SDMA SWAPS & DERIVATIVES MARKET ASSOCIATION

September 20, 2010

David A. Stawick, Secretary
Commodity Futures Trading Commission
Three LaFayette Centre
1155 21st Street, NW
Washington, DC 20581

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

RE: Comments from the Swaps & Derivatives Market Association on the **Definitions** contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act. CFTC File No. 10-012, SEC File No. S7-16-10, Federal Register 75 FR 51429.

Dear Sir/Madam Secretaries:

The Swaps & Derivatives Market Association ("SDMA") appreciates the opportunity to comment on the Advance Notice of Proposed Rulemaking (Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")). The SDMA largely supports the Dodd-Frank Act with enthusiasm and looks forward to working with the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC" and collectively with the CFTC, the "Commissions") and the through the rulemaking process to ensure that the intent of this important legislation is fully achieved. The SDMA fundamentally believes that the more OTC swaps transactions that are centrally cleared and executed on transparent multilateral facilities, the more systemic risk will be reduced and the bid ask spread on important financial instruments will be reduced – provided this is all done through processes that are open to as many qualified participants as feasible.

The SDMA is a financial markets trade group of United States based broker-dealers, futures commission merchants and investment managers participating in all segments of the exchange-traded and over-the-counter derivative and securities markets. The SDMA was created as a nonprofit organization in January, 2010 and today has over 20 member institutions representing all facets of derivatives execution and clearing. SDMA Members trade, market and/or clear credit, equity and commodity products, including credit default swaps (CDS) and interest rate swaps (IRS), providing improved liquidity, transparency, and reduced transaction costs to the securities and derivatives marketplace. Some SDMA members have also been successfully facilitating the execution and clearance of OTC commodity swap transactions since May 2002.

The SDMA believes that the key definitions set forth in the advance rulemaking, as well as others that are not included at this stage, are of critical importance as they will form the basis of which instruments and entities will be regulated. If the definitions are too narrow, then the intent of the legislation will not be fully achieved. Similarly, if the definitions are too broad, they may capture more than what was intended in the legislation and result in negative economic consequences. To assist the Commissions in their efforts, the SDMA addresses several of the key definitions below.

Because many of the requirements of the Dodd-Frank Act are nearly identical for both swaps and security-based swaps, for ease of presentation, unless otherwise indicated, the term “swaps” will be used in this letter to refer to both “swaps” and “security-based swaps,” the term “swap dealers” will be used in this letter to refer to both “swap dealers” and “security-based swap dealers,” and the term “major swap participants” will be used in this letter to refer to both “major swap participants” and “major security-based swap participants.

Swap

The definition of swap is broad and captures many types of over-the-counter (“OTC”) instruments. There are exclusions for certain types of instruments including “any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be settled.” This is an important exclusion for physically delivered commodities in the commercial commodity space and should remain available for legitimate producers and processors. However, this exception should be clarified in any final rule to limit these types of transactions to those where delivery is really contemplated. If parties are able to artificially “intend” to deliver at the time of the transaction but no such delivery actually takes place, then this exclusion can be used to circumvent the overall requirements of central clearing and more transparent execution and reporting of these transactions.

There will be transactions for which delivery was intended at the initiation but then intervening circumstances change the economics thus resulting in no actual delivery of the physical commodity. However, if this occurs with any frequency, then the issue becomes whether delivery was actually intended. The Commissions should consider providing in the definitions some language that to the extent that delivery rarely or infrequently occurs, then the applicable Commission may determine whether the delivery intent was satisfied.

Swap Dealer

The definition of swap dealer includes any entity that holds itself out as a dealer in swaps; makes a market in swaps; regularly enters into swaps with counterparties as an ordinary course of business for its own account; or engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps. The SDMA believes that it is important to clarify that the definition of swap dealer does not necessarily include Futures Commission Merchants ("FCMs") or broker-dealers. FCMs and broker-dealers generally provide execution, brokerage and clearing services. They are subject to a substantial regulatory and self-regulatory regime for these activities. FCMs and broker-dealers will be able to broker swaps between two counterparties and submit such transactions for central clearing. In addition, with the implementation of the Dodd-Frank Act, FCMs and broker-dealers will be able to provide clearing services for swaps.

The typical services provided by an FCM or broker-dealer, which can also be provided for swaps, are not dealing activities and the FCM or broker-dealer is generally not the counterparty to the transactions. Clearly activities in which the FCM or broker-dealer merely brokers swaps between two counterparties, and is not itself a party to the swaps, would not constitute the FCM or broker-dealer being classified as a swap dealer.

However, in certain instances FCMs and broker-dealers who do not hold themselves out as swap dealers may also enter into swap transactions as counterparties on behalf of their customers and promptly thereafter give up their positions to the customers or other market participants. Although the FCMs and broker-dealers are initially entering into these swap transactions "for their own account" in such situations, they are doing so to facilitate their customers' investment activities. By promptly removing the positions from their books they are fully eliminating their risks in such transactions, should not be deemed to have entered into the transactions for their own account and should not be considered swap dealers.

Alternatively, and also at the request of their customers such FCMs or broker-dealers may enter into such swaps with their customers and, in lieu of giving up their positions, may fully hedge their market risk by taking the opposite side in corresponding futures or securities positions. Although the FCMs and broker-dealers are also entering into these swap transactions for their own account in such situations, they are not taking market risk (which the Dodd-Frank Act was enacted to minimize), e.g., if the swap moves against the FCM or broker-dealer, the gain in the corresponding futures or securities position offsets the loss in the swap.

In either case, swap transactions entered into by FCMs or broker-dealers for customers as described above are economically no different than ordinary brokerage activities and should not be regarded differently as they do not enhance risk to the financial system. Provided that the FCM or broker-dealer is only performing these types of execution, brokerage and clearing services and is not holding itself out as a swaps dealer, it should not be included in the definition of swap dealer.

Moreover, an unintended consequence of defining all FCMs and broker-dealers as swap dealers may be to force some FCMs and broker-dealers who only provide the typical execution, brokerage and clearing services of FCMs and broker-dealers out of business due to the enhanced capital and margin requirements that may be imposed on swap dealers This would have the effect of reducing competition, increasing the cost of entering into brokerage as well as swap transactions and defeating one of the main purposes of the Dodd-Frank Act.

For similar reasons, a swap dealer is typically a dealer and counterparty to swap transactions or a market maker in particular types of swaps and takes market risk. It is not necessarily in the business of execution, brokerage or clearing. If the swap dealer is counterparty to the trade for its own account, holds itself out as a dealer or makes markets in swaps, but does not otherwise act as an FCM or broker-dealer, it should not be included in the definition of FCM or broker-dealer.

Of course, many FCMs and broker-dealers provide significant execution, brokerage and clearing services as well as engaging in typical dealing activities. Such FCMs and broker-dealers should be included in the definitions of FCM or broker-dealer and swap dealer unless their involvement in swap dealing is de minimis.

Major Swap Participant

The definition of major swap participant includes any entity that (i) is a financial entity that is highly leveraged relative to the amount of capital it holds and that is not subject to the capital requirements established by an appropriate Federal banking agency and (ii) maintains a substantial position in outstanding swaps in any major category as determined by the CFTC. Although many FCMs and broker-dealers who may not be defined as swap dealers maintain substantial positions in swaps and may be highly leveraged, the SDMA encourages the CFTC to exclude such positions from the definition of "substantial position" if such positions are hedged as described above and do not create substantial counterparty exposure.

Conclusion

For the reasons set forth above, the SDMA encourages the Commissions to provide clarification in the forward exclusion in the definition of swap to ensure that it is used legitimately and not in a manner to evade transparent execution and centralized clearing of transactions that rarely result in delivery.

Further, the definition of swap dealer should be clarified to ensure that it does not include FCMs or broker-dealers that provide typical services such as execution, brokerage and clearing. Provided that an FCM or broker-dealer is not the counterparty to swap transactions where it takes market risk (i.e., in transactions it does not give up or hedge its positions as described above) and does not hold itself out as a dealer or make markets, it should not be included in the definition of swap dealer.

Also, the SDMA encourages the CFTC to clarify the definition of major swap participant by defining "substantial position" so that it does not include swaps positions held by FCMs or broker-dealers if the positions are hedged as described above and do not create substantial counterparty exposure.

We appreciate the opportunity to comment on these important issues and look forward to working with the Commissions to implement this important legislation.

If you have any questions or need additional information please contact the Swaps & Derivatives Market Association at 917-297-7896 or visit our website at www.thesdma.com

Sincerely,

Swaps & Derivatives Market Association