ABA Securities Association
Financial Services Roundtable
Futures Industry Association
International Swaps and Derivatives Association
Securities Industry and Financial Markets Association

April 29, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Reopening of the Comment Period on Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC (File No. S7-27-10)

Dear Ms. Murphy:

The Securities and Exchange Commission ("SEC") has proposed Regulation MC[1] which contains various ownership limitations and governance requirements for security-based swap clearing agencies ("Clearing Agencies"), security-based swap execution facilities ("SB SEFs"), and national securities exchanges. We previously have submitted several comment letters with respect to Regulation MC, including: ISDA's comment letter dated November 23, 2010[2], SIFMA's comment letter dated November 12, 2010[3], and a letter cosigned by six trade associations dated January 11, 2011[4] that responds to comments submitted to the Commodity Futures Trading Commission by U.S. Department of Justice staff. We are sending this letter in response to the SEC's reopening[5] of the comment period for Regulation MC in light of its subsequent SB SEF Proposing Release[6] and Clearing Agency Proposing Release.[7] As in SIFMA's November 12 comment letter on proposed Regulation MC, we are focusing our comments on the SEC's proposed limits on ownership and voting power, specifically the proposed limits applicable to Clearing Agencies.

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[1] Securities Exchange Act Release No. 63107 (October 14, 2010).
[2] Please see ISDA comment letter submitted 11/23/10.
[3] Please see SIFMA pre-comment letter submitted 11/12/2010.
[4] Please see Joint Trade Association letter submitted in response to DOJ letter on 1/11/11. The ABA Securities Association, The Clearing House Association L.L.C., Financial Services Roundtable, Futures Industry Association, International Swaps and Derivatives Association, and Securities Industry and Financial Markets Association signed the letter.
[5] Securities Exchange Act Release No. 64018 (March 3, 2011).
[6] Securities Exchange Act Release No. 63825 (February 2, 2011).
[7] Securities Exchange Act Release No. 64017 (March 2, 2011).

We believe the proposed limits are neither necessary nor appropriate. In this regard, we wish to reiterate several key points made in SIFMA's November 12 letter:

- Imposing unduly restrictive limits on the voting interests of Clearing Agency participants, either individually or in the aggregate, would run counter to the intention of Congress to increase clearing of swap transactions. "If swap dealers are precluded from having a meaningful ownership interest – individually or in concert – in . . . Clearing Agencies, they are less likely to contribute their expertise or investment capital to establishing and operating such an entity. As a result, fewer . . . Clearing Agencies will be established and there will be less competition in the provision of efficient clearing services."
- Concerns that swap dealers might use their aggregate control of a Clearing Agency to limit the extent of swap transaction clearing are misplaced. Dealers have an incentive to clear because "[c]learing reduces individual counterparty risk and systemic risk, and dealers, along with other market participants benefit from that risk reduction. Moreover, clearing facilitates trade compression (eliminating offsetting transactions) which further reduces dealers' risk exposure. That dealers have an incentive to clear is demonstrated by the fact that even before . . . Dodd-Frank [dealers were] clearing a substantial portion of their inter-dealer interest rate swaps."
- Allegations of anti-competitive behavior by swap dealers are both misleading and incorrect. Representative Stephen F. Lynch (D-MA), for example, has made the assertion that five banks control "upwards of 95% of the order flow on the existing over the counter derivatives market." These allegations are based on statistics published by the Office of the Comptroller of the Currency that only reflect the activity of U.S. banks; they do not take into account the activities of non-U.S. banks. "When non-U.S. bank swap dealers are included in aggregate market data, the market share of the five largest U.S.-based swap dealers is only 37% and the market share of the five largest swap dealers overall is 45.6%." In fact, swap markets have numerous participants and are highly competitive.
- "[C]oncerns about conflicts of interest can be addressed through the . . . statutory requirements applicable to Clearing Agencies."

The trade associations' January 11 letter made several other important points:

- Adoption of the aggregate ownership limits proposed by the staff of the Department of Justice "would violate a key principle in antitrust law by imposing a burdensome set of *per se* restrictions on the ownership of key market facilities in the absence of robust empirical evidence demonstrating that such ownership would plainly lead to anticompetitive consequences with little or no potential for redeeming pro-competitive efficiencies."
- We have "serious concerns with the proposed expansion of independent director requirements beyond what is commercially reasonable at the Board level, particularly as applied to nominating and risk committees." Swap dealers and other potential investors "will be disinclined to put [their] capital at risk without an ability to protect that capital

through meaningful participation in governance, especially clearing members who have so much to lose."

We agree with the SEC's decision to reopen the comment period for proposed Regulation MC, because we believe that concerns about conflicts of interest can be addressed through various other statutory and regulatory requirements imposed on Clearing Agencies. In its release announcing the comment period reopening, the SEC notes that its Clearing Agency Proposing Release includes "proposed rules . . . designed, in part, to address conflicts of interest affecting clearing agencies."[8]

The Regulation MC proposal identified three key areas in which conflicts of interest might arise: (i) participants could limit access to clearing; (ii) participants could limit the extent to which clearing was available for particular products; and (iii) participants could influence a Clearing Agency to lower its risk management standards and require less collateral and lower guaranty fund commitments than it otherwise might. We believe these concerns are overstated and, in any event, can be addressed by measures that are less onerous and less adverse to the public interest than the ownership limits proposed in Regulation MC.

Although participants that control a Clearing Agency theoretically could limit access to clearing services by competitors, that would not be an effective strategy because the clearing business would simply go to another Clearing Agency. Moreover, the Clearing Agency Proposing Release would require that Clearing Agency participation requirements be objective (*i.e.*, based on measurable facts) and facilitate fair and open access.[9] In that release the SEC states this will "foster compliance with the requirement under Section 17A of the Exchange Act that the rules of a clearing agency must not be designed to permit unfair discrimination in the admission of participants."[10] We do not believe there is any need for a belt-and-suspenders approach that would layer on an additional limitation on aggregate ownership by participants, particularly insofar as that additional limitation likely would have a significant adverse impact on competition in the market to provide clearing services.

As explained in SIFMA's November 12 letter (and mentioned above), we do not believe that Clearing Agency participants would have an incentive to limit the extent to which clearing was available for particular products. In fact, the risk reduction benefits of clearing, which are well understood and appreciated by swap dealers, create an incentive to clear swaps whenever possible. Furthermore, if a Clearing Agency decided not to clear a particular product, there would be nothing to prevent another Clearing Agency from doing so. The participants in any particular Clearing Agency have no ability to limit the availability of clearing services elsewhere.

We also do not believe that Clearing Agency participants would have any incentive to influence the Clearing Agency to lower its risk management standards and require less collateral and lower guaranty fund commitments. In fact, again, their incentive would be to do the opposite.

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[8] Securities Exchange Act Release No. 64018, page 8 (March 3, 2011).
[9] Securities Exchange Act Release No. 64017, page 48 (March 2, 2011).
[10] *Ibid*. Exchange Act section 17A(b)(3) requires Clearing Agencies to provide fair access to clearing and a fair procedure for the denial of participation to any person seeking participation in the Clearing Agency.

Participants will have significant exposure to the credit risk of a Clearing Agency and thus will have a compelling incentive to ensure the Clearing Agency employs appropriate risk management standards and requires adequate collateral from its counterparties and sufficient guaranty fund commitments from all participants. Participants that also are investors in the Clearing Agency will have a further incentive to ensure the Clearing Agency manages its risk exposure in an effective manner. Moreover, the rules in the Clearing Agency Proposing Release would reinforce the participant-investors' risk avoidance incentives by requiring, among other things, governance arrangements that "promote the effectiveness of the clearing agency's risk management procedures."[11]

Further assurance that conflicts of interest do not compromise the public interest in proper Clearing Agency operation and management would be provided by the SEC's Proposed Rule 17Ad-25: Clearing Agency Procedures to Identify and Address Conflicts of Interest.[12] This rule requires that Clearing Agencies "establish, implement, maintain and enforce written policies and procedures reasonably designed to identify and [address] existing or potential conflicts of interest."[13] Clearing Agencies' compliance with the requirements of this rule will be the responsibility of their chief compliance officers, as specified in section 763 of the Dodd-Frank Act. Managing conflicts in this manner is a common-sense approach that would avoid the adverse effects of unnecessarily restrictive measures such as imposing limits on participants' aggregate ownership interests.

In conclusion, we believe that the conflicts of interest created by participants having an ownership interest in a Clearing Agency are limited and not readily susceptible to exploitation and thus do not warrant overly proscriptive rules or numerical or percentage limitations on ownership or voting power, particularly aggregate limits. We also believe the proposed rules to address conflicts of interest that are set forth in the Clearing Agency Proposing Release, along with the requirements of section 17A of the Exchange Act, will provide thorough protection against potential conflicts causing actual harm. Accordingly, we urge the SEC not to include in Regulation MC any limit on participants' aggregate ownership of Clearing Agencies.

Respectfully yours,

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[11] *Id.* at 61.
[12] *Id*. at 96-97.
[13] *Id.* at 96.

cc: Honorable Gary Gensler, Chairman
Honorable Bart Chilton, Commissioner
Honorable Michael Dunn, Commissioner
Honorable Scott O'Malia, Commissioner
Honorable Jill E. Sommers, Commissioner
Commodity Futures Trading Commission

Honorable Mary L. Schapiro, Chairman
Honorable Luis A. Aguilar, Commissioner
Honorable Kathleen L. Casey, Commissioner
Honorable Troy A. Paredes, Commissioner
Honorable Elisse B. Walter, Commissioner
Securities and Exchange Commission

Trade Association Signatories

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The **Financial Services Roundtable** (the "Roundtable") represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $74.7 trillion in managed assets, $1.1 trillion in revenue, and 2.3 million jobs.

The **Futures Industry Association** ("FIA"**)** is a principal spokesman for the commodity futures and options industry. FIA's regular membership is comprised of approximately 30 of the largest futures commission merchants in the United States. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States designated contract markets. For more information, visit www.futuresindustry.org.

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