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January 14, 2010

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Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Ontario Securities Commission
Saskatchewan Financial Services Commission

VIA ELECTRONIC MAIL

RE: Consultation Paper 91-401 on Over-the-Counter Derivatives Regulation in Canada

Dear Members of the CSA Derivatives Committee:

In accordance with the Canadian Securities Administrators Derivatives Committee's (the "Committee") Consultation Paper 91-401 on Over-the-Counter Derivatives Regulation in Canada published on November 2, 2010 (the "Consultation Paper"), the Working Group of Commercial Energy Firms (the "Working Group") hereby submits comments on the Consultation Paper.

The Working Group is a diverse group of international commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial and residential consumers. Members of the Working Group are energy producers, marketers and utilities, some of whom are participants in the Canadian OTC derivatives markets or have operations in Canada. The Working Group considers and responds to requests for public comment regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities, and anticipates a continuation of the current dialogue.

I. COMMENTS OF THE WORKING GROUP OF COMMERCIAL ENERGY FIRMS.

A. GENERAL.

The Committee references the commitment of G20 leaders to implement certain reforms for the OTC derivatives markets by the end of 2012.[1] As noted in the Consultation Paper,

[1] "All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements."

Canada is expected to meet this commitment as a signatory to the commitment. The Committee states that "Canadian and international regulators must quickly develop a framework within which they have the legal authority to implement new regulations to facilitate compliance with their commitments."

The Working Group agrees that the Committee and Canadian regulators should act quickly to confirm their legal authority to implement derivatives reform. Canadian regulators, however, should not rush to implement regulation but rather take the necessary time to carefully craft an effective regulatory framework that meets the Committee's stated intentions:

- strengthening Canadian financial markets and managing specific risks relating to OTC derivatives;
- implementing the G20 commitments made at the Pittsburgh Summit in 2009 and reaffirmed at the Toronto Summit in June 2010 in a manner that is appropriate for Canadian markets;
- harmonizing regulatory oversight to the extent possible with international jurisdictions in order to facilitate global markets and limit the potential for regulatory arbitrage and a flight of capital; and
- avoiding causing undue harm to Canadian markets.

The Working Group agrees that the operational implementation of the recommendations contained in the Consultation Paper will involve considerable effort both in its design and implementation and should be the subject of further consultation papers.

The Working Group also agrees with the Committee that a tremendous amount of work must be done to provide clear direction for the development of legislation and jurisdictional authority in Canada prior to implementing any of the Committee's proposed regulatory reform for OTC derivatives. In addition, industry must be afforded sufficient time to develop the infrastructure, operational procedures and communications processes necessary to meet new legislation and regulations. Moreover, further policy development will be required as international standards crystallize for the regulatory reform of OTC derivatives markets.

The Working Group commends the Committee for recognizing in each of the subject areas addressed in the Consultation Paper, that clear jurisdictional authority in each province, as well as specific rule-making powers, will need to be set out in provincial securities and derivatives legislation and that implementation of many of the Committee's recommendations will necessitate the CSA's developing information sharing and co-operation agreements with international regulators, as well as foreign trade repositories and central counterparty clearing houses ("CCPs"). Coordination with foreign regulators is important to assure that the efforts of such foreign regulators does not result in the regulation of derivatives activity that would otherwise be jurisdictional to Canadian regulators.

The Working Group applauds the design of the Consultation Paper in that it puts all of the proposals together and solicits comment on derivatives reform as one, integrated regulatory paradigm. The Working Group agrees with the Committee that further study, analysis or consultation is needed in certain areas (*e.g.*, end-user exemptions and segregation of capital) before proposals or recommendations may be made. In taking this approach, the Working Group believes that the Committee is positioning Canadian regulators to develop an effective regulatory framework for Canadian OTC derivatives markets while at the same time avoiding some of the concerns that have been expressed about the U.S. process as U.S. regulators attempt to meet the tight timelines mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[2]

The Working Group recommends Canadian regulators consider the following matters when performing further analysis for future consultation papers that would support framing OTC derivatives regulation:

- Definitions of key categories, instruments and exemptions should be the first issues addressed.
- The contracts subject to OTC derivatives reform should be carefully defined.
- Any regulatory requirements should allow firms the flexibility to organize themselves and implement internal policies to meet these requirements. OTC derivatives regulation is not done well with a highly-prescriptive regulatory design, where firms must simply meet a myriad of requirements.[3]
- Not all derivatives markets are the same. Only broad regulatory requirements should apply across all derivatives markets. Canadian regulators should permit variation on more granular regulation between derivatives markets.
- Canadian regulators should continue to enter into "memorandums of understanding" with U.S. and other major international regulators that permit the free exchange of information to promote oversight and enforcement of derivatives markets. Entering into such memorandums of understanding recognizes the reality that derivatives markets are truly international in scope and that standardization among applicable regulatory jurisdictions promotes healthy, efficient and robust markets.

The G20 commitment generally describes the central features of OTC derivatives reform across the globe: exchange trading; central clearing; trade reporting; and capital requirements. The G20 commitment is not prescriptive, and allows regulators in each country flexibility on the design of OTC derivative reform. For example, the goals apply to "standardized" OTC

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[2] Please see the letter, dated December 7, 2010, submitted to the SEC and CFTC by several leading trade groups. A copy of this letter is attached as <u>Exhibit A</u>.

[3] We applaud the Committee's recognition that both market participants and regulators play a role in developing "standardized" contracts and infrastructure for the trading and clearing of such contracts, and that regulatory rulemaking will be better informed if such development is fostered and additional information becomes known.

derivatives contracts. What is a "standardized" derivatives contract is subject to interpretation and does not include all OTC derivatives contracts. Also, exchange trading requirements should apply only "where appropriate," which is again left to the regulators to define.

Canadian regulators should recognize the flexibility inherent in the G20 commitment. A significant portion of today's derivatives markets are readily adaptable to requirements for exchange trading and central clearing. However, a portion of the markets are not. This portion, among other things, is where counterparties trade on unique terms. These unique terms may be complex derivatives, derivatives not standardized or frequently traded, or specialized credit arrangements. The G20 commitment is not a mandate to apply stringent regulatory concepts on entire derivatives markets. (The exception being reporting, which the Working Group supports so long as the reporting process is reasonable and does not cause market aberrations.) Good derivatives regulation in Canada will preserve the ability of counterparties to trade on a purely bilateral basis when necessary.

B. CLEARING.

The Consultation Papers contains an exemplary discussion of the benefits, the costs and the risks that relate to centralized clearing. This form of objective analysis is welcomed. It avoids the frequently adopted view of central clearing as a panacea for all perceived problems in today's existing OTC derivatives markets.

Clearing is a useful and effective tool for reducing the counterparty risk borne by a transacting entity, but clearing does not eliminate risk. The Working Group is concerned that the issue of liquidity risk[4] has received too little discussion in the international debate about clearing and we look forward to participating in further discussions on this matter through the consultation process.

The Working Group supports the Committee's recommendation that a central clearing requirement apply only to standardized derivatives contracts. A definition of a "standardized contract" likely always will be elusive. The best solution is for central counterparties (each, a "CCP") to identify potential contracts that might fall under the central clearing requirements and, upon application by the CCP, for regulators to determine whether such contract is appropriate for central clearing. Regulators should provide notice and invite public comments as to whether a contract is appropriate for central clearing.

The creation of a Canadian CCP should be fostered by, but not required under, OTC derivatives reform as enacted in Canada. The Consultation Paper correctly recognizes that the success of a CCP depends on liquidity. It is in the best interest of the derivative markets that CCPs naturally attract transactional volume. Any regulatory requirement that a Canadian CCP be used potentially creates a disincentive for market participants to trade in contracts covered by

[4] By "liquidity risk," the Working Group refers to lack of accessibility to cash and cash equivalents that may result when a firm delivers such assets as collateral.

a clearing requirement. Also, many of the jurisdictional questions that arise when delineating which contracts must be traded on a Canadian CCP are very complex and not susceptible to "bright line" tests.

The Working Group recommends that Canadian regulators require that any CCP accepting contracts (i) entered into by Canadian entity or (ii) through which a firm takes a material position in a Canadian commodity be (a) comprehensively regulated under a demanding regulatory paradigm for derivatives and (b) provide access to Canadian regulators for monitoring and oversight purposes in the Canadian market.

Direct participation in a CCP should not be limited to financial entities. However, given mutualization of certain risks by clearing members to a CCP, membership should be limited by reference to certain financial standards.

As discussed below, the Working Group supports a robust exemption from the central clearing requirement for commercial firms when entering into hedges.

C. TRADE REPOSITORIES.

The Working Group strongly supports transparency in all derivatives markets and supports the mandatory reporting of all derivatives contracts to data repositories or regulators. As the Committee discusses in the Consultation Paper, there are many pragmatic issues to be addressed in requiring such mandatory reporting.

The Committee properly characterizes any specific timing requirements for reporting to be premature. A multitude of technological issues must be addressed to facilitate real-time reporting or even "near real-time" reporting for bilaterally traded derivatives. Currently, much of the trade reporting for bilaterally traded derivatives is done manually. The Working Group believes that the cost of real-time or near real-time reporting of transactions could be substantial.

Canadian regulators should evaluate what data they actually need to promote comprehensive monitoring and enforcement of derivatives markets in Canada. Canadian regulators might identify core data fields (*e.g.*, date, time, counterparties (perhaps the residency of each counterparty), underlying commodity/security, notional amount, type (swap, option, financial forward, swaption, etc.). Then, market participants can design trade data capture processes that might make these data points readily available to regulators or data repositories in a "real time" or "near real time" manner

As noted above, there are many jurisdictional issues that surround the regulation of derivatives. The Consultation Paper notes Canadian regulators should have data consolidated in a manner that allows provincial regulators meaningful access to data regarding derivatives markets. These jurisdictional issues and pragmatic issues might be solved by efficient regulatory design. For example, the reporting requirement might be fashioned as mandating that any derivatives contract (i) entered into by a Canadian entity or (ii) through which a firm takes a material position in a Canadian commodity must be reported (a) to the provincial regulator for the province in which such resident resides or (b) to a data repository that provides access to such provincial regulator. This design places the burden on market participants to assure that the applicable regulator receives access to the information. Again, it would facilitate matters if the Canadian regulators established the list of necessary data points. This requirement would also provide incentives to the commercial data repositories, regardless of the country in which they are organized, to provide data to Canadian regulators.

The Working Group believes that there is value in non-confidential information being made available to the public. However, this information should be generic and should only be published for markets where demonstrated liquidity has been established. If such liquidity is not present, the reporting of a single trade might inform other market participants of a position in which they might trade against and might serve to identify the parties to such trade. The Working Group urges the Canadian regulators to adopt workable standards for method and timing by which data is publicly reported by repository.

D. ELECTRONIC TRADING.

The Committee sets out a very balanced, objective discussion of benefits, costs and risks associated with exchange trading requirements in the Consultation Paper. The Working Group supports such measured consideration of regulatory requirements. In particular, the Working Group appreciates the Committee's recognition that some derivative contracts are not appropriate for exchange trading and the inability of parties to enter into such contracts, which are often tailored to meet unique risks, may introduce other risks into the financial system and the wider economy.

The Working Group does not oppose legislative developments authorizing Canadian regulators to mandate exchange trading with respect to certain contracts. However, mandatory exchange trading should only be required, if ever, where exchange trading is the only means for achieving pre-trade transparency. The availability of central clearing should not be a pre-determining factor for mandatory exchange trading. However, absence of central clearing ability should render a contract ineligible for any mandatory exchange trading requirement.

Speaking only with respect to the energy derivatives markets, the Working Group recommends that the Committee find that allowing market participants to determine whether or not to trade on the platform is the appropriate approach. The pre-trade transparency that is the policy driver for mandating exchange trading, in the collective view of the Working Group, is largely illusory. As a general rule, market forces determine whether or not a contract listed on an exchange will attract liquidity. If a contract trades in a liquid market, off exchange execution rarely results in a material price differential. If a contract trades in a non-liquid market, exchange listed prices may not necessarily reflect determinative pricing for off-exchange execution.

Traditionally-recognized dealers in the energy derivatives markets have no advantage in observing market pricing as compared to most energy firms. Pricing in these derivatives markets is largely tied to underlying physical markets. These prices are readily transparent. Among the considerations that a Canadian regulator might consider when determining whether or not to designate a contract for mandatory exchange trading is whether or not pricing may already be transparent without the requirement. This is particularly relevant in the energy sector.

E. CAPITAL AND COLLATERAL.

The imposition of capital and collateral requirements, as the Committee observes, will require considerable policy development with prudential regulators (*e.g.*, bank regulators) and consultations with industry. This policy development is essential, particularly as market participants have a wide variety of business models. Moreover, many significant market participants do not have business models that are readily susceptible to meeting the requirements of existing capital requirements, as such requirements are fashioned for financial firms. This is particularly true in the energy derivative markets where many active traders are commercial energy firms with a unique balance sheet with a variety of illiquid assets.[5]

The Working Group agrees with the Committee's assessment that capital and collateral requirements have the potential to advantage some firms over others, and that such requirements should be designed to mitigate any such advantages. This is particularly true for capital requirements. If capital requirements are set in a manner such that only financial firms could comply with them, then only financial firms will. This may prevent many creditworthy firms from being providers of liquidity in derivatives markets.

The Working Group does not support the promotion of standardization and central clearing as a policy object of capital and collateral requirements. Such a policy objective presupposes that centralized clearing is better than bilateral settlement. This supposition is not supported by vetted academic study. The Working Group looks forward to additional discussion regarding the potential liquidity risk that is created by clearing and margining. The Working Group remains concerned that the push to central clearing may only result in the creation of yet another "too big to fail" institution.

One particular statement in the G20 commitment warrants special comment, which is the proposal that non-centrally cleared contracts should be subject to higher capital requirements. The Working Group recommends that centrally cleared contracts should not be subject to capital requirements at all or, if capital requirements do apply, they should be *de minimis*. Capital

[5] Industrial firms, such as energy firms, often have invested permanent capital in assets that produce commodities or goods. These commodities and goods are then converted into revenues. This production and revenue stream often make such firms very creditworthy. However, unlike financial institutions, such industrial firms cannot readily convert their assets into cash.

For a comprehensive discussion of capital requirements as they may apply to commercial energy firms, we encourage the Committee to review comments, dated November 24, 2010, submitted to the CFTC.

requirements address systemic risk issues. If the requirement for central clearing rests on the presumption that central clearing reduces systemic risk (a questionable tenet), [6] then there should be no reason for redundant and costly capital requirements for centrally cleared contracts. If Canadian regulators recognize this redundancy and therefore apply little or no capital requirements to cleared derivatives, then capital requirements will apply primarily to non-centrally cleared derivatives. Thus, it would be easy for Canadian regulators to meet this proposal in the G20 commitment.

If Canadian regulators impose more-than-*de minimis* capital requirements on cleared-derivatives, then they should provide a rational basis for imposing high capital requirements on uncleared derivatives. The Working Group believes that no sufficient rational basis exists beyond mitigation of systemic risk that would permit material differences in the capital requirements for cleared and uncleared derivatives. Thus, if Canadian regulators do impose capital requirements on cleared derivatives, then the capital requirements for uncleared derivatives should be only slightly greater.

Capital or Collateral Requirements should not be imposed on commercial end-users of OTC derivatives. These firms do not present risk to the financial system by virtue of their derivatives activities. Thus, any such requirements will only result in increased costs to commercial end-users without any resulting benefit to derivatives markets. To the extent that a regulator might affirmatively find that a commercial end-user does present systemic risk through its derivatives trading activities, capital or collateral requirements might be appropriate.

Canadian regulators should adopt collateral requirements that (a) preserve the ability of counterparties to enter into contractual arrangements that net exposures across all outstanding transactions in a trading relationship, including transactions that are not derivatives, when calculating collateral requirements and (b) require delivery of collateral only for net exposure that exceeds reasonable unsecured credit thresholds specified in agreements between counterparties.

F. END-USERS AND SIGNIFICANT MARKET PARTICIPANTS.

The Working Group is generally supportive of the Committee's proposal to establish an exemption from most proposed recommendations for a defined category of hedging non-financial end-users whose activities do not pose a systemic risk. Such users of derivatives constitute only a small portion of the market and hedging transactions either pose little to no systemic risk or actually reduce systemic risk.

Defining what constitutes an "end-user" is a perilous task. The definition can be subject to criticism as over- or under-inclusive. The Working Group believes the term should be left

[6] Although the G20 commitment is not explicit about this presumption, it is properly inferable. The central flaw in this tenet is that, by requiring central clearing, regulators move from a market design in which counterparty risk is defused among several participants and largely concentrates that risk in a new "too big to fail" market participant.

undefined. The exemptions should be styled as available to all market participants other than those participants Canadian regulators identify as ineligible, such as certain financial firms.

The Working Group recognizes that establishing an exemption for hedging non-financial end-users poses certain classification issues. For example, what transactions should be considered hedge transactions? The Working Group respectfully suggests that the Committee look to the CFTC's proposed definition of commercial risk as a starting point.[7] The CFTC's proposed definition covers a set of transactions that properly reflects the breadth of hedging transactions entered into by non-financial end-users to mitigate legitimate business risks.

The Working Group believes that any certification process required for non-financial end-users to avail themselves of any exemptions should be simple and efficient and should not place an inordinate burden on end-users.

G. ENFORCEMENT.

The Working Group supports legislation in Canada that provides regulators with the proper tools to monitor derivatives markets, prevent disruptive and manipulative trading practices, and enforce laws to maintain orderly markets.

The Consultation Paper places record keeping requirements and position limits in this same section as traditional market enforcement measures. While these do play a limited role in the maintenance of orderly derivatives markets, it should be noted that they apply to non-

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7 Proposed Exchange Act Rule 3a67-4 provides:

"Hedging or Mitigating Commercial Risk

For purposes of section 3(a)(67) of the Act, 15 U.S.C. 78c(a)(67) and §240.3a67-1 of this chapter, a security-based swap position shall be deemed to be held for the purpose of hedging or mitigating commercial risk when:

(a) Such position is economically appropriate to the reduction of risks that are associated with the present conduct and management of a commercial enterprise, or are reasonably expected to arise in the future conduct and management of the commercial enterprise, where such risks arise from:

(1) The potential change in the value of assets that a person owns, produces, manufactures, processes, or merchandises or reasonably anticipates owning, producing, manufacturing, processing, or merchandising in the ordinary course of business of the enterprise;

(2) The potential change in the value of liabilities that a person has incurred or reasonably anticipates incurring in the ordinary course of business of the enterprise; or

(3) The potential change in the value of services that a person provides, purchases, or reasonably anticipates providing or purchasing in the ordinary course of business of the enterprise;

abusive, regular traders. Thus, the Committee should carefully determine what the associated costs of such requirements might be. Requirements such as position limits, should not interfere with legitimate trading activity in the derivatives markets. If they do, then the market likely suffers as a whole.

H. Segregation of Collateral.

The segregation of collateral has not been a principal concern for the Working Group. In general, the Working Group advocates that (a) collateral segregation not be mandatory and the ability of counterparties to negotiate terms with respect to the handling of collateral should not be impaired, and (b) segregation requirements should not force end-users to incur costs.

II. Conclusion.

The Working Group supports tailored regulation that brings transparency and stability to the energy derivative markets in Canada. We appreciate the balance Canadian regulators must strike between effective regulation and not hindering the energy derivative markets. The Working Group respectfully requests that the Committee consider its comments set forth herein regarding the Consultation Paper.

The Working Group looks forward to further consultation papers prior to the creation of legislation and regulations supporting the design and implementation of these reforms.

If you have any questions, or if we may be of further assistance, please contact the undersigned.

Respectfully submitted,

/s/ David T. McIndoe
David T. McIndoe
Mark W. Menezes
R. Michael Sweeney, Jr.

Counsel for the
Working Group of Commercial Energy Firms

American Bankers Association
ABA Securities Association
The Clearing House Association L.L.C.
Financial Services Forum
Financial Services Roundtable
Futures Industry Association
Institute of International Bankers
International Swaps and Derivatives Association
Investment Company Institute
Managed Funds Association
Securities Industry and Financial Markets Association

December 6, 2010

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

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

Re: Comment Periods and Implementation of New Derivatives Regulations

Dear Ms. Murphy and Mr. Stawick:

As trade associations representing market participants that account for most of the activity in various derivatives markets in the United States and globally, we are highly interested in the development and implementation of new rules governing derivatives. Swaps and other derivatives are important financial tools used by asset managers, insurance companies, banks, and the vast majority of the largest commercial and industrial companies to manage risk. Adoption of new regulatory rules for derivatives pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") will provide the much-needed certainty that providers and users of derivatives products require.

Derivatives play an important role in our economy. The markets for these products are large and diverse, with rules and conventions governing trading activity that have developed over decades. Thus, it is important that the Securities and Exchange Commission ("SEC"), Commodity Futures Trading Commission ("CFTC") (together, the "Commissions"), and other agencies writing the new regulatory rules develop those rules through a process that is deliberative, gives all affected parties a reasonable opportunity to comment (and have their comments be given thoughtful consideration), and implements those rules in a manner that gives market participants sufficient time to do the work necessary to comply with new requirements being imposed on them. If the process does not have these attributes, the result will be rules that not only do not reflect full participation in the comment process, but actually undermine regulatory certainty, with the effect of unnecessarily interfering with the functioning of markets and the usefulness of important financial tools.

We appreciate that Dodd-Frank imposes short and strict deadlines by which each agency must adopt various rules and that many of these concern activities and products that are complex and new to regulatory oversight. We commend the SEC and CFTC for their diligence and dedication with regard to this unprecedented rulemaking endeavor. We believe, however, that the Commissions should consider making certain changes in the rulemaking process, as discussed below.

Specifically, we are concerned that the order in which rules are being published for comment makes it difficult for many firms to know whether they should submit comments on particular rules, and also to determine what the substance and extent of their comments should be. For example, on November 10, 2010, the CFTC approved issuance of proposed rules on six different topics, including among other things conflicts of interest, chief compliance officers, and registration of swap dealers and major swap participants ("MSPs"). In each case, these rules might raise significant issues for swap dealers and MSPs, but not be particularly significant for other entities. The timing of the issuance of these rules is problematic because the Commissions have only recently (in open meetings of the CFTC on December 1 and the SEC on December 3) addressed the terms "swap dealer" and "major swap participant" in proposed regulation. Without guidance as to the scope of these definitions, some firms – in particular, smaller firms – were (and are) uncertain whether they should comment on the rules that apply to swap dealers and MSPs, because they did not know whether these rules would apply to them. Preparing comment letters requires significant time and expense and firms are reluctant to incur the cost of commenting unnecessarily. To give all possibly affected parties an opportunity to comment on relevant proposed rules, we recommend the CFTC and SEC extend the comment deadlines for rules that utilize terms that were not defined when the rules were published so that those comment deadlines are at least no earlier than the deadlines applicable to the rules defining the terms.

We also are concerned about a process that provides for provisional registration of entities prior to adoption of final rules defining the various categories of registrants and establishing their respective obligations. A more logical sequence would first adopt definitions for the different regulated entities, then requirements for such entities, and finally registration of such entities. Such a sequence would better serve both market participants and the public.

With respect to the implementation process for new rules, we are concerned that market participants will be asked to do too much in too short a time. We agree with other commentators who have observed that application of Dodd-Frank's clearing and execution provisions across the full or a broad range of different types of swaps within a relatively short period would likely impose a compliance burden with which market participants, and in particular dealers, simply could not comply. Further, mandating the implementation of reporting requirements in the same short period as implementation of clearing and execution requirements increases the likelihood that market participants will be unable to comply. Their only alternative would be to stop entering into the transactions for which compliance is not immediately possible, thus leaving segments of the market with diminished or possibly no liquidity. This could have significant adverse consequences for the customers that rely on these products and it would be inconsistent with the risk reduction goals of Dodd-Frank. To implement a complex new regulatory structure without adequate time to adapt, prepare, and test systems also could lead to an ineffective or poorly designed reporting, clearing, and exchange infrastructure, which also would impair liquidity, and lead to higher costs, increased risk, and other adverse consequences.

Implementing clearing and execution requirements without thoroughly analyzing the ability of particular asset classes to absorb the changes carries a number of other risks as well. Clearing, for example, is an extraordinarily complex undertaking that requires significant adaptation to existing (and development of new) technology systems, operational infrastructure, and legal arrangements between parties. As new clearinghouses proliferate and compete, the early-mover advantage may entice some clearinghouses to start clearing products before they are truly ready from an operational standpoint. Problems are likely to develop, and significant disruption of the markets for certain asset classes can be expected. Similar problems are likely to arise with trade execution requirements, where liquidity considerations should play a primary role in driving implementation timeframes. In all of these instances, premature imposition of new rules can, and likely will, lead to increased risks for markets and market participants.

We respectfully note that the CFTC and SEC have discretion in determining when new regulatory measures will become applicable. For example, section 754 of Dodd-Frank provides that the provisions of Title VII, Subtitle A (covering Regulation of Over-the-Counter Swaps Markets) that require rulemaking "shall take effect . . . ***not less than*** 60 days after publication of the final rule or regulation" (emphasis added). This language reflects an understanding that regulated entities need sufficient time to comply (*i.e.*, the effective date must be no less than 60 days, but *can* be more). A corresponding provision is contained in section 774 of Subtitle B (Regulation of Security-Based Swap Markets).

The CFTC has demonstrated its willingness to use its regulatory discretion under Dodd-Frank to address impossible or impractical requirements. For example, in establishing the effective date for interim reporting of pre-enactment swaps, the CFTC noted that although the legislation imposed reporting requirements that became effective upon enactment of Dodd-Frank, there are no registered data repositories to accept the data, nor is the CFTC *ready* to accept it. Accordingly, the CFTC provided in its interim final rule that the obligation to report such transactions would not become effective until the compliance date for reporting under section 2(h)(5) of the Commodity Exchange Act or "within 60 days after a swap data repository becomes registered . . . and commences operations to receive and maintain data related to such swap, whichever occurs first." We believe it is important for the CFTC, SEC, and other agencies to utilize their discretion in this manner where it is appropriate, including situations where the demands placed upon regulated entities would make it impossible or impractical for them to comply in accordance with the most restrictive time limits provided in the legislation. Accordingly, we urge regulators to take into account the practical realities facing market participants and to phase-in the application of new regulatory requirements over a reasonable period of time, determined through discussions with the market participants that the agencies expect to be directly affected by those requirements.

We are committed to working with the SEC and CFTC to develop and implement the rules mandated by Dodd-Frank, and we strongly support completion of these efforts in a prompt and timely fashion. We urge the Commissions to use their discretion to propose, adopt, and implement rules in a sequence that will achieve these important goals.

If you would like to discuss our concerns further, please contact any of us at your convenience.

Respectfully submitted,

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International Swaps and Derivatives Association
Investment Company Institute
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