

January 31, 2013

Ms. Melissa Jurgens  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581

Re: **Public Roundtable: “Futurization of Swaps”**

Dear Ms. Jurgens:

MarkitSERV<sup>1</sup> is pleased to submit the following comments to the Commodity Futures Trading Commission (“**CFTC**” or the “**Commission**”) to support our contribution to the Commission’s Public Roundtable “*Futurization of Swaps.*”

## Introduction

MarkitSERV is a provider of confirmation, connectivity, and reporting services to the global OTC derivatives markets, making it easier for participants in these markets to interact with each other. Specifically, we provide trade processing, confirmation, matching, and reconciliation services for OTC derivatives across regions and asset classes, as well as universal middleware connectivity for downstream processing such as clearing and reporting. Such services, which are offered also by various other providers, are widely used by participants in these markets today and are recognized as tools to increase efficiency, reduce cost, and secure legal certainty. With over 2,500 firms globally using the MarkitSERV platforms, including agents for over 26,000 buy-side fund entities, our legal, operational, and technological infrastructure plays an important role in supporting the OTC derivatives markets in North America, Europe, Asia, and elsewhere. In 2012, MarkitSERV processed over 20 million derivative transaction events globally across multiple asset classes.

MarkitSERV has been actively and constructively engaged in the discussion regarding regulatory reform of financial markets. We regularly provide regulatory authorities with our insights on current market practice, for example, in relation to valuation methodologies, the provision of scenario analysis, and the use of reliable and secure means to provide daily marks. We have also advised regulatory bodies on potential approaches to enable timely and cost-effective implementation of newly established requirements through the use of multi-layered phase-in or by providing participants with a choice of means for satisfying regulatory requirements. Over the last two years, we have submitted over 29 comment letters to regulatory authorities around the world, and participated in numerous roundtables.

## Comments

We welcome the Commission’s initiative to gather views on the developments and potential issues in relation to the “Futurization” of swaps from relevant stakeholders. We also appreciate the opportunity to provide our comments.

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<sup>1</sup> MarkitSERV, jointly owned by The Depository Trust & Clearing Corporation (DTCC) and Markit, provides a single gateway for OTC derivatives trade processing. The company offers trade processing, confirmation, matching, and reconciliation services across regions and asset classes, including interest rate, credit, equity, and foreign exchange derivatives. MarkitSERV also connects dealers and buy-side institutions to trade execution venues, CCPs, and trade repositories. Please see [www.markitserv.com](http://www.markitserv.com) for additional information.

We recognize that market participants trading in derivative instruments may, at times, find that a swap more appropriately achieves their hedging or investment strategy, while at other times a futures contract may be the more appropriate choice.<sup>2</sup> Generally speaking, in the circumstance where an OTC derivative product has reached a sufficiently high level of standardization and liquidity, there may be a suitable basis for creating a standardized futures contract designed to replicate that OTC product. Once futures contracts have been launched for a specific product, they may often be used alongside swaps as an alternative where market participants decide between swaps and futures depending on the users, uses, and product specifications.

The recent process of “futuresization” has been marked by a larger-scale migration of products commonly traded as swaps to the futures markets. We believe that such “overnight” futuresization, unlike historical market-driven product evolution, has been significantly accelerated by regulation. Accordingly, we believe that this market shift should be carefully monitored by the Commission, since it may harm market functioning if market participants are no longer able to find the choice, flexibility, and/or liquidity that they require from the swaps markets. This would in particular damage end-users of derivatives that require the custom terms that only swaps provide as they look to hedge the risks that arise from their core businesses. Further, such development might harm competition if the execution of derivatives shifts from a competitive marketplace with many execution venues offering flexible products that can be cleared in any of several different DCOs to one that is dominated by very few standardized products that each trade on a single, vertically-integrated exchange and clearing platform.

We therefore encourage the Commission to carefully monitor further developments, analyze their drivers and evaluate actions it might need to take to prevent damage to the efficient functioning of the derivatives markets. Specifically, we believe that the Commission could mitigate the risk of excessive, harmful futuresization and regulatory arbitrage by: (1) finalizing its rules and issuing guidance to ensure that economically equivalent products are treated equally, regardless of whether they are called “futures” or “swaps”; (2) ensuring that regulations applicable to the swaps market are not overly burdensome; and (3) taking sufficient time for the finalization of the remaining rules to ensure that swaps markets are not unintentionally disadvantaged.

### **(1) The Commission’s rules should not unfairly disadvantage swaps compared to futures**

We believe that transactions that are economically equivalent should not be treated differently from a regulatory perspective simply because they are packaged in a different format. The Commission should therefore, in the finalization of its rules as well as in issuing guidance or interpretations, ensure that it is not more burdensome for market participants to trade in the swaps market than the futures market. Specifically, it should consider the following points:

- **Made Available to Trade**

The Commission proposed rules specifying a “*Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade*” (“**MAT**” rules).<sup>3</sup> If these determinations force a large number of illiquid swaps to be traded on SEFs or DCMs or if they cause market confusion, we believe that such determinations could drive market participants away from the swaps market to a more established and predictable market – *i.e.*, the futures market. As we commented previously,<sup>4</sup> we believe that the MAT rules could be improved by making the MAT determination based on all enumerated factors, instead of any one, and

<sup>2</sup> Service providers, such as MarkitSERV, are often providing services to allow market participants to operate in an efficient and safe manner in both markets.

<sup>3</sup> Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available To Trade, 76 Fed. Reg. 77728 (Dec. 14, 2011).

<sup>4</sup> Markit Letter to the Commission regarding Made Available to Trade rule (February 13, 2012), *available* here.

by the Commission establishing objective, measurable standards for applying the facts and circumstances to those factors. Additionally, we believe that the MAT process is more likely to deliver non-discriminatory results if it is the Commission, not an individual SEF or DCM, that ultimately determines which swaps are made available to trade after a reasonable public comment period. We also look for the Commission to set out a clear path for removing swaps from the MAT designation when they no longer meet the initial criteria.

- **Embargo Rule**

The Commission's final Real-Time Reporting rules<sup>5</sup> prohibit SEFs from disclosing the details of a swap transaction prior to "the transmittal of such data to a registered swap data repository for public dissemination."<sup>6</sup> They also allow SEFs to delegate their obligation to report transactions that have been executed on their platform to qualified third parties such as MarkitSERV.

We support the Commission's decision to allow SEFs to delegate reporting to third parties because SEFs may find that this is the most efficient and cost-effective approach to satisfy their reporting obligations since this will avoid the high costs of building connectivity to multiple SDRs. This, in turn, would lower barriers to entry for SEFs and foster competition between trading platforms. Moreover, it is important to members of SEF platforms that SEFs are permitted to flash transaction information to them as soon as possible following the execution of the transaction.<sup>7</sup> However, the "embargo rule" could be improperly read to prohibit dissemination of transaction information to the platform participants at the same time as the SEF submits the swap to a third party for reporting purposes. We are concerned that, if SEFs were obliged to amend the flow of their trading systems to connect directly to SDRs in order to "flash" transactions as early as possible and remain competitive, it could create unnecessary costs for the marketplace with no corresponding benefit. This issue is exclusive to the swaps market<sup>8</sup> and, therefore, may encourage a migration to the futures market if not clarified soon.

We do not believe that the embargo rule should be built around the time of transmittal to the SDR. Otherwise, SEFs that use qualified third parties for reporting purposes would be unfairly disadvantaged since they would have to wait to receive confirmation that the data was sent to the SDR before flashing the transaction to their members. We believe that such requirement would result in unnecessary costs and burdens, might reduce the number of competing SEFs, and might have an overall detrimental effect on market functioning. Instead, the Commission should allow SEFs to flash a transaction to their platform members as soon as they have sent the relevant data set to the SDR or, in case they have delegated the reporting to a third party, to the third party.<sup>9</sup>

- **Block Trades**

In the Commission's proposed rules regarding block trade sizes,<sup>10</sup> the Commission proposed to define the minimum thresholds that would determine which swaps are large enough to be excluded from the Commission's real-time reporting rules. Under the proposed rules, the block size thresholds for most interest

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<sup>5</sup> Real-Time Public Reporting of Swap Transaction Data, Final Rule, 77 Fed. Reg. 1182 (Jan. 9, 2012)

<sup>6</sup> 17 C.F.R. § 43.3(b)(3)(i)(A).

<sup>7</sup> This flash creates an electronic workup: a liquidity pool with a known price which allows participants to trade at that price once the original parties to the trade exhaust their interest. Workups therefore increase transparency for all of the SEF's participants because they know where instruments are trading and they are given an equal opportunity trade at that level. The matching engines that currently support trading in these instruments consist of both internally developed and externally sourced technologies that are widely used in the exchange trading marketplace. These systems produce the initial match information in their own internal format and it is necessary for us to electronically convert that message to the format required by the SDRs so that they can receive a standard formatted message. This conversion requires the use of conversion software and/or the use of a qualified agent.

<sup>8</sup> The embargo rule applies equally to swaps executed on SEFs or DCMs, but does not apply to futures contracts.

<sup>9</sup> We also believe that SEFs should be permitted to flash data at the same time that they perform the internal data conversion process necessary to match the format standards required by the agent or SDR.

<sup>10</sup> See Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, Further Notice of Proposed Rulemaking, 77 Fed. Reg. 15460 (Mar. 15, 2012).

rate and credit swaps would eventually be determined under a “67 percent notional amount calculation” and the block size thresholds for other asset classes would generally be determined by reference to economically related futures contracts. In the futures market, however, it is the exchanges (*i.e.*, the DCMs not the SDRs or unrelated SEFs) that largely set the block trade thresholds.

Additionally, block trades for swaps must be reported as soon as technologically practicable after the time at which the swap transaction has been executed,<sup>11</sup> but block trades for futures are only reported after a time lag established independently by each DCM, sometimes as long as 15 minutes. We believe that these differences between the futures and swaps regimes would create an advantage to participants in the futures market. To avoid any competitive disadvantage to the swaps market, we recommend that the Commission treat block trades in swaps and futures harmoniously such that the size of a block should be the same regardless of which clearing house, execution venue or type of product is chosen. There should also be equal requirements as to the timing of reporting of a trade execution to either a DCM or an SDR.

- **Trade Certainty**

One example of the Commission’s regulations that imposes different burdens on swaps and futures market participants is the requirement that swaps market participants ensure “trade certainty” for their transactions,<sup>12</sup> *i.e.*, they must know at the time of execution that their transaction will not be rejected when presented for clearing later. This requirement has created a significant challenge to participants in the swaps markets. In response, MarkitSERV has built Credit Centre, an industry utility providing real-time pre-trade clearing certainty for swaps in the interest rate, FX and credit asset classes across all SEFs, DCOs and Futures Commission Merchants (FCMs). This service is in testing now and will be launched in the first quarter of 2013.

However, such challenges do not currently exist in the futures markets because DCMs use the FCM access model while the SEFs use the direct access model and an FCM will simply not put through a trade to go on a DCM unless there is a sufficient amount of margin that will allow the FCM to meet its margin obligations vis-a-vis the DCO. To create a level playing field between futures and swaps in this respect we urge the Commission to permit FCMs and traders on SEFs to select the means to achieve pre-trade certainty regardless of which type of instrument, execution venue or DCO they select for execution and subsequent clearing.

**(2) The Commission should facilitate market participants’ compliance with the Dodd-Frank requirements**

There is little doubt that the Dodd-Frank Act and its related requirements impose a significant burden on swaps market participants. In certain circumstances, we believe that it may be the cumulative effect of the added regulatory burdens with respect to swaps that provide a strong incentive for market participants to use futures over swaps. This is not only because the burdens might be lower for futures compared to swaps, but also because there is often still a lack of clarity about the exact meaning of newly established requirements for transactions in swaps.

We believe that the Commission’s established practice of responding to inquiries from the industry by issuing clarification, FAQ documents, and time-limited no-action letters is beneficial and we encourage the Commission to continue those efforts. In doing so, the Commission allows swap participants to obtain clarity about the Commission’s expectations and continue their swap activity while working to come into compliance

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<sup>11</sup> See Commodity Exchange Act, § 2(a)(13)(A), 7 U.S.C. § 2(a)(13)(A).

<sup>12</sup> See Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21,278 (Apr. 9, 2012)

with the relevant rules. Continuing this practice will therefore allow market participants to remain active in the swaps market with confidence, instead of shifting their activity to the futures markets instead.

Furthermore, most of the Commission's rules under Dodd Frank will become effective and implemented during 2013. It is critical that incentives for regulatory arbitrage are not inadvertently put in place at the inception of the regulated swaps market. Therefore, those rules that impact the swaps and futures markets equally should take effect at the same time and not provide an advantage to DCMs to capture all liquidity in an economically equivalent instrument to a swap so that by the time SEFs become operational there will be no liquidity left for SEFs to thrive on. Liquidity is finite and the Commission's rule implementation process should address the likelihood that that, once a contract has successfully started trading on one venue or as a futures contract (and reported as such), it is unlikely that this contract will switch back to a different venue or instrument structure or that there will be a demand to trade this instrument again as a swap.

**(3) The Commission should take sufficient time to finalize the remaining rule makings**

We understand that the rulemaking process is time consuming and complicated, and we commend the Commission for making impressive progress since the Dodd-Frank Act was signed into law. However, we are concerned that worries about the imminent "futuresization" of the swaps market might now encourage the Commission to rapidly finalize the remaining rulemakings. While mindful of the need to achieve regulatory certainty, we urge the Commission not to follow this approach. We do not believe that speeding up the rulemaking process will quell the futuresization of the swaps market, and indeed may even have the opposite effect. We believe that the Commission would best serve the interests of the marketplace if it continued to take a considered and deliberate approach in finalizing the remaining, important Dodd Frank Act rulemakings and ensuring that they do not unintentionally shift market structure.

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We welcome the CFTC's Roundtable and we appreciate the opportunity to both participate as a Panellist and provide you with our comments. We would be happy to elaborate on, or further discuss, any of the points addressed above. In the event you may have any questions, please do not hesitate to contact the MarkitSERV Panelist Jeffrey Maron at [jeffrey.maron@markitserv.com](mailto:jeffrey.maron@markitserv.com).

Yours sincerely,



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