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September 19, 2012

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

Re: Comment Letter on the Proposed Clearing Determination Under Section 2(h) of the CEA (RIN 3038-AD86)

Dear Mr. Stawick:

The Asset Management Group (the "**AMG**")[1] of the Securities Industry and Financial Markets Association ("**SIFMA**") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "**Commission**") with comments regarding its recent proposal to mandate clearing of certain interest rate swaps and credit default swaps under Section 2(h) of the Commodity Exchange Act (the "**CEA**") (the "**Proposed Determination**").[2] We are greatly concerned that the Proposed Determination is premature. As described in more detail below, there remain material unresolved issues concerning the rules governing the protection of customer collateral for cleared swaps (the "**LSOC Rules**") and the technological and operational readiness of futures commission merchants ("**FCMs**") and derivatives clearing organizations ("**DCOs**") to comply with them. In addition, despite intensive efforts of market participants, the volume of legal documentation required for compliance with the customer clearing rules makes it unlikely that the industry will be ready in time for the compliance dates triggered by this first clearing determination.

[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds and private funds such as hedge funds and private equity funds. In their role as asset managers, AMG member firms, on behalf of their clients, engage in transactions for hedging and risk management purposes that will be classified as "security-based swaps" and "swaps" under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").

[2] Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 47,170 (Aug. 7, 2012) (to be codified at 17 C.F.R. pt. 50).

The LSOC Rules must be clarified and finalized well in advance of the first clearing compliance date to provide sufficient time for implementation and testing.

As the Commission noted in its proposed swap transaction compliance and implementation schedule (the "**Proposed Compliance Schedule**"), "finalizing the rules regarding the segregation of customer collateral prior to requiring compliance with a mandatory clearing determination is necessary to effectuate the purposes of the new [clearing requirement] section . . . of the CEA."[3] However, notwithstanding the LSOC Rule's published effective date of November 8, 2012,[4] material uncertainties regarding the requirements and obligations of FCMs and DCOs with respect to customer collateral under the LSOC Rules remain.

In particular, the AMG and other industry participants have been seeking confirmation of the following points, among others, relating to LSOC:[5]

- collateral that "[i]s intended to or does margin, guarantee, or secure a Cleared Swap"[6] embodied in the "Cleared Swaps Customer Collateral" definition captures all of a customer's property received by an FCM or DCO, including excess collateral;

- all subsequent references to "collateral" and "margin" throughout the LSOC Rules are intended as references to "Cleared Swaps Customer Collateral" as defined;

- the prohibition on an FCM's using one customer's cleared swaps collateral to secure another customer's positions[7] applies to all margin received from the first customer, including excess margin;

[3] Proposed Compliance Schedule at 58,189.

[4] Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 77 Fed. Reg. 6336 (Feb. 7, 2012) (codified at 17 C.F.R. pts. 22 and 190) (the "**LSOC Rules**").

[5] We and several other industry groups submitted a summary of these requests and comments to the Commission on August 7, 2012.

[6] LSOC Rules at 6372 (codified at 17 C.F.R. § 22.1). The LSOC Rules incorporate the definition of "Cleared Swap" provided in the Commodity Exchange Act, meaning "any swap that is, directly or indirectly, submitted to and cleared by a derivatives clearing organization registered with the Commission." 7 U.S.C. § 1a(7). The Rules further tailor this definition to exclude any swap commingled with a commodity future or option that is segregated pursuant to Section 4d(a) of the CEA. Specifically included in this definition is any trade or contract that would be required to be segregated pursuant to Section 4d(a) of the CEA or any trade or contract that would be subject to 7 U.S.C. § 30.7 but which is in either case in an account segregated pursuant to Section 4d(f) of the CEA.

[7] *Id.* at 6373 (codified at 17 C.F.R. § 22.2(d)).

- the FCM's required daily report will include all cleared swaps customer collateral, including excess margin; and

- DCOs are required to provide "a mechanism by which . . . the [FCM] is required to identify each Business Day, for each Cleared Swaps Customer, the amount of collateral posted in excess of the amount required by the [DCO]."[8]

In addition to the above requests, we suggested that the Commission issue new rulemakings or guidance as necessary to:

- require FCM reports to be made "as frequently as technologically feasible," rather than "[a]t least once each business day";[9]

- require DCOs to take "all steps necessary" to ensure that the reported information is accurate and complete, rather than merely "appropriate steps," as the LSOC Rules currently provide;[10] and

- require DCOs' "required margin" calculation and recording to be undertaken "as frequently as technologically feasible," rather than "no less frequently than once each business day," as the LSOC Rules currently provide.[11]

The above suggestions highlight the centrality of operational concerns in the effective implementation of the LSOC Rules. We believe that mandatory clearing cannot practically be applied until the above operational concerns have been resolved and systems and procedures required to satisfy the LSOC Rules are fully functional and are capable of being tested for at least three months, with respect to trades cleared on a voluntary basis.

We therefore request that the Commission clarify that the phasing-in of the clearing requirements will take into account the practical considerations concerning the extent of the ability of DCOs and FCMs to adhere to the customer collateral segregation requirements for cleared swaps. Specifically, we believe that the Commission should implement a three-month testing period for LSOC Rule implementation efforts, based on voluntarily cleared swaps, with such period to begin once the Commission and market participants have collectively completed their ongoing rule-clarification efforts.

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[8] *Id.* at 6377 (codified at 17 C.F.R. § 22.13(c)(2)).

[9] *Id.* at 6376 (codified at 17 C.F.R. § 22.11(c)(2)).

[10] *Id.* (codified at 17 C.F.R. § 22.11(e)(1)).

[11] *Id.* (codified at 17 C.F.R. § 22.12(c)).

More time is needed to put in place legal documentation necessary for clearing.

Our second major concern with the Proposed Determination relates to the amount of time required for market participants to put in place the significant amount of legal documentation necessary to come into compliance with the required clearing rules. Model documentation continues to develop in response to regulatory requirements adopted by the Commission. For example, on August 29th, the Futures Industry Association and the International Swaps and Derivatives Association ("**ISDA**") published a suggested market standard form of Addendum for Cleared Swaps.[12] This is intended to be a model form of addendum that FCMs can tack on to their existing forms of customer agreement for the execution and clearing of futures and options on futures ("**F&O Agreements**"). While a significant achievement, the form of Addendum is simply a starting point: it is well understood that it leaves open myriad issues to be negotiated between FCMs and their customers. Issues that may be negotiated include, among others, lock-ups, terms, valuations of collateral and haircuts, position limits, margin calculations, events of default, remedies upon default, cross-collateralization and porting of positions. For users of swaps who do not have existing F&O Agreements, both an F&O Agreement and the Addendum must be negotiated and, notably, there is no single market standard of F&O Agreement. Even parties to existing F&O Agreements will need to revisit and potentially renegotiate aspects of the F&O Agreement in light of its expanded use in connection with cleared swaps.

We believe that negotiations relating to F&O Agreements and Addenda will be involved and lengthy. Many of our members who have been trying to negotiate these agreements with various FCMs report that individual negotiations have been taking many months and, in some cases, nearly a year. Most of these negotiations remain unfinished. With the very recent publication of the Addendum, all market participants that currently trade the most liquid uncleared swaps which, under the Proposed Determination, would be the first to become subject to mandatory clearing will now begin to converge on limited negotiating resources at the relatively few FCMs. With a fast-approaching deadline for clearing and a condensed period to negotiate, buy-side market participants will be placed between a rock and a hard place. In fact, it has already been reported in the press that some banks offering clearing services seem to be limiting the number of clients they will take on at all, effectively excluding the smaller end-users from the market.[13] Thus, *requiring* clearing before the resolution of these timing issues could have a significantly adverse effect on the market. The AMG believes that there must be an adequate lead time for *all* market participants to negotiate appropriate provisions and execute swap clearing documentation on fair and reasonable commercial terms, particularly in light of recent FCM defaults.

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[12] "FIA and ISDA Publish Cleared Derivatives Addendum," ISDA News Release, Aug. 29, 0212, http://www2.isda.org/news/fia-and-isda-publish-cleared-derivatives-addendum.

[13] Joe Rennison, Access Denied: Hundreds of Firms Could Be Unable To Use CCPs, RISK MAGAZINE, Sept. 6, 2012.

We therefore believe that the first determination of swaps for mandated clearing should be delayed for at least six months. Moreover, we believe that the Commission should reevaluate the length of this additional time, based on data to be provided by FCMs comparing the number of clients documented for clearing against the number of clients documented for OTC trading. This would permit the clearing mandate deadline to be extended as appropriate to address the documentation gridlock that is likely to result from the implementation of the new requirements. Without such an extension, market participants who had not finalized necessary documentation would be forced to exit the market until they were in a position to transact. This would have an immediate negative effect on liquidity in the market.

Our members wish to emphasize that we believe the clearing mandate should not be applied to the buy-side at all until (i) the points we have highlighted above concerning the LSOC Rules are confirmed and fully implemented and (ii) sufficient time, no less than an additional six months, has been provided to market participants to draft and negotiate new documentation to effect the transition to clearing. In any case, we recommend that the Commission at least reclassify "active funds" into the second category under the phased clearing requirement implementation schedule. This change would provide needed time to managers of "active funds" to finish negotiations of clearing documentation and for the issues we have identified with the LSOC Rules to be clarified before mandatory clearing is required.

We do not point out the above considerations merely to delay the clearing mandate for the purposes of delay; rather our concerns are centered on market readiness and the risk of a freeze in liquidity should the mandate apply too early. We support the Commission's engagement in market efforts to implement both LSOC and documentation initiatives and recommend that the Commission continue monitoring industry commitment and progress on these endeavors as it sets the timeline for the clearing mandate.

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We thank the Commission for its consideration of our comments. If you have any questions, please do not hesitate to call the undersigned at 212-313-1389.

Respectfully submitted,

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

cc: Hon. Gary Gensler, Chairman
Hon. Jill E. Sommers, Commissioner
Hon. Bart Chilton, Commissioner
Hon. Scott O'Malia, Commissioner
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