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

November 4, 2011

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–AD60: Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements Under Section 2(h) of the CEA; and RIN Nos. 3038–AC96; 3038–AC97: Swap Transaction Compliance and Implementation Schedule: Trading Documentation and Margining Requirements Under Section 4s of the CEA

Dear Mr. Stawick:

Managed Funds Association[1] appreciates the opportunity to provide comments on the Commodity Futures Trading Commission's (the "**Commission**") proposed rule on swap transaction compliance and implementation schedule for clearing and trade execution requirements (the "**Proposed Clearing and Execution Implementation Rule**"),[2] as well as the Commission's proposed rule on swap transaction compliance and implementation schedule for trading documentation and margining requirements (the "**Proposed Documentation and Margining Implementation Rule**", and together with the Proposed Clearing and Execution

[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 "Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA", 76 Fed. Reg. 58186 (Sept. 20, 2011) (the "**Proposing Clearing and Execution Release**"), available at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-24124a.pdf.

Implementation Rule, the "**Proposed Implementation Rules**"),[3] under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").[4]

Executive Summary

MFA strongly supports the Commission's establishment of a phased implementation approach to facilitate an orderly transition by all relevant market participants to mandatory clearing of their swaps, and appreciates that the implementation plan is the subject of an express rulemaking, an approach we endorsed in our earlier comments on implementation.[5] A firm timetable for making clearing mandatory for appropriately liquid and standardized swap products will give industry participants the confidence to commit resources to the new market paradigm, and will incentivize industry participants to develop competitive services that will overcome the current structural and economic barriers to widespread clearing. Further, a properly sequenced implementation plan will provide market participants with the appropriate time to evaluate relevant final rules[6] and make any necessary adjustments to their business models or portfolio

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[3] Commission Notice of Proposed Rulemaking on "Swap Transaction Compliance and Implementation Schedule: Trading Documentation and Margining Requirements Under Section 4s of the CEA", 76 Fed. Reg. 58176 (Sept. 20, 2011) (the "**Proposing Documentation and Margin Release**"), available at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-24128a.pdf.

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

[5] See MFA's letter to Chairman Gensler, dated March 24, 2011, available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=42237 (the "**MFA Implementation Letter**"). In the MFA Implementation Letter, we recommended a timeline and sequencing for adoption and implementation of final rules related to Title VII of the Dodd-Frank Act. With respect to the implementation of central clearing, we stated: "At the time that a class of products is ready for clearing, all market participants (including buy-side participants) should be permitted (but not required) to clear those products, while confirming that they intend to be operationally ready to comply with the mandate when it comes into force. Then, there should be a phase-in period before clearing of that product becomes mandatory to give sufficient time for market participants to resolve outstanding documentation or structural issues and for the infrastructure to prove that it is ready for clearing at scale." The MFA Implementation Letter also declared that "[o]ur members uniformly agree that rule adoption and implementation should move forward as soon as possible and in a logical, thoughtful manner."

[6] Under the Proposed Clearing and Execution Implementation Rule, before market participants could be required to comply with a mandatory clearing determination, the Commission must: 1) adopt its final rules related to the end-user exemption to mandatory clearing; 2) adopt its final joint entity and product definitional rules with the Securities and Exchange Commission ("**SEC**") defining "swap", "security-based swap", "swap dealer", "security-based swap dealer", "major swap participant" and "major security-based swap participant"; and 3) adopt its final rules relating to the protection of cleared swaps customer contracts and collateral (collectively, the "**Prerequisite Clearing Rules**"). The Commission has finalized its rule regarding the process for review of swaps for mandatory clearing. Proposing Clearing and Execution Release at 58188 and 58189. On October 18, 2011, the Commission adopted its final rulemaking on "Derivatives Clearing Organization General Provisions and Core Principles", RIN 3038-AC98, which, among other significant industry effects, will greatly improve clearing access once the final regulations become effective. MFA believes the Commission's list of the Prerequisite Clearing Rules is complete and sufficient for this purpose; however, we urge the Commission to finalize and adopt the Commission's proposed rulemakings on "Customer Clearing Documentation and Timing of Acceptance for Clearing", and "Clearing Member Risk Management" as quickly as possible. We believe these two rules will eliminate further key barriers to voluntary clearing access and provide regulatory certainty to market participants and infrastructure providers, which will facilitate their compliance preparation and related infrastructure investments. We further urge that these two

composition. Additionally, such an implementation plan will provide market participants with the time required to resolve outstanding operational issues and documentation prior to compliance with the mandatory clearing requirement.

MFA firmly supports the expansion of central clearing for swaps, while recognizing that market participants need sufficient time to complete their necessary administrative and technological work to reach the goal of full-scale clearing. For these logistical reasons, we support the Commission's phase-in of mandatory clearing by category of market participant, with our requested adjustments as described herein.

However, this rationale does not apply with respect to the trade execution requirement and the uncleared swap margin requirements. In the case of the trade execution requirement, a phase-in would both fragment liquidity and subject different groups of market participants to dramatically different access to execution. In the case of the uncleared swap margin requirements, a phase-in would subject market participants in the earlier phase-in categories to materially disparate economic burdens. There is no affirmative reason to phase-in either of these requirements, as the final rules can apply to all market participants at the same time without imposing any undue logistical burden.

Additionally, MFA recommends that private funds be grouped together as Category 2 Entities, because (1) the Commission's phasing objectives will best be met by having swap dealers ("**SDs**") and major swap participants ("**MSPs**") clear first as Category 1 Entities, along with those private funds that voluntarily choose to clear alongside Category 1 Entities, and (2) certain private funds may need more time to evaluate the final rules and to make appropriate changes to their operations, infrastructure and business models to comply with the initial mandate.

We further recommend that the proposed term "active fund" be eliminated, because (1) it is over-inclusive, (2) would impose undue burdens to administer and interpret, and (3) would unnecessarily divide an existing single category of buy-side market participants—private funds—in a way that is unsupported, difficult to administer, and not required to achieve the Commission's objectives. If such term is not removed in the final rules, we are very concerned that the effect would be to impose unjustifiably disparate burdens on a very large number of

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rules also be made effective as soon as possible, ideally before market participants are required to comply with the Commission's first mandatory clearing determination. *See* MFA's letter in support of these two proposed rulemakings, dated September 30, 2011, available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48444.

In addition to the Prerequisite Clearing Rules, before market participants could be required to comply with a trade execution requirement (which, as explained *infra*, we believe should be deferred until after implementation of the initial clearing mandate), the Commission must adopt final rules related to swap execution facilities ("**SEFs**") and designated contact markets ("**DCMs**") (collectively, the "**Prerequisite Execution Rules**"). Proposing Clearing and Execution Release at 58189 and 58190. MFA believes that the Commission's list of Prerequisite Execution Rules also should include its final rule on real-time reporting of swap data, because it will contain the final provisions on block trade thresholds.

private funds and their underlying investors, including imposing disadvantageous treatment with respect to margining and execution requirements.

We appreciate the opportunity to provide comments that we believe will assist the Commission in adopting final rules to implement the clearing, trade execution, trading documentation and uncleared swap margining requirements in a way that will achieve the mandatory clearing requirement in a timely manner, while avoiding disruption to markets, or undue strain on the resources of market participants and regulators. In this context, we recommend adjustments in the Commission's proposed implementation timetable for the clearing and trade execution requirements that we believe are consistent with the Commission's intended purpose and goal for the Proposed Clearing and Execution Implementation Rule, but will allow market participants to plan with greater certainty.

Summary of MFA Recommendations

Overview. We understand that the Commission's key sequential steps to facilitate the market transition to central clearing include:

1. Finalization of the relevant clearing-specific rules.[7]

2. Implementation of those clearing-specific rules, where applicable, by relevant infrastructure providers, particularly derivatives clearing organizations ("**DCOs**") and futures commission merchants ("**FCMs**"). Implementation of such rules should eliminate certain current structural barriers to access to clearing for non-dealer market participants.

3. A voluntary clearing period, where removal of structural barriers permits voluntary access and where market participants can test and build initial volumes prior to the effectiveness of the clearing mandate.

4. Phased application of the clearing mandate.

Provided that the Commission finalizes and publishes the last of the remaining Prerequisite Clearing Rules by January 31, 2012, we believe that with our recommended adjustments to the Commission's proposed milestones, as set forth below, the industry can and should complete the full phase-in of the first clearing mandate for all U.S. market participants by the end of 2012. This timing will allow the U.S. markets to fulfill the G-20 clearing commitment.[8]

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[7] *See supra*, note 6.

[8] *See* "The G-20 Toronto Summit Declaration, July 26-27, 2010" at p. 19, declaration note 25 ("We reaffirm our commitment to trade all standardized OTC derivatives contracts on exchanges or electronic platforms, where appropriate, and clear through central counterparties (CCPs) by end-2012 at the latest".) Provided that the Commission finalizes and publishes the last of the remaining Prerequisite Clearing Rules by January 31, 2012, this timing will also enable a substantial proportion of the U.S. markets to meet the Commission's informal milestone for

To facilitate the timely completion of the Commission's implementation phase-in sequence while ensuring sufficient preparation intervals, we recommend redefining the phase-in triggering event "T" as the later of: (i) the Commission's first mandatory clearing determination, and (ii) the latest effective date of the last-adopted Prerequisite Clearing Rule (*i.e.*, 60 days after the last of the Prerequisite Clearing Rules has been published in the *Federal Register*). Our recommendation to redefine "T" in this way presumes that: (i) the Commission begins its review of a swap or class of swaps submitted for the first mandatory clearing determination no later than 90 days before "T"[9], and (ii) the last of the Prerequisite Clearing Rules is published 60 days before "T". Our recommendation results in the following timetable:

Timing	Milestone
T	• After the last Prerequisite Clearing Rule becomes effective, and the first Mandatory Clearing Determination has been issued, then the voluntary clearing periods begin for all market participants
T+90	• Mandatory Clearing for Category 1 Entities (please note proposed changes to definition of Category 1 Entity below)
T+180	• Mandatory Clearing for Category 2 Entities (please note proposed changes to definition of Category 2 Entity below)
T+270	• Mandatory Clearing for Category 3 Entities (Category 3 Entities are all entities subject to the Mandatory Clearing Determination that are not included in Categories 1 and 2)
Post-T+270	• Mandatory Execution effective for Category 1, 2 and 3 Entities only after implementation of Mandatory Clearing for all three categories

Our principal recommendations for adjustments to the Commission's milestones are:

Adjust Effective Date for Mandatory Clearing Compliance Schedules. We believe the Commission needs to adjust the date for triggering the application of the compliance schedules for the clearing requirement. In particular, with respect to the Commission's first mandatory clearing determination, MFA believes that all of the Prerequisite Clearing Rules should become

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the clearing mandate to begin by Q3 2012. *See* "Waking Up to Reality": Opening Statement by Commissioner Scott D. O'Malia: Open Meeting on Proposed Rulemakings on Implementation of Mandatory Clearing, Trading, Documentation and Margining Rules, dated September 8, 2011, at p. 2 (noting that "[t]he realities of this schedule [for completion of the last of the triggering rules] will push the clearing and trading mandate to approximately the third quarter of 2012, or just before the G-20 commitment to implement clearing.").

[9] We appreciate that the Commission is dependent on submissions from the relevant DCOs in order to commence its review of swaps for mandatory clearing. We understand, however, that the DCOs are generally prepared now to make their submissions, based principally on the swaps or classes of swaps they are currently clearing. Therefore, it is not unrealistic to expect the DCOs to complete their submissions within a timeframe that enables the Commission's overall timetable to meet the G-20 clearing commitment deadline. *See supra*, note 8.

effective (*i.e.*, 60 days after the last of such Prerequisite Clearing Rules is published in the *Federal Register*) before the proposed 90-day, 180-day and 270-day compliance schedules for Category 1, 2 and 3 Entities, respectively, are triggered. We believe market participants need time to evaluate and seek clarification on how the Prerequisite Clearing Rules are interpreted and will be implemented, and to make any adjustments to their business models, infrastructure, operations and documentation before the actual phase-in period for mandatory clearing begins. Therefore, as we explain further in Section II below, we respectfully propose that the Commission's issuance of its first mandatory clearing determination should not become effective until the latest effective date of the final Prerequisite Clearing Rules. In this regard, we urge the Commission to set prompt and consistent effective dates for such rules.

All Private Funds Should be Category 2 Entities Without Introducing the Term "Active Fund". MFA supports a phased implementation framework for the clearing requirement, which we believe is essential to an orderly transition to central clearing. However, MFA believes that the definition of "active fund" as a Category 1 Entity is over-inclusive and would raise calculation questions that would introduce new administrative and regulatory complexity for both private funds as well as Commission staff. Accordingly, we propose an alternative categorization of private funds in Section I below that removes the proposed term "active fund" and groups all private funds as Category 2 Entities. We believe this categorization will afford certain market participants with the opportunity to evaluate the final Prerequisite Clearing Rules, after these rules become effective, and to make appropriate preparations for an organized phase-in to mandatory clearing. In this regard, we urge the Commission to preserve in the final rulemaking, the current text in the Proposed Clearing and Execution Implementation Rule to the effect that, once the first clearing mandate applies to Category 1 Entities, such Category 1 Entities are obligated to clear any trade with a non-MSP "buy-side" participant if such buy-side participant elects to clear on a voluntary basis before its compliance date.[10] This provision will enable buy-side participants to ramp-up their clearing volumes in preparation for their compliance with the clearing mandate, thus accomplishing the Commission's phase-in objectives.

Eliminate Phasing of Trade Execution and Adjust Effective Date for Trade Execution Compliance. Under the Proposed Clearing and Execution Implementation Rule, the proposed compliance schedules for the trade execution requirement would be triggered upon the later of: "(1) The applicable deadline established under the compliance schedule for the associated clearing mandate; or (2) 30 days after the swap is made available for trading on either a SEF or DCM".[11] MFA strongly recommends that the Commission separate the SEF trading requirement from the clearing requirement, as we believe having the execution requirement potentially coming into effect at the same time as the clearing requirement risks complicating and delaying

[10] Section 39.5(e)(2)(i) of Proposed Clearing and Execution Implementation Rule proposes to phase in compliance with the mandatory clearing requirement for "(i) [a] swap transaction between a Category 1 Entity and another Category 1 Entity, or any other entity that desires to clear the transaction . . .". *Id.* at 58195 (emphasis added).

[11] Proposing Clearing and Execution Release at 58190.

clearing compliance, would have a substantial disparate impact on different categories of market participants, and could also result in market disruption, as discussed further in Section III below. Accordingly, we recommend that the implementation of the trade execution requirement not be tied to the schedule proposed for the clearing requirement, and indeed, should be deferred until after all relevant participant categories have complied with the initial clearing mandate.[12]

We are further concerned with the second prong in the Commission's triggering event formulation, because the meaning of "made available for trading" is not addressed in the Proposed Clearing and Execution Implementation Rule. MFA believes that this phrase is a critical component of the implementation rulemaking given that it is inextricably linked to when the execution requirement will become effective. Accordingly, we believe the Commission should clarify when and how a swap is determined to be "made available for trading". We respectfully offer recommendations on the meaning and determination of "made available to trade" in Section III below. To allow clearing to progress unencumbered by issues relating to the execution mandate, we also propose that the Prerequisite Execution Rules become effective (*i.e.*, 60 days after the last of the Prerequisite Execution Rules is published in the *Federal Register*) prior to the compliance date for the first trade execution requirement, and not before compliance with the first clearing mandate is required for all Category 1, 2 and 3 Entities. In this regard, we further respectfully submit that the Commission's proposed rule on "Real-Time Reporting of Swap Data" should be included among the list of Prerequisite Execution Rules, as it contains the rules regarding block trade thresholds.[13]

Eliminate Implementation Phasing of Margin Requirements. As explained in Section IV below, MFA believes that the proposed phase-in of the Margin Requirements[14] under Section 4s of the CEA by type of swap counterparty would distort pricing and competition across the marketplace by forcing certain counterparties to pay higher margin amounts before other counterparties with longer phase-in schedules. We strongly urge the Commission to eliminate phased implementation of the margin requirements for uncleared swaps in the final rule and instead implement the Margin Requirements for all relevant market participants at the same time.

Specifically, we respectfully propose that there be one Margin Requirements compliance date for all relevant market participants that would become effective upon the later of the final Trading Documentation rule[15] and the final Margin Requirements rule becoming effective (*i.e.*,

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[12] The Commission's proposed regulations sections 37.12 and 38.11 provide for the phased implementation of a trade execution requirement by setting forth a compliance schedule tied to the schedule proposed for the clearing requirement. Proposing Clearing and Execution Release at 58190.

[13] 75 Fed. Reg. 76140 (Dec. 7, 2010). *See also supra*, note 6.

[14] Commission Notice of Proposed Rulemaking on "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants", 76 Fed. Reg. 23732 (Apr. 28, 2011) (hereinafter "**Margin Requirements**").

[15] Commission Notice of Proposed Rulemaking on "Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants", 76 Fed. Reg. 6715 (Feb. 8, 2011) (hereinafter "**Trading Documentation**").

60 days after the last of such rules is published in the *Federal Register*) and the clearing mandates having been phased in for Category 1, 2 and 3 Entities.

I. All Private Funds Should be Category 2 Entities Without Introducing the Term "Active Fund"

MFA believes that the proposed metrics for swaps activity in the definition of "active fund"[16] for purposes of the Category 1 Entity definition[17]—20 or more swaps per month—is low enough to capture a very large number of private funds as market participants in the initial compliance cohort. An over-inclusive definition for the first participant cohort subject to the clearing mandate risks leading to market disruptions as smaller funds with fewer staff and resources struggle to comply with the clearing mandate at the same time as SDs and MSPs.

MFA is further concerned that the proposed term "active fund" would unnecessarily divide an existing single category of buy-side market participants—private funds—in a way that will lead to problems of interpretation, administration and unfair treatment among private funds and between other buy-side participant groups under the proposed implementation rulemakings. We believe these problems can be avoided in the final rules by designating all private funds as Category 2 Entities, without introducing the definition of "active fund".

Moreover, the calculation of the numerical threshold of monthly swaps activity itself raises questions about which executed swaps should be counted (*e.g.*, whether partial tear-ups, novations, amendments or substitutions executed during the month should also be included, and what jurisdictional boundaries apply to those transactions) that will require additional time to clarify and resolve by fund operations personnel and Commission staff who will need to field questions and verify such calculations.

For the foregoing reasons, we respectfully suggest that the Commission remove the definition of "active fund" from the implementation rulemakings. Instead, we recommend that the Commission re-designate all private funds that are not SDs or MSPs as Category 2 Entities with a 180-day compliance schedule in the final implementation rulemaking. This compliance schedule will also allow market participants adequate time to make any business, infrastructure, or operational changes, including unwinding or significantly repositioning a portfolio in anticipation of mandatory clearing.

We believe that instead of trying to divide the private funds group, the Commission will secure its objective of a ramp-up of mandatory clearing by expressly requiring through the

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[16] The term "active fund" means "any private fund as defined in section 202(a) of the Investment Advisors Act of 1940, that is not a third-party subaccount and that executes 20 or more swaps per month based on a monthly average over the 12 months preceding the Commission issuing a mandatory clearing determination under section 2(h)(2) of the Act". Proposing Clearing and Execution Release at 58195.

[17] The term "Category 1 Entity" means "(1) a swap dealer, (2) a security-based swap dealer; (3) a major swap participant; (4) a major security-based swap participant; or (5) an active fund". Proposing Clearing and Execution Release at 58195.

combination of Sections 39.5(e)(2)(i) and 39.5(e)(3) of the final Proposed Clearing and Execution Implementation Rule that, during the first mandatory clearing phase, SDs and MSPs not only clear all trades with other SDs and MSPs, but that they be prepared and obligated to clear any trades with other market participants that desire, on a voluntary basis, to clear. The larger private funds will be highly motivated to ramp-up their clearing during this period, so that they do not convert to clearing in a "big bang" fashion on the 180th day to comply with the Category 2 Entity clearing mandate that would apply to them. By requiring SDs and MSPs to honor a fund's election to clear, we believe the Commission will achieve its objective of seeing increased early participation by larger funds. [18]

II. Adjust Effective Date for Mandatory Clearing Compliance Schedules

The Commission's proposed triggering event for the application of the three compliance schedules for Category 1, 2 and 3 Entities, respectively, would be the Commission's issuance of a determination that the swap, or group, category, type, or class of swaps, is required to be cleared.[19] Prior to requiring compliance with the first mandatory clearing determination issued by the Commission, the Prerequisite Clearing Rules must have been finalized and adopted.[20] For the first and all other subsequent mandatory clearing determinations issued by the Commission, the process (including a public comment period) for the Commission's mandatory clearing determination must have been completed, whether based on a Commission-initiated review or pursuant to a DCO submission with a 90-day Commission review period (or longer review period if the submitting DCO agrees to an extension of the Commission's determination deadline).[21] While market participants are now generally aware of which asset classes will be

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[18] As previously noted with respect to Section 39.5(e)(2)(i) of the Proposed Clearing and Execution Implementation Rule, the Proposing Clearing and Execution Release contemplates this voluntary opt-in ability: "The Commission proposes to phase in compliance with the mandatory clearing requirement for any swap transaction between a Category 1 Entity and another Category 1 Entity, or any other entity that desires to clear the transaction". Proposing Clearing and Execution Release at 58190 and 58191 (emphasis added). The Commission clarified the intent of this clause in footnote 42 of such Release, stating that it is designed to "facilitate clearing by counterparties that desire to comply with a clearing mandate earlier than they would otherwise be required to under the compliance schedule". MFA supports this opt-in approach for the broad range of funds that comprise our fund members. We believe that the combined effect of Sections 39.5(e)(2)(i) and 39.5(e)(3) of the Proposed Clearing and Execution Implementation Rule will obligate Category 1 Entities to honor the clearing request of a counterparty in Category 2 or 3. In this regard, we note that Section 39.5(e)(3) does not contain the same affirmative language for this voluntary opt-in ability as provided in Section 39.5(e)(2)(i). Rather, the text of Section 39.5(e)(3) reads as follows: "Nothing in this rule shall be construed to prohibit any person from voluntarily complying with the requirements of section 2(h)(1)(A) of the Act sooner than the implementation schedule provided under paragraph (2)". **For internal consistency, we urge the Commission to re-phrase or supplement the current text of such Section with more affirmative language that would obligate SDs as Category 1 Entities to clear trades from their non-MSP counterparties as Category 2 Entities or Category 3 Entities that desire to clear a swap or class of swaps earlier than such counterparties would otherwise be required to clear such trades under the applicable compliance schedule.**

[19] Proposing Clearing and Execution Release at 58189.

[20] *Id.* at 58188 and 58189.

[21] *Id.* at 58188.

among the first to move to mandatory clearing,[22] there is need for greater certainty in the timing of the Commission's adoption and publication of the remaining Prerequisite Clearing Rules. In this regard, we urge the Commission to set prompt and consistent effective dates for such final rules to facilitate market participants' review and evaluation of such rules.

Given the volume of each of the Prerequisite Clearing Rules and the related analysis required by market participants to review and to make adjustments in order to comply with them after they have all been published in the *Federal Register*, MFA respectfully suggests that the final Prerequisite Clearing Rules should become effective before the respective compliance phase-in schedules could be triggered by the Commission. The additional 60 days after publication of the last of the final Prerequisite Clearing Rules before commencing the 90-day, 180-day and 270-day compliance schedules for Category 1, 2 and 3 Entities, respectively, would provide market participants with the time necessary to interpret the final rules and to analyze the impact on their businesses. This additional time would also enable market participants to better manage their compliance obligations without unduly disrupting their operations and transactions, or excessively burdening their staffs and resources.

For each subsequent clearing mandate, MFA believes that the proposed compliance schedules will only be necessary for each new asset class of swaps—*e.g.*, rates, credit, commodity—that the Commission determines is required to be cleared. However, we believe the proposed compliance schedules will be unnecessary for mandatory clearing determinations for new types, groups or categories of swaps within the same asset class that is already subject to a prior clearing mandate. For all subsequent clearing mandates issued after the first mandate to clear the initial product set, we believe market participants will need adequate advance notice, which we expect will be provided by the Commission in its process for review of swaps for mandatory clearing.

III. Adjustments to Mandatory Trade Execution Compliance

Eliminate Phasing of Trade Execution and Adjust Effective Date of Trade Execution Compliance. MFA strongly believes that clearing is both a natural first step towards, and a prerequisite for, execution on SEFs and DCMs.[23] This sequence is also the one envisioned by the Dodd-Frank Act.[24] We are very concerned with having the execution requirement potentially

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[22] For the first mandatory clearing determination, the Commission has stated that it will consider mandatory clearing determinations based on those swaps that DCOs are currently clearing (*e.g.*, interest rate swaps, broad-based index credit default swaps, and commodity swaps) or that a DCO would like to clear. *Id.*

[23] *See* Annex A to MFA Implementation Letter, stating in relevant part: "Clearing (1) is a pre-condition to, or (2) at the very least would contribute to a more efficient/effective formulation of rules related to SEF trading, real-time reporting, etc. In fact, once participants begin widespread clearing their swaps, comparatively lower barriers to entry for execution platforms and the publication of prices by CCPs may result in achievement of some transparency goals".

[24] The trade execution requirement presupposes that the clearing requirement is already in effect for a given class of swaps. *See* Section 723(a)(8) of the Dodd-Frank Act. *See also* "CFTC Staff Concepts and Questions Regarding Phased Implementation of Effective Dates for Final Dodd-Frank Rules", available at:

coming into effect at the same time as the clearing requirement. This timing overlap substantially risks complicating and delaying the transition to central clearing. Progress in the transition to central clearing is much further along than the transition to SEF/DCM execution, and there is a burdensome overlap in terms of requirements on personnel, infrastructure, and capital resources to launch the two simultaneously. Linking them for implementation purposes brings them both down to the lowest common denominator, *i.e.*, the point at which the entire market is ready for execution on SEFs/DCMs. The added challenges of trading exclusively on SEFs may thus further delay the transition to mandatory clearing, unless the transition to clearing is allowed to proceed before the transition to SEF/DCM execution.

For the foregoing reasons, MFA firmly believes that the industry's energy should be focused first on ensuring that a robust clearing infrastructure is in place that will then later support execution on SEFs and DCMs. Confidence in the former (clearing) is key to the success of the latter (execution). MFA believes that the level of market confidence in clearing hinges on the benefits derived from real-time acceptance for clearing, and the elimination of documentation barriers and anti-competitive barriers. With such benefits, SEFs will invest and compete to deliver better transparency and therefore, better pricing. As market participants evaluate and begin using SEFs, the markets will further benefit from better liquidity.[25]

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http://cftc.gov/ucm/groups/public/@newsroom/documents/file/staffconcepts050211.pdf (the "**CFTC Staff Implementation Concepts**"). Concept item 11 reiterates the intended statutory sequence: "The statute provides for some natural sequencing. . . . [T]here can be no trading requirement prior to the Commission's determination that a swap is required to be cleared, a trading platform(s) has listed the swap for trading, and the Commission has determined that the swap is made available for trading".

[25] *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) filed with the Commission on April 11, 2011, available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=35520 (the "**MFA April Letter**"). In the MFA April Letter, MFA supported real-time acceptance of trades for clearing and requested that the Commission impose the same real-time acceptance timeframe for all trades. We also recommended that the Commission modify the proposed rule to prohibit DCOs from adopting rules or engaging in conduct that is prejudicial to indirect clearing members with respect to eligibility or the timing of clearing or processing of trades. MFA emphatically supported, and enumerated the benefits of, facilitating portability of a customer's portfolio and associated margin and we provided specific recommendations for enhancing portability. We also raised multiple concerns about trilateral guaranteed clearing arrangements and requiring them or similar documentation as a precondition to access to clearing. In response, we made a number of recommendations, including that the Commission prohibit executing parties and clearing members from imposing execution limits or other forms of restrictions that are anti-competitive or that otherwise limit a customer's ability to achieve best execution in the relevant market.

See also MFA's comments on the Commission's Notice of Proposed Rulemaking on "Customer Clearing Documentation and Timing of Acceptance for Clearing", 76 Fed. Reg. 45730 (Aug. 1, 2011) filed with the Commission on September 30, 2011, *see supra*, note 6 for link (the "**MFA Sept. Letter**"). In the MFA Sept. Letter, MFA strongly supported these 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 through real-time clearing. From a cost-benefit perspective, we emphasized the benefits of real-time clearing, combined with the elimination of the need for clearing members to build systems to administer execution sub-limits, to foster competitive FCM offerings, and to reduce barriers to clearing through FCMs. We encouraged the Commission to adopt final rules in the form proposed, with several

From a liquidity perspective, for execution on SEFs and DCMs to work smoothly, the market in a given swap contract should be able to shift critical mass from off-SEF/DCM execution to on-SEF/DCM execution. Otherwise, once a clearing requirement takes effect, the Commission's proposed implementation schedule could limit liquidity that Category 1 Entities and Category 2 Entities could access, while Category 3 Entities would have the option to execute bilaterally or on a SEF/DCM. The ensuing fragmentation of liquidity in this intermediate period would likely distort pricing and competition, and undermine the utility offered by SEFs or DCMs. The need for this uniform market shift to SEF/DCM execution of a swap or class of swaps speaks to why, at a minimum, the execution requirement should not become effective until after the clearing requirement has commenced, and substantial volumes of a class of swaps have been cleared as evidence that the industry is prepared to take the next step to mandatory SEF trading.

Stated differently, sound clearing is a fundamental prerequisite to SEF/DCM trading of cleared swaps. Only when sound clearing is implemented, and has developed sufficient liquidity, can SEF/DCM models be properly tested. It is possible that even without the execution mandate, once widespread clearing is underway, SEFs/DCMs will attract liquidity, further easing the transition to the execution mandate. Even if this is not realized in practice, with the industry first comfortable with clearing operations as a whole, we believe the migration of execution to SEFs/DCMs will be greatly facilitated. Finally, only when the SEF/DCM models are functioning on a sound foundation of clearing will it be possible for market participants to evaluate the comparative merits of competing SEFs and DCMs. This timing will allow much more prudent business decisions, and will likely encourage fairer and more robust competition among execution venues, rather than requiring market participants to commit to SEFs/DCMs without a voluntary proving period.

Accordingly, MFA strongly recommends that the Commission eliminate the phased implementation of the trade execution requirement and adjust the formulation of the effective date of the trade execution requirement.[26] Rather than linking the compliance schedule for the execution requirement to the compliance schedule for the clearing requirement, MFA respectfully proposes that the execution requirement be implemented for all relevant market participants at the same time, and at the earliest, only after the phase-in of the clearing requirement has been completed for Category 1, 2 and 3 Entities.

Clarify Meaning and Determination of "Made Available for Trading". While the Proposed Clearing and Execution Implementation Rule notes that it "does not address the manner in which it may be determined or established that a DCM or a SEF has made a swap

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clarifications that we recommended to ensure that these proposed rules work in tandem with the Commission's proposed rules on "Requirements for Processing, Clearing, and Transfer of Customer Positions" to protect open access, fair competition and real-time processing of trades from the moment of execution through communication of clearing disposition.

[26] *See supra*, note 11.

available for trading",[27] this construct is a critical component of the implementation rulemaking given that it is inextricably linked to when the compliance schedule for a trade execution requirement is triggered. MFA urges the Commission to clarify the "made available for trading" construct.

MFA believes that the "made available for trading" construct should be a distinct and separate legal standard from the "listing" of a swap by a SEF or DCM. Further, we recommend that the Commission have a process whereby it either certifies or reviews applications by SEFs or DCMs that wish to make a swap available for trading, similar to the Commission's process for review of swaps for mandatory clearing. We believe the Commission's active oversight role in the "made available for trading" determination process is in line with its statutory obligation to "promote the trading of swaps on swap execution facilities".[28] In this regard, while the Commission should take into account the factors raised by a SEF or DCM in support of its application to make swap products "available to trade," we believe the Commission should also establish objective, transparent criteria and clearly enunciated factors for consideration during the process for reviewing such swaps. MFA believes such measures would lend objectivity and uniformity to such assessments.[29] In this connection, we respectfully refer the Commission to the SEC's proposed rule and discussion of the "made available to trade" construct.[30] The SEC proposes that it would assume an active role in the "made available to trade" determination process by establishing objective measures for such a determination, rather than allowing a security-based swap SEF ("**SB SEF**") or a group of SB SEFs to establish such measures.[31] The SEC concluded that the "made available to trade" determination should be made separately from

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27 Proposing Clearing and Execution Release at 58189, footnote 34.

28 Section 733 of the Dodd-Frank Act. In the CFTC Staff Implementation Concepts, Commission staff have acknowledged the Commission's responsibility to determine that a swap is made available for trading as a pre-condition to having a trade execution requirement go into effect. *See supra*, note 24.

29 MFA's proposal would be an alternative to the Commission's Proposed Rule 37.10, which requires each SEF to conduct an annual review of swaps trading on its platform to determine whether it has "made available for trading" the swaps that it offers. In completing its annual review, the Commission instructs each SEF to consider the frequency of transactions of, and open interest in, the swap or similar swaps, and any other factor requested by the Commission. *See* Proposed Rule 37.10(b). *See also* MFA's comment letter to the Commission dated March 8, 2011, in response to the Commission's proposed rules on "Core Principles and Other Requirements for Swap Execution Facilities", 76 Fed. Reg. 1214 (Jan. 7, 2011), in which MFA recommends that the Commission apply Commission-approved objective, transparent criteria to determine when a SEF can make a swap "available for trading", and submits that it should be the Commission's responsibility to make the "available for trading" determination, rather than permitting individual SEFs to make the determination in their discretion. MFA's prior comment letter is available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=31242.

30 *See* SEC Proposed Rule on "Registration and Regulation of Security-Based Swap Execution Facilities", Release No. 34-63825, File No. S7-06-11, RIN No. 3235-AK93, 76 Fed. Reg. 10948 (Feb. 28, 2011), available at: http://www.gpo.gov/fdsys/pkg/FR-2011-02-28/pdf/2011-2696.pdf.

31 *Id.* at 10969.

the clearing requirement and the "listing" of a security-based swap product on a SEF.[32] Similarly, we believe the Commission should seek an active role in the "made available for trading" determination of swaps, and to harmonize the scope of its role with that proposed by the SEC with respect to security-based swaps. We believe both agencies have the statutory authority to make judgments about which swaps should be subject to the execution requirement, separate from those swaps that are subject to the clearing requirement.[33]

IV. Eliminate Implementation Phasing of Margin Requirements

While we strongly support the Commission's phased implementation sequence for market participants to make an orderly transition to mandatory clearing, we also wish to point out that the Commission's proposed phasing implementation by type of swap counterparty of certain provisions of the Margin Requirements under Section 4s of the CEA would create unfair disparities and inconsistent treatment among market participants.[34] We do not understand there

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[32] *Id.*, stating in relevant part that the SEC "would in effect interpret the phrase 'made available to trade' in Section 3C(h) of the Exchange Act as meaning something more than the decision to simply trade, or essentially list, a SB swap on a SB SEF or an exchange. [footnote omitted] This approach would have the further effect of permitting SB swaps to be made subject to mandatory clearing independently of whether they are required to be traded exclusively on SB SEFs and exchanges, because there would not be an automatic requirement that SB swaps subject to mandatory clearing trade only on a SB SEF or exchange simply because they are listed on one". *Id*. at 10969 (emphasis added).

[33] *See* Section 733 of the Dodd-Frank Act which adds section 5h(d)(1) to the CEA, stating as follows: "The Securities and Exchange Commission and the Commodity Futures Trading Commission may promulgate rules defining the universe of swaps that can be executed on a swap execution facility. These rules shall take into account the price and nonprice requirements of the counterparties to a swap and the goal of this section as set forth in subsection (e)".

[34] Similar to the three compliance schedules for the Proposed Clearing and Execution Implementation Rule based on categories of market participants, the Commission proposes a similar three-part implementation phasing for the Proposed Documentation and Margining Implementation Rule to afford SDs and MSPs over which the Commission has jurisdiction with additional time to come into compliance with the final Trading Documentation rule and the final Margin Requirements rule. The Proposing Documentation and Margin Release sets forth compliance schedules of 90, 180 or 270 days, depending on whether the counterparty to a swap is a Category 1 Entity, a Category 2 Entity, a Category 3 Entity or a Category 4 Entity (*i.e.*, any entity not otherwise included in Categories 1, 2 or 3). *Id.* at 58181. Under the Proposed Documentation and Margining Implementation Rule, a Category 1 Entity would be defined generally the same as under the Proposed Clearing and Execution Implementation Rule, with the exception that the time period used for determining whether a private fund is an "active fund" would be triggered by the publication in the *Federal Register* of either the final Trading Documentation rule or the final Margin Requirements rule, as applicable. *Id.* For the reasons we articulated in Section I above, we also urge the Commission to remove the active fund definition from the Proposed Documentation and Margining Implementation Rule and to group all private funds as Category 2 Entities with a 180-day implementation timeframe for purposes of implementing the final Trading Documentation rule.

See also MFA's comments on the Commission's Notice of Proposed Rulemaking on "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants", 76 Fed. Reg. 23732 (Apr. 28, 2011) filed with the Commission on July 11, 2011, available at:

http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47780

to be any basis for the imposition of higher margin requirements and potentially disparate pricing for uncleared swaps on Category 1 Entities before Category 2, 3 and 4 Entities, and similarly, on Category 2 Entities before Category 3 and 4 Entities. These requirements should be implemented for all relevant market participants at the same time. Therefore, we respectfully propose that there be one Margin Requirements compliance date for all relevant market participants that would become effective only after the later of the phase-in of the clearing requirement has been completed for Category 1, 2 and 3 Entities and the latest effective date of the final Trading Documentation rule and final Margin Requirements rule (*i.e.*, 60 days after the last of such rules is published in the *Federal Register*). This additional 60 days prior to triggering such compliance date would ensure market participants have adequate lead time to evaluate the final Trading Documentation rule and the final Margin Requirements rule and to assess which adjustments need to be made to their trading documentation, business models and portfolios in an orderly manner before the compliance deadline.

V. Proposed Implementation Rules Are Justified under a Cost-Benefit Analysis, with the Exception of the Proposed Implementation of the Margin Requirements

From a cost-benefit analysis perspective, we believe a phased implementation of the clearing requirement is superior to implementing the clearing requirement for all market participants at the same time. As discussed above, we believe that market participants will benefit from the Proposed Clearing and Execution Implementation Rule, with our recommended adjustments, as it will both provide certainty and allow sufficient time for the industry to go through multiple testing and trading cycles and to build to full-scale clearing of liquid and standardized swap products, before focusing on the next wave of implementation work to achieve a successful transition to SEF/DCM execution. The U.S. markets will also benefit from the Commission's phased implementation approach and firm timetable for making clearing mandatory by motivating all relevant market participants to make deliberate progress to: (1) fulfill the key goal of the Dodd-Frank Act to see widespread transfer of risk held by both sell-side and buy-side market participants from bilateral arrangements to central clearing; and (2) meet reasonable overall systemic risk mitigation risk commitments under the Dodd-Frank Act timeframes and the G-20 commitment deadline. Providing such motivation and certainty to the marketplace will advance efforts to move toward an improved market structure that mitigates systemic risk, improves pricing and transparency, fosters open access, and promotes competition. We believe there is ample evidence that if a robust clearing infrastructure is in place, SEFs and DCMs will progress rapidly, in large part through healthy competition. For these reasons, as well as the reasons set forth above, we believe an optimal cost-benefit balance can be achieved if

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(the "**MFA Margin Letter**"). In the MFA Margin Letter, we urged the Commission to (i) issue margin requirements that promote a fair and stable market for uncleared swaps; (ii) coordinate their margin rules with the SEC and prudential regulators; and (iii) require SDs and MSPs without a prudential regulator to post and collect variation margin. We also emphasized that it is critical that the Commission permit financial entities to use robust netting arrangements in order to net across many different exposures and assets. Otherwise, overall funding costs for delivering margin will increase. In the aggregate, these incremental costs might be quite large.

the industry and regulators concentrate their efforts on making a timely shift of risk to mandatory clearing first, before turning their efforts to the implementation of mandatory trade execution.

We do not believe the timeframes set for the phase-in of mandatory clearing are reasonable, and should give sufficient time for the respective Categories of market participants to make the necessary adjustments for compliance. However, with respect to the Proposed Documentation and Margining Implementation Rule, we do not believe phase-in is appropriate. MFA believes that such an approach would distort pricing and competition across the marketplace by forcing certain counterparties to pay higher margin amounts before other counterparties with longer phase-in schedules. In this regard, we see no justification from a cost-benefit perspective to impose disparate and prejudicial cost burdens on early adopters.

Assuming the Commission adequately addresses these concerns, we believe that setting forth a firm implementation timetable by rulemaking, with the Commission's proposed intervals as adjusted herein, will benefit the U.S. markets substantially, by eliminating uncertainty, permitting investment and ensuing competition, and increasing confidence through progressive transfer of risk to clearing and establishment of a foundation for significantly increased transparency in these markets.

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MFA thanks the Commission for the opportunity to provide comments regarding the Proposed Implementation Rules. Please do not hesitate to contact 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. Bart Chilton, Commissioner
The Hon. Jill E. Sommers, Commissioner
The Hon. Scott D. O'Malia, Commissioner
The Hon. Mark P. Wetjen, Commissioner