ABA Securities Association
The Clearing House Association L.L.C.
Financial Services Roundtable
Futures Industry Association
International Swaps and Derivatives Association
Securities Industry and Financial Markets Association

January 11, 2011

David A. Stawick, Secretary	Elizabeth M. Murphy
Commodity Futures Trading Commission	Secretary
Three Lafayette Center	Securities and Exchange Commission
1155 21st Street, NW	100 F Street, NE
Washington, DC 20581	Washington, DC 20549

Re: Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest; RIN 3038-AD01;[1]

Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges With Respect to Security-Based Swaps under Regulation MC, File No. S7-27-10.

Secretary Stawick, Secretary Murphy:

As trade associations whose members account for most of the activity in U.S. and global derivatives, we are particularly concerned that the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") be implemented in a manner that preserves meaningful opportunities for competition and innovation in derivatives markets. Dodd-Frank's mandatory clearing and execution requirements accentuate the importance of competition and innovation among and by derivatives clearing organizations ("DCOs"), designated contract markets ("DCMs"), and swap execution facilities ("SEFs").[2]

We are submitting this letter to respond to the letter submitted by the Department of Justice (the "DOJ") staff on December 28, 2010 to the Commodity Futures Trading Commission (the "Commission") regarding the Proposed Rules (the "DOJ Letter"). In its letter, the DOJ staff supports the proposed aggregate ownership limit on DCOs and recommends that similar aggregate ownership limits be extended to DCMs and SEFs. The DOJ staff also supports expanded independent director requirements for DCOs, DCMs, and SEFs.

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[1] 75 Fed. Reg. 33752 (Oct. 28, 2010) (the "Proposed Rules").

[2] Although this letter refers only to DCOs, DCMs and SEFs, the views we express in this letter apply equally to securities clearing agencies, national securities exchanges and security-based swap execution facilities.

We write because the views expressed by DOJ staff appear to represent a significant departure from the DOJ's experience and writings on this subject and ignore the DOJ's antitrust analysis of the structural restraints on competition that are endemic to a vertically integrated exchange-clearing market. Most significantly, the DOJ letter does not appear to take into account the regulatory framework established under Dodd-Frank to address the very concerns it cites.[3] Specifically, the DOJ Letter fails to acknowledge the fact that Dodd-Frank directly empowers the CFTC to prevent the adoption by registered entities of rules and rule amendments that would result in anticompetitive restraints, and to do so without the anticompetitive effects to which the DOJ staff's proposed *per se* restraints would give rise.

Any aggregate ownership limit has potentially profound implications for future market structure. Accordingly, the undersigned urge the CFTC in the strongest possible terms to forego the adoption of any aggregate ownership limits, subject to further review, comment and consideration of the issues presented by the DOJ Letter in the context of the derivatives markets as a whole. Without endeavoring to address the issues raised by the DOJ Letter substantively and in the detail that they, in the fullness of time, merit, we note preliminarily the following:

The DOJ Letter argues that dealers could, despite the Proposed Rules' 20% individual ownership limit on SEFs and DCMs, use their collective control over SEFs and DCMs to exclude rivals from membership, limit pre-trade and post-trade transparency, decline to trade certain contracts to disadvantage rivals, or seek to evade exchange-trading requirements. According to the DOJ Letter, the imposition of aggregate ownership limits would serve as "the most effective structural approach to protecting competition in the derivatives markets."[4] The DOJ Letter also contends that aggregate limits would lead to the creation of new, viable SEFs and DCMs which would, in turn, increase competition in the derivatives marketplace.

To support these views, the DOJ Letter relies on three arguments. First, the DOJ Letter cites the DOJ's experience in "analyzing the competitive impact of joint ownership platforms like DCMs/SEFs" and its resulting recognition of the "potential for abuse" in such ownership arrangements.[5] In fact, consortia of dealers have, subject to oversight by the DOJ, the CFTC, and other federal regulators, taken part in the establishment of several clearing and trading initiatives in the derivatives markets that have served to increase competition by providing alternatives to incumbent market facilities. Moreover, the DOJ itself has observed that the vertically-integrated clearinghouse-exchange structure that characterizes the existing, regulated U.S. derivatives markets has led to very significant and concerning structural impediments to competition among clearinghouses and among exchanges and, by implication, other trading venues.[6] Economies of scale associated with use of a single vertically-integrated

[3] The undersigned are also of the view that the legislative history of Dodd-Frank Sections 726 and 765 indicates clearly that Congress considered and rejected aggregate (as opposed to individual) ownership restrictions of the type contemplated by the Commission and the DOJ staff, and, on its face, does not authorize the Commission to impose aggregate ownership limits.

[4] DOJ Letter at 5.

[5] Id.

[6] DOJ, Comment Letter to the U.S. Department of the Treasury, Review of the Regulatory Structure Associated with Financial Institutions (Jan. 31, 2008).

clearinghouse-exchange, such as increased netting and offsets and liquidity network effects, enable such an incumbent to gain a very large competitive advantage. The DOJ Letter, however, does not address the extent to which aggregate ownership limits would impose impediments to competition that would serve to entrench the position of existing clearinghouse-exchange silos that dominate existing markets.

The DOJ Letter next seeks to analogize competition in the derivatives markets to the airline industry. The DOJ Letter notes that a joint venture becomes anticompetitive when the public benefits of additional participants are outweighed by reduced competition among them. The DOJ Letter then asserts that, just as the addition of an additional airline to a joint venture can reduce competition among airlines, the inclusion of an additional dealer in a DCM/SEF joint venture "reduces dealers' incentives to compete with each other."[7]

This analogy, however, does not hold up under closer scrutiny. An ownership stake in a trading venue by a dealer encourages that dealer to provide liquidity on that venue. Therefore, an increase in the number of dealers that take ownership stakes in a trading venue *increases* the number of dealers competing to provide liquidity on that venue by lowering prices, displaying greater size, and otherwise providing better services to investors. Therefore, unlike in the airline industry, the inclusion of an additional dealer in a DCM/SEF joint venture *increases*, rather than decreases, competition. Indeed, the DOJ Letter's recommendation for an aggregate limit on ownership of DCMs and SEFs is more closely analogous to a recommendation to impose a limit on the number of airlines that can serve a particular airport; in both cases, it is clear that the limit would reduce the number of service providers that can be accessed by an investor or consumer, thereby reducing competition and investor/consumer welfare.

The DOJ Letter finally suggests that an aggregate ownership limit "may facilitate competition by encouraging the creation of new DCMs/SEFs."[8] Experience from the derivatives and other financial markets has proven otherwise. New clearing and trading venues depend on attracting volume in order to survive and flourish, and a key way in which new venues compete against more established venues is to attract volume from dealers and other liquidity providers through ownership stakes. Ironically, the BrokerTec example cited by the DOJ Letter[9] presents just such a case: absent ownership stakes that would have violated the DOJ Letter's proposed aggregate limits, BrokerTec likely never would have been established, much less successfully challenged incumbents. The same is true of other market entrants that have contributed to competition and efficiency but that would have been prohibited under the DOJ Letter's proposals.

The DOJ Letter's analysis appears deficient and fails to consider the relevant history and features of the derivatives markets. As such, adoption of the DOJ Letter's proposed aggregate limits would violate a key principle in antitrust law by imposing a burdensome set of *per se* restrictions on the ownership of key market facilities in the absence of robust empirical

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7 DOJ Letter at 6.

8 Id.

9 DOJ Letter at 7.

evidence demonstrating that such ownership would plainly lead to anticompetitive consequences, with little or no potential for redeeming pro-competitive efficiencies.[10]

Adoption of the DOJ Letter's proposed aggregate limits on DCMs and SEFs or the aggregate limits on DCO ownership contained in the Proposed Rules is, in any event, unnecessary in light of the oversight authority granted to the Commission under the Commodity Exchange Act ("CEA"), as amended by Dodd-Frank. In particular, the CEA provides the Commission with authority to review and prevent the adoption by DCOs, DCMs, and SEFs of new rules or rule amendments that would operate as a restraint of trade. These and related provisions provide more than adequate safeguards to ensure that dealers do not use ownership of DCOs, DCMs, or SEFs to engage in anticompetitive behavior. Moreover, ongoing Commission oversight will invariably identify and address anticompetitive behavior more effectively than *per se* restraints, without unduly disrupting the post-Dodd-Frank development of the derivatives markets.

Additionally, while we have focused in this letter on the DOJ staff's proposals regarding aggregate ownership restrictions, we also have serious concerns with the proposed expansion of independent director requirements beyond what is commercially reasonable at the Board level, particularly as applied to nominating and risk committees. These proposals do not account for the critical role that governance performs in the capital formation process, including the likelihood that private enterprise will be disinclined to put its capital at risk without an ability to protect that capital through meaningful participation in governance, especially clearing members who have so much to lose. Members must be allowed to protect their shareholders' capital by controlling their own clearing-related risks, subject to regulatory oversight and supervision.

Moreover, the types of decisions made by board committees raise issues well beyond the antitrust issues that fall within the scope of the DOJ's primary expertise. For instance, a DCO risk committee is responsible for evaluating the risk characteristics of new products for clearing and providing market expertise on the suitability of products for clearing based on factors such as liquidity, standardization, and complexity. It is essential that members of the risk and other committees have the necessary background, expertise and capital preservation goals to make these types of decisions effectively. Qualified committee members are most likely to be found in the dealer and buy-side community. Furthermore, independent director representation at the Board level, coupled with the broad regulatory powers granted to the Commission under the CEA, should be adequate to preclude biased actions by a risk or other committee that would constitute a restraint of trade. We therefore urge the Commission to reject the DOJ staff's proposed expansion of independent director requirements.

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[10] See, e.g., Broadcast Music v. CBS, 441 U.S. 1, 8 (1979) (observing that *per se* rules are only appropriate for "plainly anticompetitive" practices); United States v. Topco Assocs., 405 U.S. 596, 607-08 (1972) ("[i]t is only after considerable experience with certain business relationships that courts classify them as *per se* violations.")

Based on the foregoing, we respectfully urge the Commission to forego the adoption of aggregate ownership limits at least until it can meaningfully evaluate the impact of such limits on registered entities generally and determine that such restrictions are warranted on the basis of a more informed review and study. We also urge the Commission to reject the DOJ staff's proposals regarding expanded independent director requirements.

We would be pleased to discuss the foregoing comments and recommendations with the Commission or its staff in greater detail. Please feel free to contact the undersigned with any questions.

Respectfully submitted,

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<u>Trade Association Signatories</u>

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