INVESTMENT COMPANY INSTITUTE

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January 29, 2019

Mr. Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: *Post-Trade Name Give-Up on Swap Execution Facilities (RIN 3038-AE79)*

Dear Mr. Kirkpatrick:

The Investment Company Institute (ICI)[1] appreciates the opportunity to provide comments regarding the practice of "post-trade name give-up" for swaps that are executed anonymously on swap execution facilities (SEFs) and are intended to be cleared. Under this practice, the identity of each swap counterparty is disclosed to the other after a trade has been matched anonymously on a SEF. The Commodity Futures Trading Commission (CFTC or "Commission") asks (i) whether this practice is needed for such swaps; (ii) the costs of this practice; and (iii) whether the CFTC should intervene regarding the use of this practice.[2] For the reasons explained below, we believe that post-trade name give-up is unnecessary and harms regulated funds and their shareholders. We urge the CFTC to issue a proposal abolishing this practice with respect to swaps that are intended to be cleared and are executed anonymously on SEFs.

Background

US registered investment companies, including mutual funds, ETFs and other funds that are regulated under the Investment Company Act of 1940 ("registered funds"), and non-US regulated funds[3]

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[1] ICI is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$21.9 trillion in the United States, serving more than 100 million US shareholders, and US$7.0 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

[2] *Post-Trade Name Give-Up on Swap Execution Facilities*, 83 Fed. Reg. 61571 (Nov. 30, 2018), *available at* https://www.cftc.gov/sites/default/files/2018-11/2018-24643a.pdf.

[3] For purposes of this letter, the term "non-US regulated fund" refers to any fund that is organized or formed outside the United States, is authorized for public sale in the country in which it is organized or formed, and is regulated as a public investment company under the laws of that country. For example, UCITS, or "undertakings for collective investment in

(together with registered funds, "regulated funds") rely on their investment adviser to invest fund assets and implement the funds' investment objectives and strategies. A regulated fund's investment adviser employs portfolio managers and traders to carry out these functions on behalf of the fund. In managing a regulated fund's portfolio, the portfolio manager determines which assets to buy or sell for the fund, in accordance with the objectives described in the fund's prospectus. Traders seek to execute the transactions in the most efficient and cost-effective manner to effectuate the investment strategy. Importantly, a regulated fund's investment adviser is a fiduciary, and owes duties of loyalty and care to its clients, including the regulated funds it manages. This fiduciary duty obligates the adviser, including its portfolio managers and traders, to act in the best interest of the fund and to seek best execution of the fund's portfolio transactions.

Investment advisers use derivatives in a variety of ways on behalf of regulated funds. Derivatives are a particularly useful portfolio management tool in that they offer portfolio managers considerable flexibility in structuring the investment portfolios of regulated funds. For example, a portfolio manager may use derivatives to hedge a regulated fund's positions, equitize the regulated fund's cash that it cannot immediately invest in direct equity holdings, manage the regulated fund's cash positions, and adjust portfolio duration, all in accordance with the investment objectives stated in the fund's prospectus.

Investment advisers use SEFs to enter into swaps on behalf of their clients, including regulated funds. These swaps include (but are not limited to) swaps that are subject to the trade execution requirement. ICI and its members therefore have a strong interest in the regulation of SEFs and of SEF trading practices. Regulated funds generally support market structure reforms that promote competition, fairness, liquidity, innovation and efficiency. As detailed below, ICI believes that the practice of post-trade name give-up for swaps that are executed anonymously on a SEF and are intended to be cleared is unnecessary and harms regulated funds and their shareholders. The CFTC should abolish this practice to improve competition, fairness, liquidity, and efficiency in the swap markets.

<u>Post-Trade Name Give-Up is Unnecessary for Intended to be Cleared Swap Trades</u>

For an uncleared swap, counterparty identity is an important consideration because each party to the swap is exposed to the credit risk of its counterparty for the duration of the swap. Each party to the swap also needs to know the identity of its counterparty to monitor credit exposure and payment obligations that the party may owe to, or be owed by, its swap counterparty.

By contrast, a swap that is executed anonymously on a SEF and is intended to be cleared (which is sometimes referred to as an "alpha" transaction) is extinguished as soon as it is accepted by a Derivatives Clearing Organization (DCO) for clearing—thereby eliminating credit risk and any exposure to the

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transferrable securities," are collective investment schemes established and authorized under a harmonized European Union (EU) legal framework, currently EU Directive 2009/65/EC, as amended (UCITS IV).

counterparty to the "alpha" transaction. The extinguished alpha swap that was executed on the SEF is then replaced by two equal and opposite swaps. The buyer of the extinguished swap becomes the buyer of one of the two new swaps, with the DCO acting as the seller of such swap. The seller of the extinguished swap becomes the seller of the other new swap, with the DCO acting as the buyer of such swap. Neither counterparty to the alpha swap is exposed to the credit risk of the other counterparty to that extinguished swap. And, because the swap is extinguished upon acceptance for clearing, there are no payment obligations on that transaction. Thus, there is no reason either party to an alpha swap needs to know the identity of its counterparty.

With respect to any concerns regarding credit risk before the alpha transaction is extinguished, we confirm the CFTC's understanding that applicable pre-execution credit checks and straight-through processing requirements effectively eliminate such counterparty risk as well as the need for market participants to know the identities of the counterparties to the SEF-executed or alpha transaction.

Some advocates of post-trade name give-up have suggested that the practice should be preserved to allow banks to allocate their bank capital among their preferred customer base and that banks, if unable to so allocate their capital, would charge higher prices to all customers. We do not believe this is a compelling reason to retain post-trade name give-up. Further, a practice by banks of only entering into swaps with counterparties that are preferred customers does not promote liquidity, fairness, or competition.

Advocates of post-trade name give-up also have suggested that the identity of a buy-side participant is needed to deter participants from gaming the market. The concern appears to be that, if counterparties can trade anonymously on a SEF, they might engage in trading practices that undermine market integrity. We view this concern as misguided and believe that post-trade name give-up is not the appropriate tool to address any regulatory concerns about trading practices. Rather, existing CFTC and SEF rules regarding market conduct and trading practices appropriately address any such concerns.

Post-Trade Name Give-Up is Harmful to Regulated Funds and Their Shareholders

Post-trade name give-up for swaps that are intended to be cleared harms buy-side market participants, including regulated funds and their shareholders. As noted above, advisers to regulated funds are fiduciaries. Traders employed by the adviser must seek best execution for the fund's transactions, which involves seeking the best price available while minimizing the market impact of the transaction. The market impact of a trade will increase if information about the trade leaks into the market, allowing other market participants to anticipate future trading intentions.

Post-trade name give-up institutionalizes a form of information leakage that results in less favorable trading conditions for regulated funds, harming funds and their shareholders. For example, disclosure of the identity of a regulated fund as a dealer's swap counterparty provides the dealer with information about the fund's trading intentions, positions, strategies, and other sensitive information that can be used to the dealer's advantage. Leaking this sensitive information through the name give-up process harms funds and their shareholders both directly, by increasing trading costs, and indirectly, by disclosing real-time information about the fund's holdings, strategies and trading interest. This leaked information can help a dealer anticipate its client's future trading behavior and potentially cause the dealer to offer the client less favorable pricing and other terms for swaps that are entered into bilaterally.

Unfortunately, buy-side traders have limited tools to reduce harms associated with the information leakage that accompanies post-trade name give-up. An effective way to prevent these harms is to conduct extensive due diligence on potential trading venues and avoid using venues that require post-trade name give-up of intended to be cleared swaps. Thus, SEFs' use of post-trade name give-up acts as an impediment to greater SEF participation by buy-side participants, including advisers to regulated funds. The practice reduces liquidity and results in more fragmented swap markets. If the Commission prohibits the post-trade name give-up practice, buy-side traders would be more likely to participate in trading on venues that offer anonymous execution of intended to be cleared swaps, including venues that offer order book functionality.

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We appreciate the opportunity to comment on the use of the post-trade name give-up practice on SEFs for swaps that are intended to be cleared. We urge the Commission to propose rules that would abolish the use of this practice for such swaps. If you have any questions on our comment letter, please feel free to contact me at (202) 326-5813, Sarah Bessin, Associate General Counsel, at (202) 326-5835, or George Gilbert, Assistant General Counsel, at (202) 326-5810.

Sincerely,

/s/ Susan Olson

Susan Olson
General Counsel

cc: The Honorable J. Christopher Giancarlo
The Honorable Brian D. Quintenz
The Honorable Rostin Behnam
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Commodity Futures Trading Commission