SWAPS & DERIVATIVES MARKET ASSOCIATION

February 20th 2013

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

Re: Futurization of Swaps: SDMA endorses Bloomberg request that Commission require DCOs to impose the same margin requirements for financial swaps and their economically equivalent futures counterparts.

Dear Mr. Stawick,

The Swaps and Markets Association ("SDMA") submits this letter in support of Bloomberg LP's formal request "that the Commission adopt an order that requires DCOs to impose the same margin requirements for financial swaps as they impose on financial futures that are economically equivalent and have a compatible risk profile."[1]

The SDMA is a non-profit financial trade group formed in 2010 to support the goals of the Dodd Frank Act. It believes that systematic risk of OTC derivatives can be mitigated through their regulation, the creation of central clearing, and by ensuring open and transparent access to ensure greater competition, lower transaction costs and greater liquidity. The SDMA is comprised of many US and internationally based broker-dealers, investment banks, futures commission merchants and asset managers participating in all segments of the exchange-traded and over-the-counter derivatives and securities markets.

The SDMA strongly supports the notion that margin requirements for products that are *economically equivalent*, should be the same. Swaps and futures on swaps are economically equivalent. First, if both products are benched off the same index, like Libor and trade in the same currency and maturity then they trade off the same inputs and are likely economically equivalent. Two, economical equivalence is further confirmed if the futures contract accepts physical delivery of underlying swap at expiration.

[1] Page 3. Bloomberg Letter to Commission (Harrington. January 30, 2013).

Third, the SDMA has previously defined economical equivalence to the Commission in terms of current market practice with regard to 'hedgibility' and the notion of *swap class*. [2] Does that market practitioner seek to hedge, or trade out of an individual swap on a given point of the yield curve, or does the market practitioner consider all the swaps on the yield curve as the same *class*—and, as such, may routinely hedge the USD IRS 6.2 year, not with another USD IRS 6.2 year, but with a duration weighted basket of more liquid swap points such as the USD IRS 5yr and USD IRS 7yr?

If such practice is routine and commonplace, where one swap product is hedged by means of another within its same class, then they are *economically equivalent*. Similarly, interest swaps and their interest rate swap futures cousins are economically equivalent because the market practitioner routinely hedges one with the other. They are fundamentally within the same class.

Moreover, to further determine economic equivalence, the Commission should review DCO internal considerations with regard to risk and margining. Specifically, if the DCO permits cross margining of swaps against euro dollar contracts and deliverable swap futures, this would be a further material fact supporting DCO acceptance of economic equivalence between the swap and its future.

There are those who argue that futures are more liquid than swaps and thus are easier to liquidate in a distress scenario. But this is simply inaccurate. Swaps may not yet trade on transparent venues, but they are one of the most liquid rates products globally. First, the swaps market is vast, at least $300 Trillion in the USD market alone. Second, at least $200 Billion trade daily either cleared or un-cleared. Current market volumes for interest rate swap futures are negligible by comparison. No more than $6 Billion have traded in the last two months. In fact, recent studies by ISDA support the notion that swap liquidity, when measured by *bid –offer* differentials, are highly liquid across swap class.[3]

To be sure, liquidity should improve in interest rate futures over time. Likewise, transparent trading of swaps, shall also improve with the mandatory swaps trading requirement under Dodd Frank. One product should not be given the benefit of expected extrapolated future liquidity where the other's liquidity is ignored simply because it does not occur yet on a regulated trade venue.

Moral hazard and regulatory arbitrage may occur if financial instruments that are economically equivalent have different margins in the cleared context. Market participants will seek out the 'cheaper' product ignoring the fact that suboptimal margin is being collected. Such an artificial market migration may be accentuated if such a clearing house has access to the Fed discount window or is deemed systemically important or "*too big to fail*" by the government. In such a scenario, it is only as matter of time before the tax payer pays the cost.

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[2] Page 7. *SDMA Letter to CFTC regarding Made Available to Trade (RIN 3038-AD18)*.(March 12, 2012).
[3] http://www2isda.org/functional-areas/research/discussion-papers/("Costs and Benefits of Mandatory Electronic Execution Requirements for Interest Rate Swaps," dated November10, 2011).

In conclusion, the SDMA supports the notion of a vibrant, competitive futures market place for swaps instruments. It expects such a futures market to organically develop as a natural evolution of a more liquid and democratized marketplace. But such a marketplace should operate only on a fair and level landscape where one product is not unfairly advantaged over the other. As such the SDMA endorses Bloomberg request that Commission require DCOs to impose the same margin requirements for financial swaps and their economically equivalent futures counterparts.

Sincerely,

/s/ James Cawley

James Cawley
Board Member
The Swaps & Derivatives Market Association

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