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September 30, 2011

VIA Electronic Submission (comments.cftc.gov)
David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW.
Washington, DC 20581

Re: Customer Clearing Documentation and Timing of Acceptance for Clearing, 76 FR 45730 (August 1, 2011); RIN #3038-AD51

Dear Mr. Stawick:

The DRW Trading Group ("DRW") appreciates the opportunity to comment on the rules proposed by the Commodity Futures Trading Commission ("CFTC") regarding Customer Clearing Documentation and Timing of Acceptance for Clearing. For reasons discussed below, we support the proposed rules as an critical component of ensuring that the market structure for cleared swaps promotes competition and transparency as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "DF Act").[1]

The DRW Trading Group

DRW is a principal trading organization. We trade our own capital primarily in exchange-listed and centrally-cleared instruments. DRW has no clients, customers or outside investors and does not hold the funds of any third parties.

DRW provides significant liquidity, domestically and internationally, in futures and options across all asset classes. This occurs in trading pits, on electronic platforms and in off-exchange, centrally-cleared transactions. The longevity, experience and breadth of DRW (including trading through several crises) make us uniquely qualified to comment on the proposed rules.

I founded DRW in 1992 and act as its Chief Executive Officer. In addition to overseeing DRW, I am on the Board of the Futures Industry Association ("FIA") and act as Chairman of the Principal Trading Group Division of the FIA.

DRW is also a signatory, with other principal trading firms, to a comment letter, dated the date hereof, regarding these same proposed rules (the "Principal Trading Firm Letter").

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

The Futures Industry Model

Since the financial crisis of 2008, there has been significant focus has been on what went wrong and how to prevent a recurrence. A key component of this is to learn from sectors that performed well. Throughout the turbulence of 2008, the futures markets not only functioned, but functioned well. We witnessed this first hand. Several factors contributed to the success of the futures markets (and certain cleared swaps facilities such as CME Group's ClearPort and ICE's WebICE), including:

1. Central Clearing (including elimination of counterparty risk, setting of initial margin and determination of settlement prices)
2. Transparency
3. Competitive markets (in part resulting from low barriers to entry)
4. Real time acceptance of trades[2]
5. Anonymity of trades

Because of these factors, the futures markets (and certain cleared swaps facilities) have naturally evolved into a true "any-to-any" market structure where any party can, without conditions, trade with any other party in a competitive marketplace. This not only adds to liquidity and provides access to the best price, but also adds to stability as risk is warehoused by a diverse, non-concentrated group of market participants. It should be stressed that the totality of these factors, not just central clearing enabled the futures markets to perform flawlessly through periods of historic turbulence.

It is important to emphasize that the futures markets have minimal barriers to entry. The paperwork necessary to enter the futures market is minimal. Other than establishing an account with a qualified futures commission merchant ("FCM"), no other relationships are required to enter the markets. The margining system is efficient and independent, allowing parties to carry positions without undue burden, while still protecting the overall system. The low barriers to entry associated with trading futures have materially increased access to the markets and resulted in greater competition, liquidity and transparency.

The DF Act

It is useful to restate of the purpose of the DF Act:

> "To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail", to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."[3]

(emphasis added). This short, concise passage clearly enunciates Congressional intent to address opaque market structures that directly contributed to the financial crisis of 2008.

More specifically, the DF Act mandates central clearing. Specifically, §723(a)(3) states that "[i]t shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a [DCO] that is registered under this Act or a [DCO]

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[2] Real time acceptance gives parties certainty in their trades, and certainty in trades is critical in providing good liquidity. A liquidity provider will hedge trades immediately. However, if there is no certainty in the trade for a long period of time, a liquidity provider is stuck in a dilemma as to whether to hedge.

There has been much debate about whether, from a technology perspective, real time acceptance, with all the appropriate credit checks, is currently feasible. We do not purport to be experts on the clearing process, but it would seem to us from our involvement in the futures space that real time acceptance is already a technological reality. Perhaps we are over simplifying the issue, but we do not see the difference between a future and a cleared swap in this regard. Moreover, cleared swaps on platforms such as CME Group's ClearPort and ICE's WebICE facility already have real time acceptance upon the submission of a trade.

[3] *Supra* n. 1.

that is exempt from registration under this Act if the swap is required to be cleared."[4] But it does not stop there. Facilitating competition and opening access is at the heart of the DF Act. Congress was explicit in mandating open and competitive markets. An example of this is where the DF Act states "[...] a swap dealer or major swap participant shall not – (A) adopt any process or take any action that results in any unreasonable restraint of trade; or (B) impose any material anticompetitive burden on trading or clearing".[5] [6] Finally, transparency, the ability to see what is occurring and has occurred in a market in near real time, is stressed.[7] In effect, the DF Act requires the democratization of markets.

The Proposed Rules

The proposed rules address two aspects of the clearing process: (i) the documentation between a customer and an FCM that clears on behalf of the customer; and (ii) the timing of the acceptance or rejection of trades for clearing by designated clearing organizations ("DCOs") and clearing members. These proposed rules advance the fundamental principles of open, transparent and competitive markets as mandated by the DF Act, and they do so in a balanced and sensible manner. Requiring clearing alone, without certain logical extensions provided for in the proposed rules, does not fulfill the full DF Act mandate. Markets with the attributes of the futures industry have proven to be open, competitive and transparent, and it is clear that the proposed rules sensibly draw from the lessons of the futures markets. The concepts embedded in the proposed rules are all individually important and collectively work together towards a similar end for cleared swaps.

Real time trade acceptance, as required by the proposed rules, provides the marketplace with certainty on trades and promotes liquidity and transparency. It is difficult to understand any arguments against requiring real time acceptance "as quickly as would be technologically practicable if fully automated systems were used."[8] We agree that "[m]inimizing the time between trade execution and acceptance into clearing is an important risk mitigant."[9]

The proposed rules relating to documentation set out principals within which swap dealers, major swap participants, FCMs and DCOs must deal with customers. These rules require that these parties modify their dealings on to ensure that anonymity of trades is maintained and prohibit them from limiting the number of counterparties which whom a market participant can transact, impairing a party from seeking the best price or restricting the size of positions a party can take other than on the basis of an overall limit. These are all fundamental attributes of the futures markets and are critical in the development of an open, competitive and transparent marketplace.

We are concerned that without the proposed rules, the existing market structure for swaps will remain opaque and non-competitive, even with a central clearing mandate. But coupling the proposed rules with mandatory clearing (and certain other components) will guide the market for cleared swaps towards an "any-to-any" market. In our view, realiziing that market structure is the purpose of the DF Act and is the ultimate risk reducing structure to the financial system.

If in fact an "any-to-any" market for cleared swaps develops, new liquidity providers like DRW and its competitors (of which there are many fine organizations) will enter the market. I know with certainty that our involvement provides a market with increased liquidity, transparency and diversity. The inception of CME Group's ClearPort facility in 2002 is an excellent example of this. With low barriers to entry, we and other liquidity providers from the futures markets entered the market for ClearPort cleared energy swaps. In a very short period of time, much of the bilateral energy market had moved to ClearPort, and firms like DRW became the primary source of liquidity. We fear, however, that without the proposed rules, the market structure for other cleared swaps will never evolve into a meaningful "any-to-any" market.

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[4] DF Act § 723 (to be codified at 7 U.S.C. 2).
[5] DF Act § 731 (to be codified at 7 U.S.C. 1 et seq.).
[6] *See* DF Act § 725 (to be codified at 7 U.S.C. 7(a)(1)(c)). Open access to markets is a critical component in the DF Act where it amends the Core Principles for DCOs and states that "[t]he participation [...] of each [DCO] shall – (I) be objective; (II) be publicly disclosed; and (III) permit fair and open access".
[7] *Supra* n. 1.
[8] 76 Fed. Reg. 45730, 45737 (proposed Aug. 1, 2011).
[9] *Id.* at 45732.

FIA-ISDA Documentation[10]

The FIA-ISDA Cleared Derivatives Execution Agreement[11] sets forth the rights of parties if a swap trade is not accepted for clearing. The FIA-ISDA documentation consists of a main agreement and two "optional" annexes.

The futures markets and certain platforms that accept bilateral trades for clearing (e.g. ClearPort and WebICE) function quite well on the premise of real time acceptance, eliminating the need for extensive documentation. Assuming the proposed rules are adopted, there should be no need for the main agreement. Although we believe the main agreement to be unnecessary, two parties should be able to agree in advance on their respective rights in the event a trade breaks. Such agreements in and of themselves will not inhibit the purpose of the DF Act.[12]

We have significant concerns, however, with the trilateral annexes. These annexes require FCMs to guarantee the cleared swaps transactions of their customers in the event that trades are not accepted for central clearing. We believe that the trilateral annexes will, amongst other things:

1. Limit the counterparties with which a party can transact. Only if FCM approved counterparties will be accessible to a party.
2. Inhibit a party's ability to access the best price (by virtue of limiting the parties with whom a party can transact).
3. Insert credit intermediation into the clearing process, creating sub-limits within a party's overall trading.
4. Sacrifice the anonymity of the parties to a trade.
5. Create burdensome documentation that must be put in place and administered.

Regardless of intent, a trilateral regime as proposed by FIA-ISDA will undermine the fundamental principles of the DF Act. For truly open, competitive and transparent markets to develop for cleared swaps, the regulatory groundwork for an unrestricted "any-to-any" market structure must be set. The proposed rules attempt to accomplish just this.

We have heard several arguments defending the FIA-ISDA documentation. First, while the FIA-ISDA documentation (including the trilateral annexes) is "voluntary", we do not believe the documentation will be voluntary in practice. This issue is covered in greater detail in the Principal Trading Firm Letter.

Second, we are told that the documentation is intended to be only "temporary" – until Swap Execution Facilities develop. Real time acceptance obviates the need for the matters covered in the trilateral annexes. As discussed in Footnote 2 above, real time acceptance exists today in the futures markets and on ClearPort and WebICE. The "temporary" explanation infers that the process of clearing swaps is so much different from what occurs with futures and platforms like ClearPort and WebICE. We do not believe that cleared swaps are unique in this regard. Furthermore, the "temporary" argument is potentially dangerous. As we have seen time and time again, like old habits, for a variety of reasons, old market structures die hard.

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[10] The FIA-ISDA release claims that the documentation is the result of a broad industry initiative. While there may have sixty organizations involved in the process, it should be noted that no principal trading firms were involved in the process. Thirty-six principal trading firms are FIA members.

[11] Futures Industry Association, *FIA and ISDA Publish Documentation for Cleared Swaps* (2011) (available at http://www.futuresindustry.org/fia-and-isda-publish-documentation-for-cleared-swaps.asp)

[12] We note one issue with the main agreement. Paragraph 4(g) provides:

> "For avoidance of doubt, except with respect to those Swap Execution Facilities listed on Schedule 1 hereto, the provisions of this Paragraph 4 shall supersede the rules of any Swap Execution Facility on or through which the Derivatives Transaction is executed."

This provision seems to permit parties to agree that the rules of a trading venue are optional and can be supplanted by agreement. Regardless of whether the proposed rules are adopted, we suggest that the CFTC consider a rule that would prohibit parties from agreeing to override the rules of a Swap Execution Facility.

In summary, it is our view that the FIA-ISDA documentation would inhibit an "any-to-any" market structure for cleared swaps from evolving and thus impede the fundamental principles of the DF Act.

The DF Act, Government Intrusion and Competition

We have heard concerns that the proposed rules intrude into the right of parties to contract. We too are opposed to governmental intrusion into economic matters and the workings of free markets. However, there are circumstances when the government should be involved in regulating private agreements. We believe this to be one of those circumstances.

The government regularly enacts laws and promulgates rules and regulations that restrict the rights of parties to contract. A classic example of this is the Sherman Antitrust Act, Section 1 of which states:

> "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."[13]

This is a clear case of the government intervening into the free market process and restricting private parties' right to contract.

The issue is whether, given the circumstances, it is advisable and prudent for the government to intervene. Guidance on this issue can be taken from the Supreme Court where, regarding the Sherman Antitrust Act and competition, it said:

> "The purpose of the act is not to protect businesses from the working of the market; it is to protect the public from the failure of the market. The law directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself. It does so not out of solicitude for private concerns, but out of concern for the public interest."[14]

This passage sets forth a compelling philosophy about protecting competition and protecting the public from failures in the marketplace. Clearly the epic OTC market failure of 2008 caused Congress to enact the DF Act to enable competition and to protect the public from failures in the marketplace, similar to the Sherman Antitrust Act.[15] It is for that reason that we feel it is appropriate in this case for the proposed rules to impose restrictions on counterparty dealings.

Conclusion

For reasons the stated herein, we support the proposed rules as a critical step towards achieving the goals of the DF Act. The futures industry has taught us that "any-to-any" markets with low barriers to entry are the most stable and efficient and function well during times of duress, and the proposed rules sensibly apply important attributes of the futures markets to the market for cleared swaps.

Thank you for your consideration.

Very truly yours,

/s/ Donald R. Wilson, Jr.

Donald R. Wilson, Jr.
Founder and CEO, DRW Holdings, LLC

cc: Honorable Gary Gensler, Chairman

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[13] 15 U.S.C. §1.

[14] *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458 (1993).

[15] Competition considerations are discussed throughout the DF Act. *See* DF Act § 731 (to be codified at 7 U.S.C. 6(s)); § 733 (to be codified at 7 U.S.C. 7(b)(3)); § 735 (to be codified at 7 U.S.C. 7(d)); § 763 (to be codified at 15 U.S.C. 78(c)(4)); § 763 (to be codified at 15 U.S.C. 78(j)(2)); and § 764 (to be codified at 15 U.S.C. 78(o)(8)).

Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner