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Sent: Wednesday, November 24, 2010 2:15 PM
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Cc: Carp, Jeffrey <JCarp@StateStreet.com>; Gavell, Stefan M <smgavell@StateStreet.com>; Phelan Legal, David C <dcphelelan@statestreet.com>
Subject: State Street Corporation Comments -- Swap Execution Facility (SEF) Registration Requirements
Attach: 101124 SEFs - CFTC.SEC.pdf

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To CFTC and SEC:

On behalf of David Phelan of State Street Corporation, attached please find comments from State Street on potential registration requirements for swap execution facilities (SEFs) under Title VII of the Dodd-Frank Act.

Please contact me if you have any questions.

Thank you,

Lisa Tuomivaara

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November 24, 2010

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

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

Re: Swap Execution Facility (SEF) Registration Requirements

Dear Mr. Stawick and Ms. Murphy:

State Street Corporation¹ (together with its subsidiaries, “**State Street**”) thanks the Commodity Futures Trading Commission (“**CFTC**”) and the Securities and Exchange Commission (“**SEC**” and, together with the CFTC, the “**Commissions**”) for the opportunity to comment on issues related to swap execution facilities (“**SEFs**”) and security-based swap execution facilities (“**SB SEFs**”) raised by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank**”) and proposed rules by the Commissions under Dodd-Frank. In particular, this letter addresses State Street’s concern regarding interpretation of the SEF registration requirement for persons who “operate a facility for ... processing of swaps.”

I. Registration Requirement for “Processing of Swaps”

Title VII of Dodd-Frank requires that an entity that “operate[s] a facility for the trading or processing of swaps” register as a SEF or designated contract market and that any entity that “operate[s] a facility for the trading or processing of security-based

¹ With over \$20 trillion of assets under custody and administration and \$1.9 trillion of assets under management at September 30, 2010, State Street is a leading specialist in meeting the needs of institutional investors worldwide. Our customers include mutual funds, collective investment funds and other investment pools, corporate and public retirement plans, insurance companies, foundations, endowments and investment managers. Including the United States, we operate in 25 countries and more than 100 geographic markets worldwide. We conduct our business primarily through our principal banking subsidiary, State Street Bank and Trust Company, which traces its beginnings to the founding of the Union Bank in 1792. State Street Bank's current charter was authorized by a special act of the Massachusetts Legislature in 1891, and its present name was adopted in 1960.

swaps” register as a SB SEF or national securities exchange.² In addition, Title VII allows both SEFs and SB SEFs to “(A) make available for trading any [security-based] swap; and (B) facilitate trade processing of any [security-based] swap.”³ These provisions added by Dodd-Frank can be read to require registration for some universe of “processing” activities for swaps and security-based swaps (collectively, “Swaps”) that are not pure “trading” activities.

However, Dodd-Frank did not define exactly what constitutes “processing of Swaps” for the purpose of this registration requirement. The phrase “processing of Swaps” is not separately defined in the Commodity Exchange Act or in the Securities Exchange Act of 1934 (the “**Securities Exchange Act**”). In addition, no “processing” function is referred to in the definition of SEF, designated contract market, SB SEF or exchange (collectively, “**SEF or exchange**”).⁴ The lack of definition of “processing of Swaps” and the consequential potential for an overly broad interpretation of such term is causing uncertainty in the marketplace for a wide variety of entities that provide processing services in connection with the settlement and maintenance of derivative transactions and, specifically for entities like State Street, that provide outsourcing services for middle- and back-office functions related to derivatives or security processing activity. Legal certainty is needed for these entities to develop the operational support that will be needed for the clearing environment required by Dodd-Frank. A definition of processing that is too broad raises issues for existing post-trade processing

² Dodd-Frank Sections 733 and 763. In particular, new Section 5h of the Commodity Exchange Act, added by Section 733 of Dodd-Frank, requires that “[n]o person may operate a facility for the trading or processing of swaps unless the facility is registered as a swap execution facility or as a designated contract market under this section.” New Section 3D of the Securities Exchange Act, added by Section 763 of Dodd-Frank, requires that “[n]o person may operate a facility for the trading or processing of security-based swaps, unless the facility is registered as a security-based swap execution facility or as a national securities exchange under this section.”

³ Dodd-Frank Sections 733 and 763.

⁴ The definitions of SEF and SB SEF do not directly reference “processing of swaps.” Instead, the definition of “swap execution facility,” new Section 1a(50) of the Commodity Exchange Act added by Section 723 of Dodd-Frank, is limited to “a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that—(A) facilitates the execution of swaps between persons; and (B) is not a designated contract market.” The definition of “security-based swap execution facility,” new Section 3(a)(77) of the Securities Exchange Act added by Section 761 of Dodd-Frank, is substantively similar and also does not directly refer to “processing.”

“Designated contract market” is not a defined term; it instead refers to the designation of a “board of trade” to trade a specific CFTC-regulated product. The definition of “board of trade,” and the definitions of the terms that comprise “board of trade,” contain no reference to “processing.” *See* Commodity Exchange Act Section 1a.

“National securities exchange” is not a defined term; it instead refers to registration of an “exchange.” The definition of “exchange” does not reference “processing.” It does, however, reference “performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange.” *See* Securities Exchange Act Section 3(a).

services with respect to derivative positions that we do not believe to be intended by, or achieves any objective sought by, Dodd-Frank.

II. “Processing of Swaps” refers to the trade execution matching and comparison function.

Given that the definition of a SEF only references trading systems and platforms, without any reference to processing activities, the Commissions could view the provisions of Dodd-Frank relating to registration of SEFs for “processing” as being inconsistent with the provisions of Dodd-Frank defining SEFs. Accordingly, in adopting implementing rules, the Commissions could resolve the statutory ambiguity by limiting the scope of SEFs for the purpose of all aspects of Dodd-Frank in a manner consistent with the definition of SEFs; that is, only to apply to trading systems and platforms and not processing activities.

Alternatively, we encourage the Commissions to resolve the statutory conflict by viewing the references to processing in Section 733 and 763 of Dodd-Frank narrowly and applying the registration requirements to processing only to the extent that such processing activities are directly tied to the trade matching and execution functions of a trading system or platform. State Street believes that “processing of Swaps” must be read as a function related to the defined purpose of these facilities, namely of “execut[ing] or trad[ing] Swaps by accepting bids and offers made by multiple participants in the facility or system.” If the “processing” of Swaps were a function wholly distinct from “execut[ing] or trad[ing] Swaps by accepting bids and offers,” entities engaging in any form of “processing” would face a dilemma: they would be required to register as a SEF or SB SEF, but would not fall within this defined class of entity. In addition, the registration requirement for “processing” of Swaps is found within the SEF and SB SEF sections of the Commodity Exchange Act and Securities Exchange Act, which implies that “processing” is a function related to the core trade execution facilities these entities provide. Registering as SEFs would cause registration and standard of conduct requirements to be applied to entities involved in processing although such requirements would not advance the objectives of Dodd-Frank. These registration and conduct requirements may be incompatible with the business of service providers who perform post execution processing functions on an agency basis for asset owners and managers and may cause established providers of these services to exit the market.

State Street believes that “processing of Swaps” should be read to mean the trade matching and comparison functions of an exchange or SEF, whereby typically an exchange or SEF, but potentially a third party, compares Swap transaction data submitted to the exchange or SEF by both counterparties to the Swap (or their agents), matches counterparties and reports the details of the trade to the clearing house and trade repository. Thus, Swap processing would mean processes of SEFs and exchanges that result in the execution of a trade and ensure that the details of the executed trade are submitted accurately to a clearing house and/or trade repository. This definition would be limited to activities that occur prior to the trade being transmitted for clearing, and should be understood as distinct from post-execution reconciliation functions that are performed within the clearing house or between Swap dealers and their counterparties, such as trade confirmation, reconciliation and reporting activities, as discussed below.

Defining “processing of Swaps” in this way is consistent with the SEF and exchange definitions, as trade matching and comparison functions are a required element

of providing market participants “the ability to execute or trade Swaps by accepting bids and offers.” These trade matching and comparison functions determine when a user of an exchange or SEF has “accept[ed]” an actual “bid or offer” made by another exchange or SEF user. These trade matching and comparison functions have long been a critical element of exchanges and other markets, particularly where orders are executed by voice or other manual means, but also where erroneous trade policies apply to electronic orders. They typically occur before a compared trade is sent from the exchange or other market for clearance and settlement by a clearing house or clearing agency.

Such trade execution matching and comparison functions have been separately identified in and, in part, exempted from the regulatory scheme for regulation of payment, clearance and settlement systems in Title VIII of Dodd-Frank. In particular, Title VIII excludes from the definition of “financial market utility” SEFs, designated contract markets, SB SEFs⁵ and national securities exchanges that would meet the definition “solely by reason of their providing facilities for comparison of data respecting the terms of settlement of securities or futures transactions effected on such exchange ...”.⁶ This separate identification of trade execution matching and comparison functions is consistent with an understanding that such comparison functions are an integral part of exchange trading that should be regulated as part of the overall scheme for regulation of the trading functions of SEFs and exchanges.

III. “Processing of Swaps” should not be read to include other processing activities distinct from “execut[ing] or trad[ing] Swaps”

State Street believes that the requirement of an entity to register for activities involving “processing of Swaps” does not, and should not, sweep in other activities that must be performed as part of the post-execution lifecycle of Swap transactions. These activities, often referred to as middle- or back-office functions, include trade reconciliation between the client portfolio and the counterparty for purposes of collateral exchange, processing of the legal confirmation of the trade, market and counterparty credit risk management, profit/loss and valuation, collateral exchange, funding, foreign exchange and interest rate hedging, and regulatory and internal reporting. We believe that such an interpretation is clearly consistent with statutory intent.

Separate regulatory regimes exist for many entities that perform different types of “processing” functions for Swaps, including clearing houses, data repositories, swap dealers and major swap participants.⁷ A broad definition of “processing” activity that

⁵ The language in Title VIII refers to “swap execution facilities registered under the Commodity Exchange Act [and] ... swap execution facilities registered under the Securities Exchange Act.” It seems clear that the latter reference is meant to refer to “security-based swap execution facilities” as “swap execution facilities” are not registered under the Securities Exchange Act. The use of the term “swap execution facilities registered under the Securities Exchange Act” is likely an uncorrected holdover from a previous version of the Dodd-Frank bill in which such facilities for swaps and security-based swaps were each referred to as “swap execution facilities.”

⁶ Dodd-Frank Section 803(6)(B)(i).

⁷ In addition, Dodd-Frank does not change the SEC’s ability to regulate as clearing agencies any confirmation and affirmation services that automatically match responses. *See Interpretation: Confirmation and Affirmation of Securities Trades; Matching, Securities Exchange Act Release No. 39829 63 Fed. Reg. 17,943 (April 6, 1998).*

includes middle- and back-office functions could sweep in many of these regulated entities and subject them to duplicative registration that cannot have been intended. While the CFTC and SEC have not yet released the registration requirements for SEFs, we note that considering transmission of confirmations to customers to constitute “processing of swaps” would result in a requirement that swap dealers register as SEFs or exchanges, which is impossible under the proposed conflict of interest rules of the CFTC and SEC.⁸ Registration and resulting regulatory requirements would likely need to be different for “processing” SEFs and those that engage in typical trading functions.

While some aspects of post-trade processing occur outside the regulatory entities noted above, those activities are generally conducted on an outsourced basis as agent on behalf of an entity that could otherwise conduct such activities directly without registration or other regulation. For instance, while the provision of middle-office services is not specifically regulated by the Commissions, middle-office functions are solely activities that an asset owner or asset manager could conduct directly without registration by the Commissions. This is because such activities are purely processing in nature, where the middle-office provider is acting as agent and only representing the interest to one side of a trade.

A broad definition of “processing” would also potentially sweep in activities as to which regulation has not historically been determined to be necessary and in a manner that would not advance the objectives of Dodd-Frank. These unintended results can be avoided by reading the “processing of Swaps” as including trade executing and comparison and not other processing activities done as a subsequent part of the lifecycle of a Swap transaction.

* * *

State Street appreciates the opportunity to provide the Commissions with its views on the registration requirement for “processing of Swaps.” Please feel free to contact me at 617.664.1783.

Sincerely,



David C. Phelan

cc: Jeffrey N. Carp, State Street Corporation, EVP and Chief Legal Officer
Stefan M. Gavell, State Street Corporation, EVP and Head of Regulatory and
Industry Affairs

⁸ See SEC Notice of Proposed Rulemaking, 75 Fed. Reg. 65,882 (Oct. 26, 2010); CFTC Notice of Proposed Rulemaking, 75 Fed. Reg. 63,732 (Oct. 18, 2010).