International Swaps and Derivatives Association, Inc.

Comments to the Anti-Manipulation NPRM

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About ISDA

- ISDA is the global trade association representing participants in the privately negotiated derivatives industry.
- Over 670 member entities from 47 countries.
- Many ISDA members purchase and sell wholesale petroleum products and other energy commodities, and trade derivatives contracts based upon notional quantities of such commodities.
- ISDA developed the ISDA Master Agreement, the form of trading agreement that is the recognized standard in the derivatives industry, and is developing a physical annex that will be used to trade wholesale petroleum products.

ISDA’s Interest In Competitive Markets

- ISDA’s goal is to help the Staff draft a Rule that will protect markets from manipulative activity without inhibiting competition.
- ISDA members have an interest in supporting healthy and competitive markets free from manipulative activity.
- A competitive market is the best partner to an active enforcement regime.

NPRM Achievements

ISDA commends the Staff for:

- Focusing the proposed Rule on prohibiting fraudulent practices.
- Clarifying that the proposed Rule does not impose affirmative disclosure requirements on sophisticated commercial market participants that are capable of protecting their interests in bilateral negotiations.

Proof of Specific Intent and Market Effect

- An enforcement regime designed to protect competitive markets from manipulation should require proof of:
  - **specific intent** (not recklessness); and
  - some **direct and material market effect.**
- This is critical to encourage dynamic competition.

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Commodities versus Securities

- The Commission will have a more effective anti-manipulation Rule that protects the markets but does not chill competition if it relies on **commodities manipulation precedent** rather than non-analogous securities precedent.

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The Securities Conundrum

- The problems caused by relying on securities precedent are that:
  - It will create **confusion**.
  - It will create **uncertainty** whether competitive behavior short of intentional manipulation may be punished.
  - **<u>Confusion and uncertainty are likely negatively to impact participation and ultimately market liquidity.</u>**

The Source of Confusion

- The securities regulatory scheme is characterized by:
  - **Expansive disclosure** requirements
  - **Consumer-protection** oriented, rather than market-protection driven rules
    - Relaxed intent standard for manipulation enforcement, and
    - No proof of effect required

The Source of Confusion

- The securities regulatory scheme was designed in the context of **fiduciary relationships:**
  - Duties of broker to client
  - Duties of corporate insider to corporation & other market participants
  - Designed to protect **retail investors**

Retail Investors Versus Sophisticated Market Participants

- Why is securities regulation different than commodities regulation?
  - Securities markets are comprised primarily of **individual retail investors.**
  - However, commodities markets are comprised of **Sophisticated Market Participants** capable of protecting their interests in bilateral negotiations**.**

Relying on Securities Precedent Is Likely To Have Unintended Consequences

- Confusion and uncertainty are **likely to impact participation and ultimately market liquidity**.
  - Traders could very well reduce their level of participation because of uncertainty whether their competitive trading strategies (or miscalculations) may later be misconstrued by regulators.
  - Will reduce arbitrage which helps prices converge.
  - Other potential entrants may decide that the regulatory risks exceed the potential benefits and opt not to enter the market.

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Commodities Regulation and Market Integrity

- The anti- manipulation standards developed by the courts pursuant to the Commodity Exchange Act ("CEA") were designed to protect markets from manipulation while also protecting competition.

A Practical Standard

- The standards developed under the CEA **will enable the Commission to prosecute manipulation** while also protecting competition.
  – The Rule should not prosecute someone unless it can be inferred from the facts and circumstances that their intent was to manipulate the price.
    » Evidence of conduct, statements.
  – A Rule prosecuting conduct that has no effect does not benefit the market.
    » Evidence that prices are different than would be expected in light of supply and demand fundamentals.
  – Most enforcement occurs through settlements.

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The Statutory Authority

- Unlike the FERC's statutes, Section 811 **does not** direct the Commission to apply SEC precedent.
- This is a **mandate to the FTC to take a different approach than the FERC**.
  - "Congress is presumed to act intentionally and purposely when it includes language in one [statutory provision] but omits it in another."
  - A letter from five Senators does not change the plain meaning of the statute as written.

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The term “Manipulative” connotes intentional or willful conduct

- Manipulation is a term of art that means “the intentional exaction of a price determined by forces other than supply and demand.”
- Specific intent is required in both commodities and FTC market-protection statutes.
  - The FTC requires proof of specific intent and market effect to find a violation of its market-protection statutes (e.g., Sherman and Clayton Acts).

Market Effect

- Prosecuting conduct that has an adverse effect on the market provides a tangible benefit to market participants.
- The Commission has said when talking about conduct related to non-jurisdictional activity, that proof of effects would be required (e.g., ethanol).
- The Commission should require proof of effects for <u>all</u> alleged manipulative activity.
- Proof of market effect is required in both commodities and FTC market-protection statutes.

Don’t Turn a Blind Eye to Manipulative Activity

- If enforcement staff uncovers fraudulent conduct that does not involve or directly affect a jurisdictional transaction, they should coordinate with the CFTC or other appropriate agency to ensure that the behavior is investigated and prosecuted where necessary.

Questions for ISDA?

Thank you.