



**Americans for Financial Reform**  
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February 13, 2012

Mr. David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Center  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

Re: Notice of Proposed Rulemaking – Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade (CFTC RIN 3038–AD18)

Dear Mr. Stawick:

Americans for Financial Reform (“AFR”) appreciates this opportunity to comment on the above-referenced notice of proposed rulemaking (the “NOPR”) by the Commodity Futures Trading Commission (the “Commission”) proposing regulations (the “Proposed Rules”) that establish a process for a designated contract market (“DCM”) or swap execution facility (“SEF”) to make a “swap available to trade,” as required by or pursuant to provisions of section 723 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

AFR is an unprecedented coalition of over 250 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups as well as economists and other experts.

As drafted, the proposed rule is inconsistent with the statutory language and will not fulfill congressional intent to expand pre-trade price transparency. It should be fundamentally restructured.

### **Introduction**

Section 723 of the Dodd-Frank Act is in major part devoted to the mandate that swap transactions must be cleared whenever clearing is offered and no exception is provided. The section includes a further mandate related to swap execution:

- (A) IN GENERAL.—With respect to transactions involving swaps subject to the clearing requirement of paragraph (1), counterparties shall—
  - (i) execute the transaction on a board of trade designated as a

contract market under section 5; or  
(ii) execute the transaction on a swap execution facility registered under 5h or a swap execution facility that is exempt from registration under section 5h(f) of this Act.

(B) EXCEPTION. —The requirements of clauses (i) and (ii) of subparagraph (A) shall not apply *if no board of trade or swap execution facility makes the swap available to trade* or for swap transactions subject to the clearing exception under paragraph (7). [Emphasis added.]

Importantly, the general rule is that a class of swaps that must be cleared is also subject to the execution mandate. The “available to trade” provision is an exception that applies only if *no* DCM or SEF makes the swap available to trade. The Proposed Rules establish the process under which the “available to trade” provision would be implemented.

The quality of this process can be assessed only in terms of the Congressional purpose that underlies the provision. This purpose was well articulated by Chairman Gensler in his remarks in support of the proposed rules regarding core principles for SEFs:

I believe that transparency and competition in markets is consistent with [the structure that] Congress mandated in the definition of a swap execution facility, whereby all market participants can communicate with all market participants such that everybody gets the benefit of a competitive and transparent price discovery process.<sup>1</sup>

Congress addressed the issue of swap execution with the purpose of increasing pre-trade price transparency while maintaining competition. Toward that end, the goal of the legislation was to ensure that as much of the market as *could* trade over execution facilities *would* trade over execution facilities.

The Proposed Rules approach the issue of “available to trade” with little regard for this purpose. The process proposed relies on SEFs and DCMs to secure the benefits of the execution mandate by actively procuring a designation that a class of swaps is made available to trade.

There is no requirement or even suggestion in the Dodd-Frank Act that a claim by an execution venue is a condition precedent to the triggering of the execution mandate. Put another way, the execution mandate is not a privilege to be seized by a SEF or DCM because it serves a business interest. It applies when the condition is met, regardless of the action of a trade execution venue. Quite simply, unless a class of swaps is not made available to trade by a SEF or DCM, under the Dodd-Frank Act, a condition exists that triggers the execution mandate.

The proper role of the Commission is to procure and monitor the relevant information and determine whether the conditions exist to trigger the mandate. It would be appropriate to make

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<sup>1</sup> CFTC Notice of Proposed Rulemaking, Core Principles and other Requirements for Swap Execution Facilities, 76 FR 1258.

public both the determination and other relevant information. A passive role, as envisioned by the Proposed Rules, is not justified by the statutory language of Section 723 and is inconsistent with the desired outcome of expanding pre-trade price transparency. Furthermore, it does not even provide the information needed to make a determination based on the Commission's stated standards for determining whether a class of swaps is made available to trade.

Unfortunately, to fulfill the mandate of Congress set out in Section 723, the Proposed Rules must be fundamentally restructured.

## Discussion

### *Minimum Liquidity Standards*

The Proposed Rules set forth standards to evaluate whether the market for a class of swaps is sufficiently liquid so that the class can be designated as "available to trade." These standards, to be applied by a DCM or SEF (discussed in detail below), are as follows:

- (1) Whether there are ready and willing buyers and sellers;
- (2) The frequency or size of transactions on swap execution facilities, designated contract markets, or of bilateral transactions;
- (3) The trading volume on swap execution facilities, designated contract markets, or of bilateral transactions;
- (4) The number and types of market participants;
- (5) The bid/ask spread;
- (6) The usual number of resting firm or indicative bids and offers;
- (7) Whether a swap execution facility's trading system or platform will support trading in the swap; or
- (8) Any other factor that the swap execution facility may consider relevant.

As a threshold matter, this approach is flawed and must be discarded for the Commission to properly implement Section 723.

The very words of Section 723 provide clear guidance that this procedural inquiry is misguided:

- The pre-condition is that the class of swaps is cleared by a derivatives clearing organization ("DCO").
- The statute then provides that the class of swaps is subject to the execution mandate.
- The exception is worded as follows: shall not apply *if no board of trade or swap execution facility makes the swap available to trade.*

Inescapably, the language means that if *any* DCM or SEF makes the class of swaps available to trade, the exception does not apply, regardless of market-wide trading activity. In contrast under the Proposed Rules, a class of swaps can be cleared and one or more DCMs or SEFs could

legitimately list the class of swaps for trading, and the execution mandate would nonetheless not be in effect because of a liquidity test.

This outcome must not be permitted. The structure of Section 723 is compellingly rational. A DCO can only clear a class of swaps if a reasonable level of market liquidity is demonstrated. Otherwise, the DCO could not establish the statistically sound expected loss levels in a liquidation of positions so as to set an initial margin level.

The proper inquiry by the CFTC is whether a given DCM or SEF listing of the class of swaps is legitimate and *bona fide*. The relevant question is whether the DCM or SEF has the capacity to facilitate the matching of the trades in terms of hardware and software and whether the terms for use of the DCM or SEF are reasonable for market participants.

### *Responsibility for Making Determination*

Regardless of the standards to be applied, the Proposed Rules establish a process for designation of a class of swaps as available to trade that is initiated by a DCM or SEF. This cannot be the only mechanism for such designation. The Commission must be able to initiate the process, and must collect and monitor the information necessary to see when it is necessary to do so.

First, the statute provides that classes of cleared swaps are subject to the execution mandate. The “available to trade” provision is an exception that comes into play only if there is no DCM or SEF that provides the service.

The purpose of the execution mandate is not to permit a trading venue to take advantage of a regulatory requirement that market participants use its services. The applicability of the execution mandate is conditioned on the existence of a set of conditions set forth in Section 723, not on an elective initiation of a process by a DCM or SEF. It is easy to imagine a set of circumstances in which an oligopolistic group of market participants derive substantial profits from bi-lateral trading of a class of swaps. A DCM or SEF may conclude that it is not in its overall business interest to initiate a process for mandatory execution, perhaps (though not necessarily) because of explicit inducements. By establishing a procedure that inserts a condition that is not envisioned by Section 723 and is contrary to its clear meaning, the Commission would facilitate the subversion of the Dodd-Frank Act.

The Commission must take responsibility for monitoring the market information necessary to determine whether the conditions for applicability of the execution mandate have been met; must be able to initiate a decision making process as to whether the conditions have been met, and must be able to make the final determination. There should be rules requiring reporting of relevant information by SEFs and DCMs,

### **Conclusion**

Unfortunately the Proposed Rules are inconsistent with the requirements of Section 723 relating to “available to trade.” The standards, which envision a detailed analysis of the liquidity characteristics of the market for a subject class of swaps, are simply inconsistent with the intent

of Congress and must be changed. Furthermore, the required initiation of the process for designation of a class of swaps as “available to trade” not only ignores the clear intent of Congress, but also opens the potential for evasion of the requirements of Section 723. The Commission must take on the responsibility for evaluating whether the exception to the rule that all classes of swaps that are cleared must be executed *via* a DCM or SEF.

Sincerely,

Americans for Financial Reform

## **Following are the partners of Americans for Financial Reform.**

*All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.*

- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- Americans for Democratic Action, Inc
- American Income Life Insurance
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Information Press

- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women’s Policy Research
- Krull & Company
- Laborers’ International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People’s Action
- National Council of Women’s Organizations
- Next Step
- OMB Watch
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer’s for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now

- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

*List of State and Local Signers*

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA

- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA

- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

***Small Businesses***

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET

