification by the Commission. We take this opportunity to refer to these again, as the recommended clarifications will ensure that provisions of the Proposed Customer Positions Rules work in tandem with the Proposed Rules to protect open access, fair competition and real-time processing of trades from the moment of execution through communication of clearing disposition.

Specifically, we request that the Commission clarify that:

**1.** All trades not executed on a SEF or DCM are required to be timely submitted to DCOs (making allowances for after-hours trade submission protocols), either under the specific rules of each DCO or under ongoing guidance from the Commission, in order to minimize the time between trade execution and clearing and to ensure compliance with the proposed real-time clearing requirements.[33]

[33] In this regard, we believe that trade counterparties will enter the details of the vast majority of non-SEF executed trades into automated trade capture systems at essentially the same time that they execute the trade, but we submit that rules are needed to prevent the risk that one party to the trade could create a window of counterparty credit exposure. Currently, many futures exchanges require submission of the details of any off-exchange or block trades within minutes of execution. *See, e.g.*, CME Rule 526, which requires the seller in a block trade to report the trade to the CME "within five minutes of the time of execution; except that block trades in interest rate futures and options executed outside of Regular Trading Hours (7:00 a.m. through 4:00 p.m. Central Time, Monday through Friday on regular business days) and Housing and Weather futures and options must be reported within fifteen

We believe such timely submission is required under Section 23.506(a), but we encourage the Commission to confirm this requirement.[34] Specifically, the final rules should clarify that the protocols finalized by DCOs, together with their FCMs, stipulate time frames that are as short as technologically practicable, consistent with the Proposed Rules' timing requirement for clearing processing;

**2.** DCOs must communicate the acceptance or rejection of a trade for clearing immediately upon execution in real time. For SEF-executed trades, this communication would be to the SEF, which in turn would forward the confirmation to the transacting participants. For trades executed off-exchange/SEF, the DCO communication would be delivered by the DCO to the parties to the trade, via the interfaces or utilities used by the parties to submit the trade and track its disposition;

**3.** DCOs are prohibited from adopting rules or engaging in conduct that is prejudicial to indirect customers of clearing members as compared to direct clearing members with respect to eligibility or the timing of clearing or processing of trades generally; and

**4.** Clearing members are required to transfer all or a portion of a customer's portfolio in any situation "as soon as technologically practicable" following receipt of transfer instructions from the customer [or a DCO], even if such clearing member is not in default. In addition, the Commission should confirm that the DCO rules must specify that upon a requested transfer, the DCO will simultaneously transfer margin along with the related positions, and prohibit ceding clearing members from imposing extraordinary charges on transfers that could act as deterrents or hidden consent rights.

Finally, we note that the Proposed Documentation Rules impose prohibitions against certain "arrangements" between customers and SDs to protect customers from SD-imposed conditions on access to execution and clearing.[35] According to the Proposing Release, "[t]his

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minutes of the time of execution. The report must include the contract, contract month, price, quantity of the transaction, the respective clearing members, the time of execution, and, for options, strike price, put or call and expiration month."

[34] Section 23.506(a)(1) would require SDs and MSPs to have the ability to route swaps that are not executed on an SEF or DCM to a DCO in a manner that is acceptable to the DCO for the purposes of risk management. Section 23.506(a)(2) would require SDs and MSPs to coordinate with DCOs to facilitate prompt and efficient processing in accordance with proposed regulations related to the timing of clearing by DCOs.

[35] Section 23.608 would prohibit "arrangements" involving FCMs, SDs, MSPs or DCOs that would: (a) disclose to an FCM, SD or MSP the identity of a customer's original executing counterparty; (b) limit the number of counterparties with whom a customer may enter into a trade; (c) restrict the size of the position a customer may take with any individual counterparty, apart from an overall credit limit for all positions held by the customer at the FCM; (d) impair a customer's access to execution of a trade on terms that have a reasonable relationship to the best terms available; or (e) prevent compliance with specified time frames for acceptance of trades into clearing.

measure protects the customer from any discriminatory behavior by potential clearing members or counterparties and helps ensure that customers have open access to the markets and an opportunity to obtain execution on competitive terms."[36] We strongly support this principle, but we believe that even with these prohibitions, the Commission should clarify that customers are permitted to voluntarily disclose certain information (including the identity of the customer's executing counterparty) to their SDs on a post-trade basis (*e.g.*, at month end) to facilitate commercial discussions with such SDs.

## VI. Proposed Rules Are Justified under a Cost-Benefit Analysis

As discussed above, we strongly believe that market participants will greatly benefit from the Proposed Rules, as they will ensure that all customers have access to competitive pricing and liquidity, protect the anonymity of their execution counterparties, can effectively manage their risk in real time, and can utilize their full risk limits without anti-competitive constraints. In addition, the Proposed Rules will greatly facilitate the development of electronic trading and anonymous central limit order books. Moreover, the Proposed Rules provide additional benefits that are required under the Dodd-Frank Act. Real-time clearing, combined with the elimination of the need for clearing members to build systems to administer execution sub-limits, will foster competitive FCM offerings, will reduce barriers to access to clearing through FCMs and eliminate substantial unnecessary legal costs that would arise across the industry if customers and FCMs had to enter into execution agreements with all of their customers' trading counterparties. Dealer-to-dealer clearing will also benefit from real-time clearing and the elimination of clearing uncertainty, particularly in times of market stress. Absent the Proposed Rules, these positive benefits would be jeopardized.

In terms of cost to market participants, the Proposed Rules require DCOs and FCMs to develop or adapt systems that have long existed in other cleared derivatives markets, and which many market participants have been developing or adapting over the past three years for OTC derivatives, namely the infrastructure to clear with straight-through-processing. In proposing documentation and processing standards for the cleared swaps market as required by the Dodd-Frank Act, the Commission has appropriately crafted the Proposed Rules in a manner that will foster the right model of real-time clearing, which is largely built and ready to support customer clearing. For these reasons, MFA strongly believes that the benefits to the derivative markets of real-time clearing and the elimination of documentary barriers to access will far outweigh the cost of updating the infrastructure necessary for these changes.

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[36] 76 Fed. Reg. 45735.

MFA thanks the Commission for the opportunity to provide comments regarding the Proposed Rules. Please do not hesitate to contact Carlotta King, Laura Harper, or the undersigned at (202) 730-2600 with any questions the Commission or its 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. Gary Gensler, Chairman
The Hon. Michael Dunn, Commissioner
The Hon. Bart Chilton, Commissioner
The Hon. Jill E. Sommers, Commissioner
The Hon. Scott D. O'Malia, Commissioner