published: 7.24.98

VIA ELECTRONIC MAIL & FEDERAL EXPRESS

July 24, 1998

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
Mail Stop 6-9 450 Fifth Street, N.W.
Washington, D.C. 20549

**Re: File No. SR-GSCC-98-02: Government Securities Clearing Corp./Notice of Proposed Rule Change Regarding the Implementation of the GCF Repo Service**

Dear Mr. Katz:

The Bond Market Association (the "Association")[1] appreciates the opportunity to comment on the legal and policy issues raised by the proposed rule change filing by the Government Securities Clearing Corporation ("GSCC") and certain comment letters filed in response to the Commission's publication of the filing. The Association wishes to make clear that it takes no position with respect to the merits of the GCF Repo Service proposed to be implemented by GSCC. However, once again the Association feels compelled to address certain statements contained in comment letters filed by the Commodity Futures Trading Commission ("CFTC"), the Chicago Board of Trade ("CBOT") and the Chicago Mercantile Exchange ("CME") with respect to GSCC's proposed rule change. Some of these letters we believe contain or are based on certain inaccuracies as to the status of current law relating to the scope of the Treasury Amendment of the Commodity Exchange Act ("CEA") and the exclusion of over-the-counter market transactions involving government securities, as well as the clearing corporations which provide services for such transactions, from the jurisdiction of the CFTC.

Unfortunately, the Association's concerns as expressed in our March 26, 1998 comment letter regarding the Delta Clearing Corporation's RAITS product filing, have been realized – the Commission's process for approving rule changes by registered clearing corporations is once again being used by the CFTC, CBOT and CME to attempt to assert regulatory jurisdiction over the OTC government securities markets. The result is that once again, yet another new product initiative may be delayed in getting to the marketplace and innovation stifled and delayed while questions regarding the CFTC's jurisdiction are resolved through a process not suited to deal with these sorts of questions. Yet none of the three comment letters make any attempt to advance a regulatory or policy justification for expanding the CFTC's jurisdiction into the OTC government securities repo market or for delaying approval of a new product if the Commission otherwise determines that the product is beneficial for the repo markets in these securities.

In particular, the CFTC's letter states no rationale for why it believes it has the responsibility to analyze the GCF Repo Service and what legal issues it believes would justify the Commission's delaying approval of the proposed rule change. If the CFTC believes it has jurisdiction over the GCF Repo Service or GSCC, it should pursue whatever action it deems appropriate, separate from the Commission's clearing corporation rule approval process.

The Association believes that all three commenters, either explicitly or implicitly, mistakenly understate the scope of the Treasury Amendment. Market participants have long understood the Treasury Amendment to exempt transactions not only *in*, but *in any way involving*, government securities (as long as the transactions do not involve the sale of such securities for future delivery conducted on an organized exchange).[2] In February of 1997, the Supreme Court upheld this interpretation of the Treasury Amendment in Dunn v. Commodity Futures Trading Commission, 117 S.Ct. 913 (1997). Clearly, repurchase agreement transactions involving government securities would be within the scope of the Treasury Amendment. The involvement of already regulated clearing corporations, such as GSCC, in the clearance and settlement of such repurchase agreement transactions should not affect that legal conclusion.

Of course, the Treasury Amendment's exclusion from the coverage of the CEA is inapplicable if the transactions involve the sale of an enumerated product for future delivery conducted on a board of trade. The CME comment letter explicitly and incorrectly characterizes inter-dealer brokers as a "board of trade". The Association strongly disagrees with the characterization of an inter-dealer broker that enters into repurchase agreement transactions with dealers and submits that information to GSCC on behalf of such dealer counterparties as a "board of trade".

Market participants active in the bond markets have long believed that the term "board of trade" as used in the Treasury Amendment means essentially the equivalent of an organized exchange, where members can regularly execute orders for standardized contracts with clearance and settlement of those contracts through exchange facilities.[3] This view of "board of trade" was supported by the recent decision of the Court of Appeals for the Ninth Circuit in Commodity Futures Trading Commission v. Frankwell Bullion Ltd., 99 F.3d 299 (9th Cir. 1996). The US Supreme Court in Dunn implicitly endorsed the Frankwell Bullion definition of "board of trade" by concluding that the activities of a private dealer in foreign currency options were within the scope of the Treasury Amendment's exclusion from CFTC jurisdiction.[4] The Association does not believe that the inter-dealer broker becomes a "board of trade" or operates in the functional capacity of a futures exchange when market participants execute repo transactions through an inter-dealer broker, negotiate their own transaction terms, and then, purely for efficiency and time-saving, authorize that inter-dealer broker to submit that transaction information to a registered clearing corporation on their behalf for netting, clearance and settlement.[5]

The CBOT letter asserts that if the GCF Repo Service constitutes a futures contract, then the CFTC may regulate it as a clearing agency or facility in futures contracts. However,

the Association is unaware of any independent statutory authority that grants the CFTC jurisdiction over clearing corporations. Not even the clearinghouse of a futures exchange is considered a "board of trade" within the meaning of the CEA. See Board of Trade Clearing Corporation v. United States, __ F. Supp. (D.D.C. 1976), reprinted at [1975-77 Transfer Binder] Comm. Fut. L. Rep. (CCH) 20,246 ("the Clearing Corporation, which is neither a board of trade nor a designated contract market.").

The CBOT and CME comment letters express concern that "forward start" repo products may be "futures", apparently because they contend that "offsetting" transactions may be entered into and delivery may not take place. This reflects a misunderstanding of the nature of these transactions. A forward start repo is simply a repo transaction that is agreed to on a date, to commence at some deferred start date. Forward start repos are often a key method used by primary dealers to ensure in advance the availability of financing for their purchases of US Treasury securities on auction dates. When the repo transaction commences on the start date, the repo securities that are subject of the repurchase agreement are delivered to the repo buyer. At the maturity of the repo transaction, the repo buyer will re-transfer and re-deliver the repo securities to the repo seller. The mere fact that deliveries of certain securities to be delivered and received in connection with repurchase and reverse repurchase transactions are netted to a single receive or deliver position through the facilities of a clearing corporation such as GSCC does not make the transactions futures under the CEA. The GCF Repo service is intended to be a funding product, not a facility to simulate interest rate trading.[6]

The GCF Repo Service is simply a new way to facilitate the netting, clearance and settlement of certain types of repo transactions known as general collateral repo trades. At the conclusion of GSCC’s process, securities will be delivered and received by GSCC participants based on their net position. The essential nature of the repurchase agreement market is not changed into a market over which CFTC jurisdiction is legally justifiable or warranted just because of enhancements to the clearance and settlement process. To the extent that, in the judgment of the Commission, those enhancements are beneficial to the marketplace, they should be allowed to proceed.

If you have any questions concerning this letter, please feel free to contact Paul Saltzman, Senior Vice President and General Counsel, or Patricia Brigantic, Vice President and Associate General Counsel, of The Bond Market Association at 212.440.9400.

Sincerely,

DANIEL O. MINERVA
Chair, Funding Division
The Bond Market Association

PAUL G. SCHEUFELE
Vice Chair, Funding Division
The Bond Market Association

cc: The Honorable Arthur Levitt, Chairman
*Securities and Exchange Commission*

Richard Lindsey, Director, Division of Market Regulation
*Securities & Exchange Commission*

Robert L. Colby, Deputy Director, Division of Market Regulation
*Securities and Exchange Commission*

The Honorable Brooksley Born, Chair
*Commodity Futures Trading Commission*

I. Michael Greenberger, Director, Division of Trading & Markets,
*Commodity Futures Trading Commission*

Robert Rubin, Secretary
*United States Department of Treasury*

Gary Gensler, Assistant Secretary for Financial Markets
*United States Department of Treasury*

Roger Anderson, Deputy Assistant Secretary for Federal Finance,
*United States Department of Treasury*

William McDonough, President
*Federal Reserve Bank of New York*

Oliver Ireland, Associate General Counsel
*Board of Governors of the Federal Reserve System*

Sal Ricca, President
*Government Securities Clearing Corporation*

Jeffrey Ingber, General Counsel & Secretary
*Government Securities Clearing Corporation*

Funding Division Executive Committee
Primary Dealers Executive Committee
CEA Working Group
Legal and Regulatory Staff of *The Bond Market Association*

---

**FOOTNOTES**

- ***1*** The Bond Market Association represents securities firms and banks that underwrite, distribute and trade in fixed income securities, both domestically and internationally. Our members are actively involved in the funding markets for such securities, including the securities lending and repurchase agreement markets. Further information regarding the Association, its members and activities can be obtained from our website (www.bondmarkets.com).
- ***2*** See Statement of PSA The Bond Market Trade Association before the Senate Committee on Agriculture, Nutrition and Forestry, Hearing on the Commodity Exchange Act Amendments of 1997 (February 13, 1997) ("Senate Statement"); Statement of PSA The Bond Market Trade Association before the House Subcommittee on Risk Management and Specialty Crops, House Committee on Agriculture, Hearing on the Commodity Exchange Act Amendments of 1997 (April 16, 1997) ("House Statement"). The Association was formerly known as the Public Securities Association and PSA The Bond Market Trade Association.
- ***3*** See Senate Statement and House Statement.
- ***4*** The interpretation of "board of trade" recently adopted by the U.S. District Court for the Southern District of New York in Rosner v. Peregrine Finance Ltd., S.D.N.Y., No.95 Civ. 10904 (KTD), 1998 U.S. Dist. LEXIS 7170 (May 18, 1998), would not warrant a different conclusion with respect to the role of inter-dealer brokers and GCF Repo. The rationale used by the Court in Rosner to extend the protections of the CEA to unsophisticated individual investors is inapplicable to the GCF Repo Service where participants will be registered broker-dealers, in an OTC repo market already regulated by the Treasury Department, the Federal Reserve and the Commission.
- ***5*** The CFTC staff has consistently recognized that clearinghouses are not "boards of trade" by imposing ultimate responsibility for enforcement of clearinghouse rules on the contract market (board of trade) for which clearing services are performed. See CFTC Interpretive Letter No. 82-5 (June 15, 1982), reprinted at [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) 21, 964.
- ***6*** It is similarly inconceivable that the CME can argue that forward start repurchase transactions are somehow swaps.