From: Dmitry.Binkevich@barclayscapital.com
Sent: Friday, February 4, 2011 12:33 PM
To: rule-comments@sec.gov; SwapReview <SwapReview@CFTC.gov>; SEFRules <SEFRules@CFTC.gov>; RealTimeReporting <RealTimeReporting@CFTC.gov>; Recordkeeping <Recordkeeping@CFTC.gov>
Subject: Barclays Capital comment letter on the phase-in of clearing, execution and reporting requirements for swaps and security based swaps mandated by the Dodd Frank Act
Attach: Barclays letter on implementation of clearing, execution and reporting requirements.pdf

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Dear Secretary Stawick and Secretary Murphy

Please find attached a Barclays Capital comment letter to the CFTC and the SEC on the phase-in of clearing, execution and reporting requirements for swaps and security based swaps mandated by the Dodd Frank Act.

Thank you very much,

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February 3, 2011

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

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

Re: Phase in of clearing, execution and reporting requirements for swaps and security-based swaps mandated by the Dodd-Frank Act

Secretary Murphy, Secretary Stawick:

Barclays Capital welcomes the opportunity to provide input to the Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC and, together with SEC, the Commissions) on implementation and phase-in of the clearing, execution and reporting requirements for swaps and security-based swaps mandated by the Dodd-Frank Act.

Barclays Capital fully supports the end goals envisioned by Congress in Title VII of the Dodd-Frank Act – more transparent, more stable, safer financial markets that retain their ability to effectively allocate capital and serve the needs of all market participants.

Title VII, however, also represents a dramatic change from the manner in which these financial markets operated historically. Markets play a key role in capital allocation and their continuous, unimpeded operation is crucial to the overall health of the economy. Changes envisioned by Title VII require very significant investment into operational, IT and other infrastructure - infrastructure that will take time and resources to build, test and optimize. The ability to fund and execute the necessary infrastructure build, as well as put in place the risk management and operational processes needed to conduct business under the new regulatory regime, will vary significantly by asset class and type of market participant.

In light of this, we are concerned that implementing clearing, execution and reporting requirements simultaneously for all asset classes and all types of market participants could result in significant market disruptions, ranging from erosion of liquidity in certain products and markets to complete market seizure, with knock-on effects on the real economy, impacting the firms that use financial markets to fund their business, shift unwanted risk or invest retirement savings of tens of millions of Americans. To avoid these unintended consequences, we recommend that the Commissions phase in the clearing, execution and reporting requirements gradually over time, staggered by asset class. In addition, within each asset class, we recommend that clearing and execution requirements be phased in by type of market participant.

A gradual approach that recognizes the divergent starting points of the different asset classes would considerably mitigate the risks of a simultaneous implementation by providing market participants with time to build and test the necessary infrastructure while extending the desired systemic stability benefits to a substantial portion of the market.

Within each asset class, we recommend that the Commissions consider making the clearing and execution requirements binding on dealers first, as the dealer community is best placed to comply from a resource availability and expertise perspective. Dealers should be followed, after a reasonable interval, by other marker participants. Reporting requirements should be made binding on all participants within an asset class in order for the reported information to be useful to the public and to the regulators.

Clearing

We see two broad areas of concern in the implementation of clearing requirements: (i) readiness of various asset classes and market participants and (ii) readiness of the market infrastructure.

(i) As mentioned previously, asset class readiness for clearing varies significantly. As an example, the Committee of European Securities Regulators (CESR) in their July 19, 2010 paper on standardization of OTC derivatives markets came to the conclusion that credit and rates derivatives are most highly standardized among various asset classes, while equity derivatives are least standardized, with commodities and FX falling in the middle. This conclusion was based on criteria such as number of market participants and conventions on standard trading terms and life cycle events, among others. CESR's work clearly demonstrates that different asset classes are at very different stages in their journey towards being able to accommodate clearing requirements.

Establishing the necessary infrastructure to enable clearing without causing market disruption will take significant time and effort – IT systems and links to clearinghouses and other participants, operations and risk management processes would need to be adapted and, in some cases, built from scratch. In addition, market participants will need to renegotiate existing legal contracts and enter into new additional ones to accommodate widespread clearing requirements.

An asset class-based gradual implementation would allow the parts of the market with best infrastructure in place to move first while providing the needed time for others to catch up.

As indicated previously, we believe the implementation should begin with swap dealers, to be followed by other market participants, with a reasonable time interval between each to allow the market to digest the changes. Given their role in the financial markets, dealers are more likely to have the necessary IT and operational infrastructure in place, as well as to have the ability to link to multiple clearinghouses. Starting the implementation process with dealers would allow the

Commissions to extend protections sought by Congress to a significant portion of the market without having to wait for other market participants to put in place the requisite infrastructure and processes.

(ii) In order to implement the clearing requirement, market infrastructure beyond that under control of market participants must be in place. Specifically, clearinghouses need to be ready to clear the trades. Here, we have two concerns: (a) readiness of infrastructure, risk management and operations that is substantially addressed above and (b) presence of sufficient liquidity on clearinghouses that we focus on below.

Mandatory clearing requirements have spurred a great deal of market activity, with existing clearinghouses looking to expand into new asset classes and with new clearinghouses forming. We expect that clearinghouses will compete to be the first to announce that they could clear a category of swap as well as try to clear as many categories of swaps as possible. This represents a potential danger because acceptance by a clearinghouse is as likely to be driven by jockeying for competitive position as by a realistic assessment that it could, indeed, clear a given category of swaps. We urge the Commissions to make the clearing requirement contingent on sufficient liquidity being present on those clearinghouses that declare themselves ready to clear a product to support clearing for a substantial portion of the market volume in a given swap category.

Liquidity should be present at the clearinghouse to clear any volume of swaps within a given category that are submitted to it by clearing members. Inability of the clearinghouse to accommodate the necessary volume would prevent market participants from trading as not clearing trades deemed mandatorily clearable would be illegal. The Commissions' assessment of clearinghouse readiness could be further strengthened by examining how many dealers and other market participants are connected and have necessary legal agreements with a given clearinghouse. This would prevent the competitive dynamics among clearinghouses from detracting from systemic safety objectives sought by Dodd-Frank.

Execution

Swaps that will be mandated for clearing will also have to be executed on a SEF or an exchange. Here, as with clearing, readiness and level of standardization among asset classes will vary and a simultaneous imposition of execution requirements will risk destabilizing markets for the less ready assets.

In addition to this issue, we are especially concerned with potential lack of liquidity on many of the SEFs resulting from (i) the emergence in the next 12 – 18 months of multiple new SEFs which would compete with existing platforms for market share, and (ii) transition to electronic execution in asset classes that have, to date, been dominated by OTC contracts and

voice brokerage. These changes have the potential to drain liquidity, especially in the less standardized products. Given these dynamics, a scenario where SEFs announce ability to trade certain swaps without securing requisite liquidity while market participants struggle to build the IT and operational underpinnings for electronic trading appears plausible.
In order to mitigate these dangers and ensure orderly phase-in of the execution requirements without disrupting activity of crucial markets, we recommend that the Commissions follow a protocol outlined above for clearing, with phase-in staggered by asset class in an order reflective of the asset class standardization and readiness for electronic execution as well as by type of market participant. We would further recommend that the timing of execution requirements implementation for a given asset class lag the implementation of the clearing requirement to enable the market to adapt to the new regulations.

Reporting

Real-time and data repository reporting phase-in presents challenges similar to clearing and execution requirements. Infrastructure and risk management and operational processes required for clearing and execution overlap significantly with those required to comply with reporting mandates. As an added complication, however, different asset classes use different, and often mutually incompatible, booking systems. An asset-class based phasing, therefore, would allow the market participants to work within the current market set-up, minimizing the chances of unintended consequences. Phasing by type of market participant would not be useful for reporting obligations, in our view, as the reported information needs to reflect the entirety of the market to be useful for the market participants and regulators

In addition, we propose instituting a 'risk-free trial period', during which market participants would report on a voluntary basis, without risking sanction in case of a system malfunction. This period would allow the market participants to ensure that the new infrastructure and operational processes are working well without

We note that on November 19th, 2010 the Commissions released for comment proposed rules for real-time reporting of swaps and security-based swaps. The SEC has proposed a phased implementation approach for public dissemination of the security-based swaps data, with portions of the security-based swap markets brought into compliance with the reporting requirements over a period of time. The CFTC has indicated in its proposed real-time reporting rules that full compliance will be required by January 2012 for all market participants across all asset classes, without phasing for any step of the process. In light of this, we urge the Commissions to formally adopt asset class phasing both for public dissemination and reporting to swap data repositories to ensure that both the industry and SDRs have sufficient time to build and test the needed infrastructure in order to prevent any potential market disruptions that could result from the implementation of new rules..

Phased approach has worked well in the past

Both the Federal Reserve Bank of New York (FRBNY) and FINRA have successfully used the phased implementation approach in the past when applying new requirements to the financial markets.

In the case of the FRBNY, the bank implemented stringent processes related to issues such as processing of unexecuted trade confirmations and clearing of CDSs. Aggressive targets were coupled with a phased approach to implementation, ultimately leading to FRBNY's objectives being met with minimal impact on the functioning of the markets.

Similarly, when FINRA implemented its TRACE reporting system, the initial reporting deadline was relatively permissive but progressively moved to 15 minutes over time, where it remains to date. This was achieved in a manner that gave the market participants time to build the needed infrastructure and implement the necessary processes.

It is clear from these examples that a phased approach to implementing new and challenging capital markets regulations has worked well in the past and should be adopted by the Commissions as the path forward on derivatives market reforms. We have discussed these issues during our recent meetings with the staff at both SEC and CFTC and would welcome any further opportunity to continue those discussions.

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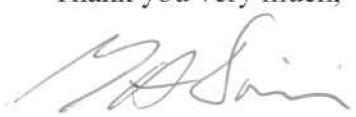
Barclays Capital fully supports the end goals envisioned by Congress in Title VII of the Dodd-Frank Act – more transparent, more stable, safer financial markets that retain their ability to effectively allocate capital and serve the needs of all market participants. We are concerned, however, that an approach for implementation of the clearing, execution and reporting requirements that does not take into account the present state of the swaps markets and market participants, and the considerable technical and operational challenges that need to be overcome to achieve the desired end state presents a needlessly high risk for a significant market disruption.

To minimize the risk of market disruption while extending protections envisioned by Congress, we recommend that the Commissions adopt a gradual implementation schedule as outlined in this note.

Thank you very much,



Gerald Donini
Barclays Capital Inc.