February 14, 2011

VIA EMAIL
Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing (File Number S7-44-10)

Dear Ms. Murphy:

The American Federation of State, County and Municipal Employees ("AFSCME") is the largest union in the AFL-CIO representing 1.6 million state and local government, health care and childcare workers. AFSCME members participate in over 150 public pension systems whose assets total over $1 trillion. In addition, the AFSCME Employees Pension Plan (the "Plan") is a long-term shareholder that manages $850 million in assets for its participants, who are staff members of AFSCME and its affiliates.

During consideration of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), AFSCME strongly supported the inclusion of provisions establishing the strongest possible market reforms, oversight and transparency for the "shadow markets" – principally the over-the-counter ("OTC") market that has grown to a size that dwarfs other, more transparent, derivatives markets.

The Importance of Strong Derivatives Regulation is Undeniable

Before passage of Dodd-Frank, OTC derivatives – including interest rate swaps, foreign exchange contracts, equity swaps, commodity swaps, credit default swaps, and others - were described as bilateral agreements between sophisticated parties. As such, OTC derivatives contracts were not subject to obligations to trade on regulated exchanges and clear through regulated clearinghouses – obligations that apply to other segments of the derivatives markets.

The need to bring OTC derivatives into these regulated markets is demonstrated in the public record of analyses from the months following the crisis in the financial industry, and in the economy, "It is widely acknowledged that OTC

derivatives contracts, and particularly CDS, played a significant role in the current financial crisis. Although OTC derivatives have been justified as vehicles for managing financial risk, they have also spread and multiplied risk throughout the economy in the current crisis, causing great financial harm."[1]

With the passage of Dodd-Frank – and strong implementation – standardized swap contracts, with some exceptions, will be entered into on regulated exchanges or swap execution facilities. This will improve the extent to which buyers and sellers meet in an open marketplace where prices are publicly available. Standardized swaps will be cleared through a regulated clearinghouse charged with acting as intermediary to the transaction, collecting and protecting collateral from the parties. Regulated clearinghouses will mitigate counterparty risk for individual transactions as well as the systemic risk that can build invisibly.

Strong Implementation of Clearing Requirements is Critical to Economic Security

Strong rules regarding mandatory clearing are vital to the operation of a derivatives marketplace that earns investor confidence. As Chairman Schapiro noted when the Commission approved this proposed rule addressing the review process for mandatory clearing determinations, "Promoting clearing wherever possible and appropriate is a key to building a regulatory framework for the derivatives market. . . . Through the clearing process itself, regulators will be more easily able to monitor transactions including prices and positions taken by traders, and thereby rein in the risks associated with these investments."[2]

Strong "Process" Requirements are Key to Managing Counterparty Risk

The Commission is required to establish procedures whereby clearing agencies submit to the Commission information on security-based swaps they propose to clear. The information must fulfill the following criteria:

- address qualitative and quantitative information regarding the five factors which the statute requires the Commission to consider in making determinations as to whether clearing is mandatory;

- explain how the rules of the clearing agency making the submission provide for open access; and

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[1] "U.S. Financial Regulatory Reform: The Investors' Perspective", Investors Working Group, an Independent Taskforce Sponsored by CFA Institute Centre for Financial Market Integrity and Council of Institutional Investors, published in July 2009, submitted to the Federal Reserve Board September 22, 2010.

[2] SEC Release 2010-243, "SEC Proposes Review Process for Mandatory Clearing of Security-Based Swaps Under Dodd-Frank Act"

- provide the public with notice of the submission within two days by disclosing it on the agency's website, to be followed by a 30-day period for public comment to the Commission regarding the clearing decision it must make.

The five factors to be addressed in each submission for a determination regarding mandatory clearing, "to the extent they are applicable to the security-based swap, the clearing agency and the market" are as follows:

1. The existence of significant outstanding notional exposures, trading liquidity and adequate pricing data;
2. The availability of a rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded;
3. The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the clearing agency available to clear the contract;
4. The effect on competition, including appropriate fees and charges applied to clearing; and
5. The existence of reasonable legal certainty in the event of the insolvency of the relevant clearing agency or one or more of its clearing members with regard to the treatment of customer and security-based swap counterparty positions, funds, and property.

Investor Protection Requires Definitive, Specific Information Parameters

The proposed rules give examples of the kinds of information that "might" be responsive to the factors that the Commission must, by statute, evaluate. We are troubled by the tentative tone of these examples. Given the losses suffered by investors, the Commission must prioritize specifying the content of a valid submission for mandatory clearing. Investors must have a concrete basis for evaluating a mandatory clearing determination. The Commission itself requires a basis for its immediate decisions as well as its statutory obligation to conduct ongoing reviews to determine what should be subject to mandatory clearing. We urge the Commission to revise and adopt these examples so that they are definitive:

> *"For example, in connection with the discussion responsive to factor (i) above, the clearing agency* ***could*** *address pricing sources, models and procedures demonstrating an ability to obtain price data to measure credit exposures in a timely and accurate manner, as well as measures of historical market liquidity and trading activity, and expected market liquidity and trading activity if the security-based swap is required to be cleared (including information on the sources of such measures).*
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> *"With respect to the discussion of factor (ii) above, the statement describing the availability of a rule framework could include a discussion of the rules, policies or procedures applicable to the clearing of the relevant security-based swap. Additionally, the discussion of credit support infrastructure* ***could*** *include the methods to address and communicate requests for, and posting of, collateral.*
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> *"With respect to factor (iii) above, the discussion of systemic risk* ***could*** *include a statement on the clearing agency's risk management procedures, including among other things the measurement*

and monitoring of credit exposures, initial and variation margin methodology, methodologies for stress testing and back testing, settlement procedures and default management procedures.

"With respect to factor (iv) above, the discussion of fees and charges ***could*** *address any volume incentive programs that may apply or impact the fees and charges.*

"With respect to factor (v) above, the discussion ***could*** *address segregation of accounts and all other customer protection measures under insolvency."*

We urge the Commission to draft rules that mandate the disclosures and discussions outlined in the examples suggested above. At a minimum, the Commission must replace the word "could" with the word "shall" in the list of required disclosure. Similarly, the proposed rules ask, *"should a clearing agency be required to include in its Security-Based Swap Submissions specific product specifications, including copies of any standardized legal documentation, generally accepted contract terms, standard practices for managing and communicating any life-cycle events associated with the security-based swap and related adjustments, and the manner in which the information contained in the confirmation of the security-based swap trade is transmitted?"* We urge the Commission to adopt these requirements.

The Commission appears to take great pains to emphasize the existing entities with registration obligations to which disclosure obligations will fall, and their existing reporting requirements. Great effort is undertaken to minimize new forms and new filing deadlines. Similar attention to detailed specifics must be given what the investing public will be able to review as a basis for its comment regarding a mandatory clearing determination.

Worker retirement savings were eroded by the systemic risk of unregulated derivatives, and these same instruments continue to threaten our economy. Suggestions and "examples" of disclosure that "could" form a basis for determinations that may be stayed, appealed and otherwise challenged are insufficient to protect investors. Furthermore, when the resources of the Commission are as stretched as they are – by the explosion in the size and complexity of the work you must do and the hundreds of trillions in notional value you must oversee, as well as other threats to your budget –clear and concrete disclosure obligations that the public can use will be one of the most important, efficient, and independently useful tools possible. As one official said recently in a public meeting discussing the importance of public disclosure when resources are limited, "it's the least we can do."

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We appreciate the opportunity to express our views on this matter.

Sincerely,

GERALD W. McENTEE
International President