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February 13, 2012

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

Re: RIN 3038-AD18 – Process for Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade under Section 2(h)(8) of the Commodity Exchange Act

Dear Mr. Stawick,

Vanguard¹ appreciates the opportunity to provide the Commodity Futures Trading Commission (the “CFTC” or “**Commission**”) with our views on the Commission’s proposal that would establish a process for a designated contract market (“**DCM**”) or swap execution facility (“**SEF**”) to make a swap available to trade (“**MAT**”)² (the “**Proposal**”) pursuant to the overall mandate for certain swaps to be traded solely on a DCM or SEF and no longer over-the-counter, as a part of the new regulatory regime enacted by the derivatives title (“**Title VII**”) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “**Dodd-Frank Act**”).

Vanguard is fully supportive of the mandate of Title VII to bring much-needed regulation to the derivatives markets including subjecting derivatives to regulatory oversight and requiring the clearing of standardized swaps. As a part of the prudent management of our mutual funds and other portfolios, we enter into over-the-counter swaps, and exchange-traded futures and options (collectively, “**futures**”) to achieve a number of benefits for our investors including hedging portfolio risk, lowering transaction costs, and achieving more favorable execution compared to traditional investments.

The MAT process proposed by the Commission requires the DCM or SEF to evaluate a swap and, following such evaluation, propose such swap for approval by the Commission to be mandated for DCM or SEF trading. Such evaluation may consider any of seven factors, or such other factors as may be considered relevant by the DCM or SEF.³ Once mandated for DCM or

¹ Vanguard is a Securities and Exchange Commission (“**SEC**”) registered investment adviser with more than \$1.5 trillion in assets under management. Vanguard offers more than 170 U.S. mutual funds and serves approximately 9 million shareholders.

² Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade, 76 Fed. Reg. 77,728 (proposed December 11, 2011) (amending 17 CFR Parts 37 and 38).

³ The factors proposed by the Commission include: (1) whether there are ready and willing buyers and sellers; (2) the frequency or size of transactions on SEFs, DCMs, or of bilateral transactions; (3) the trading volume

SEF trading, market participants will no longer be permitted to trade such swap over-the-counter (“OTC”). While the factors proposed by the Commission address the liquidity of the applicable swap, the assessment of none of the factors is required, no liquidity standard or threshold has been established, and the DCM or SEF, and not the Commission, performs the evaluation.

Given the size and complexity of the swap market, the absence of meaningful data on swap liquidity, the complex infrastructure yet to be developed and perfected to digest the wholesale clearing and trading of all swaps, and the inherent conflict presented by appointing the DCMs and SEFs as decision-makers where the expedited shift of the market from OTC to DCM or SEF trading will present a huge boon to such DCMs or SEFs, Vanguard cautions the Commission to allow time to gather the relevant facts, to assess the ripeness of key market components and to either retain the ultimate discretion or appoint a balanced team of market experts to make the MAT assessment and recommendation.

For the reasons outlined below, Vanguard supports a more thoughtful, measured approach based on the following objectives:

- **Adhere to a phased implementation schedule for mandated swap reporting, clearing and trading over a 30 month period based on mandate and participant type.**
- **Establish a “Pilot Program” whereby select swaps are identified for DCM and SEF trading mandates to facilitate infrastructure build-out.**
- **Analyze data gathered by swap data repositories (“SDRs”) to formulate minimum liquidity thresholds to guide MAT determinations.**
- **House the swap assessment for the MAT determination in the CFTC or, in the absence of adequate resources, in a balanced working group of expert market participants.**
- **Refresh MAT determinations quarterly, allow adequate time for public comment and an extended time for implementation of each new MAT mandate to enable market connectivity and avoid disruptions in liquidity.**

on SEFs, DCMs, or of bilateral transactions; (4) the number and types of market participants; (5) the bid-ask spread; (6) the usual number of resting firm or indicative bids and offers; (7) whether a SEF’s trading system or platform or a DCM’s trading facility will support trading in the swap; or (8) any other factor that a SEF or DCM may consider relevant.

I. Adhere to a phased implementation schedule for mandated swap reporting, clearing and trading over a 30 month period based on mandate and participant type.

As noted in Vanguard's comment letter to the CFTC dated November 4, 2011 relating to the implementation timetable for derivatives reforms, while risk reduction and increased transparency are dual objectives of the Dodd-Frank Act, given the significance of the market dislocations experienced in 2008, tools to mitigate perceived risks in the swaps markets must receive prioritization with respect to rule implementation. Issues related to counterparty risk and margin levels figured heavily in the causes of the crisis and deserve expedited reforms.

Initiatives aimed at achieving enhanced market transparency are valuable both to level the playing field with respect to product availability and pricing as well as to provide regulators a window to assess market weaknesses, however these goals must be viewed as secondary to those addressing the sources of potential systemic risk. Moreover, the proposed tools to enhance transparency, such as mandated exchange trading and public reporting of trades, also present significant risks to the liquidity of certain parts of the swaps market.

If there is any doubt as to the enormous investment in market infrastructure needed to accomplish the proposed reporting, clearing and trading reforms, the intense effort underway to achieve such goals, and the current state of unreadiness of the SDRs, derivatives clearing organizations ("**DCOs**"), futures commission merchants ("**FCMs**"), DCMs, SEFs and market participants generally, we urge the Commission to enter into regular dialogue with the FIA / ISDA working groups and other relevant groups for status updates.

For these reasons, Vanguard recommends a phased implementation approach starting with reporting, then clearing and, only after collected data is analyzed and market infrastructures are robust, ending with mandated DCM or SEF trading.

For swap dealers, major swap participants ("**MSPs**") and highly active market participants (more than 200 swaps per month) ("**Active Funds**"), we recommend that following rule finalization, mandated reporting should apply in six months, mandated clearing in twelve months and mandated DCM or SEF trading in eighteen months.

For non-fund "financial entities" that are not swap dealers or MSPs and private funds that are neither Active Funds nor "third party sub-accounts" (managed accounts that are not funds), we recommend that following rule finalization, mandated reporting should apply in twelve months, mandated clearing in eighteen months and mandated DCM or SEF trading in twenty-four months.

For non-financial end-users, "third-party subaccounts" and funds other than private funds, we recommend that following rule finalization, mandated reporting should apply in eighteen

months, mandated clearing in twenty-four months and mandated DCM or SEF trading in thirty months.

Absent such a measured, informed approach, reforms designed to mitigate risk and improve transparency are likely to present significant impediments to liquidity.

II. Establish a “Pilot Program” whereby select swaps are identified for DCM and SEF trading mandates to facilitate infrastructure build-out.

In support of our recommended implementation timeline for market reforms, Vanguard is an active member in key industry initiatives to develop the future state of market infrastructure, including a robust new clearing and trading architecture and new standard legal documentation, each anticipating ongoing rulemaking.

We are aware that certain parties have advocated that the MAT determination should be relatively straightforward, with either all swaps currently cleared, or all swaps currently listed for trading, to receive MAT status. However we believe such an approach was never the intention of Congress in enacting the Dodd-Frank Act. Moreover, given the significant differences in swap liquidity, such an approach could have unintended negative consequences in terms of swap pricing, liquidity and even availability.

While a thoughtful, informed approach is needed, to expedite the development of new businesses for swaps trading, including DCMs and SEFs, and new business models for swaps clearing, including DCOs and FCMs, we enthusiastically support the initiation of a “Pilot Program” whereby select swaps can be identified early for mandated clearing and DCM and SEF trading. A balanced team of experts from DCOs, FCMs, DCMs, SEFs and market participants on both the buy and sell sides should be assembled and tasked with formulating the initial list of swaps for MAT status. This initial list should comprise the most liquid swaps currently cleared and traded on DCMs and SEFs.

Armed with an agreed list of swaps for MAT status, all market participants can more easily work to build out their business models, infrastructure and connectivity to best ensure the smooth transition to the ultimate DCM or SEF trading mandates on the timeline advocated above.

III. Analyze data gathered by SDRs to formulate minimum liquidity thresholds to guide MAT determinations.

We agree with the Commission that for a swap to qualify for MAT treatment, relative liquidity must be assessed with only highly liquid swaps to be excluded from the OTC market to trade exclusively on DCMs or SEFs. We also agree that the factors specified by the Commission are relevant to this assessment. However, as each factor is relevant, the consideration of *all* such factors should be mandated.

In addition to the required consideration of all such factors, several are so critical to a liquidity assessment that a swap should not qualify for MAT treatment unless rigorous standards associated with such factors are met. For a swap to be mandated for trading only on a DCM or SEF, over the previous calendar quarter it must trade at least a minimum number of times each day, it must have a minimum number of market participants in active trading and it must meet an overall notional trading volume per quarter.

Trade frequency levels, number of market participants and overall notional volume should be assessed based on existing trading on both DCMs and SEFs as well as in the OTC market. It is critical that a meaningful percentage of existing trading is actually performed on a DCM or SEF to demonstrate that the DCM and SEF approach has reached a critical mass in terms of creating an active trading market that can accommodate all existing and future trading volumes in the relevant swap.

Consistent with our proposed implementation timeline, the Commission can use the data acquired by the SDRs early in the process to inform its establishment of appropriate liquidity standards. While such standards may differ across asset classes, it is important for there to be objective benchmarks to guide MAT determinations on a consistent basis. Such consistency will benefit the market as heightened liquidity in particular swaps evolves to trading on execution facilities.

IV. House the swap assessment for the MAT determination in the CFTC or, in the absence of adequate resources, in a balanced working group of expert market participants.

For MAT determinations to be legitimate, it is imperative that the parties making the assessment be free from potential business conflicts. While it would be ideal for such a role to reside in the CFTC, if resource constraints necessitate an alternative, an independent, impartial, and expert committee should be established for this purpose.

The determinations of such a group could avoid any potential taint of business exigency, and better ensure that unexpected negative consequences involving pricing, liquidity and availability not arise as overall pricing transparency is pursued.

Such a group could formulate the list of swaps to be included in the Pilot Program, could analyze SDR data to recommend liquidity standards for application in assessing future swaps for MAT treatment, could digest lessons learned from the Pilot Program and could perform quarterly reassessments of previous MAT determinations. While DCMs and SEFs would be key members, we'd expect such a group would also include swap dealers, MSPs and the most active buy-side market participants.

V. Refresh MAT determinations quarterly, allow adequate time for public comment and an extended time for implementation of each new MAT mandate to enable market connectivity and avoid disruptions in liquidity.

We expect the swap data to indicate that liquidity levels with respect to specific swaps fluctuate over time. It is possible that a swap that once traded in significant volumes, with a broad mix of market participants, may eventually ebb in liquidity. For this reason, we believe it is important to reassess MAT status at least quarterly. Absent such reassessment, it may be challenging to gain access to the swap on a DCM or SEF or to do so at a reasonable price.

In addition, we believe that once a MAT recommendation is submitted to the Commission for approval, there needs to be a reasonable period for public comment. At minimum, we believe 30 days is needed for the public to analyze any supporting data and submit views as to the merit of a MAT designation.

Finally, we believe that once a MAT designation is made, there needs to be adequate time for the market to react to ensure that participants have full connectivity to the relevant DCM or SEF so as not to be locked out of trading the particular swap. While a relatively longer period (e.g., ninety days) makes sense for at least the first few years of the trading mandate, such implementation period may be shortened over time as market participants become more seasoned with respect to DCM or SEF trading.

For all of these reasons, we urge the Commission to reconsider its proposed approach for MAT designation. To avoid unintended negative consequences, there needs to be adequate time to gather and analyze data and to establish standards for assessing critical liquidity factors. If the CFTC cannot own the MAT determinations, a balanced, independent, and neutral group of market experts needs to be established to legitimize the process. There must also be adequate time for public comment and for the implementation of each MAT designation. Far from any desire to slow the move toward change, we earnestly believe that without these key fixes, the overall risk-reducing elements of the swaps market could be irreparably damaged. Time for both infrastructure development and informed rulemaking is the best answer to achieve the overall objectives of Title VII: namely to open access to derivatives markets for all parties with robust clearing and trading methodologies designed to minimize market and credit risk and provide best execution and ample liquidity across products.

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We'd like to thank the Commission for the opportunity to comment on the MAT Proposal and appreciate the Commission's consideration of Vanguard's views. If you have any questions

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about Vanguard's comments or would like additional information, please contact William Thum, Principal, at (610) 503-9823 or Michael Drayo, Senior Counsel at (610) 669-4294.

Sincerely,

/s/ Gus Sauter

Managing Director
and Chief Investment Officer
Vanguard

/s/ John Hollyer

Principal and Head of Risk Management
and Strategy Analysis
Vanguard

cc: Commodity Futures Trading
Commission

The Honorable Gary Gensler

The Honorable Jill E. Sommers

The Honorable Bart Chilton

The Honorable Scott D. O'Malia

The Honorable Mark P. Wetjen