Deutsche Bank

October 6, 2010

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

Dear Ms. Murphy and Mr. Stawick:

Deutsche Bank AG ("DBAG" and, together with its affiliates, "Deutsche Bank") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC" and, together with the CFTC, the "Commissions") with our views and suggestions regarding certain key issues related to registration, clearing, trade execution and conflicts of interest arising under the derivatives title ("Title VII") of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

Deutsche Bank supports the policy goals underpinning the provisions of Title VII, including reduced systemic risk, increased transparency and investor protection. Yet, we are concerned that these provisions not be implemented in a way that would unintentionally weaken clearing systems, fragment businesses, increase systemic risk, impair liquidity or distort pricing in the derivatives markets. This letter explains our concerns and suggests workable approaches to rulemaking.

Consistent Rulemaking

Title VII imposes a host of requirements including clearing, trade execution, capital and dealer registration, relating to both swaps and security-based swaps under the jurisdiction of the CFTC and SEC, respectively. The rules each Commission imposes will have profound effects on the swaps markets and their participants, including changes to dealer organizational structure, capitalization and activities. It is imperative that the Commissions harmonize their efforts to encourage regulatory efficiency and systemic stability. Indeed, we urge the Commissions, as they did with the recent issuance of the Advanced Joint Notice of Proposed Rulemaking and the recently organized roundtables, to continue to propose in tandem the rules that relate to the same subject matter for both swaps and security-based swaps so that the public can comment on these issues in a holistic manner.

Futures Commission Merchant Registration Requirements

The requirements for registration as a futures commission merchant ("FCM") and the attendant capital and other regulatory requirements present thorny issues for swap dealers, security-based swap dealers and possibly other swap market participants. These requirements could result in the weakening of clearinghouses, the fragmentation of derivatives businesses and an increase in systemic risk.

Requiring all clearing members to register as FCMs will weaken clearinghouses.

Section 724 of the Dodd-Frank Act makes it unlawful for any person to accept money, securities or property (or extend credit in lieu thereof) from, for, or on behalf of a swaps customer to margin, guarantee, or secure a swap cleared by or through a derivatives clearing organization unless such person is registered as an FCM under the Commodity Exchange Act. At Deutsche Bank, derivatives transactions generally are booked in a single regulated bank, which also functions as a clearing member in existing OTC derivatives clearinghouses. Accordingly, Section 724 would apply to DBAG, acting as a clearing member for its swaps customers, thus requiring it to register as an FCM.

As an FCM, DBAG would become subject to the FCM capital regime. The regulatory capital regime for FCMs is inconsistent with that of banks. To comply with this requirement, DBAG and other banks similarly situated would be incented to use an existing FCM subsidiary or create a new entity to act as the clearing member for its swaps customers. Doing so would undermine the benefit of having a highly capitalized bank as a clearing member that can contribute to a clearinghouse guaranty fund, absorb the potential default of other clearing members by assuming the risks of the positions of defaulting members, accept the transfer of the positions of the defaulting members' swaps customers that are "ported" to it and fund any further assessments required by the clearinghouse to replenish the depleted clearinghouse guaranty fund. We believe that regulation should encourage such highly capitalized entities to act as clearing members. Requiring clearing members to register as FCMs would have the opposite effect.[1]

[1] We believe other firms face the same issue. Thus, clearinghouses may see a migration in its membership from highly capitalized bank entities to less well-capitalized FCM entities.

A broad reading of the FCM definition would fragment derivatives businesses.

Section 724 of the Dodd-Frank Act effectively requires the use of an FCM as a clearing member for its swaps customers. Applying an FCM registration requirement to swap dealers in general would render the registration and capital requirements applicable to swap dealers superfluous. It would further fragment the derivatives business by shifting the non-customer clearing-related business out of better capitalized entities into the FCM entities.

In addition, the definition of FCM contained in Section 721 of the Dodd-Frank Act includes an entity that:

> (I) is –
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> (aa) engaged in soliciting or in accepting orders for –
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> …
>
> (CC) a swap
>
> …; or
>
> (bb) acting as a counterparty in any agreement, contract, or transaction described in Section 2(c)(2)(C)(i) or Section 2(c)(2)(D)(i); and
>
> (II) in connection … [therewith] accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom …"

It has been argued, and we agree, that the phrase "engaged in soliciting or in accepting orders for a swap," when read against the phrase "acting as a counterparty in any agreement . . .," makes clear Congress's intent that merely acting as a counterparty on a swap does not cause an entity to be an FCM. We also understand it is the position of the staff of the CFTC that the definition of FCM does not contain a registration requirement; such a registration requirement is only established in connection with cleared swaps pursuant to Section 724. We agree that Congress did not intend to require registration as an FCM except in connection with swaps cleared on behalf of swaps customers, a view which we believe is supported by the explicit exclusion authority granted to the CFTC by clause (B) of the definition of "futures commission merchant." In light of the amendments made by the Dodd-Frank Act to Section 6d(a)(1) of the Commodity Exchange Act and the general uncertainty on this point in the marketplace, we would propose that the CFTC exercise this authority by promulgating a rule excluding from the definition of FCM swap dealers who do not clear customer swaps or deal in non-cleared swaps.

A contrary reading – i.e., that a swap dealer who self-clears, or accepts collateral in connection with non-cleared swaps, would be required to register as an FCM – would lead to fragmentation of derivatives businesses. Under Sections

761, 763 and 768 of the Dodd-Frank Act, a security-based swap dealer need not also register as a securities dealer due to its business in security-based swaps.[2] Therefore, a bank could solicit and accept orders for, and book and accept collateral with respect to, non-cleared security-based swaps without becoming subject to the capital regime for securities dealers.[3] Instead, the security-based swap dealer's capital requirements will be set by its prudential regulator, if any.[4] In contrast, if such activity with respect to swaps requires the bank to register as an FCM, it would become subject to the capital requirements of an FCM. The differential capital requirements will incent institutions to book swaps and security-based swaps in separate entities. Additionally, for uncleared transactions many customers will prefer to face banks, rather than FCMs, due to the formers' generally higher credit ratings and capitalization.

This would have some surprising and counter-intuitive results. For example, credit default swaps on broad-based indices (e.g., a swap on the CDX IG index) would be transacted in an FCM while credit default swaps on single names or narrow-based indices (e.g., security-based swaps on individual constituents in the CDX IG index) would be transacted in a security-based swap dealer.

Splitting up the businesses in this way would undermine the significant economic benefits of consolidated counterparty risk management across products and consolidated market risk management of derivatives portfolios. For example, by using a single entity for the booking of, and collection of collateral for, cleared and non-cleared swaps and security-based swaps and other derivatives, customers can realize better pricing and lower overall collateral requirements as a result of the ability to offset the bank's exposures to these various positions. In addition, the use of a single entity provides significant efficiencies in risk management

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[2] Sections 761 and 768 of the Dodd-Frank Act amend the definitions of "security" under the Securities Exchange Act of 1934 (the "Exchange Act") and the Securities Act of 1933, respectively, to include security-based swaps. However, Section 761 of the Dodd-Frank Act also amends the definition of "dealer" under the Exchange Act to provide an exception for activities involving security-based swaps.

[3] A potential issue arises out of the definition under the Exchange Act of "broker." Unlike the definition of "dealer," it was not amended by the Dodd-Frank Act to provide an exception for activities in security-based swaps. To the extent that clearing houses adopt systems in which clearing members act as an agents for their customers in principal transactions with the clearinghouse, such activity could constitute securities "brokerage" activity requiring the clearing member to register as a securities broker and comply with all requirements applicable to brokers. This would subject such clearing members to broker-dealer regulation by the SEC, including capital regulation, which would raise similar problems to the ones discussed in the FCM context above. We would propose the SEC promulgate rules to carve-out security-based swap dealers from the definition of "broker."

[4] In the case of DBAG, this would be the Federal Reserve.

oversight, operations and systems management. The loss of these benefits would increase systemic risk.

In addition, it is not clear whether a clearing member that is registered as an FCM will also be required to register as a swap dealer. In our view, so long as the clearing member solely clears transactions for swap dealers, it would not be engaged in activity rising to the level of a swap dealer. This should be the result regardless of whether the clearing model requires the clearing member to act as agent for the customer or as principal in a back-to-back transaction. We believe the CFTC should clarify this point through rulemaking.

There are several possible regulatory solutions.

There are several possible regulatory approaches the CFTC could employ to be consistent with its statutory mandate and achieve the important policy goal of systemic risk mitigation. One approach would be to permit the registered swap dealer (the bank) to be the clearing member of the clearinghouse without requiring registration as an FCM so long as a separately registered FCM holds the customer margin. A second solution would be to allow banks to clear proprietary positions in swaps without becoming an FCM and to require customer positions to be cleared through an FCM. A third approach would be to require FCM registration of clearing members with respect to swaps cleared on behalf of its customers but to exempt such clearing members from the FCM capital regime (if another capital regime is imposed by the clearing member's primary regulator) and other non-essential regulatory requirements.[5]

Extensions of credit to customers of an affiliated FCM should not trigger the FCM registration requirement.

As pointed out above, Section 724 requires that persons holding customer collateral or extending credit in lieu thereof register as an FCM. There is no indication that Congress intended in the Dodd-Frank Act to restrict the use of proceeds of loans made to customers of a banking group. We therefore would recommend that the Commissions permit banks affiliated with an FCM to extend credit to customers of the affiliated FCM without such registration.

Execution Facilities, Transparency and Liquidity

Swap dealers have provided liquidity to clients throughout the existence of the OTC derivatives market. Due to the competitive nature of the market, clients

[5] Another potential solution might be crafted jointly by the Commissions. This solution would permit the creation of a form of swap dealer ("SD Lite") for both swaps and security-based swaps that would be based on the model of the "OTC derivatives dealer" or so-called "broker-dealer lite" under the SEC's rules.

have enjoyed access to abundant liquidity and a high degree of pre-trade price transparency with respect to a large number of "on-the-run" contracts that are traded in the market. Implementation of the Dodd-Frank Act should not diminish the availability of liquidity for clients or increase their cost of execution. It is vital that, in a world in which swaps are executed on swap execution facilities and security-based swap execution facilities, dealers continue to provide liquidity for contracts that are relatively illiquid (even if there is sufficient transparency for risk management in a clearinghouse) and for block trades in more liquid products. Requiring exchange-like transparency will force dealers to withdraw liquidity and place execution risk in the hands of the end-user, with the potential for higher costs to the client. For these reasons, the trading provisions of the Dodd-Frank Act need to be applied with flexibility and an appropriate amount of discretion to preserve the liquidity of the swaps markets.

Trade execution facilities should be flexible enough to foster "liquidity in size."

Many end-users of derivatives who seek to hedge significant commercial and other risks require the ability to execute swaps and security-based swaps in large or "block" size. In addition, they often seek to execute transactions in less actively traded swaps and security-based swaps or to negotiate individual terms and conditions in such swaps and security-based swaps.

In our experience, one of derivatives customers' most significant concerns is "liquidity in size." This was contemplated by the drafters of Title VII. The core principles governing swap execution facilities and security-based swap execution facilities require that each such facility "establish rules governing the operation of the facility, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the facility, <u>including block trades</u>." [6] The need for special rules for the execution and reporting of block trades is well-recognized in other financial markets. For example, existing rules of stock exchanges and boards of trade clearly provide a regime for treatment for block trades, and the SEC has included exceptions for blocks in its proposed rules for dark pool transparency.[7]

Deutsche Bank believes that rules governing swap execution facilities and security-based swap execution facilities must be flexible enough to provide a low-cost and efficient form of price discovery for actively-traded swaps and security-based swaps while accommodating such pre-negotiated large sized trades. Traditional exchange and electronic markets rarely display significant liquidity publicly because of fear of adverse selection by anonymous, better informed

[6] Dodd-Frank, Section 763(c) and 733. Emphasis added.

[7] Exchange Act Release No. 60997 (November 13, 2009).

traders.[8] To provide liquidity swap execution facilities and security-based swap execution facilities should allow for customers to contact multiple dealers for pricing and other trade-specific data without the dealers being able to see each other's quotes. In our view, appropriate types of trading systems or platforms would include, perhaps among others, (a) multi-dealer request-for-quote platforms where buy-side investors can obtain price quotes from a range of dealers simultaneously, (b) multi-dealer request-for-market platforms where buy-side investors can request two-sided market quotes and negotiate interactively with individual dealers to customize transactions, (c) voice brokerage systems, (d) inter-dealer brokers using both voice and electronic trading systems to intermediate transactions among dealers and (e) systems that aggregate buying and selling interest and available liquidity from multiple single-dealer platforms and distribute to multiple buy-side entities through, for example, web-based interfaces. By allowing for a variety of types of trade execution facilities, price discovery will be enhanced and liquidity in size can be provided to customers.

In addition, Deutsche Bank believes that the rules governing swap execution facilities and security-based swap execution facilities should reflect the fact that many swaps and security-based swaps do not trade frequently. For example, the average single-name credit default swap with a 5 year maturity trades less than twice a day, and even less frequently in other tenors. As a result, continuous exchange-like pre-trade price transparency would be inappropriate and would severely limit liquidity. Thus, broad definitions of swap execution facility and security-based swap execution facility, and flexible rules governing any such facility, are required to ensure that the attempt to increase transparency in the market does not instead make the market untenable due to decreased liquidity and effectively make these instruments impossible to trade.

This flexible approach is consistent with definitions and legislative intent.

Deutsche Bank believes that this approach is consistent with the requirements and intent of the Dodd-Frank Act. Title VII defines a swap execution facility as

> "a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that— (A) facilitates the execution of swaps between persons; and (B) is not a designated contract market."[9]

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[8] In contrast, there are higher costs for price discovery in retail markets, though these transactions must be executed on an exchange.

[9] Dodd-Frank, Section 721(a)(21). The definition of "security-based swap execution facility" is substantially similar.

The definition of swap execution facility can be compared to the definition of a "trading facility" under the Commodity Exchange Act. Unlike the definition of a trading facility, a swap execution facility requires bids and offers from multiple participants, not that "bids or offers [be] open to multiple participants." Deutsche Bank believes that the definition of swap execution facility is intended by Congress to be broader than the "trading facility" definition and, as such, should be interpreted to include additional execution venues. Otherwise, Title VII could simply have used the term "trading facility" instead of "swap execution facility." Instead trading facilities are included as one type of swap execution facility. In particular, Deutsche Bank believes the swap execution facility definition is intended to include systems that provide multiple dealer quotes to individual customers.

Moreover, in interpreting key language in the statutory definition of "exchange,"[10] Rule 3b-16 under the Exchange Act requires that the entity "bring together orders of multiple buyers and sellers." The rule also requires that an entity "use[] established, non-discretionary methods … under which such orders interact with each other." This suggests that there must be methods to dictate the terms of trading among the multiple buyers and sellers in the system. Read as a whole, Rule 3b-16 explicitly excludes as an "exchange" those systems that form only traditional broker-dealer activities, such as order routing to other facilities for execution; systems operated by a single market maker to display its own bids and offers and limit orders of its customers and execute against such orders; and systems employed to enter orders for execution against the bids and offers of a single dealer. In contrast to Rule 3b-16, neither "non-discretionary methods under which orders interact" nor "bring[ing] together orders" are required elements in the definition of a security-based swap execution facility. Deutsche Bank believes, therefore, that the security-based swap execution facility must be broader than the SEC's definition of an exchange, including non-traditional broker-dealer activities.

In sum, the terms, "swap execution facility" and "security-based swap execution facility" should be clarified to include many existing platforms that meet client needs. With the focus on liquidity and transparency, these facilities must allow for multiple liquidity providers as well as multiple liquidity takers. For example, an individual swap or security-based swap could have a single

[10] Promulgated by the SEC in connection with Regulation ATS, Rule 3b-16 provides: "An organization, association, or group of persons shall be considered to constitute, maintain, or provide 'a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange,' as those terms are used in section 3(a)(1) of the [Securities Exchange] Act if such organization, association, or group of persons: (1) Brings together the orders for securities of multiple buyers and sellers; and (2) Uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade." 17 C.F.R. § 240.3b-16(a).

liquidity provider that provides bids and offers to multiple liquidity takers or multiple liquidity providers and a single liquidity taker.

We believe these platforms would all fit within the language of the Dodd-Frank Act. Swap execution facilities and security-based swap execution facilities will play an essential role in enhancing transparency in the swaps markets. Enhanced transparency can be accomplished without damaging market liquidity and dealers' ability to meet customers' needs. By providing for flexible swap execution facilities and security-based swap execution facilities that are able to efficiently execute block trades, the Commissions can fulfill the Dodd-Frank Act's policy objective of enhancing transparency while maintaining the liquidity that customers require.

Post-trade price transparency must be balanced with liquidity and risk of price distortion.

Deutsche Bank supports the creation of price transparency as critical to achieving the Dodd-Frank Act's purposes. Deutsche Bank supports full, real-time access by relevant regulators to all data on executed swaps and security-based swaps, to provide the Commissions with the relevant information to monitor the swaps and security-based swaps markets and preemptively address systemic risks. Deutsche Bank also supports *public* post-trade transparency regarding swaps and security-based swaps, tailored to achieve the public good while preserving efficient markets. Deutsche Bank believes that the issue requiring the most care in this context is determining the appropriate relationship between the size of a trade and the speed of public reporting. In other words, the regulators must balance the need for the execution of block trades with the investing public's need to have access to post-trade information. The Commissions should carefully consider the appropriate time delay and the designation of transactions as block trades in achieving this balance.

Title VII requires the Commissions by rule "to specify the appropriate time delay for reporting large notional swap [or security-based swap, as appropriate,] transactions (block trades) to the public."[11] Deutsche Bank urges the Commissions to consider that the maintenance of a market for block trades is extremely significant for clients. As opposed to trades of smaller sizes, clients are willing to compensate a dealer for executing a large notional transaction at the market price if doing so transfers the client's risk of working out of, or into, a position to the dealer. For example, if the prevailing market price is $100, then a client may be willing to sell in block size at $98 understanding that the dealer will work off the block at the $100 price. The client would be willing to trade at this level because it understands that if it were to execute in successive sub-block transactions, it would bear the risk of completing the entire trade at an average

[11] Dodd-Frank, Sections 727 and 763(i).

price that is worse than $98; in essence the client has priced this risk at the $2 differential. Without appropriate delays in the reporting of such a block trade, market participants would recognize that the dealer may be holding the position and sell ahead of the dealer, hoping to buy back at a lower price. This will raise the cost to the dealer of facilitating the block, thus reducing the dealer's willingness to provide liquidity, and thereby will correspondingly increase the cost to clients. As an alternative, reliable delayed pricing information would provide the public with critical post-trade block transaction data while maintaining efficiency and liquidity. This data will also be useful to swap and security-based swap counterparties in pricing their non-cleared transactions.

Additionally, crucial to effective public post-trade transparency, Title VII requires the SEC and CFTC to "to specify the criteria for determining what constitutes a large notional swap [or security-based swap, as appropriate,] transaction (block trade) for particular markets and contracts."[12] Deutsche Bank believes a block trade is best understood as a swap or security-based swap transaction that has the power to move the market price in a manner that is disproportionate to the value of the underlying component transactions. Deutsche Bank believes that block sizes must be determined through a dynamic process that varies across underlying asset classes and even within asset classes. A variable scheme would allow the Commissions to account for the differing relationships between transparency and liquidity across and within asset classes. To account for these variations, threshold levels could be set at levels equal to the standard quotation size for a particular instrument times a multiplier that would be set by the Commissions depending on the market for that instrument. Combining sufficient time delays for public reporting and appropriate criteria for designating a transaction as a block, both varying across asset classes to maximize liquidity, would allow the Commissions to significantly increase the amount of post-trade transparency while maintaining liquidity provision for large trades. For example, for each asset class (and in many cases for each contract within an asset class) a multi-tiered reporting approach might be adopted, where each tier is defined by volume. The lowest tier would be subject to real-time reporting of price and volume, a middle tier would be subject to delayed reporting of price and volume, and the highest tier would be subject to delayed reporting of price only. This is essentially the approach discussed by CESR in its July 29, 2010 Technical Advice relating to Transparency of Non-equity Markets. We would be pleased to discuss further with the Commissions our views on the appropriate multipliers or other metric for the definition of a "block trade" for varying asset classes and the appropriate time delay for reporting of blocks, which may be more than a single day under some circumstances.

[12] Dodd-Frank, Sections 727 and 763.

Conflicts of Interests and Limitations on Dealer Ownership and Control

Sections 726 and 765 of the Dodd-Frank Act require the Commissions to mitigate conflicts of interest with respect to certain swap and security-based swap market utilities. Clause (b) of each section indicates that a review would need to be conducted prior to any such rulemaking. These conflict of interest rules may – but are not required to – include, with respect to certain types of entities, known as "enumerated entities,"[13] numerical limits on the control of, or the voting rights with respect to, any swap or security-based swap clearinghouse or on the control of any swap or security-based swap execution facility or designated contract market or national securities exchange that clears or posts swaps or security-based swaps or makes such transactions available for trading. On October 1, 2010, the CFTC announced a proposed rule (the "Conflicts Proposal") to implement this requirement that, among other requirements, would limit members' and enumerated entities' ownership and voting interest in derivatives clearing organizations ("DCOs"), designated contract markets and swap execution facilities. While we intend to respond to the specific requests of the Conflicts Proposal in a separate and subsequent letter, we provide the following general thoughts and views for your consideration.

Numerical limitations on aggregate ownership and control increase conflicts of interest.

Deutsche Bank believes that a limitation on the ownership percentage by any one swap dealer or security-based swap dealer of a clearinghouse, exchange, or swap or security-based swap execution facility may be warranted, and believes that a limit that is consistent with the 20% cap on member ownership of national securities exchanges would adequately address conflicts concerns. We also believe that numerical limitations on aggregate ownership, control and voting rights of these entities by swap and security-based swap dealers will exacerbate, rather than diminish, conflicts of interest, particularly with respect to clearinghouses. As a result, Deutsche Bank does not support the proposed aggregate limitation on enumerated entities owning on a beneficial basis more than 40% of any class of voting equity in a DCO or directly or indirectly voting more than 40% of the voting power of any class of equity interest in the DCO. When a clearinghouse is owned and controlled by its swap dealer members, there is a greater emphasis placed on equal access, safety and democratic decision-making. When a clearinghouse is owned and controlled by nonmembers, there is greater emphasis placed on achieving a return on investment, risk-taking and

[13] In particular, any bank holding company with total consolidated assets of $50,000,000,000 or more, a nonbank financial company which has been designated systemically significant and therefore is under the supervision of the Federal Reserve, an affiliate of such a bank holding company or a nonbank financial company, a security-based swap dealer, a major security-based swap participant, or a person associated with a security-based swap dealer or major security-based swap participant.

hierarchical decision-making. Most importantly, nonmember owners do not bear the enormous risks of default that are borne by members. The ability of these nonmember-owners to impose risks on members creates moral hazard.

In contrast, the incentives of clearing members are aligned with the goal of reducing systemic risk. Clearing members must meet strict capital and financial soundness tests and make significant contributions to a guaranty fund that backstops the clearinghouse when margin is insufficient. It is therefore critical that clearing members be deeply involved in determining the methodology for margining complex transactions and ensuring that only those transactions that are properly margined are accepted for clearing. By protecting their own interests, clearing members protect the safety and soundness of the clearinghouse and the financial system.

A clearinghouse in which clearing members lack a significant ownership stake would face an opposite set of incentives. Without the possibility of loss in the case of improper margining methodologies leading to failure, owners of clearinghouses will be incentivized to clear as many swaps and security-based swaps regardless of the ability to properly risk-manage them, in order to earn clearing fees.

Concerns that widespread dealer ownership of clearinghouses would lead to fewer clearable swaps and security-based swaps being accepted for clearing by those clearinghouses are unfounded. Dealers benefit from the mitigation of systemic risk that accompanies a pervasive swap clearing environment.[14] The increased certainty as to the ability to recover in the default of another dealer allows the dealer community to enter in swap and security-based swap trades with greater confidence. In addition, dealers receive improved risk-weighted asset ("RWA") treatment for cleared transactions, which may make cleared trades less expensive than their non-cleared counterparts. This manifests itself in two ways.

First, Deutsche Bank and other similarly situated banks derive a benefit from clearing due to the application of an exposure value of zero for counterparty credit risk on trades facing a qualified clearinghouse. This can be substantial when compared against the counterparty risk capital charges typically assessed on

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[14] For these reasons, dealers have developed certain derivatives clearing facilities outside of the prescriptions of the Dodd-Frank Act. For example, LCH.Clearnet, which is 83% owned by its users, has operated SwapClear, an inter-dealer facility for clearing interest rate swaps, since 1999. SwapClear current clears more than 40% of the interest rate swap market, or $229 trillion in notional contracts.[14] In addition, in the past several years, dealers have engaged in a joint effort with buyside firms, industry associations, clearinghouses, the New York Federal Reserve and others to develop clearing solutions for credit default swaps. These clearinghouses are rapidly increasing the scope of their offerings, and potential new entrants are exploring new clearing solutions. As such, the keen interest of the dealer community in clearing makes it apparent that worries about the commitment of dealers to clearing are unfounded.

non-cleared trades (even for trades facing highly rated counterparties, such as banks). In particular, Deutsche Bank calculates counterparty exposure-related RWA for derivatives transactions as contemplated in Annex 4 of the revised Basel II Framework by using the internal model method for calculating the exposure at default ("EAD") based on the expected positive exposure ("EPE") methodology. For derivatives exposures facing qualified clearinghouses, since exposure at default is zero (per the Annex 4 rules), no counterparty risk capital charges will be assessed. For non-cleared exposures, Deutsche Bank has to model the exposure at default. This exposure at default is then multiplied by a number of other regulatory metrics such as a counterparty's probability of default, and loss given default to arrive at a regulatory capital charge for the counterparty risk exposure. The same exposure versus a qualified clearinghouse would not attract regulatory capital charges for counterparty risk.

Second, the clearing process incorporates a compression mechanism whereby the positions of the clearing member at the clearinghouse (and, consequently, the counterparty exposure to the clearinghouse) is netted, rather than remaining at a gross position level, as would be the case in a non-cleared scenario. As an example, if Deutsche Bank enters into a trade with counterparty A and enters into an offsetting trade with counterparty B, it would still have counterparty exposure to both counterparty A and counterparty B (even though it is flat on a market risk basis). Counterparty exposure-related RWA would apply for both positions. However, if both trades are cleared, then Deutsche Bank's net position in this example would be reduced to zero as the result of clearing. Thus, Deutsche Bank would not have any counterparty related RWA on these two trades. The capital benefits related to compression would apply for all of a clearinghouse's clearing members (regardless of their capital regime) and irrespective of whether a clearinghouse was "qualified" or not.

Deutsche Bank also believes that limitations on ownership and control by swap and security-based swap dealers will increase the risk of monopoly pricing. Without the possibility for ownership and control, fewer dealers will be willing to take on the risks of membership in a new clearinghouse. This will tend to entrench the most powerful clearinghouses and increase the likelihood of their monopolistic behavior.

Conflicts of interest are best addressed through governance rules.

Deutsche Bank believes that the Conflicts Proposal's provisions addressing governance are a positive step, and as mentioned above we will comment more fully on the Proposal's specifics in a separate letter. As a general matter, we believe that conflicts of interest are best addressed through governance rules requiring clearinghouses to have boards of directors whose composition represents the interests of a variety of market participants (including a number of independent directors), a risk committee and an independent advisory committee. We do not believe, however, that there should be any other limitations on clearinghouse board positions or voting power placed on swap dealers, security-based swap dealers, major swap participants, major security-based swap participants or any other type of entity.

Risk committees and independent advisory committees can be important in ensuring that conflicts of interest do not develop at a clearinghouse. Through such committees, potential conflicts and other governance issues can be addressed at early stages, including by external, independent parties, and mitigated before they become a problem. Clearinghouse boards would need compelling reasons not to follow the recommendations of these committees. Many existing clearinghouses, including ICE Trust and CME Clearing, already use such committees as part of best governance practices. In addition, we believe there is a role for independent directors on swap and security-based swap clearinghouse boards. Independent directors for clearinghouses, like independent directors for any other company, will help ensure that a variety of viewpoints are considered in the governance of the clearinghouse.

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We thank the Commissions for the opportunity to comment on the topics discussed above and for the Commissions' consideration of Deutsche Bank's views. We would be happy to provide the Commissions any additional information on any of the subjects discussed in this letter or any other issues that would be useful to the Commissions in implementing Title VII.

Please feel free to call either of the undersigned with any question or request for additional information that you may have.

Sincerely,

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