Testimony of Stephen O'Connor
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and
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Before the
US House of Representatives Committee on Agriculture
Subcommittee on General Farm Commodities and Risk Management
May 25, 2011

Chairman Conaway, Ranking Member Boswell and Members of the Subcommittee:

Thank you for the opportunity to testify today. The issues you are exploring are of vital interest and concern -- not only to US financial institutions, but more broadly to the US financial markets, and to the thousands of US companies who use those markets to fund their growth and manage their risks.

In the time allotted to me this morning, I would like to focus in particular on three key issues:

The first concerns the applicability of US regulations to both US companies and non-US companies. The second relates to the pace and scope of the implementation of the Dodd-Frank Act in the US. And the third centers on key policy differences emerging between the US and EU on derivatives regulation.

Each of these issues gives rise to its own specific concerns, which I will discuss in more detail. But all three are also inter-related in that they have the potential to create competitive disadvantages for US firms and for the US economy.

They could, in effect, create an uneven playing field and they would do so without making that playing field substantially safer or better or more robust. Finally, we at ISDA do not believe these issues address the public policy goals that gave rise to the Dodd-Frank Act and similar efforts in other jurisdictions.

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Let me state very clearly at the outset: both the institution that I represent today – the International Swaps and Derivatives Association – and the firm where I have worked for some 23 years – Morgan Stanley – squarely support financial regulatory reform. What's more, we have worked actively and engaged constructively with policymakers in the US and around the world to achieve this goal.

ISDA, in fact, has worked to make over-the-counter (OTC) derivatives markets safe and efficient since its founding in 1985.

Over the past three decades, ISDA has helped to significantly reduce credit and legal risk by developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions. The Association has also been a leader in promoting sound risk management practices and processes.

Today, ISDA has more than 800 members 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.

In the years leading up to and since the passage of the Dodd-Frank Act, ISDA, the major dealers, buy-side institutions and other industry associations have worked collaboratively to deliver structural improvements to the global over-the-counter (OTC) derivatives markets.

These structural improvements, which have helped to significantly decrease systemic risk, involve three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure.

To reduce counterparty credit risk, ISDA and the industry have embraced central clearing of derivatives transactions. Today, the industry has cleared approximately 50 percent of outstanding interest rate swaps volume and over $17 trillion of credit default swaps volume. OTC derivatives have been cleared since 2000, with clearing arising from the industry proactively working with clearing houses to develop a better way for managing counterparty.

To improve regulatory transparency, ISDA and market participants have established trade repositories for interest rate, credit default and equity swaps and is in the process of doing so for commodity swaps. These repositories provide global regulators with unprecedented visibility into risk exposures in the OTC derivatives markets.

To strengthen the industry's operational infrastructure, ISDA and market participants have worked to standardize and automate middle and back office processes.

In these and other ways, ISDA and the industry are demonstrating our commitment to build robust, stable financial markets and a strong financial regulatory framework. Our work is not done yet. Further progress lies ahead, and in fact we recognize that there must be a process of continuous improvement in risk measurement and management.

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Let me turn to address the issues that are the main focus of your hearing today.

In the past few months, the issue of extraterritoriality has become a topic of much concern to US financial markets participants.

Extraterritoriality refers to the application of one jurisdiction's laws to activities conducted outside that particular jurisdiction, and to institutions operating within the jurisdiction but not based in it. It's about whether and how US laws and regulations apply to non-US companies doing business with non-US firms, with US banks and/or their non-US subsidiaries. It is also about how US laws and regulations apply to non-US dealer firms doing business with US firms and companies. Ensuring that non-US firms can continue to provide new sources of capital, liquidity and risk management solutions for US corporations and US financial markets is an important consideration.

To date, there has been a lack of clarity about how the provisions of the Dodd-Frank Act, and the rules subsequently issued by the CFTC and the SEC, pertain to non-US banks, foreign subsidiaries and branches of US banks or US subsidiaries of foreign banks.

Recently, though, US federal banking regulators issued rules on margin requirements that included provisions regarding extraterritorial application of the margin requirements, at least for swap dealers subject to prudential regulation. These rules appear to apply the margin requirements just to the US activities of a non-US swap dealer with a foreign parent on the one hand but to the global activities of a non-US swap dealer with a US parent on the other. By subjecting the non-US activities of non-US swap dealers of American banks to the margin requirements, these proposed rules potentially establish a framework that would create significant competitive issues for swap dealers affiliated with American holding companies.

US banks are global in nature. Large components of their businesses are based in foreign countries and generally operated through subsidiaries or branches. If the framework described above for margin rules were to be adopted more broadly by US regulators that could create serious issues for US competitiveness. For instance, if derivative transactions between an Italian company and the UK subsidiary of an American bank were subjected to transaction level Dodd-Frank rules, such as margin rules or rules requiring clearing or electronic execution, but similar transactions between that German company and a UK bank without a US parent were not subject to those same rules, the end result would be that foreign companies would avoid doing business with swaps dealers affiliated with American companies. They would instead transact with non-US financial institutions not covered by the scope of these margin requirements. It could put US firms at a serious competitive disadvantage.

The extraterritoriality proposals are inconsistent with Congressional intent regarding the territorial scope of the new regulatory framework for derivatives. The Congress included provisions in Dodd-Frank that explicitly instruct regulators to impose the regulations outside the U.S. only if there is a "direct and significant connection" with U.S. activities or commerce or as necessary to avoid evasion of Dodd-Frank. These provisions are intended to appropriately balance the protection of the safety of the financial system with the competitiveness of US institutions, which is also necessary for a healthy US banking system.

Similarly disadvantaging foreign institutions and US subsidiaries of such institutions, through divergent capital requirements or otherwise, discourages foreign investment in US subsidiaries, which leads to less jobs and to less competition within our shores. Such divergent treatment also creates the potential for retaliatory measures abroad, thus limiting opportunities for US firms to grow overseas.

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Clearly, the extraterritoriality issue is one that requires careful and thoughtful consideration amongst a country's domestic regulators, as well as regulators and policymakers across jurisdictions.

This leads me to my second point today: such deliberation is extremely difficult to achieve given the scope and pace of the regulatory reform efforts that are currently underway.

The volume of rulemakings is very large, they are complicated, and there are significant interdependencies among many of the rules. Many market participants do not yet know whether or how or when the new rules will apply to them. The scale of change required in the swaps market by the Dodd-Frank Act, including new trading, reporting and clearing requirements, registrations, compliance regimes, and documentation requirements cannot be overstated.

All of this creates a great deal of uncertainty. It may also unintentionally create competitive disadvantage for US firms. The fact that US firms will be subject to a new regulatory framework well before a complementary framework is established in other key jurisdictions is itself a cause for concern. The potential for that US framework to inadvertently create an uneven playing field for US firms adds to those concerns.

Similarly, there is a significant amount of uncertainty for the many well-regulated non-US firms who are members of ISDA and who operate in US markets. The prospect of complying with two sets of regulatory regimes is unprecedented and could ultimately lead to increased costs, decreased liquidity and a reduction in the overall availability of capital in the U.S. markets.

We believe the CFTC has taken a step toward addressing the need for market participants to assess the full mosaic of rules by reopening Title VII comment periods for 30 days. However, simply re-opening the comment period does not provide any insight on how the extensive prior comments on the original proposals may have influenced the Commission's thinking in crafting final rules. The comment period re-opening cannot replace the value of allowing consideration of how the over 14,000 comments in the Commission's 2011 comment file will be incorporated into the rules. In order to ensure that the substance of the final rules work efficiently as a whole, it is essential that market participants have an opportunity for additional review and comment on the entire revised set of rules which the Commissions will publish after evaluating comments received.

In addition to the need for a second or subsequent comment period on rule proposals, there is also a significant need for a rational, appropriate phase-in of implementation of the rules across markets and market participants. The former will be essential so that rules are appropriately tailored, work in tandem, and avoid unduly impairing market liquidity or adversely impacting investors. The latter is about enabling market participants to implement the changes most effectively. Both issues are, however inter-related: it is not enough to phase-in implementation if the final rules themselves are unworkable or in conflict.

As we approach the July deadline for the Commissions to finalize these mandated rules, it has become increasingly clear to market participants and the Commissions, as well as legislators, that the process will require more time than had been contemplated by Dodd-Frank. As a result, ISDA supports efforts to provide policymakers and market participants with additional time needed to weigh the individual and cumulative impact of the proposals, as well as their costs and benefits. This would help to ensure that US firms are not unintentionally disadvantaged by any aspects of the proposed rulemakings.

The Commissions have the flexibility to determine the effective dates for many of their finalized rules. However, many of the significant provisions of Title VII are self-executing. That is, they become automatically effective on July 16 without rulemaking. We have developed, and have discussed with the Commissions, suggested approaches that would phase in the implementation of new rules. Our approach is based on a series of key principles that we believe should govern the implementation schedule. Our six key principles (outlined in more detail in the attached letter) are:

First, provide time for market infrastructure and business operations to implement the final rules to avoid disruption in the markets. New market infrastructure and technologies, including central clearing services, data reporting services and trading platforms, will be required under the new swaps regulatory regime. Unless sufficient time is allotted for these components to adequately develop, all market participants (and particularly end users) will face interruptions in their ability to access markets.

Second, swap data reporting to regulators should be the first priority for implementation in order to inform future rulemaking. The Commissions will have much visibility into all aspects of swap markets from the data collected by trade repositories. This knowledge will be essential in developing rules that meet Dodd-Frank's requirements while still allowing for active and liquid swap markets.

Third, phase-in requirements by type of market participant and asset class. We believe the Commissions should require clearing, reporting and electronic execution for the "better-prepared" asset classes first and should provide ample time for the maturation of those asset classes and products that are not yet at that stage. Better prepared assets classes would include those with an establish clearing infrastructure, such as interest rate and credit products.

Fourth, within each asset class and type of market participant, prioritize reduction of systemic risk. A principal objective of Title VII of Dodd-Frank is the reduction of systemic risk in the financial markets. As a result, the Commissions should, within each asset class and type of market participant, prioritize implementation of requirements that reduce systemic risk ahead of other requirements.

As an example, Dodd-Frank requires central clearing of swaps to decrease systemic risk, so clearing should be prioritized in the phase-in schedule. Other requirements of Title VII, such as electronic execution and public real-time reporting, should be implemented after clearing. In fact, implementing these provisions prematurely can increase systemic risk.

Fifth, allow time for adequate testing by, outreach to and education of customers and for changes to customer relationships. A flexible approach to rulemaking and implementation will provide customers the necessary opportunity to understand these ongoing changes and their own regulatory obligations.

Sixth, where different regulators will apply different rule sets to similar transactions, sequence implementation so that effectiveness of each rule set is coordinated across interrelated applicable rule sets. We believe that the Commissions and other US regulatory agencies should anticipate where the rulemaking may overlap, and possibly conflict, and make every effort to actively coordinate with each other and with foreign regulators both as to harmonizing the substance of related regulations and the timing of their implementation.

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Turning now to my third and final point: today, OTC derivatives market participants are concerned by the potentially divergent approaches being taken in key regulatory jurisdictions.

Much of the derivatives regulatory framework for the EU is still under discussion. There is a significant concern that the EU's approach could differ significantly from the US regulators' approach. Requirements for the use and structure of execution platforms, capital and margin requirements, and business conduct standards, to name but a few examples, could differ substantially between regimes. It is too early to know for sure what frameworks will be adopted in the EU, but EC officials have indicated publicly that it is not their intention to change the structure of the OTC derivatives markets. The EC has not, of course, completed its rule-making process so we cannot be sure of what other differences may lie ahead. It appears, however, that the EC is focusing on the key systemic risk issues arising from the financial crisis that have been identified by the G-20 and the Financial Stability Board -- counterparty credit risk, regulatory transparency and market infrastructure.

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In conclusion, while some differences between jurisdictions in terms of detailed rules are inevitable, a far greater degree of convergence is essential to the long-term health of the global financial system and to the relative standing of individual financial systems.

We ask policymakers to avoid introducing rules in a way that leads to a significant level of divergence between markets, or that leads to regulatory overlap or to regulatory conflict.

Each of these approaches carries significant costs. If the US and the EC continue to take divergent approaches, the potential exists for significant differences to develop in how our markets function and operate, and ultimately in how well customer needs are met in each. This could put American firms and American markets at a disadvantage, including by discouraging continued growth and participation by non US firms in American financial markets, thereby concentrating risk and liquidity in far fewer dealers

Duplicative rules will raise costs, ultimately impacting the real economy, while not serving any regulatory goal. Conflict between regulatory approaches will lead to regulatory arbitrage and competitive advantage based not on better strategic decisions or more effective resource allocation, but on government fiat.

Chairman Conaway, Ranking Member Boswell and Members of the Subcommittee: Thank you for your time today. Let me close by reiterating ISDA's support for a stronger, more robust financial regulatory framework and safer, more efficient OTC derivatives markets.
I would be happy to answer any questions that you might have.

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May 4, 2011

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

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Phase-In Schedule for Requirements for Title VII of the Dodd-Frank Act

Dear Mr. Stawick and Ms. Murphy:

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Title VII**" of "**Dodd-Frank**") will fundamentally transform the swap and security-based swap (collectively, "**Swap**") markets. As the Commodity Futures Trading Commission (the "**CFTC**") and the Securities and Exchange Commission (the "**SEC**" and, together with the CFTC, the "**Commissions**") are acutely aware, Congress sketched out broad parameters of this new regulatory regime but left to the Commissions the enormous and delicate task of filling in the details through rulemaking. Generally, Title VII requires the Commissions to finalize these mandated rules by July. As we approach that time, it has become increasingly clear to market participants and the Commissions, as well as legislators, that finalizing these rules will require more time than had been contemplated by Dodd-Frank. Fortunately, however, the Commissions have the flexibility to determine the effective dates for those finalized rules.

In a series of recent meetings, representatives of the Futures Industry Association (the "**FIA**"), the Financial Services Forum, the International Swaps and Derivatives Association ("**ISDA**") and the Securities Industry and Financial Markets Association ("**SIFMA**" and together, the "**Associations**")[1] have discussed with CFTC Chairman Gensler, CFTC Commissioner Sommers, CFTC Commissioner Dunn and their staffs, as well as with the SEC staff, the significant practical hurdles to implementing this new regulatory structure for Swaps, the interdependencies of the key portions of that structure and the Associations'

[1] Further information on the Associations is available in Appendix A.

suggested approaches to a phased-in implementation schedule. Attached are two timelines we provided to the Commissions at these meetings. In light of those discussions, and at the CFTC's request, this letter lays out key principles for the development of a phase-in schedule.

Our six key principles are:

1. **Provide time for market infrastructure and business operations to implement the final rules to avoid disruption in the Swap markets.** New market infrastructure and technologies, including central clearing services, data reporting services and trading platforms, will be required to give effect to the new Swap regulatory regime. Unless sufficient time is allotted for these components of market infrastructure and technologies to adequately develop, all market participants (and particularly end users) will face interruptions in their ability to enter into Swaps to hedge their business risks or manage investments to meet client objectives.

2. **Prioritize data reporting to regulators to inform future rulemaking.** The Commissions should prioritize implementation of data reporting, including registration of Swap data repositories ("**SDRs**"), to regulators ahead of real-time reporting and other requirements, including public reporting. The Commissions will learn much about the full range of Swap markets from the data collected by SDRs. This knowledge will be essential in developing rules that meet Dodd-Frank's requirements while still allowing for active and liquid Swap markets.

3. **Phase-in requirements by type of market participant and asset class.** The Commissions should phase in requirements based on the state of readiness of each particular asset class (including, where applicable, by specific products within an asset class) and market participant type. However, the Commissions should allow and encourage the development of necessary infrastructure on a voluntary basis for less-developed asset classes and any interested market participants, regardless of size, even as these requirements are being phased in on a mandatory basis for others.

4. **Within each asset class and type of market participant, prioritize reduction of systemic risk.** Within each asset class and type of market participant, the Commissions' top priority should be to implement requirements that reduce systemic risk, such as the use of centralized Swap clearinghouses. Implementation of requirements designed to achieve other goals, such as trade execution, should be phased in only once clearing has been successfully implemented. Other requirements for which SDR-collected data is crucial, such as public real-time reporting, should follow.

5. **Allow time for adequate testing by, outreach to and education of customers and for changes to customer relationships.** Dealers, major Swap participants, asset managers, technology and systems providers, and the Commissions will need to engage in a concerted effort over a period of time to educate their clients and the market about the changes in business and regulatory practices that the new rules will require. The Commissions should provide adequate time for these important tasks as part of any implementation schedule.
6. **Where different regulators will apply different rule sets to similar transactions, sequence implementation so that effectiveness of each rule set is coordinated across interrelated applicable rule sets.** Application of provisions of Title VII to the diversity of Swaps and market participants will involve the interaction of rules relating to different asset classes and products as well as differences among rules imposed by different U.S. regulators and regulators in different countries. Understanding these interactions and sequencing implementation of the rules accordingly will create a more robust regulatory structure.

These principles have been informed by the experience of the firms represented by the Associations in implementing significant market reforms, including Europe's move to the Euro currency, development of new clearing systems, the implementation of MiFID I, changing capital requirements under Basel rules, equity decimalization, and the introduction of TRACE, to name a few. Our member firms' experiences in developing systems, technological connections, policies and procedures, documentation and other changes in response to these prior changes lead us to believe that the tasks involved in implementing Title VII are monumental.[2]

As we discuss further in this letter, there are significant interdependencies among many of the rules, and many market participants do not yet know whether or how the new rules will apply to them. We believe the CFTC has taken a positive step toward addressing the need for market participants to assess the full mosaic of rules by reopening Title VII comment periods for 30 days.[3] We are concerned,

[2] Although not all rules have yet been proposed, it is essential to address implementation sequencing and phase-in schedules now. It is worth noting, however, that we and our members are also still focused on many critical issues raised by Title VII and the rules proposed by the Commissions so far. These include, by way of example, key definitions, extraterritorial application, segregation requirements for customer collateral, margin and capital requirements, and achieving consistency, to the extent appropriate, between the rules of the two Commissions and those of international regulators. We will continue to participate in the public rulemaking process with respect to these and other issues, even as we suggest appropriate implementation timing for those rules.

[3] Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 25274 (May 4, 2011) (extending comment period for rule makings until June 3, 2011).

however, with the significant possibility that the final rules will differ substantively from the rules as proposed in ways that present, when viewed as a whole, important new issues. While these differences may not rise to the level that would require a reproposal of the rules under the Administrative Procedures Act, we nonetheless are concerned that they may merit reconsideration by market participants and the public at the time that all rules have been put in final form.

1. Provide time for market infrastructure and business operations to implement the final rules to avoid disruption in the Swap markets.

Title VII requires the development of significant new Swap market infrastructure, including SDRs, clearinghouses and trade execution facilities. As a result of strenuous efforts in recent years, key building blocks for parts of this infrastructure exist for certain asset classes of Swaps. However, even this existing infrastructure will need to be significantly changed in response to the Title VII and the Commissions' final rules. For example, existing data repositories will need to update their data fields to conform to requirements in the final rules, and existing Swap clearinghouses will need to make significant modifications to their models to comply with rules regarding the protection of customer collateral. Title VII will also require the development of entirely new trading platforms, such as Swap execution facilities.

In addition, Title VII requires enormous changes to the business operations of market participants. Swap dealers and major Swap participants ("**Swap Entities**") will need to conform their reporting, clearing and trading processes to the final rules, as well as comply with complex rules relating to position limits, documentation and recordkeeping. These requirements will affect the compliance, legal, technology, front-office, trading desk, human resources and other departments within Swap Entities. While some Swap Entities have begun to organize themselves for implementation of Title VII, such efforts are very preliminary as no rules have been finalized. The Commissions must provide sufficient time for all of these steps to proceed in an orderly manner. The amount of time this will take is highly dependent on the final form of the rules. In particular, if existing systems are not easily adaptable to the Commissions' ultimate requirements, more time will be needed.[4] Clients will similarly need to make significant modifications to their businesses, including changes to the documentation that governs their relationships with Swap Entities. In many cases, these changes may require board authorization. Since boards may only meet periodically, this may result in further delay.

[4] Beyond this, the Title VII rules and other financial reform changes (such as the Basel III regulatory capital standards) are causing Swap Entities and the organizations of which they are a part to evaluate the corporate structures that will enable them to provide the highest degree of service and continuity to clients while effectively managing risk. Adapting such structures requires additional independent systems, compliance and documentation implications.

These two types of changes—market infrastructure and business practices—are interdependent. In the area of clearing, for example, Swap clearinghouses will need to develop rules that meet the Commissions' requirements and obtain requisite approval of those rules. Potential clearing members will need to understand the new rules put into place by each Swap clearinghouse, determine which Swap clearinghouses to join as clearing members, negotiate appropriate documentation, set up technological connections and develop clearing offerings for their clients. Non-members, including many buy-side firms, will need to understand the rules put into place by each Swap clearinghouse, determine which Swap clearinghouses they are comfortable with, evaluate which Swap clearinghouses clear certain products, choose clearing members to clear through, negotiate documentation with clearing members, and create any necessary technological connections with clearing members. Legal documentation, treatment of collateral, margin requirements, account setup, and fee negotiations, for example, between the Swap clearinghouses and their clearing members will take significant time.

In addition, the amount of time it will take to implement this infrastructure is highly dependent on market readiness. All end users will need to clear their trades at a limited number of Swap clearinghouses through a limited number of dealers offering clearing services. If the Commissions do not provide sufficient time for this to occur, bottlenecks are sure to develop, with asset managers, for example, unable to process accounts at Swap clearinghouses overwhelmed with an influx of documentation and applications. The result will be disruption of trading as these money managers, or similar entities, will be unable to enter into Swaps that they legally would be required to clear but operationally cannot.

Allowing sufficient time for infrastructure and business practices to develop will save unnecessary costs. For example, under Title VII, SDRs will be required to accept universal, unique identifiers for Swap market participants and products, and market participants will be required to incorporate these unique identifiers into their reporting systems. Systems will be more efficiently designed and implemented if universal identifiers are developed and instituted prior to the new SDR reporting requirements. The alternative would require Swap Entities to redesign reporting systems when unique identifiers were later required.

2. Swap data reporting to regulators should be the first priority for implementation in order to inform future rulemaking.

SDR reporting to regulators will significantly increase, in the near term, the information that the Commissions have at their disposal regarding the Swap markets. Armed with a larger set of data, the Commissions will be in a better position to adopt rules that achieve Dodd-Frank's goals while maintaining active and viable Swap markets. As a result, the Commissions should delay finalizing requirements that could benefit from the additional knowledge gained from this data until SDRs have been established and are operational, and enough time has passed to allow sufficient data collection and analysis.[5]

For example, we believe that the rules defining block trades are extremely important and will have a significant impact on the liquidity of the Swap markets. Appropriate block trade thresholds, and therefore public real-time reporting requirements, can only be set after SDR reporting to regulators has been established and Swap market transaction data is carefully analyzed.[6] Any determination of block trade thresholds before that market data is available to regulators would be inappropriate. Once the relevant information has been collected, the Commissions should begin phasing in real-time reporting requirements slowly, beginning with low block trade thresholds, and adjust the thresholds as necessary once the impact on the market can be assessed.

In the interim, in order to provide the public transparency anticipated by Dodd-Frank without risking significantly decreased liquidity, the Commissions could require end of day reporting of Swap notional size to regulators early in the implementation schedule, provided that all trades above a certain notional threshold would be reported as "$X or above." After more is known about the Swap markets through data collection by SDRs, the thresholds could be adjusted slowly while the effect on market liquidity is studied.

Similarly, it is important for the Commissions to understand the Swap markets, through analytical data analysis, before adopting commodity position limits that restrict the Swap positions market participants can take. Otherwise, the Commissions might unwittingly set commodity position limits so low as to disallow legitimate and desirable activity and inadvertently decrease liquidity, thereby negatively impacting pricing.

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[5] To maximize the effectiveness of information gathered across asset classes from SDR recordation, the Commissions should strive to harmonize their reporting requirements. Inconsistencies between the CFTC and SEC reporting requirements will significantly complicate implementation because swaps and security-based swaps are transacted by the same business units of our member firms. For example, the same business unit may trade both single-name CDS, which would be subject to the SEC's reporting rules, and index CDS, which would be subject to the CFTC's. In addition, the Commissions should strive to align their reporting requirements with those of international regulators.

[6] The CFTC has proposed a two-part test for determining the block trade threshold, which is highly dependent on data about swap transactions. Because SDR reporting will increase the amount of information available to the Commissions across various markets and asset classes, we believe such a rule is premature and should not be adopted absent further data.

3. Phase-in requirements by type of market participant and asset class.

The term "Swap" encompasses a wide variety of products in a wide variety of asset classes. These products have different attributes, including differing levels of standardization, liquidity and existing market infrastructure. As a result, some products are more ready for centralized clearing and electronic execution than others. For example, certain commodity and interest rate products are already quite liquid and standardized and have been subject to interdealer clearing for several years. On the other hand, certain foreign exchange, credit and equity Swaps are less standardized and are generally transacted bilaterally. We believe that the Commissions should require clearing, reporting and electronic execution for the "better-prepared" asset classes first and should provide ample time for the maturation of those asset classes and products that are not yet at that stage.

Sequencing that reflects these differences would allow the Commissions and market participants to understand and solve the problems that arise in these relatively less complex, more liquid products before moving on to more complex, less liquid products. For example, issues relating to client clearing can be more readily worked out in the interest rate swap market where interdealer clearing already exists; lessons learned there can then be applied to the clearing of other Swap categories, which will require new clearing methodologies even for the interdealer market.

In addition, the Commissions' rules under Title VII will affect a wide variety of market participants, ranging from market makers, to financial end-users that use Swaps for portfolio risk-management purposes, to commercial enterprises that use Swaps to hedge business risks. These market participants vary dramatically in their resources, market sophistication and rationale for using Swaps. Swap Entities, in general, have greater resources, access to technology and clearing infrastructure than their end user counterparties. Consequently, the interdealer market, which already uses central clearing extensively for interest rate and credit products, may be able to adjust more quickly than some other markets to new Title VII requirements.

Much like phased implementation by product, phased implementation by type of market participant will allow the Commissions and market participants to use lessons learned from larger market participants when developing rules applicable to end users. For example, interdealer clearing within each asset class should be required before customer clearing, so that the lessons learned from the interdealer experience can be applied to customers before the additional complications that customer clearing brings, such as the protection of customer collateral, are fully tackled. This is not to say that the customer clearing systems should not be built in parallel; the Commissions should encourage a move to Title VII-compliant activity across all market participants and products and market participants should be permitted to clear prior to the required dates if they are ready and willing to do so. However, the Commissions, for example, should not *require* clearing by any end users until the interdealer experience within each asset class is well-established and understood.

4. Within each asset class and type of market participant, prioritize reduction of systemic risk.

A principal objective of Title VII of Dodd-Frank is the reduction of systemic risk in the financial markets. As a result, the Commissions should, within each asset class and type of market participant, prioritize implementation of requirements that reduce systemic risk ahead of other requirements.

As an example, Dodd-Frank requires central clearing of Swaps to decrease systemic risk. As a result, clearing should be prioritized in the phase-in schedule. In contrast, other requirements of Title VII, such as electronic execution and public real-time reporting, should be implemented after clearing. In fact, implementing these provisions prematurely can increase systemic risk. For example, implementing mandatory trade execution with overly narrow block exceptions that have not been informed by a sufficient amount of analytical data could significantly decrease Swap market liquidity, making it more difficult for end users to manage their risks and potentially adding risk to the financial system.

However, even systemic risk-reducing changes must be done carefully; simultaneous changes could lead to errors that unintentionally result in increased and concentrated systemic risks. For example, while central clearing has the potential to significantly reduce systemic risk, the fact that a clearinghouse is the counterparty to all Swaps it clears means that, if clearinghouse risk management and control processes are not sufficiently robust, systemic risk could increase in a cleared environment rather than decrease. As discussed above, the Commissions should strive to minimize such unintended consequences by sequencing effectiveness of requirements with ample time for thoughtful and careful implementation supported by sufficient analytical data.

The existence of a robust set of cleared swaps is also a prerequisite for implementation of margin requirements. Initial margin requirements will be significantly higher for noncleared Swaps (proposed to cover 99% of movements over a 10-day window) than for cleared Swaps (which generally seek to cover 95% or 99% of movements over a 3-5 day range). Implementing these margin requirements for noncleared Swaps before Swap clearinghouses are operational would force market participants to post inappropriately high levels of margin to enter into Swaps that they would otherwise be interested in clearing.

5. **Allow time for adequate education of customers and for modifications to customer relationships, including documentation.**

Dealers, major Swap participants, asset managers and the Commissions will need to engage in a concerted effort over a period of time to assist customers and other market participants in understanding the changes in business and regulatory practices that the new rules will require. Furthermore, key market practices will further evolve as new market infrastructure is put into place. A flexible approach to rulemaking and implementation will provide customers the necessary opportunity to understand these ongoing changes and their own regulatory obligations.

For example, while dealers and asset managers have been anticipating Title VII's changes in regulatory structure, they will face an enormous task of educating their clients that can only commence once final rules are known and forms of documentation are finalized. These entities may have thousands of clients with a wide range of sophistication. For example, asset manager clients include pension funds and other tax exempt entities. Dealers and asset managers will each play a role in helping inform their clients not only about Title VII and the Commissions' rules, but about the rules and changes to their transactions that will result from the use of new clearinghouses, trade execution platforms and SDRs.

6. **Where different regulators will apply different rule sets to similar transactions, sequence implementation so that effectiveness of each rule set is coordinated across interrelated applicable rule sets.**

Swap businesses will, in many cases, be subject to regulation by both Commissions. Infrastructure providers and market participants will need to develop systems and procedures to comply with rules from both Commissions. To the extent there are substantively different rules applied by the two Commissions, implementation and compliance systems will need to be designed to track and account for these differences.

In addition, given the global nature of today's financial markets, it is unclear to what extent foreign regulation, in addition to regulation by the Commissions, may affect U.S. Swap market participants. In each case, it would be premature to implement any requirements where there remains uncertainty as to other potentially applicable requirements. For example, it is uncertain what would happen if one of the Commissions and its foreign counterpart both required that the same transaction be cleared but did not have common permitted clearinghouses.

We believe that the Commissions and other U.S. regulatory agencies should anticipate where the rulemaking may overlap, and possibly conflict, and make every effort to actively coordinate with each other and with foreign regulators both as to harmonizing the substance of related regulations and the timing of their implementation. Otherwise, the development of the Swap markets will be vulnerable to false starts, significant revisions and inefficiencies, and possible regulatory arbitrage across, or the flight to, other jurisdictions.

The Associations are grateful for the opportunity to comment to the Commissions regarding these important issues. Please feel free to contact the Associations should you wish to discuss this letter.

Sincerely,

Financial Services Forum
Futures Industry Association
International Swaps and Derivatives Association
Securities Industry and Financial Markets Association

cc: Honorable Gary Gensler, Chairman
Honorable Bart Chilton, Commissioner
Honorable Michael Dunn, Commissioner
Honorable Scott O'Malia, Commissioner
Honorable Jill E. Sommers, Commissioner
Commodity Futures Trading Commission
Honorable Mary L. Schapiro, Chairman
Honorable Luis A. Aguilar, Commissioner
Honorable Kathleen L. Casey, Commissioner
Honorable Troy A. Paredes, Commissioner
Honorable Elisse B. Walter, Commissioner
Securities and Exchange Commission

Credit

	T1	T2	T3	T4	T5	T6	T7	T8	T9
Clearing	Commence Registration of DCOs		Interdealer & MSP Clearing	Initiate FEU Clearing				FEU and CEU Clearing	
Execution	Commence Registration of SEFs			Interdealer & MSP SEF Execution			Initiate FEU SEF Execution		FEU and CEU SEF Execution
Data Reporting to SDR	Commence Registration of SDRs	Interdealer reporting to DTCC warehouse		Interdealer, MSP & FEU Reporting to SDR (EOD)		Interdealer & MSP reporting to SDR (Real Time)		FEU and CEU Reporting to SDR (Real Time)	
Public Real Time Reporting	Commence Block Trade Study				Interdealer, MSP & FEU RTR to public (RTR = EOD)				All Trades RTR to Public (RTR = Real Time)
Capital & Margin	Commence Registration of SDs and MSPs								Capital & Margin Rules Finalized
Business Conduct Standards						Initiate Business Conduct Standards			Finalize Business Conduct Standards

Key:

FEU = Financial End User
SDR = Swap Data Repository
CEU = Corporate End User

EOD = End of Day
RTR = Real Time Reporting

- The sequencing is illustrative and for discussion purposes only; it is dependent on many yet unsettled factors, including, but not limited, to the substance of final rules. The charts were prepared by the Associations in response to a request for discussions on approaches to phasing-in of implementation, not a specific timetable for implementation.

Interest Rates

	T1	T2	T3	T4	T5	T6	T7	T8	T9	T10
Clearing	Commence Registration of DCOs				Interdealer & MSP Clearing	Initiate FEU Clearing	→	→	FEU and CEU Clearing	
Execution	Commence Registration of SEFs					Interdealer & MSP SEF Execution		Initiate FEU SEF Execution	→	FEU and CEU SEF Execution
Data Reporting to SDR	Commence Registration of SDRs			Interdealer, MSP & FEU Reporting to SDR (EOD)			Interdealer & MSP reporting to SDR (Real Time)			All FEU and CEU reporting to SDR (Real Time)
Public Real Time Reporting	Commence Block Trade Study				Interdealer, MSP & FEU RTR to public (RTR = EOD)					All trades RTR to public (RTR = Real Time)
Capital & Margin	Commence Registration of SDs and MSPs									Capital & Margin Rules Finalized
Business Conduct Standards						Initiate Business Conduct Standards	→	→	Finalize Business Conduct Standards	

Key:
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Appendix A

FIA is a principal spokesman for the commodity futures and options industry. FIA's regular membership is comprised of approximately 30 of the largest futures commission merchants in the United States. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States designated contract markets. For more information, visit www.futuresindustry.org.

The Financial Services Forum is a non-partisan financial and economic policy organization comprising the CEOs of 20 of the largest and most diversified financial services institutions doing business in the United States. The purpose of the Forum is to pursue policies that encourage savings and investment, promote an open and competitive global marketplace, and ensure the opportunity of people everywhere to participate fully and productively in the 21st-century global economy.

ISDA was chartered in 1985 and has over 800 member institutions from 54 countries on six continents. Our members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the risks inherent in their core economic activities. For more information, visit www.isda.org.

SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.