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February 13, 2012

Mr. David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, N.W.  
Washington, D.C. 20581

*Re: Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade under Section 2(h)(8) of the Commodity Exchange Act (RIN 3038-AD18)*

Dear Mr. Stawick:

The Investment Company Institute<sup>1</sup> is submitting this letter in response to the Commodity Futures Trading Commission's ("Commission") proposal that would establish a process for a designated contract market ("DCM") or swap execution facility ("SEF") to make a swap "available to trade" for purposes of Section 2(h)(8) of the Commodity Exchange Act ("Proposed Rules").<sup>2</sup> We appreciate that the Commission has acknowledged concerns raised by commenters that the process for making a swap "available to trade" should include greater Commission involvement because of incentives that DCMs and SEFs may face to prematurely mandate trading of swaps on their platforms.<sup>3</sup> We also appreciate that the Commission held a roundtable on January 25, 2012 to discuss this and other issues raised by the Proposed Rules ("Roundtable"). We believe, however, that the Proposed Rules fail to provide the Commission with a significant enough role in the process for making a swap available to trade so as to protect against the incentives faced by DCMs and SEFs.

As a preliminary matter, it is important to clarify that the "make available to trade" ("MAT") determination is the determination of whether a swap will be subject to mandatory execution; if a swap

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<sup>1</sup> ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding and otherwise advance the interest of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$12.5 trillion and serve over 90 million shareholders.

<sup>2</sup> *Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available To Trade*, 76 FR 77728, (December 14, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-31646a.pdf> ("Release").

<sup>3</sup> *Id.* at 77730.

is deemed “available to trade,” it can *only* be traded on a DCM or SEF, and all bilateral trading in that swap must cease. Given the importance of that determination, and the differences between the clearing and trading execution requirements, we believe it is essential that the MAT determination process be separate and distinct from the mandatory clearing process. Only those swaps that are the most liquid should be subject to mandatory execution.

To address the incentives a DCM or SEF may have to make a swap “available to trade” prematurely, we recommend that the factors the Commission require DCMs and SEFs to consider as part of the MAT determination process include objective standards or thresholds, and that consideration of each factor be mandatory. We also recommend that the MAT determination process incorporate a 60-day public comment period.

We recognize that, until the Commission is able to obtain a sufficient amount of data from swap data repositories (“SDRs”), it may be difficult for the Commission to establish objective thresholds for the MAT determination process that reflect the trading characteristics of particular swaps. Until then, we would support, in concept, a one-year “pilot program” to determine those swaps subject to mandatory execution, an idea that was raised by a participant at the Roundtable.

We suggest that the Commission increase to quarterly the frequency of the proposed review required by DCMs and SEFs regarding their MAT determinations, with the ability for the Commission or market participants to request more frequent reviews if it appears a swap may no longer meet the MAT criteria. We also suggest that the Commission incorporate into the final rules a process for determining that a swap is no longer available to trade in order to ensure sufficient liquidity in swaps that have been made available to trade, and provide certainty to the swaps markets.

In addition, we are concerned that the proposed definition of “economically equivalent swap,” like the proposed MAT determination process itself, gives too much discretion to a DCM or SEF without providing objective standards, and would create uncertainty regarding which swaps are subject to a MAT determination. We recommend that the concept be eliminated and that, instead, all swaps that will be made available for trading be analyzed according to the same objective factors under the MAT determination process.

We believe that it is important for all market participants to have adequate time following a final MAT determination to prepare their systems and procedures before that determination is made effective. Accordingly, we recommend a period of 90 days after a MAT determination is final before it is made effective. We also recommend that the Commission notify industry participants of final MAT determinations in a central location on its website.

Each of these recommendations is discussed in more detail below.

I. The MAT Determination Process Should be Separate and Distinct From the Mandatory Clearing Determination Process

At the outset, we think it is important to clarify that “make available to trade” is a misnomer, in that the MAT determination process actually is a mandatory execution determination. Section 2(h)(8) of the Commodity Exchange Act provides that transactions involving swaps that are required to be cleared must be executed on a DCM or SEF unless no board of trade or SEF “makes the swap available to trade” or the transaction is subject to the clearing exception for end-users. Thus, if a swap is deemed to be “available to trade,” it can *only* be traded on a DCM or SEF, and all bilateral trading in that swap must cease.

At the Roundtable, several participants expressed the view that the MAT determination process should be made a part of the mandatory clearing determination process, because both determinations are subject to the same considerations. We strongly disagree. Congress was clear in imposing separate clearing and trading execution requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), including a specific framework by which the Commission must make mandatory clearing determinations.<sup>4</sup> By interposing a regulated clearing house between swap counterparties, the mandatory clearing requirement was designed as the linchpin to effect Congress’ goal to reduce systemic risk, increase transparency and enhance oversight of the swaps market. This intent is reflected in the factors imposed by Congress with respect to a mandatory clearing determination, which include, in addition to considerations relating to liquidity, the effect on the mitigation of systemic risk, the effect on competition, and the existence of reasonable legal certainty in the event of default, among several others.<sup>5</sup>

By contrast, a swap may be listed on a DCM or SEF, yet not be subject to mandatory execution. As Senator Blanche Lincoln, then Chairman of the Senate Committee on Agriculture, noted in a colloquy in the Congressional Record, “[t]he mere ‘listing’ of the swap by the swap execution facility, in and of itself, without a minimum amount of liquidity to make trading possible, should not be sufficient

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<sup>4</sup> See Section 723(a)(3) of the Dodd-Frank Act, which added a clearing requirement under Section 2(h)(8)(A) of the Commodity Exchange Act, added a trade execution requirement under Section 2(h)(8)(A) of the Commodity Exchange Act, and set out the framework by which the Commission must make mandatory clearing determinations.

<sup>5</sup> Section 723(a)(3) of the Dodd-Frank Act. The full list of factors is: (A) the existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data; (B) the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded; (C) the effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the derivatives clearing organization available to clear the contract; (D) the effect on competition, including appropriate fees and charges applied to clearing; and (E) the existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property.

to trigger the Trade Execution Requirement.”<sup>6</sup> Significantly more is necessary for a swap to be subject to mandatory execution. Reflecting this distinction, the factors the Commission has proposed with respect to the MAT determination process focus almost exclusively on those elements that contribute to liquidity.<sup>7</sup> While, as discussed below, we have some concerns with the lack of objective standards attached to the factors the Commission has proposed for a MAT determination, we strongly agree with the Commission’s focus on liquidity in those factors.<sup>8</sup> Thus, the MAT determination process should capture only that subset of cleared swaps that is *the most* liquid, in order to ensure that mandatory execution over DCMs and SEFs is warranted and appropriate and does not drive trading to other markets because of concerns by market participants regarding the risks associated with low volume (e.g., limited market, pricing information, flexibility, etc.).

## II. Proposed Factors for a MAT Determination

The Proposed Rules provide that a DCM or SEF would submit initial MAT determinations for swaps to the Commission, either for approval or self-certification, pursuant to the Commission’s existing filing procedures.<sup>9</sup> The DCM or SEF would be required to include an explanation and analysis of its consideration, as appropriate, of the factors set out in the Proposed Rules.<sup>10</sup> The Commission states in the Release that “[n]o single factor would be dispositive, as the DCM or SEF may consider any

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<sup>6</sup> 156 Cong. Rec. S5923 (daily ed. July 15, 2010) (statement of Senator Blanche Lincoln). The complete statement of Senator Lincoln is:

In interpreting the phrase “makes the swap available to trade,” it is intended that the CFTC should take a practical rather than a formal or legalistic approach. Thus, in determining whether a swap execution facility “makes the swap available to trade,” the CFTC should evaluate not just whether the swap execution facility permits the swap to be traded on the facility, or identifies the swap as a candidate for trading on the facility, but also whether, as a practical matter, it is in fact possible to trade the swap on the facility. The CFTC could consider, for example, whether there is a minimum amount of liquidity such that the swap can actually be traded on the facility. The mere “listing” of the swap by a swap execution facility, in and of itself, without a minimum amount of liquidity to make trading possible, should not be sufficient to trigger the Trade Execution Requirement.

<sup>7</sup> These factors are: (1) whether there are ready and willing buyers and sellers; (2) the frequency or size of transactions on SEFs, DCMs, or of bilateral transactions; (3) the trading volume on SEFs, DCMs, or of bilateral transactions; (4) the number and types of market participants; (5) the bid/ask spread; (6) the usual number of resting firm or indicative bids and offers; (7) whether a SEF’s trading system or platform or a DCM’s trading facility will support trading in the swap; or (8) any other factor that the SEF or DCM may consider relevant. Proposed Rules 37.10(b) and 38.12(b).

<sup>8</sup> The Commission also emphasizes, in the Release, that “the mere listing or trading of a swap on a DCM or SEF does not mean that the swap is available to trade,” acknowledging the significance of the MAT determination. Release, *supra* note 2, at n.47.

<sup>9</sup> Proposed Rules 37.10 and 38.12 under the Commodity Exchange Act.

<sup>10</sup> See *supra* note 7.

one factor or several factors to make a swap available to trade.”<sup>11</sup> Under the Commission’s approval procedure, the Commission would have a 45-day period to review the determination, any time during which it could notify the DCM or SEF that it was not going to approve its MAT determination because it is inconsistent or appears to be inconsistent with the Commodity Exchange Act or the Commission’s rules.<sup>12</sup> Under the certification procedure, the Commission would have 10 business days to review a MAT determination before it would be deemed certified and could be made effective, unless the Commission issued a stay of the certification for an additional 90 days.

We are concerned that these factors provide a DCM or SEF with significant discretion to assert that a swap should be made available to trade without providing the Commission adequate means or, in the case of the certification process, time, to consider or challenge the basis for that assertion. For example, the proposed factors include no mandatory, objective standards or thresholds, potentially permitting a DCM or SEF to assert that a swap satisfies the factors even in the absence of a liquid trading market for that swap. As noted above, the Commission anticipates that a DCM or SEF potentially could consider only a single factor; given that the last factor is “any other factor that the SEF or DCM may consider relevant,” the Proposed Rules effectively delegate the authority to establish MAT standards to the DCM or SEF.<sup>13</sup> While, under its approval and certification procedures, the Commission has some recourse if it disagrees with a DCM’s or SEF’s MAT determination, we agree with Commissioner Sommer’s concern expressed in her dissent to the Proposed Rules that “given the lack of any mandatory, objective criteria contained in the rules, it is difficult to envision how the Commission could find a [MAT] determination to be inconsistent with the Act or regulations.”<sup>14</sup>

We also believe it is critical, due to the incentives faced by DCMs and SEFs with respect to the MAT determination, as well as the important implications of mandatory execution for market participants, that the public has an adequate opportunity to provide input during the Commission’s review process. We recommend a public comment period of 60 days, but in no event fewer than 30 days.<sup>15</sup> We believe the Commission’s existing filing procedures, especially the certification process, may not provide sufficient time for this essential input.

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<sup>11</sup> Release, *supra* note 2, at 77732.

<sup>12</sup> This review period may be extended by the Commission for an additional 45 days under certain circumstances.

<sup>13</sup> We also believe that the second factor, “the frequency or size of transactions on SEFs, DCMs, or of bilateral transactions” should be two distinct factors – one addressing frequency, and the other addressing size. *See supra* note 7.

<sup>14</sup> Commissioner Jill E. Sommers, *Opening Statement Before the Sixth Open Meeting to Consider Final Rules Pursuant to the Dodd-Frank Act* (December 5, 2011), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/sommersstatement120511>.

<sup>15</sup> We note that the Commission’s process for review of swaps for mandatory clearing includes a 30-day public comment period. The MAT determination process should include a comment period that is no shorter.

A process that lacks mandatory, objective standards for MAT determinations raises the risk that DCMs or SEFs, in order to increase their business, would seek to make a swap available to trade in the absence of a liquid market for that swap. Such a result would have significant negative consequences for buy-side participants. A registered investment company, for example, may be unable to trade in a particular swap that has been made available to trade because there is limited or no trading in that swap. Limited trading also could negatively affect the pricing of the swap, indirectly raising costs to investment company shareholders.

We note that the Securities and Exchange Commission (“SEC”), in discussing its proposed process for MAT determinations with respect to security-based swaps, also has recognized that SEFs face a conflict of interest with respect to such determinations. Accordingly, the SEC has stated that the MAT determination should be made “pursuant to objective measures established by the [SEC], rather than by one or a group of [security-based SEFs].”<sup>16</sup> The SEC has suggested that such objective measures might include threshold tests established by it. We support the SEC’s approach to MAT determinations and recommend that the Commission harmonize its approach to be more consistent with that of the SEC.

We recognize, however, that until the Commission is able to obtain a sufficient amount of data from SDRs, it may be difficult for the Commission to establish objective thresholds for the MAT determination process that reflect the trading characteristics of particular swaps.<sup>17</sup> Until the Commission can do so, we would support, in concept, a “pilot program” to determine those swaps subject to mandatory execution, an idea that was raised by a participant at the Roundtable. As we understand this proposal, SEFs and DCMs would, with the input of industry participants, agree on a limited group of highly liquid swaps as the best current candidates for mandatory execution, and would propose that the Commission make those swaps “available to trade” for a year. After this limited group of swaps traded for a year, the Commission could assess whether it had sufficient swap data from SDRs to propose objective thresholds for the MAT determination process. If not, it could continue the pilot program for a limited further period of time, possibly with additional swaps included.

We are still in the process of considering this proposal, which is at a preliminary stage. We are interested to understand the proposal further, as more details may be developed, and the specific swaps that may be discussed for inclusion in such a pilot program. We believe, however, that such an approach could bridge the gap between the Commission’s proposed list of factors for the MAT determination process, which lacks objective criteria, and its acknowledgment that “as the swaps

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<sup>16</sup> *Registration and Regulation of Security-Based Swap Execution Facilities*, 76 Fed. Reg. 10948, 10970 (February 28, 2011).

<sup>17</sup> We note that the SEC has acknowledged the importance of data in establishing objective standards for MAT determinations, and declined to propose standards last February because it did not have sufficient data at that time. *Id.* at 10970.

markets evolve and the Commission gains experience with overseeing these markets, it may consider setting objective factors based upon an empirical analysis of swap trading data in a future rulemaking.”<sup>18</sup>

### III. Periodic Review and Determining a Swap is No Longer Available to Trade

The Commission’s proposed MAT determination process contemplates that DCMs and SEFs would be required to perform an annual review and assessment to evaluate whether swaps previously determined to be available to trade should continue to be treated in that manner. The Proposed Rules would require that, upon completion of the annual review, the DCM or SEF must submit a report of its review electronically to the Commission.

We support the Commission’s inclusion in the Proposed Rules of a periodic review process for MAT determinations. We recommend, however, that it be strengthened in several ways. First, we recommend that the review be required quarterly, rather than annually, to reflect that the liquidity of a swap can change dramatically in a short period of time. Second, we recommend that the final rules provide the Commission or a market participant with the authority to request that a DCM or SEF undertake a review at a time in addition to that of the quarterly review if the Commission or market participant believes that a swap may no longer meet the MAT criteria. The process should also provide a means for a market participant to appeal to the Commission a declination by a DCM or SEF of the market participant’s request for review. Third, we recommend that the final rules include a process for market participants to appeal to the Commission, for its further review, assessments made by a DCM or SEF in its quarterly reports that particular swaps should continue to be treated as available to trade. Finally, to provide transparency for the public and the swaps markets, we request that the final rule clarify that the DCM’s or SEF’s electronically-submitted report of its review and assessment will be available to the public.

While the Proposed Rules include a periodic review process for MAT determinations, they do not specify a process to determine that a swap previously deemed available to trade no longer should be available to trade. We recommend that the Commission incorporate such a process into the final rules in order to ensure sufficient liquidity in swaps that have been made available to trade, and provide certainty to the swaps markets.

The Commission requests comment on whether, if it specifies such a process, it should require use of its existing filing process. It also asks who would make the determination and to which DCMs or SEFs it should apply. As noted above, we have concerns about whether the Commission’s existing filing process could accommodate the need to have adequate public comment as part of the MAT determination process, a concern that is equally applicable to a process for determining a swap is no longer available to trade. Subject to our comments above regarding the need to utilize mandatory,

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<sup>18</sup> Release, *supra* note 2, at 77732.

objective factors in the MAT determination process, we believe the same or similar factors could be used in the process of determining a swap is no longer available to trade.

We strongly recommend that any determination that a swap no longer is available to trade be based on trading over all DCMs and SEFs that have made that swap available for trading in order to provide certainty to the swaps markets. It is unclear how it would be consistent with the trade execution requirements of the Commodity Exchange Act if a swap were deemed to be no longer available to trade on one DCM or SEF, but was available to trade on another DCM or SEF. If, on the other hand, only one DCM or SEF were no longer in a position to make a swap available for trading, it would be more appropriate for the DCM or SEF to no longer list or trade that swap.

#### IV. Eliminate the Concept of “Economically Equivalent Swap”

Under the Proposed Rules, an “economically equivalent swap” is defined as “a swap that the swap execution facility or designated contract market determines to be economically equivalent with another swap after consideration of each swap’s material pricing terms.” We are concerned that this definition, like the proposed MAT determination process itself, gives too much discretion to a DCM or SEF without providing objective standards, and would create significant uncertainty regarding which swaps are subject to a MAT determination. It is unclear, for example, how narrowly or broadly “economically equivalent” should be interpreted and what would be considered “material pricing terms.” We believe the vagueness of the proposed definition could allow DCMs and SEFs to circumvent the important analysis required by the MAT determination process when making swaps available for trading, merely by designating such swaps as “economically equivalent.”

We recommend that the Commission eliminate the concept of an “economically equivalent swap.” Instead, a DCM or SEF should be required to submit a MAT analysis for all swaps that it wishes to make available for trading. This would ensure that all swaps that will be made available for trading are analyzed according to the same objective factors.

#### V. The Commission Should Provide Adequate Time Before a MAT Determination is Effective

We believe that it is important for all market participants to have adequate time following a final MAT determination to prepare their systems and procedures before that determination is made effective. For example, other DCMs and SEFs that would be required to make the swap available to trade may need to update their systems or make other technological changes to effect the change. Having a period of time in which to do this would mitigate the effects of a “first mover” advantage for the SEF or DCM that first makes the swap available to trade. Market participants also will need time to receive notice of the final MAT determination and update their systems, processes, and procedures accordingly. This notice is important not only for swaps traded on SEFs and DCMs, but also for OTC trading, because once a swap is deemed made available to trade, it will no longer be eligible for trading in the OTC markets.



While the Commission acknowledges these concerns, it indicates that they would be addressed by the Commission's recent proposed implementation schedule to phase in compliance with the trade execution requirements under Section 2(h)(8) of the Commodity Exchange Act.<sup>19</sup> In particular, the Commission notes that a swap transaction would be subject to the Commodity Exchange Act's trade execution requirement upon the later of the following: (1) the applicable deadline established under the compliance schedules for the clearing requirement, or (2) 30 days after the swap is first made available to trade on either a SEF or DCM.

While we agree that mandatory execution should not take place until other requirements have been appropriately phased in, we also believe that market participants will need an adequate period for compliance beginning after the clearing requirement has been phased in *and* after the swap is first made available to trade on a DCM or SEF. As we explained in our comment letter to the Commission on its proposed implementation schedules, we believe it is essential that: (1) the sequencing of compliance dates follows a logical, progressive order, and (2) the deadlines under the implementation schedules are adequate to accommodate all of the changes market participants must undertake to comply with the Commission's new rule requirements.<sup>20</sup> Satisfying these sequencing issues involves finalizing the trading documentation requirements, completing the swap reporting requirements, and beginning to gather and analyze the data produced pursuant to those requirements before market participants are required to comply with mandatory clearing, and consequently exchange trading rules.<sup>21</sup> The timing of the MAT determination process must account for these preconditions to adequately inform the Commission's rule requirements and thereby avoid adverse effects on the swaps markets and market participants, as well as ensure an efficient transition to mandatory execution. Furthermore, under the Proposed Rules, if a swap is made available to trade fewer than 30 days before the applicable deadline established under the Commission's proposed compliance schedules for clearing, a swap transaction would be subject to mandatory execution with a less than a 30 day compliance period. For the reasons described above, we believe it would be appropriate to instead provide DCMs, SEFs, and market participants with 90 days after a MAT determination is final before it is made effective.

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<sup>19</sup> See *Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA*, 75 FR 58186 (September 20, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-24124a.pdf>.

<sup>20</sup> In our letter, we recommended a compliance period of 18 to 24 months following adoption of final rules. See Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Mr. David A. Stawick, Secretary, Commodity Futures Trading Commission, dated November 4, 2011.

<sup>21</sup> Tiered compliance with the clearing and execution requirements based on the category of market participant and swap, as proposed by the Commission in its implementation schedule, is critical to enable the Commission to benefit from the data collected through the reporting requirements and appropriately tailor or adjust the evolving regulatory framework.

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VI. The Commission Should Provide for an Effective Means of Notification Regarding MAT Determinations

Under the Commission's existing filing rules, DCMs and SEFs would be required to post a notice and copy of their MAT submission on their website at the same time they file the submission with the Commission. The Commission also would post DCM and SEF MAT submissions on its website. The Commission states that it currently is assessing the feasibility of posting notices of all swaps that are determined to be made available to trade on an easily accessible page on its website. We strongly encourage the Commission to provide for an effective means of notifying industry participants of final MAT determinations in a central location on its website.

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If you have any questions on our comment letter, please feel free to contact me directly at (202) 326-5815 or Sarah Bessin at (202) 326-5835.

Sincerely,

/s/ Karrie McMillan

Karrie McMillan  
General Counsel

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