November 4, 2011

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Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
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Via agency website

Re: "Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA" / File Number RIN 3038-AD60; "Swap Transaction Compliance and Implementation Schedule: Trading Documentation and Margining Requirements under Section 4s of the CEA" / File Numbers RIN 3038-AC96 and 3038-AC97

The Coalition for Derivatives End-Users (the "Coalition") is pleased to respond to the two requests for comments issued by the Commodity Futures Trading Commission ("CFTC" or the "Commission") entitled *Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA* (the "Clearing Implementation Rule") and *Swap Transaction Compliance and Implementation Schedule: Trading Documentation and Margining Requirements under Section 4s of the CEA* (the "Margin Implementation Rule"). The Coalition represents companies that use derivatives predominantly to manage risks. Hundreds of companies have been active in the Coalition throughout the legislative and regulatory process, and our message is straightforward: Financial regulatory reform measures should promote economic stability and transparency without imposing undue burdens on derivatives end-users.

Derivatives end-users did not contribute to the financial crisis. Imposing unnecessary regulation on them would create more economic instability, restrict job growth, decrease productive investment, and hamper U.S. competitiveness in the global economy. We are pleased to offer comments focused on ensuring that the implementation timelines for proposed rules help to effectively regulate the derivatives markets, do not pose undue burdens on the business community, and accurately reflect both the letter of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and legislative intent.

We appreciate that the CFTC has issued both the Clearing Implementation Rule and the Margin Implementation Rule. Together, these proposals provide end-users with an opportunity to comment on the time it will take them to comply with key Dodd-Frank Act regulations.

As proposed, the implementation schedules do not provide sufficient time for end-users to adapt to new clearing, trade execution, margin, and documentation requirements, and we encourage the CFTC to grant end-users more time to adapt to these requirements, as discussed further below. Moreover, end-users' ability to comply with new regulations in a timely manner depends on the aggregate effect of all Title VII rules, including rules relating to board approval, reporting, recordkeeping, and other requirements. We thus urge the CFTC to publish implementation proposals for all Title VII rules that ultimately will affect end-users and to reflect in those proposals implementation timeframes that account for end-user challenges. Publishing a comprehensive implementation schedule that provides clear, appropriate guidance about when and how the entire mosaic of rules will apply to end-users, as Commissioners Sommers[1] and O'Malia[2] and Congressional leaders[3] have urged the Commission to do, would be an effective and needed step towards reducing regulatory uncertainty for end-users.

I. The Commission should Wait until after Category 1 Entities Come into Compliance before Setting an Implementation Deadline for End-Users

A. End-User Dependency on Category 1 Entities

The Commission has correctly identified that end-users need more time to comply with the Dodd-Frank derivatives regime. This need arises in part because end-users will necessarily depend on swap dealer and major swap participant counterparties, and the development of market infrastructure such as swap execution facilities ("SEFs"), to fully comply with Title VII's requirements. We believe that waiting at least until swap dealers and major swap participants have come into compliance before setting end-user compliance deadlines would provide the smoothest and most logical transition. In connection with the CFTC's implementation roundtable, participants raised concerns about the ability of market participants to come into compliance within the timeframe allowed by the proposed implementation schedules.[4] It is also

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[1] "As I have said many times, formulating and sharing with the public a thoughtful plan on how the Commission will logically sequence its consideration of final rules, along with a transparent implementation plan that will allow for a reasonable phased-in approach, is critical." Commissioner Sommers, *Opening Statement, Second Open Meeting to Consider Final Rules Pursuant to the Dodd-Frank Act* (Jul. 19, 2011).

[2] "I strongly urge the Commission to put forward an implementation plan for public comment during the month of August. This provides a perfect opportunity to receive comment on rule order and implementation, without delaying the Commission schedule this fall. If we wait until September, we will only have ourselves to blame." Commissioner O'Malia, *Concurrence Statement of the Order Regarding the Effective Date for Swap Regulation* (Jul. 14, 2011).

[3] "The Commission should publish an implementation plan and timeline and subject it to public comment." Letter from Reps. Frank Lucas and Michael Conaway to Chairman Gary Gensler (Jul. 14, 2011).

[4] For example, in response to a question about how long it would take "to transition into full mandatory clearing across [a] product for all market participants" from the time that DCOs are "open for business," Bill DeLeon of PIMCO replied that "it's probably 18 months to 24

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not guaranteed that all or many of the Category 1 entities will actually be able to come into compliance by the deadlines proposed for Category 1 entities. If end-users' principal external counterparties have not come into compliance, end-users themselves will not be able to meet deadlines that build off of the Category 1 entities. We urge the Commission to wait to set hard, end-user compliance deadlines and thus avoid compounding problems by building subsequent deadlines on top of earlier ones that could not be met.

B. The Current Accommodation for End-Users is not Sufficient to Allow for Compliance

The proposed implementation periods for both financial and non-financial end-users are insufficient. We firmly believe that waiting to set implementation deadlines for all end-users until it is clear when other market participants will be compliant is the best approach. Pre-determined deadlines for end-users would be arbitrary and inefficient, disrupting market and business operations. In the event that the Commission nonetheless imposes an inefficient, pre-determined deadline for end-users, the Coalition recommends providing end-users with one year to come into compliance with final margin, documentation, clearing, and exchange trading rules. End-users need this amount of time because there are limited resources currently available in the market, and the imposition of the final rules will impose large burdens that will be a substantial change from current market practice for many end-users. For example, in the case of trade documentation, a Coalition survey found that nearly 40% of end-users do not currently employ bilateral margin agreements. Negotiating and putting such agreements into place will take time because of the large administrative and legal costs involved.[5]

To comply with Title VII requirements, end-users will rely heavily not only on their Category 1 counterparties, but also on third-party vendors. And they will not be working toward compliance in a vacuum. Instead, all end-users will be competing both with each other, and especially with other types of entities, for access to these limited resources. As discussed at the Commission's implementation roundtable, end-users are concerned that there will be a "traffic jam" of many market participants, all seeking to comply with new regulations at the same time.[6]

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months to get everyone onboard given the documentation issues associated with opening that money [sic] accounts with that many clearing organizations." *CFTC-SEC Staff Roundtable Discussion on Dodd-Frank Implementation*, Transcript p.59 ll.21-22, p.60 ll.1-5 (May 3, 2011).

[5] An analysis of the Coalition for Derivatives End-Users' Survey on Over-the-Counter Derivatives (Feb. 11, 2011) *available at* http://www.chathamfinancial.com/wp-content/uploads/2011/02/OTC_Derivatives_Survey0211.pdf.

[6] ". . . if you try to funnel all of the end-users in at once through the clearing brokers and then through the CCPs, you'll have massive bottlenecks and contention problems." *CFTC-SEC Staff Roundtable Discussion on Dodd-Frank Implementation*, Transcript p.14, ll.1-5 (May 3,

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This mass rush to comply may impede the ability of end-users to come into compliance quickly. Swap dealers and major swap participants will transact a much higher volume of swaps than most end-users. Thus, compared to these other types of entities that have higher trading volumes, end-users will already be at a disadvantage for attracting the talent and attention from service providers that end-users will need to comply. Failing to provide end-users with more time will put them at a competitive disadvantage relative to other types of entities that must also clear and execute swaps. It will also tend to disadvantage smaller end-users the most. Congress sought to ensure fair and open access to clearing by stipulating in the Dodd-Frank Act that the "participation and membership requirements of each derivatives clearing organization shall . . . permit fair and open access."[7] This requirement will not be met if end-users that are required to clear are not given sufficient time to comply with the new requirements, while other entities are.

End-users that have to clear their swap transactions will need considerable time to meet the clearing mandate's requirements. For example, end-users will have to examine the service offerings of multiple clearinghouses and SEFs to determine which they want to engage. They will have to determine where to clear particular products and may have to employ multiple clearinghouses to ensure full coverage. They will then have to select clearing members and negotiate agreements and arrangements—including to ensure connectivity—with them. It will also take end-users more time to put in place agreements for cleared swaps customer collateral protection, for exchange execution, and for margin agreements. The documentation requirements alone could exhaust the additional time afforded to end-users, but this time would also be needed for due diligence on multiple potential partners and to establish or ensure adequate technological connections.

If the aggressive timeline proposed by the Commission were necessary to mitigate systemic risk, these burdens might be easier to justify. But end-users do not meaningfully contribute to systemic risk. Federal Reserve Board Chairman Ben Bernanke emphasized this point when he wrote that the Federal Reserve "does not believe that end-users other than major swap participants pose the systemic risk that the legislation is intended to address."[8]

II. Financial End-Users should be Treated the Same as Non-Financial End-Users

The Coalition believes that all end-users should receive equal treatment unless otherwise specifically provided for in the Dodd-Frank Act. Financial end-users include entities such as

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2011) (statement of William DeLeon, PIMCO); "… there would be bottlenecks if everybody tried to utilize that infrastructure at once and that infrastructure is not yet at full scale, despite the fact that many parts of it are operationally ready." *Id.* p.20, ll. 1-7 (statement of Gary O'Connor, International Derivatives Clearing Group).

[7] 7 U.S.C. § 7a-1(c)(2)(C)(iii); Dodd-Frank Act § 725(c).

[8] Letter from Chairman Bernanke to Senator Crapo (Dec. 2010).

pension plans, captive finance affiliates, mutual life insurance companies, and commercial companies with non-captive finance arms. These entities use derivatives predominantly to hedge risks associated with their businesses and thus do not pose systemic risk. In short, they use derivatives in the same way that non-financial end-users do.

They also enter into derivatives contracts on a scale that is more consistent with non-financial end-users than with swap dealers. We thus believe that financial end-users should be given the maximum amount of time to comply, instead of being placed with Category 2 entities. This approach would avoid disruptions in swap markets and accord with the realities of the resources available for end-users to come into compliance.

III. Requirements also should be Phased-in by Product-Type, According to Systemic Risk

The Coalition agrees that phasing-in requirements by entity type is desirable and will help achieve the goal of imposing regulations on those entities that pose the greatest amount of systemic risk first. The Commission should go further, however, and also phase-in implementation deadlines by swap-type, according to the amount of systemic risk posed by a type of swap. It is unlikely that end-users and other entities relied on by end-users will be able to meet the requirements for clearing, exchange trading, margin, and trade documentation for all swaps if the requirements are imposed for all swap products at the same time. For clearing, the nature of the clearing and exchange trading requirement framework already facilitates the phasing-in of clearing and exchange trading requirements by product-type, as the Commission must make a clearing determination about each swap or type of swap before clearing is required. The Commission should similarly implement the margin and trading documentation requirements by type of swap as well.

We urge the Commission to publish for comment an implementation schedule that outlines the order and timeframes for when final rules will apply to different types of swaps. This approach will reduce regulatory uncertainty, enabling end-users to plan accordingly. Phasing requirements by product-type also makes sense both because the nature of some types of swaps lend themselves to meeting the requirements more quickly than others and, more importantly, because different types of swaps introduce different levels of systemic risk into the financial system. For example, in the case of clearing, swaps that are already being cleared today should be subject to the clearing requirement first, as there is already market intelligence and experience for clearing these types of swaps.[9] Clearing swaps that pose more systemic risk

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[9] We note that the preamble to the Clearing Implementation Rule suggests that the Commission may already be planning such an implementation approach: "Because the Commission initially will consider mandatory clearing determinations based on those swaps that DCOs are currently clearing or that a DCO would like to clear, the initial sequence of mandatory clearing determinations will be based on the market's view of which swaps can be cleared and which asset classes are ready for clearing, as reflected by the fact that a DCO is

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first also makes sense, as the Dodd-Frank Act's clearing requirements aim to achieve risk reduction.

The same logic holds for margin requirements. For example, policymakers have acknowledged that certain products are more closely associated with the cause of the financial crisis. Specifically, credit default swaps tied to the subprime mortgage market are those that contributed to AIG's failure. On the other hand, interest rate, foreign currency, and commodity swaps contributed little to the cause of the financial crisis. A risk-based implementation approach to the margin requirements would focus the market's energies where they will make the greatest impact on risk reduction, while at the same time minimizing implementation burdens for end-users.

IV. The Commission should Adopt a Presumption that it will Provide for the Phase-in of Clearing Requirements Each Time it Makes a Clearing Determination

The preamble to the Clearing Implementation Rule provides that the Commission "anticipates that it will exercise its authority to trigger the proposed compliance schedules each time it issues a mandatory clearing determination."[10] Thus, as currently proposed, there would be no phased implementation timeline for end-users unless the Commission affirmatively acts to trigger phased implementation each time it makes a clearing determination. Under this approach, immediate—instead of phased—implementation of a clearing determination would be the default.

The Coalition believes that the Commission should instead establish a presumption that the Commission will rely on the phased-in compliance schedule that it ultimately adopts for each mandatory clearing determination that it issues, unless the Commission finds that phased-in implementation is not necessary in a specific case. In other words, phased-in implementation should occur by default. A presumption in favor of phased implementation would most closely match market realities and indicate to end-users that phased implementation of clearing determinations would be the rule, instead of the exception.

V. The Commission should Ensure that the "Active Fund" Definition does not Capture End-Users

The CFTC defines "active fund" as "any private fund as defined in section 202(a) of the Investment Advisors Act of 1940, that is not a third-party subaccount and that executes 20 or more swaps per month based on a monthly average over the 12 months preceding the [CFTC

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either currently clearing a group, category, type, or class of swaps or is intending to do so." 76 Fed. Reg. 58188.

[10] 76 Fed. Reg. 58191.

determination].”[11] The Coalition is concerned that this definition may unintentionally capture end-users on the margins. To prevent such an unintended consequence, the Coalition suggests that the Commission revise the active fund definition in two ways. First, in addition to a threshold based on number of swaps executed, the Commission should add a minimum notional threshold that also must be triggered. This would prevent an end-user that executed 20 swaps with an aggregate value of only $10 million, for example, from being classified as an active fund. Also, swaps that are used to hedge commercial risk and inter-affiliate swaps should not be counted for the purpose of determining whether an entity meets the threshold of executing the 20 swaps.

VI. Conclusion

We thank the Commission for the opportunity to comment on these important implementation issues. The Coalition looks forward to working with regulators to help implement swaps requirements that serve to strengthen the derivatives market without unduly burdening end-users and the economy at large. We are available to meet with the Commission to discuss these issues in more detail.

Sincerely,

Business Roundtable
Commodity Markets Council
Financial Executives International
National Association of Corporate Treasurers
National Association of Real Estate Investment Trusts
The Real Estate Roundtable
U.S. Chamber of Commerce

[11] 76 Fed. Reg. 58195.