



April 9, 2013

Via Electronic Mail

Gary Barnett
Director, Division of Swap Dealer and Intermediary Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Request for Prompt and Appropriate Relief for Intermediated Trading Relationships from the Final Rules on Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties

Dear Mr. Barnett:

Managed Funds Association (“MFA”)¹ respectfully requests that the Commodity Futures Trading Commission (the “Commission”) provide prompt and appropriate relief from its final rules on “Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties” (the “**External Business Conduct Rules**”)² prior to the May 1, 2013 compliance date³ for: (1) intermediated trading, (2) of all classes of products (*e.g.*, foreign exchange, rates and credit products), (3) where the prime broker or intermediary is acting in its capacity as a prime broker or intermediary (“PB”), and (4) the PB and executing dealer (“ED”) are both swap dealers (“SDs”).⁴ MFA broadly supports the goals of the External Business Conduct Rules and their general application to SDs and their trading with counterparties.

¹ Managed Funds Association represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

² 77 Fed. Reg. 9734 (February 17, 2012), available at <http://www.gpo.gov/fdsys/pkg/FR-2012-02-17/pdf/2012-1244.pdf>.

³ See Commission extension of compliance dates; request for comment on “Business Conduct and Documentation Requirements for Swap Dealers and Major Swap Participants; Extension of Compliance Date”, 78 Fed. Reg. 17 (January 2, 2013), available at <http://www.cftc.gov/ucm/groups/public/@Irfederalregister/documents/file/2012-30885a.pdf>, delaying the compliance date for the relevant External Business Conduct Rules to May 1, 2013.

⁴ We note that this issue exists: (1) in both the cleared and uncleared markets (*i.e.*, in the cleared market, the derivatives clearing organization is the intermediary), and (2) in intermediated trading relationships where the ED is not an SD. We ask that the Commission also consider what relief may be appropriate in these situations as well.

However, due to the practical issues resulting from the rules, as outlined below, we are concerned that, without relief, existing intermediated trading relationships will be disrupted and market liquidity will diminish.

A. Structure of Prime Brokerage Arrangements

MFA's buy-side members broadly employ prime brokerage arrangements for derivatives trading. Under such arrangements, a customer establishes a direct relationship with one or more PBs that provide a variety of services to the customer (e.g., financing, securities lending, cash management, etc.). In particular, a PB will serve as an intermediary by allowing its customer to negotiate trades with any number of EDs with whom the PB has a direct credit relationship, but ultimately, the customer will derive the economic benefit of the trade by entering into the trade PB while the PB enters into an identical trade with the ED. As a result, under such prime brokerage or intermediated trading relationships, our members are customers to SDs use such trading relationships to, among other things:

- (1) minimize the number of firms they face thereby simplifying management of their counterparty credit risk,
- (2) eliminate the need for them to enter into trading documentation with each ED with which they want to trade, and
- (3) increase their collateral efficiencies by permitting PBs to net the customers' collateral obligation across all trades handled by the PB.

These arrangements are well-established and provide for practical and efficient trade execution, clearance and settlement across a broad range of financial products.

B. Practical Issue for Intermediated Trading

As the Commission knows, Section 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act⁵ amended Section 4s(h) of the Commodity Exchange Act and provided the Commission with authority to prescribe rules intended to protect customers by, among other things, imposing duties, disclosure requirements, and "know your counterparty" obligations on SDs and major swap participants. The purpose of these rules is to prevent fraud, manipulation and other abusive practices involving swaps. In response to this Congressional grant of authority, the Commission adopted the External Business Conduct Rules, which place various obligations on SDs with respect to their counterparties.

The External Business Conduct rules impose requirements that fall into one of two categories. First, the rules impose responsibilities that relate to the general relationship between the SD and its counterparty, including for example, "know-your-counterparty" obligations, requirements to disclose material incentives and conflicts of interest and other related relationship-level responsibilities ("**Relationship-Level Business Conduct Standards**").

⁵ Pub. L. 111-203, 124 Stat. 1376 (2010), available at: <http://www.gpo.gov/fdsys/pkg/CRPT-111srpt176/pdf/CRPT-111srpt176.pdf>.

Second, there are requirements that impose responsibilities that are specific to the trade entered into between the SD and its counterparty. These requirements include, for example, obligations for the SD to provide to the counterparty pre-trade mid-market quotes, risk disclosures and scenario analyses (“**Transaction-Level Business Conduct Standards**”).

The External Business Conduct Rules impose both the Relationship-Level Business Conduct Standards and the Transaction-Level Business Conduct Standards on a customer’s SD counterparty because the rules presume that the SD counterparty has a direct relationship with and knows the customer, provides the mid-market quotes and scenario analyses to the customer, and negotiates the trade terms with the customer. However, for intermediated trading, one SD does not provide all of those services. Rather, one SD (a PB or other intermediary) has a direct relationship with the customer, knows the customer and becomes counterparty to both the customer and its ED when it steps into the trade by entering into identical back-to-back trades with the customer and its ED on the terms agreed to by the customer and the ED. In addition, a second SD (the ED, which typically does not know the customer’s identity) provides the mid-market quotes, scenario analyses and negotiates the terms of the transaction. In such intermediated trading, we believe that it is appropriate and feasible for only the PB to comply with the Relationship-Level Business Conduct Standards and for only the ED to comply with the Transaction-Level Business Conduct Standards. The External Business Conduct Rules do not account for such intermediated trading relationships, and thus, do not provide for or allow proper allocation of these responsibilities between the PB and ED. As a result, we request Commission relief so that customers’ intermediated trading relationships may continue to exist uninterrupted in their current form.

C. Justification for Requested Relief

As discussed above, intermediated trading necessitates a division of the responsibilities in the External Business Conduct Rules between the PB and ED. Because the External Business Conduct Rules do not provide for such a division, we are concerned that, without the Commission providing appropriate relief prior to May 1, 2013, the market for intermediated trading will be halted, or at least significantly impacted. For example, to comply with the External Business Conduct Rules, trading on all classes of products would need to occur bilaterally. Since customers and PBs do not necessarily have bilateral, contractual relationships with all EDs with which customers may trade, many customers and PBs would need to negotiate and enter into the necessary documentation and EDs, which can be a lengthy process and would delay trading. This disruption to trading would harm market liquidity, customers’ management of their counterparty credit risk and customers’ efficient use of their collateral.

Accordingly, MFA requests that the Commission provide appropriate relief from the External Business Conduct Rules for intermediated trading, which we believe is necessary, consistent with the intent of the External Business Conduct Rules (*i.e.*, to protect customers while preventing fraud, manipulation and other abusive swap practices) and will ensure that customers can continue to maintain their existing intermediated trading relationships. We emphasize that we believe any such relief should apply to: (1) all intermediated trading relationships, (2) related to any class of products, (3) where the SD is acting in its capacity as a PB, and (4) where both the PB and ED are SDs. We believe that limiting the scope of the relief

Mr. Barnett
April 9, 2013
Page 4 of 4

in this manner will ensure that the Commission addresses the intermediated trading relationships of concern to customers, while also being sufficiently narrow to prevent evasion of the otherwise necessary and protective obligations in the External Business Conduct Rules.

We appreciate your consideration of our request for appropriate relief for intermediated trading relationships. We would welcome the opportunity to discuss our views in greater detail. Please do not hesitate to contact the undersigned or Carlotta King at (202) 730-2600 with any questions the Commission or its staff might have regarding this letter.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President, Managing Director &
General Counsel

cc: The Hon. Gary Gensler, Chairman
The Hon. Bart Chilton, Commissioner
The Hon. Jill E. Sommers, Commissioner
The Hon. Scott D. O'Malia, Commissioner
The Hon. Mark P. Wetjen, Commissioner

Frank Fisanich, Division of Swap Dealer and Intermediary Oversight
Ward Griffin, Division of Swap Dealer and Intermediary Oversight
Katie Driscoll, Division of Swap Dealer and Intermediary Oversight