



September 6, 2012

Via Electronic Submission: <http://comments.cftc.gov>

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, D.C. 20581

Re: CFTC Notice of Proposed Rulemaking on Clearing Requirement Determination Under Section 2(h) of the CEA (RIN 3038-AD86)

Dear Mr. Stawick:

Managed Funds Association (“**MFA**”)¹ appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the “**Commission**”) on its notice of proposed rulemaking to establish a “Clearing Requirement Determination Under Section 2(h) of the CEA” (the “**Proposed Clearing Determination**”)² under Title VII³ of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “**Dodd-Frank Act**”)⁴. The Proposed Clearing Determination would: (i) require that certain classes of credit default swaps (“**CDS**”) and interest rate swaps (“**IRS**”) be cleared by a derivatives clearing organization (“**DCO**”); and (ii) establish regulations to prevent potential evasion of the clearing requirement and abuse of any exception or exemption to the clearing requirement by any person. MFA wishes to note that it supports the efforts of the Commission and other regulators to clear liquid and standardized derivatives as a means to protect against systemic risk. Accordingly, we offer these comments in the spirit of working to address practical issues in furtherance of the move to derivatives clearing.

¹ Managed Funds Association 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 alternatives 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 Notice of Proposed Rulemaking on “Clearing Requirement Determination Under Section 2(h) of the CEA”, 77 Fed. Reg. 47170 (Aug. 7, 2012) (the “**Proposed Clearing Determination Release**”).

³ Entitled “The Wall Street Transparency and Accountability Act.”

⁴ Pub. L. No. 111-203, § 701, 124 Stat. 1376 (2010).

Executive Summary

MFA strongly supports the Commission's decision to focus on CDS and IRS in its initial clearing requirement determination. In general, we agree with the product scope in the Commission's first Proposed Clearing Determination. However, we have practical implementation concerns specific to the iTraxx® Europe CDS indices (the "iTraxx class") given the potential timing mismatch between: (i) the effective date of the clearing requirement and (ii) the availability of a customer clearing offering. Otherwise, we believe each of the specified classes of IRS and CDS products satisfies the five statutory factors that the Commission is required to consider in reviewing swaps for mandatory clearing.⁵

While we believe the iTraxx class is suitable for mandatory clearing, we are concerned that customers are currently unable to clear the iTraxx class, and that a customer clearing offering for the iTraxx class may not be available until shortly before, or even possibly after, the clearing requirement for the iTraxx class becomes effective. This potential scenario would limit the time customers have to test clearing of the iTraxx class on a voluntary basis prior to mandatory clearing, or put customers in the uncertain, and perhaps untenable, position of having to comply with a clearing requirement for the iTraxx class before any customer clearing offering is available. We believe the Commission has a number of options at its disposal to resolve this anomaly, as outlined further in Section II below. We thus respectfully recommend that the Commission affirmatively address this scenario by ensuring that, following the date that clearing of the iTraxx class is available to *all* market participants, there is a 60- to 90-day implementation period before market participants are subject to the clearing requirement for the iTraxx class. The Commission should also more proactively consider the availability of customer clearing in its future clearing requirement determinations.

I. The Commission Should Not Require Clearing of the iTraxx Class until a Reasonable Period of Time after Clearing has been Made Available to All Market Participants

While we believe the iTraxx class broadly meets the five statutory factors that the Commission is required to consider in reviewing swaps for mandatory clearing, we are concerned that the iTraxx class is currently unavailable for customer clearing. The effective date for any clearing requirement for the iTraxx class needs to be coordinated with the availability of a customer clearing offering for the iTraxx class. Further, the effective date must provide for a reasonable implementation period during which customers can clear the iTraxx class on a voluntary basis to fully vet clearing offerings and test related operational processes.

⁵ The five statutory factors for mandatory clearing determinations by the Commission are summarized as follows: (1) the existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data; (2) the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract; (3) the effect on the mitigation of systemic risk, taking into account the size of the market for such contract; (4) the effect on competition; and (5) the existence of reasonable legal certainty in the event of insolvency of the relevant DCO. See Commission Regulation §39.5(b)(3)(ii).

If the Commission does not address this issue in its final clearing requirement determination for the iTraxx class, buy-side market participants would find themselves in, at best, the uncertain position of assuming the clearing requirement does not apply to them since no customer clearing offering is available,⁶ and at worst, the untenable position of having to comply with the clearing requirement before it is possible to do so. There is a further undesirable scenario in which a customer clearing offering for the iTraxx class becomes available just days before the clearing requirement for iTraxx comes into effect. In this scenario, customers would be left without adequate time to test and ensure operational readiness for clearing their trades in the iTraxx class.

To alleviate these concerns, MFA asks that the Commission ensure that market participants are provided with a 60- to 90-day implementation period, following the date when a DCO makes customer clearing of the iTraxx class available, prior to the clearing requirement for iTraxx becoming effective. We strongly believe that a 60- to 90-day implementation period would be a reasonably sufficient window of time for buy-side market participants, such as Active Funds as Category 1 Entities and other private funds as Category 2 Entities, to undertake the requisite testing to ensure that they are operationally ready for mandatory clearing of their trades in the iTraxx class.

II. The Commission Has the Statutory Authority to Properly Sequence the Effectiveness of the Clearing Requirement for the iTraxx Class After Clearing has been Made Available to all Market Participants

We believe the Commission has the authority to take appropriate actions to address the iTraxx class issues in its final clearing requirement determination and to provide for a reasonable implementation period after the iTraxx class becomes available for clearing by *all* market participants. We specifically urge the Commission to consider one of the following courses of action to resolve the situation:

- In the Commission's final rule on the process for review of swaps for mandatory clearing⁷, the Commission is empowered to issue a stay of the clearing requirement, either on its own initiative or by application of a counterparty.⁸ If the Commission uses this option, we would respectfully urge the Commission itself to issue the stay for the iTraxx class at the same time the Commission issues its final clearing determination, rather than relying on one or more counterparties to apply for it.

⁶ We note, for example, that in §39.5(c)(3), the Commission contemplates a situation in which no DCO has accepted a swap for clearing, but for a number of reasons, we do not believe it provides certainty to buy-side market participants as to their compliance status with a clearing requirement.

⁷ Commission Final Rule on "Process for Review of Swaps for Mandatory Clearing", 76 Fed. Reg. 44464 (July 26, 2011).

⁸ See *id.* at 44474 for Commission Regulation §39.5(d), which provides the Commission with the ability to stay the clearing requirement until the Commission completes a review of the terms of the class of swaps and the clearing arrangement.

- In the Commission’s final rule on swap transaction compliance and implementation schedule for the clearing requirement, the Commission has discretion as to when and how it uses the prescribed phased implementation schedule.⁹ The Commission could therefore tailor the phased implementation schedule for the iTraxx class only, such that it does not begin until the date upon which a DCO makes iTraxx available for customer clearing.
- The Commission is also authorized to consider other factors beyond the five statutory factors, such as the availability of customer clearing, in reviewing swaps for mandatory clearing¹⁰. Thus, the Commission could elect at this point not to include the iTraxx class in this final clearing requirement determination, but rather to consider it in a future review of swaps for mandatory clearing pursuant to a new submission from a DCO once that DCO has made iTraxx available for clearing by all market participants.

We respectfully offer these suggestions as ways for the Commission to take appropriate and authorized actions to address our concerns with respect to the timing of mandatory clearing of the iTraxx class. Each option could be used to provide buy-side market participants with the requested 60- to 90-day period to ensure that customers are afforded ample time following the availability of a customer clearing offering for the iTraxx class before making the clearing mandate effective for the iTraxx class.

III. The Commission Should Consider the Availability of Customer Clearing in its Future Clearing Requirement Determinations

In future determinations, we respectfully urge the Commission to carefully consider the availability of client clearing for a particular swap or class of swaps in its process for review of swaps for mandatory clearing. We strongly recommend that the Commission should request that DCOs confirm the availability of customer clearing when they submit contracts for the Commission’s review. With respect to this Proposed Clearing Determination, ensuring that customers have a reasonable and practical implementation period after the iTraxx class becomes available for customer clearing, but before the clearing mandate applies to the iTraxx class, would establish the right precedent for the Commission’s future clearing requirement determinations.

IV. The Commission Should Coordinate with the SEC to Approve Pending Portfolio Margining Petitions to Address the Potential Restructuring Event Complexities with the iTraxx Class

⁹ 77 Fed. Reg. 44441 (July 30, 2012) at 44456 for §50.25(b): “Upon issuing a clearing requirement determination ... the Commission **may** determine, based on the group, category, type, or class of swaps subject to such determination, that the following schedule for compliance with the requirements ... shall apply:...” (**emphasis added**)

¹⁰ See *id.* at 44473-74 for Commission Regulation §39.5(b)(3)(ii) and (ix) (requiring that a DCO submission statement should include, “but is not limited to,” information that will assist the Commission in making an assessment of the five statutory factors; the Commission is authorized to specifically request any additional information).

There is a final technical issue regarding the iTraxx class. We understand that the iTraxx class presents some complexities due to the existence of a Restructuring credit event in the standardized legal documentation for such class. These complexities arise after a Restructuring credit event is triggered with respect to a reference entity in the applicable index, whereby a single-name CDS trade on such reference entity would be created. The resultant single-name CDS transaction would be a new security-based swap subject to the jurisdiction of the Securities and Exchange Commission (“SEC”). We recently confirmed with ICE Clear Credit that they are making progress in testing scenarios to handle these complexities.

We also confirmed with ICE Clear Credit that such complexities would be substantially resolved if the Commission and the SEC promptly issued their respective orders approving ICE Clear Credit’s pending portfolio margining petitions. Such petitions seek approval to: (1) hold in a cleared swap account subject to Section 4d(f) of the Commodity Exchange Act, as amended, customer funds and other property used to margin, secure or guarantee cleared positions in both broad-based index CDS, including the iTraxx class, and single-name CDS, including any newly created single-name CDS resulting from a triggered Restructuring credit event under the terms of the iTraxx class documentation; and (2) calculate margin for such for cleared swaps customer accounts pursuant to a portfolio margining program approved by the Commission and the SEC.¹¹

The need for such portfolio margining orders is even more time-sensitive in light of the inclusion of the iTraxx class in the Commission’s Proposed Clearing Determination. We believe that the issuance of these orders provides another compelling reason for the Commission to establish a reasonable implementation period in its final clearing requirement determination before mandatory clearing of the iTraxx class becomes effective.

¹¹ MFA submitted letters to both the Commission and the SEC in support of ICE Clear Credit’s portfolio margining petitions. See MFA’s letter to the Commission, dated December 21, 2011, available at: http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/mfa_122111.pdf. See also MFA’s letter to the SEC, dated June 13, 2012, available at: <http://www.sec.gov/comments/4-641/4641-4.pdf>.

Mr. Stawick
September 6, 2012
Page 6 of 6

MFA appreciates the opportunity to comment on the Commission's Proposed Clearing Determination. If the Commission or its staff has questions, please do not hesitate to call Laura Harper or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President, Managing Director &
General Counsel

cc: The Hon. Gary Gensler, Chairman
The Hon. Jill E. Sommers, Commissioner
The Hon. Bart Chilton, Commissioner
The Hon. Scott D. O'Malia, Commissioner
The Hon. Mark P. Wetjen, Commissioner