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COMMENT

February 10, 2009

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

Re: Comments on Proposed Rules Implementing the CFTC Reauthorization Act of 2008

Dear Mr. Stawick:

This letter contains the response of the International Swaps and Derivatives Association, Inc. ("ISDA") to the request for comments issued by the Commodity Futures Trading Commission (the "Commission") regarding the implementation of the CFTC Reauthorization Act of 2008 ('CRA'), specifically the creation of a new regulatory category - Exempt Commercial Markets ("ECMs") with Significant Price Discovery Contracts ("SPDCs"). The request for comments contained background information on the creation of ECMs and subsequent issues arising from the changing nature of the energy markets, all of which were published in the Federal Register on December 12, 2008 (73 Fed. Reg. No. 240 at 75887 *et seq.*) (the "Release").

ISDA, which represents participants in the privately negotiated derivatives industry, is the largest global financial trade association, by number of member firms. ISDA was chartered in 1985, and today has over 800 member institutions from 56 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities

Background

As part of the Food, Conservation and Energy Act of 2008, Congress passed the CFTC Reauthorization Act of 2008 ('CRA'). Among other provisions, the CRA expands the Commission's authority to provide additional oversight of ECMs, which have grown significantly since their inception in 2000. The CRA also directed the Commission to adopt regulations implementing the provisions of the CRA. ISDA commends the Commission for its careful consideration of the issues raised in the CRA and its thoughtful development of the Release. The implementation of the Release will allow ECMs to operate efficiently, providing commercial participants with legal certainty and market stability. ISDA believes that increased accountability and transparency in ECMs will ensure that they accurately reflect fundamental market forces and will reduce the opportunity for market manipulation that causes severe market disruptions. However, ISDA also has several concerns with the Release as drafted and welcomes this opportunity to shares its thoughts on these issues.

Volume Accountability Limits. We believe that the Release goes beyond the Commission's mandate in the CRA by requiring accountability levels for uncleared SPDCs listed on an ECM. Uncleared SPDCs would be subject to a new measure of trading activity, the "volume accountability level," which would operate in a manner similar to position accountability rules. This requirement would obligate an ECM to track each trader's net uncleared transactions and to initiate an investigation if a trader's net volume exceeds the volume accountability limit. If the trading activity is not justified, the ECM should require the trader to reduce the volume of uncleared trades. This provision undermines the function of bilateral contracts and would even apply to long-term uncleared contracts between commercial participants with established bilateral credit lines. The potential for forced liquidation of uncleared trades will discourage activity on the ECM and thereby reduce market liquidity.

Moreover, the CRA only requires ECMs to adopt position limits or position accountability for "agreements, contracts, and transactions that are treated by a derivatives clearing organization."[1] The CRA does not give the Commission the authority to set limits for uncleared trades. Congress prudently recognized that the same types of limits cannot feasibly be imposed on uncleared contracts as on cleared contracts. The Release should be modified in a manner consistent with the CRA.

Speculative Position Limits. Under the Release, ECMs would be required to adopt speculative position limits for SPDCs that are "economically equivalent" to contracts traded on a DCM, at the same level as the related DCM contract. However, the Release does not provide guidance as to how ECMs will identify "economically equivalent" contracts on DCMs and the provision will therefore require ECMs to make

[1] Title XIII of the Food, Conservation and Energy Act of 2008, Pub. L. No. 110-246, 122 Stat. 1624 (June 18, 2008) at Sec. 13201 (C)(ii)(IV).

highly subjective judgments as to whether or not a particular SPDC is "economically equivalent" to a DCM contract. Moreover, requiring an ECM to adopt the same limits imposed by an unaffiliated DCM can be anti-competitive and provides the DCM with significant authority over trading on the ECM. It would allow DCMs to set the position limits even when the ECM is the dominant market. This would permit a DCM to set a limit at such a low level that it would effectively prohibit equivalent transactions on an ECM, thereby stifling competition. In addition, ECMs with SPDCs have independent regulatory responsibilities and there is no reason to believe that they could not establish appropriate position limits. The Commission should consider modifying the language so that an ECM has the authority to establish its own position limits, at a level that is appropriate in light of its market as well as any related DCM market.

The Release also recommends that ECMs adopt as an "acceptable practice" non-spot individual month and all-months-combined position limits, based on the analogous rules adopted by some DCMs.[2] However, these rules have not been adopted by DCMs on an industry-wide basis nor has the industry come to agreement on their added benefit in relation to uniform position accountability limits. The Commission should take a comprehensive approach to position limit requirements and this proposal should be addressed in new regulations promulgated by the Commission. This will provide DCMs and ECMs the opportunity to comment on the feasibility of applying these rules, taking into account the specific commodity and the manner in which it trades.

Compliance with Core Principles. If an agreement, contract or transaction listed on an ECM is determined to qualify as a SPDC, the Release requires the ECM to demonstrate compliance with the Core Principles within 90 calendar days from the Commission's order designating the SPDC. This timeframe is reasonable and allows market participants to make the necessary changes to their trading systems to ensure compliance with the Core Principles. However, for each subsequent determination, an ECM is only allowed 15 calendar days to comply. This timeframe should be modified, recognizing the additional obligations compliance imposes on and the likely system changes required of ECM participants.

Reference to Clearing Members and other Brokers. The Release makes several references to clearing members, foreign brokers and traders who are "carrying" the account and/or "carrying" large positions on ECMs. In addition, there are references to large trader reporting, which also relates more to brokers, not market participants.[3] These terms are not defined in the Release. For example, the discussion in the *Market, Transaction and Large Trader Reporting Rules* section refers to "ECM clearing members

[2] 73 FR 75896, see Footnote 59 (December 12, 2008).
[3] 73 FR 75896 (December 12, 2008).

that clear SPDCs" and to accounts on ECMs "carried by such brokers."[4] The *Cost Benefit Analysis* section discusses the role of brokers in monitoring and reporting large SPDC positions held in accounts "carried by" brokers.[5] And the discussion of the applicability of the Regulatory Flexibility Act states that "clearing members, foreign brokers and traders would be subject to the proposed regulations only if carrying or holding large positions."[6] However, ECMs, by definition, are principal-to-principal markets that do not permit brokers. As a result the obligations of the ECM in this context are unclear. All references in the Release to clearing members, brokers, foreign brokers, persons "carrying" large positions, and large trader reporting should be clarified to take into account the nature of ECMs.

Conclusion

The public policy rationale for the CRA is to protect energy markets from trading practices that significantly distort energy prices from their fundamental values based on supply and demand. The CRA balances the need for commercial innovation, while carefully providing additional regulatory authority to the Commission to ensure market protection. ISDA believes that public policy is best served by implementing the CRA, without unnecessarily expanding its scope. To that end, the Release outlines regulatory provisions that will provide additional accountability and transparency to ECMs, which ISDA welcomes. However, ISDA is concerned with certain provisions in the Release highlighted in this letter that may create uncertainty for commercial participants on ECMs as to their legal requirements. Such confusion fails to achieve the objectives of the CRA.

ISDA appreciates the opportunity to provide these comments. Should you require any further information, please do not hesitate to contact the undersigned.

Sincerely,

Gregory Zerzan
Counsel & Head of Global Public Policy
North American Regulatory Committee
International Swaps and Derivatives Association, Inc.

[4] 73 FR 75896 (December 12, 2008).
[5] 73 FR 75899 (December 12, 2008).
[6] 73 FR 75900 (December 12, 2008).