STATE STREET.

R. Bryan Woodard
Senior Vice President and Senior
Managing Counsel

State Street Corporation
State Street Financial Center
One Lincoln Street
Boston, MA 02111-2900

Telephone: 617.664.2160
rbwoodard@statestreet.com

Via Courier and E-mail

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Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581
E-mail: dcodcmsefGovernance@cftc.gov

Re: Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest – 75 Fed. Reg. 63732 (October 18, 2010); RIN 3038-AD01

Dear Mr. Stawick:

State Street Bank and Trust Company ("State Street")[1] submits this letter in connection with the rules that have been proposed by the Commodity Futures Trading Commission (the "Commission") regarding the ownership and governance requirements for swap execution facilities ("SEFs").[2] As discussed in more detail below, the broad cross-ownership restrictions set forth in the Proposed Rules would preclude an entity, including, without limitation, a swap dealer or a futures commission merchant (an "FCM") that is affiliated with the sponsor of a SEF, from being a direct participant on that SEF (an "Affiliated SEF"). We believe that excluding an

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1 With over $22.4 trillion of assets under custody and administration and $1.9 trillion of assets under management at June 30, 2012, State Street is a leading specialist in meeting the needs of institutional investors worldwide. Our customers include mutual funds, collective investment funds and other investment pools, corporate and public retirement plans, insurance companies, foundations, endowments and investment managers. Including the United States, we operate in 29 countries and more than 100 geographic markets worldwide. We conduct our business primarily through our principal banking subsidiary, State Street Bank and Trust Company, which traces its beginnings to the founding of the Union Bank in 1792. State Street Bank's current charter was authorized by a special act of the Massachusetts Legislature in 1891, and its present name was adopted in 1960.

2 *See* 75 Fed. Reg. 63732 (October 18, 2010) (the "Proposed Rules").

affiliated swap dealer or FCM from trading on an Affiliated SEF does not further the goals of the Commission, particularly when multiple competing dealers trade on the platform. This restriction could substantially decrease the liquidity available on a SEF and, where that affiliate is an FCM, interfere with the FCM's ability to obtain the best possible price for its customers' orders, without providing any countervailing benefits. Accordingly, we are requesting that the Commission revise the Proposed Rules to permit entities that are affiliated with a SEF ("Affiliated Entities") to effect transactions on such SEFs in the circumstances described herein.

Section 726 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") provides in relevant part that the Commission shall adopt rules which may include numerical limits on the control of SEFs. Section 726 further provides that the Commission must adopt such rules if it determines that they are necessary or appropriate to improve the governance of, or mitigate conflicts of interest in connection with, the conduct of business by a swap dealer or major swap participant on a SEF in which it has a material debt or equity investment. In adopting these rules, the Commission must consider any conflict of interest that may arise in connection with the amount of equity owned by a single investor in a SEF and the governance arrangements of that SEF.

The Commission has accordingly proposed to adopt Regulation 37.19(d)(2)(i), which would prohibit any SEF participant from owning more than twenty percent (20%) of any class of voting securities issued by a SEF or from exercising more than twenty percent (20%) of the voting power of a SEF. For purposes of applying these ownership and voting limitations, proposed Regulation 37.19(d)(2)(i) would aggregate a SEF participant's ownership and voting interests with those of its "related persons," which includes any person that shares a common parent with the SEF participant. Proposed Regulation 37.19(d)(2)(i) thus requires the attribution of ownership across affiliates, no matter how tenuous or remote the affiliation and regardless of the existence of any actual control relationship among such affiliates. As a result, entities that are affiliated with SEF sponsors would not be permitted to become participants in these SEFs, thus removing a potential source of liquidity from the marketplace.

Proposed Regulation 37.19(d)(2)(i) Is Unnecessary When Applied to Foreign Exchange Swaps

The Commission has expressed concern that competition among SEFs or between SEFs and designated contract markets could cause a SEF to prioritize commercial interests over self-regulatory responsibilities and restrict access or impose burdens on access in a discriminatory manner,[3] and has indicated that limits on the ownership of voting equity and the exercise of voting rights have the potential to enhance the other "structural" governance requirements that it

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[3] *See* 75 Fed. Reg. 63732, 63736-37 (October 18, 2010)

has proposed.[4] We respectfully submit that this enhancement is unnecessary when applied to the robust and intensively competitive market for foreign exchange swaps.[5]

With average daily turnover of nearly $4 trillion,[6] the foreign exchange market is widely acknowledged to be the largest financial market in the world. Unlike certain other over-the-counter derivatives markets, the liquidity, transparency and strong operational infrastructure of the foreign exchange markets have allowed them to continue to operate in a safe and sound manner, despite wrenching market disruptions, such as the currency crises of the 1990s, the bursting of the high-tech bubble in 2000-2001 and the financial crisis of 2008-2009. As the Foreign Exchange Committee of the Federal Reserve Bank of New York has observed:

> The [foreign exchange] marketplace itself is spread across a series of liquid trading centers in different time zones and operates twenty-four hours a day, each business day. Absent such consideration of these key characteristics of the foreign exchange market, the potential for negative unintended consequences of any efforts to improve market resiliency is quite large. ...
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> The market functioned well [during the 2008 financial crisis], despite strains seen in international funding and credit markets, and enabled participants to measure and mitigate risk dynamically in a global marketplace. ... [S]ystemic risk mitigants built into the OTC FX market structure over the years proved successful in providing a liquid and continuous market despite the volatility, defaults, and disruptions of [2008 and 2009].[7]

State Street has played a unique role in fostering openness and market structure improvements in the foreign exchange market over the past fifteen years, including through the launch in 1999 of FX Connect, the first multi-dealer foreign exchange trading platform designed with input from buy-side participants, including pension funds and mutual funds, and the acquisition of Currenex, Inc., an operator of an industry leading multi-dealer foreign exchange trading platform, in 2007.[8] State Street is also in the process of developing a trading platform

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4 *See* 75 Fed. Reg. 63732, 63742 (October 18, 2010) .

5 For this purpose, we use the term "foreign exchange swaps" to include deliverable foreign exchange forwards, foreign exchange swaps, foreign exchange options and non-deliverable foreign exchange forwards to the extent that one or more of those products is traded on a SEF. *See* 77 Fed. Reg. 48208, 48252 (August 13, 2012) (Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping; Final Rule).

6 Bank for International Settlements, Triennial Central Bank Survey – Report on Global Foreign Exchange Market Activity in 2010, at 6-7 (December 2010).

7 Foreign Exchange Committee of the Federal Reserve Bank of New York, Overview of OTC Foreign Exchange Market: 2009, at 7 (November 9, 2009).

8 There are currently approximately 370 active buy-side and 60 active sell-side subscribers to the FX Connect platform and approximately 250 active buy-side and 50 active sell-side subscribers to the Currenex platform.

that is expected to apply for registration as a swap execution facility to support execution of, among other instruments, foreign exchange swaps. As drafted, proposed Regulation 37.19(d)(2)(i) would prohibit State Street from becoming a participant on that platform. Given the existing liquidity, transparency and strong operational infrastructure of the foreign exchange market, current market data does not support the need to exclude State Street's liquidity from the market available to buy-side participants, including mutual funds and pension funds, on the platform.

Given the unparalleled depth and breadth of the market for foreign exchange swaps, we believe that it is simply not necessary for the Commission to restrict the ability of market participants to effect foreign exchange swaps on an Affiliated SEF. It is one thing for the Commission to conclude that it must impose limits on the ability of an Affiliated Entity to effect transactions on an Affiliated SEF in markets where liquidity is limited and where an Affiliated Entity could exert an undue influence on the market operated by its Affiliated SEF. It is quite another thing for the Commission to impose such a restriction on SEFs that list foreign exchange swaps. The existing transparency in the foreign exchange market, combined with the overwhelming size of that market – which is largely comprised of a limited number of commonly traded currency pairs and maturities – diminishes, if not eliminates, the potential for an Affiliated Entity to exert a meaningful influence on an Affiliated SEF. We therefore urge the Commission to modify proposed Regulation 37.19(d)(2)(i) to permit Related Persons (as defined in the proposed Regulation) to be members of or participants in a SEF to the extent such Related Persons effect transactions on the Affiliated SEF solely in foreign exchange swaps.

Proposed Regulation 37.19(d)(2)(i) Should Additionally Be Modified to Permit an FCM to Act as Agent for its Customers on an Affiliated SEF

In addition to removing the ownership limitation described above for foreign exchange swaps, we also believe that the broad scope of proposed Regulation 37.19(d)(2)(i) generally should be narrowed so as not to inadvertently disadvantage market participants who wish to effect transactions on SEFs. More specifically, we expect that some market participants will not want to take on the responsibility of becoming a SEF participant, but instead will request that their FCM become a SEF participant and either (i) act as an executing broker and place orders and execute trades as agent on behalf of the customer on the SEF or (ii) provide the customer with direct market access to the SEF as an authorized user sponsored by the FCM.

If an FCM, acting in an agency capacity as an executing broker finds that the best market available for its customer's order is on its Affiliated SEF, Regulation 37.19(d)(2)(i) would preclude that FCM (an "Affiliated FCM") from executing the order directly on the Affiliated SEF because it would prohibit the Affiliated FCM from being a participant on an Affiliated SEF.[9] An Affiliated FCM would in such a case be required to interpose another SEF participant in the execution process, which would delay execution of its customers' orders. This restriction,

[9] As noted above, proposed Regulation 37.19(d)(2)(i) would preclude the FCM from being a participant in a SEF if the FCM and the SEF are indirectly owned by the same parent company.

therefore, would have an adverse impact on customers if those delays cause the customer to receive an inferior execution. Customers that want direct market access under the sponsorship of their FCM similarly would need to establish new brokerage arrangements if they want to access a SEF that shares ownership with their FCM. When combined with the uncertainty as to how many SEFs will ultimately survive in the marketplace, the restrictions on an Affiliated FCM acting in an agency capacity on an Affiliated SEF could materially and adversely affect an FCM's ability to provide a full suite of services to its client base.

Accordingly, we believe the Commission should revise the Proposed Rules to permit FCMs that are affiliated with SEFs to effect transactions on such SEFs in an agency capacity. Precluding an Affiliated FCM from doing so would not provide any benefits to the marketplace and could instead decrease the liquidity available on that SEF and be detrimental to the FCM's customers.

Proposed Regulation 37.19(d)(2)(i) Should Additionally be Modified to Permit an FCM to Trade on an Affiliated SEF for Risk Management Purposes

The Commission should additionally modify proposed Regulation 37.19(d)(2)(i) to permit an FCM to effect swap transactions on an Affiliated SEF as necessary to manage the risks resulting from a default by a customer or other clearing member. An FCM that is acting as a clearing broker and carrying positions in cleared swaps for customers is responsible to the applicable derivatives clearing organization ("DCO") for the performance of its customers' financial obligations arising out of those swap transactions. If a customer fails to meet a margin call, the FCM will use its own capital to make the required payment and will promptly take steps to liquidate the customer's swap position and/or hedge the associated risk. In addition, an FCM that is a member of a DCO may be required, upon the default of another clearing member, to accept an allocation from the DCO of all or a portion of the defaulting clearing member's positions. As with a customer default, the FCM will need to act promptly to liquidate or neutralize the risk of those positions.

In either such case, it is in the best interest of the FCM, the DCO through which those swaps are cleared and the markets as a whole if those positions can be liquidated or hedged as promptly and efficiently as possible. Imposing an artificial barrier that constrains an FCM's ability to effect those transactions on an Affiliated SEF could have materially adverse consequences, particularly in cases where liquidity in the swaps in question is concentrated on the Affiliated SEF. The Commission, therefore, should permit an FCM to effect transactions on an Affiliated SEF as necessary to manage the risks resulting from the default of a customer or clearing member.

The Commission Should, at a Minimum, Permit a SEF to Obtain a Waiver of the Restriction Similar to that Allowed for DCOs

We believe that there are a number of commercial and regulatory safeguards in place which mitigate the conflict of interest that may arise if an Affiliated Entity is permitted to effect transactions on an Affiliated SEF. A SEF will generate income primarily through transaction fees, and thus will be highly incentivized to maximize the number of participants in, and the

number of swaps traded through, its facilities. The SEF, therefore, has a significant commercial incentive not to give preferential treatment to an Affiliated Entity and instead maintain its reputation as a trading platform that applies its rules fairly and impartially in order to maximize participation on the SEF and enhance the liquidity of its marketplace.

Moreover, we believe that any potential conflicts are sufficiently mitigated by other regulatory requirements applicable to SEFs. For example, under the Proposed Rules, thirty-five percent of a SEF's directors will be required to meet strict independence standards, and a SEF must have a Regulatory Oversight Committee that is composed solely of independent directors. Although SEFs are not defined as self-regulatory organizations under the Commodity Exchange Act or Commission regulations, they will be required to establish fair access standards and provide a fair procedure for disciplining participants for rule violations.[10] For these reasons, we believe the conflict of interest concerns that proposed Regulation 37.19(d)(2)(i) seeks to address are already adequately dealt with by the existing framework applicable to SEFs in the Act and in the regulations that have been or will be promulgated thereunder.

For all of the foregoing reasons, we believe that the Commission should remove the restriction on Affiliated Entities as participants on SEFs along the lines described above, but to the extent it chooses to retain that restriction it should nevertheless permit a SEF, on a case by case basis, to obtain a waiver of this restriction based on a demonstration that the SEF's governance arrangements satisfy the Commission's independence requirements and ensure the impartial enforcement of the SEF's rules. In this regard, the Commission has recognized that the imposition of strict ownership limitations may not be appropriate for all DCOs, and has proposed to grant waivers from these requirements if it determines that these limitations are not necessary or appropriate to improve the governance of the DCO or mitigate conflicts of interest that may arise in connection with a participant's conduct of business with the DCO.[11] We believe that the Commission should take this flexible approach with respect to SEFs as well, and that the factors considered in determining whether a DCO is eligible for a waiver apply equally to SEFs. Please refer to the comment letter dated December 1, 2010 that State Street previously provided on this topic for further information.

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[10] For example, proposed Regulation 40.9(b)(1) requires that at least 35% of the Board of Directors of each SEF be comprised of public directors, and separately requires that each registered entity, including each SEF, submit to the Commission within 30 days of the election of its Board of Directors a description of the relationship, if any, between such directors and the registered entity or its members and their respective affiliates. Proposed Regulation 37.19(d) separately requires a SEF to report to the Commission in the event that its Board of Directors rejects a recommendation or supersedes an action of the SEF's Regulatory Oversight or Membership or Participation Committees, each of which must be chaired by a public director. Finally, proposed Regulation 37.19(a) requires each SEF to minimize conflicts of interest in its decision-making process and establish a process for resolving the conflicts of interest. This request, therefore, assumes that an Affiliated Entity will be held to the same standards and requirements as other SEF participants and will not be afforded any special privileges by virtue of its affiliation with the owner of the SEF.

[11] *See* 75 Fed. Reg. 63732, 63734 (October 18, 2010).

State Street appreciates the opportunity to submit these comments on the proposed ownership and governance requirements for SEFs. If the Commission has any questions concerning the matters discussed in this letter, please contact me at (617) 664-2160.

Sincerely,

R. Bryan Woodard
Senior Vice President and Senior Managing Counsel

cc: Honorable Gary Gensler
Honorable Jill E. Sommers
Honorable Bart Chilton
Honorable Scott O'Malia
Honorable Mark P. Wetjen
Alicia L. Lewis, Special Counsel, Division of Clearing and Risk

Jeffrey N. Carp, State Street Corporation, EVP and Chief Legal Officer
David C. Phelan, Executive Vice President and General Counsel
Stefan M. Gavell, State Street Corporation, EVP and Head of Regulatory and Industry Affairs