

# SPRING TRADING, INC.

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February 13, 2012

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

**Re: RIN 3038-AD18: Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade**

Dear Mr. Stawick:

The Commodity Futures Trading Commission ("CFTC" or "Commission") has requested public comment on proposed rules published in the Federal Register ("the Proposal") that would establish a process for a designated contract market ("DCM") or swap execution facility ("SEF") to make a swap "available to trade" as set forth in new Section 2(h)(8) of the Commodity Exchange Act ("CEA" or the "Act") pursuant to Section 723 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). Our firm, Spring Trading, Inc. ("Spring Trading"), operates a service called TeraExchange, and we are submitting a second comment letter on this rule proposal to follow up on our initial comment letter, which was submitted to the Commission on January 12, 2012.

This comment letter will focus specifically on the determination of whether one swap is "economically equivalent" to another swap. Under the Proposal, an "economically equivalent" swap would be a swap that the SEF or DCM initially determines to be economically equivalent with another swap after consideration of each swap's material pricing terms, with that determination then being submitted to the CFTC for its review and oversight.

Spring Trading has filed notice with the Commission for operation as an exempt board of trade ("EBOT") and will submit a name change to shift EBOT status to TeraExchange. TeraExchange intends to apply to the CFTC for designation as a SEF and/or as a DCM and with the Securities and Exchange Commission as a security-based ("SB") SEF. TeraExchange will provide the market with a fully transparent electronic central limit order book execution facility for clearable swaps along with a sophisticated cross-asset trading, data and analytics platform, which will enable participants to connect to TeraExchange as well as to other liquidity venues across multiple regions and asset classes.<sup>1</sup> All trades will be cleared with the authorized derivatives clearing organization. TeraExchange anticipates listing essentially all cleared swap products for trading, including credit default, interest rate, energy, agricultural and FX swaps.

We find it reasonable that the SEF or DCM make the initial assessment on whether another swap is economically equivalent and then have that assessment be submitted to the CFTC for its further review and oversight. However, there is need for greater guidance from the CFTC as to the relevant factors or objective criteria that should be considered by a SEF or DCM in making that initial assessment. As a note, providing some form of guidance or objective criteria thereby would provide a basis that could be

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<sup>1</sup> For participants wishing to connect directly to TeraExchange via in-house and 3<sup>rd</sup> party applications, FIX and FIX FAST connectivity will also be offered. TeraExchange will also provide full voice support and execution consulting for customized transactions and block trades. All orders submitted to TeraExchange must first pass through a pre-trade credit checks set by the customer's clearing member.

addressed by the SEF or DCM when it submits its reasoning to the CFTC on its initial determination on economic equivalence.<sup>2</sup>

In particular, given that the term “economically equivalent” does not already have an established definition in financial markets, it is therefore necessary to identify relevant factors based on the regulatory objective to be achieved.<sup>3</sup> While the term “economically equivalent” is also utilized in the context of open access for Derivative Clearing Organizations (“DCOs”), a different regulatory purpose or objective is triggered at the trading stage (as contrasted with the clearing stage) in the life of the swap. It is relevant to consider the regulatory purpose for the economically equivalent determination in the context of the made available to trade (“MATT”) determination. The MATT determination should involve some consideration of the extent of liquidity available for a particular swap. Accordingly, it also makes sense to analyze the factors relevant to considering economic equivalence at the SEF or DCM level in an analysis that focuses on the factors relevant to a trader comparing two different swaps as possible price substitutes.

For example, suppose that there is a natural gas swap listed for trading on various SEFs that is cleared by the CME and at some point one of the SEFs submits a rule filing that goes into effect and that identifies that swap as made available to trade. Suppose also that there is a natural gas swap with the same product terms that is cleared at a different DCO (for example ICE or LCH). (Assume for purposes of this example that SEFs and DCMs list swaps as separate products depending on where those swaps are cleared.) Should that second swap be deemed to be economically equivalent even though it is cleared by a separate DCO? Some might respond that the value proposition for the second swap is distinct from the first swap because the initial margin and other clearing requirements could be different at ICE and LCH as contrasted with the CME.

While that is true, in our experience, most traders who are primarily trading the CME-cleared swap would nonetheless want to follow the pricing in an ICE-cleared swap with the same product terms. In other words, in this trading context, fungibility is simply not the end of the analysis because in this case there is no fungibility given that the two competing swaps are cleared by totally separate DCOs. What is relevant is the extent to which these two competing swaps could be considered to be close price substitutes for one another.<sup>4</sup>

As another example, suppose that ICE lists two natural gas swaps for clearing that have the same product terms, except that one swap has a one-year duration and the second swap has a duration of two

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<sup>2</sup> As to ensuring compliance, once a particular swap has been determined to be economically equivalent, that determination could be reflected both as a special ID code with respect both to the trading on a DCM or SEF as well as in the records to be maintained by the applicable swap data repository.

<sup>3</sup> In this regard, we appreciate the concerns noted by Commissioner Sommers at the CFTC’s December 20 meeting regarding the use of similar but different terms (*i.e.*, “economically related”, “economically fungible” and “economically equivalent”) in various Commission rule proposal. At that meeting, Chairman Gensler requested that CFTC staff undertake a review of these terms; we support that review and further support efforts to provide consistency across the various rule initiatives now underway. Consequently, we realize that the final rules in this area may utilize a term other than economically equivalent.

<sup>4</sup> Last year, the CFTC provided regulatory approval to allow the New York Portfolio Clearing Corporation and DTCC’s FICC to proceed to offer cross-margining relief for fixed income cash and futures positions. This action seemingly recognizes that even products that are disparate from a regulatory perspective and that may not share the same exact terms can nonetheless be highly correlated in price and so can mitigate or reduce market risk.

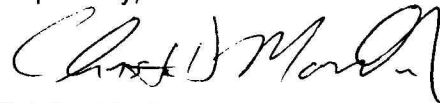
years. Suppose that the CME also lists for clearing natural gas swaps with the same product terms that are of one and two year durations. In addition, the CME also lists for clearing a natural gas swap with the same product terms that is of 18 months duration. Suppose further that a SEF submits the appropriate filing to the CFTC that results in those two natural gas swaps that are cleared by ICE as being identified as MATT. How should this affect the trading of those three natural gas swaps that are cleared by the CME? In our view, the one year swap and two year swap cleared by the CME both should be deemed to be economically equivalent, but so too should the 18-month swap, as a trader would take into account the pricing activity of that 18-month swap when trading either the one year swap or the two year swap.

As a further example, suppose that the one year swap in the prior example that is cleared at ICE is submitted to the CFTC by a SEF and identified as MATT. Suppose in addition that a market participant establishes a long position in that swap when it is first listed for trading and holds that position for six months but then wants to offset that position. Depending on how trading is structured at a particular SEF or DCM, one possible approach would be for the market participant to establish a short position in a swap of six months duration in order to achieve that offset.

In our view, the liquidity of the market for the MATT swap can best be supported by having swaps with the same product terms but with shorter durations be deemed to be economically equivalent. In other words, a trader will have greater confidence in trading in the MATT swap if that trader knows that his or her initial position can be easily offset because transaction flow in swaps of shorter duration has been channeled so as to be available in the centralized trading venue of that SEF or DCM. Given the value of considering two competing swaps as price substitutes for each other, it could also then be useful to a determination on economic equivalence to assess the extent of arbitrage that occurs between those two swaps. Consequently, at least some of the analysis undertaken by the CFTC staff in the context of considering whether a particular OTC product should be deemed to be a "significant price discovery contract" could also be relevant in an assessment on economic equivalence.

In conclusion, TeraExchange very much appreciates the diligence, insight, and hard work of the CFTC and its staff as the development of SEF regulation unfolds. As to the process of determining economic equivalence, we believe that there is need for greater detail and clarity in the definition for an economically equivalent swap. We look forward to working with the CFTC to achieve the Congressional objective of promoting swap trading on SEFs. If you have any comments or questions about our comment letter or SEF issues generally, please contact me at [cmartin@teraexchange.com](mailto:cmartin@teraexchange.com) or at (908) 273-8288.

Respectfully,



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Chief Executive Officer  
Spring Trading, Inc.  
d/b/a TeraExchange

cc: Chairman Gary Gensler  
Commissioner Bart Chilton  
Commissioner Jill Sommers  
Commissioner Scott O'Malia  
Commissioner Mark Wetjen