



| asset management group

May 14, 2013

Ananda Radhakrishnan
Director of Division of Clearing and Risk
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Request for Relief with respect to Rule 39.13(g)(2)(ii)

Dear Mr. Radhakrishnan:

The Asset Management Group (the “**AMG**”)¹ of the Securities Industry and Financial Markets Association (“**SIFMA**”) is writing to request that the Commodity Futures Trading Commission (the “**Commission**”) take prompt action to provide relief from the terms of Rule 39.13(g)(2)(ii). In particular, we are writing to support the requests made on behalf of Bloomberg L.P. (“**Bloomberg**”) in a letter dated March 11, 2013, and a Motion for Stay dated April 24, 2013, for relief from the 5-day minimum liquidation time required for the calculation of initial margin requirements for swaps (other than swaps on agricultural commodities, energy commodities and metals) cleared on derivatives clearing organizations (“**DCOs**”). We understand that, notwithstanding the related legal actions recently filed on behalf of Bloomberg in District Court for the District of Columbia, such requests remain pending with the Commission.

We are aware of the extensive attention given to this issue by the Commission and its staff, including the Commission’s consideration of comments received on the rule as initially proposed and your solicitation of public input through the Public Roundtable on Futurization of Swaps (the “**Roundtable**”) held on January 31, 2013. We take this

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 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**”).

opportunity to offer the perspective of our buy-side member firms and to highlight several important market developments.

Background

Rule 39.13(g) provides that DCOs shall employ models that will generate margin requirements adequate to cover the DCOs' potential future exposure to a clearing customer's position based on price movements between the last collection of variation margin and the time within which the DCO estimates that it would be able to liquidate a defaulting clearing member's positions. Under the final rule the models must assume, unless an exception is granted, that it will take at least one day to liquidate futures and options ("**Futures**") and agricultural commodity, energy commodity and metal swaps ("**Commodity Swaps**") and that it will take at least five days to liquidate all other cleared swaps ("**Non-commodity Swaps**"). In the preamble to the final rule, the Commission explained that these "bright-line" minimum liquidation times would provide certainty to the market, ensure that margin requirements would be established for the "thousands of swaps that are going to be cleared" and prevent a potential "race to the bottom" by competing DCOs.

AMG believes that the minimum liquidation time of 5 days for Non-commodity Swaps (a) is arbitrary and overly conservative, (b) is based on a fundamentally flawed assumption as to a difference in liquidity between futures and swaps, (c) creates an artificial economic incentive for market participants to use futures rather than swaps and (d) is contrary to Congress's goal of promoting trading of swaps on swap execution facilities ("**SEFs**"). We strongly believe that the minimum liquidation time for Non-commodity Swaps should be the same as for Futures and Commodity Swaps – *i.e.*, 1 day – with DCOs using their reasonable and prudent judgment to set higher liquidation times for particular types or classes of transactions where warranted by their specific liquidity characteristics as evidenced by quantitative analyses derived from sources such as swap data repository data.

The 5-day Minimum Liquidation Time for Non-commodity Swaps is Arbitrary and Overly Conservative

Nowhere in the adopting release for the final or proposed rules does the Commission explain why the minimum liquidation time for Non-commodity Swaps should be 5 times that for Commodity Swaps and Futures. Initial margin set by a DCO for a particular transaction is intended to cover the potential future exposure of the DCO during the maximum period between the last collection of variation margin and the time within which the DCO estimates that it would be able to liquidate a defaulting clearing member's position(s) in such transaction. Thus, the appropriate liquidation time for a particular transaction will be affected by a number of factors, including: the trading volume, open interest, and predictable relationships with highly liquid products of such

transaction. In adopting a one-size-fits-all 5-day liquidation time for Non-commodity Swaps, the Commission relied on a flawed assumption, which we discuss below, that Non-commodity Swaps categorically take 5 times longer than Futures and Commodity Swaps to liquidate. This belief is not supported and fails to adequately take into account the wider range of options available for closing out swap transactions as compared to Futures.

Moreover, a 5-day liquidation time for Non-commodity Swaps is overly conservative. The Commission does not provide any data or analysis of the liquidity in the interest rate, credit default, foreign exchange or equity index swap markets to support the 5-day liquidation time for Non-commodity Swaps.

The Commission’s Assumption about the Difference in Liquidity between Futures and Commodity Swaps, on the one hand, and Non-commodity Swaps, on the other hand, is Fundamentally Flawed

The Commission’s assumption that Non-commodity Swaps are categorically 5 times less liquid than Futures and Commodity Swaps is fundamentally flawed. Many swap contracts have become highly standardized and fungible; conversely, new swap futures offerings have customized terms. This convergence makes prior distinctions between futures and swaps no longer relevant.²

Standardization of over-the-counter swap terms has been underway for some time and is currently accelerating in response to the new regulatory developments under the Dodd-Frank Act such as the implementation of mandated central clearing and exchange trading. For example, the standardization of auction settlement and contract terms of credit default swaps began in 2009 under ISDA’s “big bang” protocol. More recently, interest rate swaps (“**IRS**”) are becoming standardized as well. AMG, working in collaboration with ISDA, has introduced Market Agreed Coupon Contracts (“**MAC Contracts**”) which are IRS contracts with pre-defined, market-agreed terms, including start and end dates and fixed coupon rates.³ Similarly, trueEX LLC (“**trueEX**”), a Designated Contract

²In its Final Rule defining “swap” and “security-based swap,” the Commission described a comment received from the CME that the CFTC should “clarify that nothing in the release was intended to limit a DCM’s ability to list for trading a futures contract regardless of whether it could be viewed as a swap if traded over-the-counter or on a SEF, since futures and swaps are indistinguishable in material economic effects.” The Commission declined to provide the requested clarification noting that prior distinctions between swaps and futures (such as the presence or absence of clearing) may no longer be relevant, and as result it is difficult to distinguish between the two instruments on a blanket basis. Further Definition of “Swap,” “Security-Based Swap,” and “Security-based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48208, 48303 (Aug. 13, 2012).

³ See SIFMA website: <http://www.sifma.org/services/standard-forms-and-documentation/swaps/>.

Market (“DCM”) launched in 2012, plans to list for trading on its electronic trading platform US dollar denominated Standard Coupon & Standard Maturity Interest Rate Swap contracts (“SCSM Contracts”) with standardized coupons, maturities, roll dates and other terms. In both cases, these standardized specifications are intended to create fungible, liquid contracts regardless of the date acquired and are highly similar to swap futures contracts offered on futures exchanges.

Despite having highly similar, or in some case indistinguishable, trading and liquidity characteristics, the arbitrarily longer liquidation time mandated for Non-commodity Swaps by Rule 39.13(g)(2)(ii) puts them at a significant competitive disadvantage and creates an artificial economic incentive for market participants to use futures rather than swaps, which could result in unintended and unjustifiable regulatory arbitrage. For example, in December 2012, Eris Exchange launched “Eris Standards,” swap futures contracts with quarterly effective dates, pre-determined fixed rates, and cash settlement upon maturity, but as described in a press release, these swap futures contracts “are expected to offer margin savings of 40-80% compared to cleared OTC interest rate swaps.”⁴ In contrast, without relief from the Commission, the MAC Contracts – which also have quarterly effective dates, predetermined fixed rates and more flexible means of settlement, including cash unwind – would be required to use a 5-day liquidation time under Rule 39.13(g)(2)(ii).

AMG believes that these deliverable swap futures contracts and MAC swap contracts are similar instruments and would require substantially similar time periods to liquidate in the case of a customer default. Accordingly, we strongly believe that the minimum margin requirements for these instruments should be the same. Also, we do not believe there is any basis whatsoever to increase the margin requirements or minimum liquidation times for Futures. As expressed in our prior comment letters, we also continue to believe that the Commission should not require minimum liquidation times that exceed 1 day for cleared swaps, whether Commodity Swaps or Non-commodity Swaps.⁵

Rule 39.13(g)(2)(ii) is Contrary to Congress’s Goal of Promoting Trading of Swaps on SEFs

⁴ Eris Exchange to Launch New, Margin-Efficient Interest Rate Swap Futures (Press Release, Dec 5, 2012) avail at <http://www.prnewswire.com/news-releases/eris-exchange-to-launch-new-margin-efficient-interest-rate-swap-futures-182180261.html>.

⁵ See SIFMA AMG Letter to the Commission on Risk Management Requirements for Derivatives Clearing Organizations (Jun. 3, 2011), available at <http://sifma.org/workarea/downloadasset.aspx?id=25861> (“In the context of cleared transactions, we believe that a 1-day liquidation period for swaps executed on either a DCM or SEF and a 2-day liquidation period for all other swaps is sufficient for this purpose...”).

By creating incentives favoring futures trading over swap trading, Regulation 39.13(g)(2)(ii) runs counter to Congress's explicit goals "to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market."⁶ A nearly identical concern led the Commission to abandon its originally proposed bright-line distinction between 1-day and 5-day minimum liquidation times for swaps executed on DCMs and SEFs, respectively. In the preamble to the final rule, the Commission noted that "requiring different minimum liquidation times for cleared swaps that are executed on a DCM and similar cleared swaps that are executed on a SEF could have negative consequences."⁷ The Commission acknowledged the comments of multiple parties that this distinction, among other things, would put SEFs at a competitive disadvantage to DCMs, potentially create detrimental arbitrage between standardized swaps traded on a SEF and contracts with the same terms and conditions traded on a DCM and undermine the goal of the Dodd-Frank Act to promote trading of swaps on SEFs.⁸ In response to such comments, the Commission determined not to mandate different minimum liquidation times for cleared swaps based on whether they are executed on a DCM or a SEF.⁹ We believe that the same logic should be applied such that minimum liquidation times for cleared swaps executed on a DCM or a SEF should be no higher than that for exchange-traded futures.

By arbitrarily setting the liquidation time for Non-commodity Swaps at 5 days, as compared to 1 day for Futures, Rule 39.13(g)(2)(ii) increases the margin required for Non-commodity Swaps relative to Futures and creates an artificial economic incentive for market participants to favor Futures, even though the trading and liquidity characteristics of the two instruments may be the same. Surely, it could not have been Congress' intent in adopting Title VII of the Dodd-Frank Act for the Commission to create a market structure that would move liquidity away from swaps and into Futures.¹⁰ However, Rule 39.13(g)(2)(ii) puts SEFs at a competitive disadvantage to DCMs, and creates a detrimental arbitrage between Non-commodity Swaps and futures contracts with the same terms and conditions. It is critical to our members' interests as swap market participants that SEFs be robust and vibrant trading platforms and not disadvantaged by external costs that arise solely due to

⁶ Commodity Exchange Act § 5h(a)(1)(e).

⁷ Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69334, 69367 (Nov. 8, 2011).

⁸ *Id.* at 69366.

⁹ *Id.* ("The Commission is persuaded by the views expressed by numerous commenters that requiring different minimum liquidation times for cleared swaps that are executed on a DCM and equivalent cleared swaps that are executed on a SEF could have negative consequences.")

¹⁰ Indeed, post-implementation of rules adopted by the Commission under the Dodd-Frank Act, the cleared swaps markets may provide more protections to participants than the Futures market. For example, the Commission's collateral segregation model for cleared swaps (complete legal segregation), once implemented, will be more protective than the model for Futures, as the MF Global and Peregrine collapses have shown.

regulatory status. However, if the minimum liquidation times established by the Commission under Rule 39.13(g)(2)(ii) remain unchanged, the Congressional goal of promoting trading of swaps on SEFS will be undermined.

Relief Requested

Accordingly, we encourage the Commission to provide relief in the form of a stay of Rule 39.13(g)(2)(ii) that would immediately adjust the minimum liquidation time for all cleared Non-commodity Swaps, whether executed on a SEF or DCM, to a 1-day liquidation time, conditioned on the obligation of the relevant DCO to use its reasonable and prudent judgment to set higher liquidation times for particular types or classes of transactions where warranted by their specific liquidity characteristics, as evidenced by quantitative analysis derived from sources such as swap data repository data. We respectfully request that the Commission act expeditiously to do so, in view of the importance of relief before the June 10, 2013 mandatory clearing date for category 2 participants, as Bloomberg has explained in its Motion for Stay. Relief before June 10 is necessary to give market participants more certainty and provide a greater incentive for participants to clear their Non-commodity Swap trades.

Based on the foregoing, we respectfully request that the Commission grant the relief described in this letter. We appreciate the Commission's consideration of this request, and stand ready to provide any additional information or assistance that the Commission might find useful. Should you have any questions, please do not hesitate to call Tim Cameron at 212-313-1389 or Matt Nevins at 212-313-1176.

Sincerely,



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



Matthew J. Nevins, Esq.
Managing Director and Associate General Counsel, Asset Management Group
Securities Industry and Financial Markets Association

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

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Certification Pursuant to CFTC Regulation 140.99(c)(3)

As required by CFTC Regulation 140.99(c)(3), we hereby (i) certify that the material facts set forth in the attached letter dated May 14, 2013 are true and complete to the best of our knowledge; and (ii) undertake to advise the CFTC, prior to the issuance of a response thereto, if any material representation contained therein ceases to be true and complete.

Sincerely,



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



Matthew J. Nevins, Esq.
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Securities Industry and Financial Markets Association