ISDA® Safe, Efficient Markets

May 17, 2011

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

Re: Proposed Interpretive Order: Antidisruptive Practices Authority (RIN 3038—AD26)

Dear Mr. Stawick:

The International Swaps and Derivatives Association, Inc. ("**ISDA**") appreciates the opportunity to comment on the proposed interpretive order, promulgated by the Commodity Futures Trading Commission (the "**Commission**") pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**"), setting forth a proposed interpretive guidance intended to clarify the following three statutory disruptive practices set forth in new section 4c(a)(5) ("**Subsection 5**") of the Commodity Exchange Act (the "**CEA**") pursuant to section 747 of the Dodd-Frank Act ("**Section 747**"): (i) violation of bids and offers; (ii) intentional or reckless disregard for the orderly execution of transactions during the closing period; and (iii) spoofing, *i.e.*, bidding or offering with the intent to cancel the bid or offer before execution. 76 F.R. 14943, Mar. 18, 2011 ("**Antidisruptive Practices Authority**") ("**Proposed Guidance**").[1] As noted in the Proposed Guidance, the Commission intends the Proposed Guidance to provide market participants and the public with clarification as to the scope of the three statutory disruptive practices.

[1] On November 2, 2010, the Commission issued an advance notice of proposed rulemaking for new sections 4c(a)(5) through (7) of the CEA. 75 FR 67301, Nov. 2, 2010 ("Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Report and Consumer Protection Act") (the "**ANPR**"). However, on March 18, 2011, the Commission terminated the ANPR, opting instead to address only the scope of the statutory prohibitions set forth in Subsection 5 by means of the Proposed Guidance. 76 FR 14826, Mar. 18, 2011 ("Antidisruptive Practices Authority"). Given that the Commission has withdrawn its rulemaking for the remainder of new section 4(c), it would be helpful to know when and whether the Commission intends to address those items separately. *Certainly the remaining provisions of Section 747 of the Dodd-Frank Act should not be left unexplicated by regulation*. This is true with respect to both new sections 4c(a)(6) and (7). Please see our earlier letter in response to the ANPR, dated January 3, 2011 (*available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26890&-SearchText=) (the "**January 3 Letter**"), and our letter in response to RIN 3038-AD27, dated December 28, 2011 (*available at* http://comments.cftc.gov/PublicComments/View-Comment.aspx?id=26803&SearchText=).

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Since 1985, ISDA has worked to make the global over-the-counter ("**OTC**") derivatives markets safer and more efficient. Today, ISDA is one of the world's largest global financial trade associations, with over 800 member institutions from 56 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers.[2]

ISDA respectfully submits the following comments in response to the Proposed Guidance.

ISDA supports the Commission's effort to facilitate fair and equitable trading on registered entities by issuing guidance as to the parameters of the three statutory disruptive practices found in Subsection 5. Such guidance should be instrumental in ensuring that Subsection 5 is used to target disruptive conduct specific to the swaps markets in a consistent manner. To that end, ISDA submits that the Proposed Guidance would benefit from the following:

(i) Express Identification of Facilities Subject to Subsection 5. The Commission's discussion in the Proposed Guidance leads to the conclusion that only a narrow group of "order-book" facilities carrying highly uniform and liquid products are suitable to be subject to Subsection 5. (Proposed Guidance at 14946.) Express acknowledgment of that fact would promote clarity as to the intent and application of Subsection 5.

(ii) Combined and Consistent Rulemaking with Section 753. Section 753 of the Dodd-Frank Act ("**Section 753**"), which concerns market manipulation, overlaps with Subsection 5 in a number of respects. Joint and consistent guidance on both sections would increase predictability of application.

A discussion of each recommendation is below.

A. The Proposed Guidance Should Make Plain that Subsection 5 Applies At Most to a Narrow Range of Facilities.

Subsection 5, though stated to apply to all "registered entities"—that is, swap data repositories ("**SDRs**"), swap execution facilities ("**SEFs**") and designated contract markets ("**DCMs**")—should be clearly limited at the outset only to those order-book trading facilities within the Commission's proposed regulation, 17 CFR § 37.9(a)(1)(i)(C), for the definition of "order book." 76 F.R. 1240, Jan. 7, 2011 ("Core Principles and Other Requirements for Swap Execution Facilities") ("Order Book means * * * [a] trading system or platform in which all market participants in the trading

[2] Information about ISDA and its activities is available on the Association's web site: www.isda.org.

system or platform can enter multiple bids and offers, observe bids and offers entered by other market participants, and choose to transact on such bids and offers." ("**Order-Book C**")) ("**SEF NPR**"). Otherwise, Subsection 5 would purport to cover facilities for which Subsection 5's prohibitions are inapplicable or intrinsically vague.

(i) <u>SDRs</u>. The Commission clarified in a note in the Proposed Guidance that trades do not fall under Subsection 5's purview "solely because" they are reported to an SDR. (Proposed Guidance at 14945 n.26.) We request clarification that the Commission intends to say that the reporting of a trade to an SDR is irrelevant for Subsection 5 purposes and that disruptive conduct on an SEF or a DCM is the only basis for Subsection 5 concern. Definitively excluding SDRs from Subsection 5 would be helpful.

(ii) <u>SEFs</u>. The Commission has proposed that SEFs may be order books, request for quote markets ("**RFQ Markets**"), voice-based systems ("**Voice-Based Systems**") (or something not yet developed) for "Permitted Transactions." *See* SEF NPR at 1214. It appears nonetheless that the Subsection 5 violations, as described by the Commission, apply only to SEFs that meet the Order-Book C definition. For example, to violate bids and offers, as described in the Proposed Guidance, one must have a fixed range of bids and offers, seemingly an Order-Book C trait. Furthermore, other types of SEFs should be allowed to offer greater flexibility. As we noted in our January 3 Letter, price alone may not determine choice of counterparty in the OTC markets.

The Commission's assertion that Subsection 5(A) will operate in "any trading environment where a person exercises some control over the selection of bids and offers against which they transact" (Proposed Guidance at 14946) would apply an irrelevant or possibly injurious paradigm to RFQ Markets or Voice-Based Systems, or even potentially some of the order-book platforms possible under subclauses (A) and (B) of proposed regulation § 37.9(a)(1)(i). This "any trading environment" reference dissipates the clarity intended by the Proposed Guidance and we urge that it be withdrawn.

Subsection 5(B), dealing with orderly execution during the closing period similarly should be applicable only in settings where developed concepts of "orderly execution" and "closing period" apply. It would seem, for example, an RFQ Market or Voice-Based System, which may not offer a "daily settlement price" or any of the other Proposed Guidance note 42 indicators, may not have a "closing period." This also may be true with respect to variants upon order-book systems. As for conduct that affects "orderly execution," the examples in the Proposed Guidance are all from exchange trading and are inapposite to other platforms. (In fact, most are securities exchange examples and of questionable relevance.) (Proposed Guidance at 14946-47 n.43.) Finally, the Commission's observation (seemingly in response to new section 4c(a)(6)) that it may see "disorderly" conduct outside the closing period as a basis for investigation (*id.* at 14946) leaves the orderly execution concept without any bounds. We urge the Commission to keep its discussion, intended to clarify and guide, focused and narrow. The Commission is of course free (in fact, duty-bound) to further clarify or define violations as the new markets develop.

The Commission states that the Subsection 5(C) spoofing provision does not reach RFQ Markets and other authorized pre-trade communications. (Proposed Guidance at 14947.) In fact, the entire Proposed Guidance discussion of spoofing is in exchange terminology and facially applicable only in an exchange environment. Again, we believe this is, if applicable at all, applicable at this time only to Order-Book C facilities.

(iii) DCMs. The violations the Commission describes are virtually all drawn from either futures exchange or securities exchange examples. It cannot be known how these descriptions will or will not apply to the novel exchange-traded swaps market. We urge the Commission to provide further, refining guidance as such facilities develop that reflects the actual styles of trading those facilities use.

B. The Proposed Guidance Should Be Combined and Made Consistent With Section 753 Rulemaking.

The Proposed Guidance, in conjunction with other Commission proposals on anti-fraud and manipulation regulation, creates reasonable uncertainty as to the Commission's stance on fraud and manipulation, particularly with respect to the nascent markets that will be subject to the swaps execution requirement. Accordingly, at minimum, the Proposed Guidance should not be separated from the Section 753 rulemaking as the conduct associated with disruptive practices and manipulation overlap and addressing them separately will lead to overlap of violations and inconsistent standards of intent.

For example, Section 753 is aimed generally at manipulation and giving false information and is subject to varying intent standards, *i.e.*, intentional, reckless (as interpreted in securities law cases), knowing or reckless disregard, and specific intent to manipulate. Subsection 5, with its specific proscribed behaviors (all in the nature of manipulation), is described as subject, in different parts, to an intentional/reckless standard (as interpreted in CEA cases), a "some degree of intent" standard and a *per se* standard. This is an inherently unclear treatment of manipulation and fraud violations. Appreciating the Commission's effort to clarify Subsection 5 violations, we urge the Commission to extend that effort to other antimanipulation provisions in the CEA. Rationalizing the conduct and intent standards of all of Section 747 (including new sections 4c(a)(6) and (7)) in direct conjunction with those of Section 753 will be a large step towards encouraging a confident market. Additionally, we believe that promulgating rules, and not interpretive guidance, for the entirety of Section 747 and Section 753 will promote better understanding and uniformity of application.

Applying a *per se* standard to Subsection 5(A) is particularly troubling given the lack of clarity as to its parameters and how it will apply to the various swaps platforms, including not-yet developed platforms. Even in an order book context, for example, the idiosyncratic circumstances of OTC dealing may be perceived as violative of a *per se* standard. In such circumstances, "where the complained-of practice is novel or unique," "a rigid *per se* classification is especially inappropriate." *Granite Partners, L.P. v. Bear, Stearns & Co.*, 17 F. Supp. 2d 275, 297 (citing *Hertz Corp. v. City of New York*, 1 F.3d 121, 129 (2d Cir. 1993) (stating that a "*per se* rule is used in the relatively narrow circumstances where courts have sufficient experience with the activity to recognize that

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it is plainly anticompetitive and lacks any redeeming virtue.”)). Therefore, ISDA urges the Commission to reconsider its view that Subsection 5(A) is subject to a *per se* standard, and instead adopt a standard that requires some showing of intent.

* * *

In sum, the Proposed Guidance implicitly presents a clear logic that should result in the final order containing an explicit limitation of Subsection 5 to very specific, narrow circumstances in terms of relevant facilities, actions and intent. Without clear guidance as to the application of Subsection 5 to the *swaps markets specifically*, enforcement of Subsection 5 will likely be inconsistent and produce consequences unintended by Congress. Without a unitary and comprehensive exposition by the Commission of all of its anti-fraud and anti-manipulation statutory and regulatory tools, the new market contemplated by the Dodd-Frank Act will be confused and inhibited.

ISDA appreciates the opportunity to provide its comments on the Proposed Guidance and looks forward to working with the Commission as the rulemaking process continues. Please feel free to contact me or ISDA’s staff at your convenience.

Sincerely,

Robert G. Pickel

Robert Pickel
Executive Vice Chairman