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November 4, 2011

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

Re: Swap Transaction Compliance and Implementation Schedules (RIN 3038-AC96, RIN 3038-AC97, and RIN 3038-AD60)

Dear Mr. Stawick:

The Investment Company Institute¹ is submitting this letter in response to the Commodity Futures Trading Commission's (the "Commission" or "CFTC") proposed compliance and implementation schedules for swap transactions ("schedules").² The proposed schedules are designed to phase in compliance with many of the rules promulgated by the Commission to implement Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), which imposes mandatory clearing and exchange trading requirements for over-the-counter derivatives to better control for risks in the swaps markets.

Implementation of the Dodd-Frank Act will establish a new regulatory framework for the swaps markets and their participants, dramatically transforming the manner in which swaps transactions are undertaken. ICI strongly supports the Commission's phased in approach to implementation of the new rules and appreciates the Commission's efforts to address issues raised by

¹ 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 \$11.8 trillion and serve almost 90 million shareholders.

² *Swap Transaction Compliance and Implementation Schedule: Trading Documentation and Margining Requirements under Section 4s of the CEA*, 75 FR 78176 (September 20, 2011) ("Trading Documentation Release"), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-24128a.pdf> and *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> ("Clearing Release;" together "Releases").

the Institute in its prior letter to the Commission regarding the process of finalizing and implementing such rules.³ We are concerned, however, that the proposed schedules for phasing in compliance with the rules significantly underestimate the time needed for the swap market to transition to the new framework and for the transition to take place in an orderly manner that provides market participants with a level playing field and minimizes disruption to the marketplace.

To ensure a smooth, efficient and effective transformation of the swaps markets, ICI recommends that the Commission provide a transition period of 18 to 24 months following adoption of final rules. Equally important, rules should not be finalized until such time as the Commission has adequate data to inform its rulemaking and understand the economic effects associated with the unique attributes of a particular swap. Only then can the Commission, for example, make an educated determination to require mandatory clearing and therefore exchange trading (if available) having appropriately weighed related costs and benefits.

In addition, ICI seeks clarification from the Commission on a number of issues related to the proposed schedules, as discussed below, including the interaction of the proposed time frames with the definition of major swap participant (“MSP”), the interaction of the trading documentation requirements with the mandatory clearing requirements, and the scope of the definition of third-party subaccount.

I. Timing for Phase In Schedules

ICI supports the Commission’s approach in the proposed schedules to phase in compliance with the identified rule requirements by the type of market participant. As noted by the Commission in its Releases, there are meaningful differences between market participants with respect to resources, readiness, and expertise. Market participants also will be affected by the new requirements to differing degrees. A phased approach to compliance will allow the Commission to balance its goal of obtaining adequate representation at each stage of the regulatory roll-out with the goal of avoiding anti-competitive concerns. It does so by recognizing the differences among market participants, staggering their compliance dates, and allowing immediate and voluntary compliance with the rules by market participants earlier than their respective deadlines. The proposed phase in will be critical to a successful transition in the swaps markets.

A. Clarify Trigger for Phase In Schedules

The proposed implementation schedules should begin only after final adoption of all rule proposals related to clearing, trade execution, trading documentation and margin because of the complexity and interconnected nature of these rules. However, before finalizing the rules, particularly

³ Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Ms. Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, and Mr. David A. Stawick, Secretary, Commodity Futures Trading Commission, dated June 10, 2011 (“June 2011 Letter”).

those related to trading practices and market transparency, the Commission should gather sufficient data to inform itself regarding the unique attributes of a particular swap to determine whether clearing, and consequently exchange trading, should be mandated.⁴ Gathering such data would ensure that the Commission does not prioritize speed over quality in finalizing its rules, duly evaluates the costs and benefits of its rules and clearing determinations, and does not adversely affect certain segments of and participants in the swaps markets. As discussed in ICI's June 2011 Letter, the Commission should first finalize and implement its rules requiring reporting of swap transaction data to regulators. Transaction data would aid the Commission in "better understanding the structure and operations of the swaps markets and in adopting appropriately tailored and effective rules," including those underlying the proposed schedules.

Similarly, to address the many-faceted and global nature of the derivatives markets, the Commission's rules should be finalized only after harmonizing requirements and principles with those rules being adopted by the Securities and Exchange Commission and foreign regulators. Where harmonization is not possible, coordination should be undertaken. Absent such efforts, the interconnected nature of the derivatives markets will present opportunities for certain market participants to take advantage of regulatory gaps or seek to transact in "lighter" regulatory regimes to the disadvantage of other market participants and the greater imposition of risk on the financial system as a whole.

At a minimum, the Commission should ensure that adoption of the final rules identified in the Releases occurs only after thorough consideration of commenters' concerns. Until the definition of swap and the rules providing for protection of customer collateral are finalized, for example, market participants cannot finalize their documentation with counterparties or prepare for centralized clearing.⁵ Completion of these rules is integral to the ability of market participants to understand the rules and their interrelations as well as to implement policies and procedures to comply with the extensive margin, documentation, clearing, and trading requirements being imposed by the Commission pursuant to the Dodd-Frank Act.

In addition, ICI recommends that the Commission revise the proposed schedules – while retaining the approach of phasing in compliance for market participants – into a single, comprehensive

⁴ The phase in schedules should be determined based on asset class, as well as by type of market participant, to account for the unique characteristics surrounding each particular asset class. The Commission's individual assessment of a swap's readiness to be cleared (either on the Commission's own initiative or through the application of a derivatives clearing organization) would allow for the necessary phase in by asset class.

⁵ As evidenced by the reports regarding the bankruptcy of MF Global Holdings Ltd., which allegedly failed to keep its customers' accounts separate from its own funds in violation of Commission and Chicago Mercantile Exchange customer segregation requirements, serious and real issues need to be resolved in developing the regulatory framework for swaps, including the appropriateness of transposing the futures regulatory model into the swaps market irrespective of the unique characteristics of these markets. *See, e.g.*, "MF Global did not separate customer accounts – CME," Reuters, November 1, 2011.

proposed implementation schedule addressing all of its Title VII rulemaking.⁶ A single implementation and compliance plan would eliminate many of the potential gaps, and questions regarding interaction, presented by proposing two partial schedules. Significantly, it would allow market participants to better formulate an implementation strategy for compliance with the new regulatory regime which, in turn, would facilitate a smoother transition for market participants and the swaps markets.

B. Expand Duration of Implementation Schedules

The Commission should amend the proposed schedules to provide for compliance over an 18- to 24-month period following adoption of final rules (as discussed above). The time frames discussed in the Releases are inadequate to accommodate all of the changes market participants must undertake to comply with the rule requirements without disadvantaging certain market participants or disrupting the swaps markets. The many steps that market participants will need to complete before being able to comply with the Commission's proposed rules, as detailed in ICI's June 2011 Letter, will take considerable time.⁷ Eighteen to 24 months is a fair and reasonable estimate of the time frame that will be necessary to make the dramatic changes to the swaps markets under the Commission's proposed rules, as required by the Dodd-Frank Act.⁸ The Commission's Releases recognize some of the essential changes to existing swaps infrastructure and business practices, the requirement to build and test new systems and adapt to new regulatory requirements, and the need to educate customers on many of the business and operational changes. Yet, as proposed, the compliance dates with the requirements identified in the schedules would be as short as 30, 90, 180, or 270 days from adoption of certain rules or a clearing determination by the Commission.⁹ These time periods are woefully insufficient. Instead of reducing risk in the swaps markets – a primary goal of Title VII of the Dodd-Frank Act – the likely consequences of proceeding with such short deadlines would be disruption of trading that would be harmful to market participants, their customers, and the swaps markets.

⁶ A complete schedule would include a period of time for the Commission to gather and analyze swap transaction data required to be reported under the Dodd-Frank Act before finalizing rules relating to trading practices, among others. Notably, the Securities and Exchange Commission ("SEC") has stated that it will seek public comment on "a detailed implementation plan that will permit a roll-out of the new securities-based swap requirements in a logical, progressive, and efficient manner, while minimizing unnecessary disruption and costs to the markets." *See Registration of Security-Based Swap Dealer and Major Security-Based Swap Participants* (October 12, 2011), available at <http://www.sec.gov/rules/proposed/2011/34-65543.pdf>.

⁷ *See* June 2011 Letter, *supra* note 3.

⁸ Furthermore, during this same time frame, many market participants will be subject to other regulatory changes due to the Dodd-Frank Act, wholly apart from Title VII, that also will demand considerable resources.

⁹ As discussed below, the Commission also could impose a compliance date on its own accord for mandatory clearing of a particular swap or class of swaps. Based on the Commission's comments in the Releases, we think it is reasonable to assume that any such determination would not fall within an 18- to 24-month time frame.

The Commission specifically seeks comment on whether the proposed 30-day period for compliance with the trade execution requirements, available in certain circumstances, is adequate. It is not. In many cases, a 30-day period would be too short to provide designated contract markets (“DCM”), swap execution facilities (“SEF”), and market participants with the time necessary to comply with the rule. In particular, additional time would be needed to establish the technological linkages among the various parties. We recommend that the Commission consider a 60-day period to ensure better coordination between trading venues and market participants and minimize disruption to and negative implications for swap market participants and customers as part of the transition to exchange trading. Further, ICI is concerned that small market participants could be competitively disadvantaged in those instances where there is an active market for a swap, but the DCM or SEF making the swap available for trading has to queue market participants beyond 30 days for linkages because of the significant interest in trading the swap.

C. Provide Legal Certainty for Phase In Schedules

The Commission should amend the proposed schedule for mandatory clearing to provide legal certainty that the phase in by type of market participant would apply to each mandatory clearing determination issued. As proposed, the Commission could set an effective date by which all market participants must comply with a mandatory clearing determination. The Commission would have discretion to permit use of the 90, 180, and 270 day phase in schedule. Market participants should be afforded certainty and consistency to allow them to develop and execute their compliance programs for the clearing requirements in an orderly manner in anticipation of a specified deadline for compliance. At a minimum, there should be a presumption that the Commission would rely on the proposed phase in schedule unless it determines that the schedule is unnecessary to facilitate the transition to mandatory clearing in a manner that does not unduly disrupt the derivatives markets and swaps transactions.

The Commission also should consider providing additional time to market participants to comply with the mandatory clearing and trade execution requirements in those cases where it makes a clearing determination for a group, type, or class of swap instead of a single swap. The Commission has stated in the Releases that it may establish a compliance date that differs from the date it issues its clearing determination.¹⁰ The novelty associated with the new type or class of swap as well as the additional operational burden associated with preparing for a group of swaps warrant extra time to “on board” in the least disruptive way possible.

¹⁰ In such cases, ICI recommends that the phase in schedule for different market participants would be triggered by that later date.

II. Operation of Phase In Schedules

A. Clarify Entity Categorization for MSPs and Security-Based MSPs

The proposed schedules would define “Category 1 Entities” to include those major participants in the swap and security-based swap markets that “will be registered” or “will be required to register” with the Commission or the SEC – *i.e.*, MSPs and security-based MSPs. Both types of MSPs would have 90 days to come into compliance with the respective requirements in the proposed schedules (except in the case of the Commission setting a single compliance deadline for all market participants for a particular clearing determination). The Releases note that a security-based MSP would be classified as a “Category 2 Entity,” having 180 days for compliance, if it is not yet required to register with the SEC at such time as the Commission issues a mandatory clearing determination. The Releases do not address those instances in which a market participant is not yet required to register with the Commission as an MSP at the time the Commission issues a mandatory clearing determination.

We recommend that the Commission provide greater clarity regarding the application of the Category 1 Entity designation to potential MSPs. In its final rules further defining MSPs, the Commission will establish the process, including the frequency, by which market participants must evaluate whether they qualify as MSPs. If market participants are tasked with evaluating their swaps positions for purposes of assessing their status as an MSP every 90 days, a market participant could cross the threshold for MSP status at any point during that period, even though its registration with the Commission would be tied to the conclusion of that period. During that same 90-day period, the Commission could issue clearing determinations that would trigger the proposed phase in schedule. To avoid confusion, the Commission should provide that a market participant would review its obligation to register as an MSP with the Commission for purposes of the proposed schedules at the same time that it is required to review its status as an MSP for purposes of the Commission and SEC rules further defining the term MSP (*e.g.*, at the end of the 90 days).

B. Clarify Interaction between Mandatory Clearing and Trade Documentation Requirements

The Commission should provide clarity regarding the interaction between the two proposed schedules and, in particular, the mandatory clearing requirement and the trade documentation requirements. In the Trade Documentation Release, the Commission states that the rules relating to trading documentation must be finalized prior to the rules regarding margin requirements because some of the margin requirements are dependent on certain provisions in the rules related to trading documentation. ICI supports this sequencing. We also support the proposed sequencing in the Clearing Release that certain rules must be finalized prior to the trade execution requirements. There is no explanation in the Releases, however, as to how the proposed schedules would relate to each other.

Trading documentation requirements must be finalized before market participants are required to comply with mandatory clearing. If the documentation process is not required to be completed prior

to any clearing deadline, market participants will be forced to scramble to negotiate, finalize, and ratify the necessary agreements and contracts among various parties.¹¹ Such haste could impact the quality and number of future swaps transactions and the protections provided to customers, as well as hinder a smooth transition to the new swaps regulatory framework. These factors could negatively affect the swaps markets as a whole, contrary to the intent of the Dodd-Frank Act to reduce risk in these markets. Further, small market participants could be disproportionately impacted and likely would be excluded from the process to the extent they did not accept the terms being offered by the limited number of dealers providing clearing services. ICI recommends that the Commission pursue a systematic approach to the clearing and trading documentation requirements by specifying that documentation related rules, including the trading documentation and margining requirements schedule, must be finalized prior to implementation of the proposed clearing schedule.

C. Expand Definition of Third-Party Subaccount

The proposed schedules would classify third-party subaccounts as “Category 3 Entities” entitled to a 270-day compliance period. A third-party subaccount would be defined as a managed account that requires specific approval by the beneficial owner of the account to execute documentation necessary for executing, confirming, margining, or clearing swaps. The additional time provided in the proposed schedules is designed to provide asset managers with adequate time to enter into arrangements and satisfy documentation obligations for their potentially thousands of managed subaccounts. While strongly supportive of the additional time proposed for third-party subaccounts, ICI is concerned that the proposed definition for such accounts may inadvertently exclude from Category 3 many accounts that the Commission intended to be eligible for the 270-day compliance period. We therefore recommend that the Commission expand the definition of third-party subaccount to include any managed account regardless of the level of authority granted in the advisory agreement to enter into trading agreements.

Certain advisory agreements include a general grant of authority to enter into trading agreements on behalf of clients. These advisory agreements do not require specific approval by the beneficial owner of the account to execute the trading agreements. Ultimately, however, the adviser may need to verify its decision with the client or involve the client in the negotiation process as a practical matter because of the representations that the adviser must make on the client’s behalf in order to enter into the trading agreement.¹² Further, the practice for many managers faced with a grant of general authority to enter into agreements on behalf of their clients is to consult with their clients prior to finalizing any such agreement to ensure that the client fully understands the associated risks. For example, most ERISA accounts would not qualify under the proposed definition, and would be

¹¹ The existence of standardized templates would not resolve the sequencing concerns. Such templates may be voluntary and they are only starting points from which the buy-side would need to negotiate protections on behalf of their customers.

¹² In addition, a clearing broker’s business practices might require that the client execute the trading agreement directly.

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classified as “Category 2 Entities” subject to the proposed 180-day compliance period, because, as is often the case in investment management agreements (“IMAs”), ERISA accounts’ IMAs do not generally have a clause with the explicit “specific approval” language or their agreements are silent, even though they effectively require approvals. Because externally managed accounts present the same or expanded operational challenges contractually, whether they include specific approval language or general grants of authority to enter into trading agreements on behalf of clients, all such accounts should be uniformly classified as Category 3 Entities eligible for the 270-day compliance period.¹³

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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 Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott D. O’ Malia, Commissioner

¹³ The same issue may be raised with respect to private funds and offshore funds that are clients of an adviser.