INVESTMENT COMPANY INSTITUTE

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

August 13, 2012

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

Re: *Statement of General Policy on the Sequencing of the Compliance Dates for Final Rules Applicable to Security-Based Swaps Adopted Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act (File No. S7-05-12)*

Dear Ms. Murphy:

The Investment Company Institute ("ICI")[1] is submitting this letter in response to the statement of general policy by the Securities and Exchange Commission ("SEC" or "Commission") on the anticipated sequencing of the compliance dates of final rules to be adopted for security-based ("SB") swaps under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[2] The Statement explains the general order in which SB swap market participants might prepare for compliance with the final rules and discusses the sequencing of the rules in relation to one another. The Statement does not provide specific compliance dates for the final rules nor does it provide a conclusive sequencing of compliance dates.

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[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.1 trillion and serve over 90 million shareholders.

[2] *Statement of General Policy on the Sequencing of the Compliance Dates for Final Rules Applicable to Security-Based Swaps Adopted Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act*, Release No. 34-67177, 77 FR 35625 (June 14, 2012) available at http://www.gpo.gov/fdsys/pkg/FR-2012-06-14/pdf/2012-14576.pdf ("Statement"). The SEC also describes the timing of the expiration of the exemptions previously granted by the SEC from certain provisions of the Securities Exchange Act of 1934, the Securities Act of 1933, and the Trust Indenture Act of 1939.

ICI generally supports the SEC's proposed sequencing of final rules applicable to SB swaps. We appreciate the Commission's effort to provide a sequential and coordinated process to implement the Dodd-Frank requirements for the SB swaps market while minimizing unforeseen and unintended consequences for market participants and customers. We believe the proposed sequencing takes a logical approach to sequencing of the SB swap rules and support the SEC's proposed sequencing of the rules in relation to one another.

Over the last two years, there have been a myriad of new rules and rule proposals with respect to swaps and SB swaps from the Commodity Futures Trading Commission ("CFTC") and the SEC. Given the introduction and implementation of a new regulatory framework for swaps, we request that the SEC continue to be mindful of the burdens imposed on those that must comply with the panoply of new requirements and provide entities sufficient time to come into compliance. We urge the Commission to adopt an implementation schedule that will accommodate operational, technological, data and other challenges facing market participants. In this regard, we believe it would be helpful if the SEC provided specific timeframes for compliance based on the type of asset class and market participants entering into a swap transaction.[3]

The Commission should start with the most liquid, standardized and cleared asset classes to provide for a smoother transition to the new regulatory framework and help inform the process for other asset classes. Moreover, there are meaningful differences among market participants with respect to resources, readiness and expertise. For entities that do not engage in the level of swap activity that would trigger registration as an SB swap dealer ("SBSD") or major SB swap participant ("MSBSP"), the SEC should provide more time to come into compliance. Affording adequate time to put systems in place and to revise policies and procedures to ensure compliance regarding margin, documentation, clearing, and trading requirements in a thoughtful manner would ultimately produce better results rather than imposing a short compliance deadline. We recommend that the SEC provide a period of 18

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[3] The CFTC has taken a somewhat similar approach with respect to specific timeframes for compliance. *See Swap Transaction Compliance and Implementation Schedule: Clearing Requirement under Section 2(h) of the CEA*, 77 FR 44441 (July 30, 2012), *available at* http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-18383a.pdf ("Clearing Compliance Schedule"); *Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA*, 75 FR 58186 (Sept. 20, 2011), *available at* http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-24124a.pdf ; *Swap Transaction Compliance and Implementation Schedule: Trading Documentation and Margining Requirements under Section 4s of the CEA*, 75 FR 78176 (Sept. 20, 2011), *available at* http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-24128a.pdf. ICI made similar comments on the CFTC's proposal. *See* Letter from Karrie McMillan, General Counsel, ICI, to David A. Stawick, Secretary, CFTC, dated Nov. 4, 2011

to 24 months following adoption of final rules for funds to come into compliance.[4] We provide some more detailed comments below.

Sequencing of SB Swap Rules

The SEC proposes an order of compliance dates by five groups of SB swap rules categorized as follows:

> (1) rules further defining, among others, the terms "security-based swap," "security-based swap agreement," and "mixed swap," ("Definitional Rules") and the rules concerning the treatment of cross-border SB swap transactions and non-U.S. persons acting in capacities regulated under Title VII of the Dodd-Frank Act ("Cross-Border Rules");
> (2) rules pertaining to the registration and regulation of security-based swap data repositories ("SDRs"), the reporting of SB swap transaction data to SDRs, and the public dissemination of SB swap transaction data;
> (3) rules pertaining to the mandatory clearing process of SB swap transactions, clearing agency standards, and the end-user exception from mandatory clearing;
> (4) rules pertaining to the registration and regulation of SBSDs and MSBSPs; and
> (5) rules pertaining to the mandatory trading of SB swap transactions, including the rules on the registration and regulation of SB swap execution facilities ("SB SEFs").[5]

In the Statement, the SEC proposes that the Definitional Rules should be the first set of rules that should be adopted and effective. The SEC, however, notes that it may be appropriate for the procedural rules related to mandatory clearing determinations and certain clearing agency standards to be adopted before the Definitional Rules are adopted and/or effective so that registered clearing agencies that are designated by the Financial Stability Oversight Council ("FSOC") under Title VIII of

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[4] Recently, the CFTC adopted regulations to establish a schedule to phase in compliance with the requirement to clear swaps. Unfortunately, a "Category 2 Entity" – into which registered funds will likely fall – would be required to comply with the requirement to clear within 180 days after the clearing mandate determination is published in the Federal Register. *See* Clearing Compliance Schedule, *supra* note 3. We continue to believe that more time should be provided for entities like registered funds to come into compliance with the substantive swaps requirements.

[5] The SEC has categorized into these five groups twelve rule proposals it has issued (prohibition of fraud and manipulation; trade reporting and real-time public dissemination of trade information; SDR registration process and obligations of SDRs; process for mandatory clearing of SB swaps; end-user exception to mandatory clearing; confirmation of SB swap transactions; registration and regulation of SB SEFs; clearing agency standards; product definitions; standards of conduct for SBSDs and MSBSPs; registration process for SBSDs and MSBSPs; mitigation of conflicts of interest at SB swap clearing agencies, SB SEFs, and exchanges) and one adopting release relating to SB swaps (SBSD and MSBSP definitions) under the Dodd-Frank Act along with the proposals the SEC has yet to publish with respect to capital, margin, and segregation requirements and reporting and recordkeeping requirements for SBSDs and MSBSPs and the Cross-Border Rules.

the Dodd-Frank Act as systemically important can comply with certain requirements.[6] After the SEC published the Statement, the SEC and the CFTC adopted the Definitional Rules and the SEC adopted rules on the process for a clearing agency's submissions for review of SB swaps for mandatory clearing and the rules on advance notices filed by clearing agencies that are designated as systemically important.[7]

Thereafter, the SEC expects to propose the Cross-Border Rules to address the application of the SB swap requirements to cross-border SB swap transactions and non-U.S. persons acting in capacities regulated under the Dodd-Frank Act. These rules would address the extent to which non-U.S. swap market participants would be subject to the requirements arising from the Dodd-Frank Act. We strongly support the SEC proposing the Cross-Border Rules early in the rulemaking schedule. Given the global nature of the swaps market and the interconnectedness of the markets around the world, we believe it is critical for the SEC to set forth its approach regarding the application of SB swap requirements to transactions that may implicate non-U.S. persons and/or other jurisdictions. We also believe that the Commission should continue to strive to harmonize its regulatory approach to the extent possible with domestic and international regulators to address the global nature of the derivatives markets.[8]

The SEC believes the next step in the implementation process should be requiring SDRs to register with the SEC and to comply with applicable duties and core principles. The SEC also would require the reporting of SB swap transactions to registered SDRs earlier in the implementation process to enable the SEC to use the data reported to registered SDRs to inform other aspects of the SEC's rulemaking. We support the proposed order of these rulemakings and agree with the Commission that it needs adequate data to inform its SB swaps rulemakings and to understand better the attributes of a particular SB swap. For example, the Commission must be sufficiently informed on the unique characteristics of a particular SB swap to determine whether clearing, and consequently exchange

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[6] Any financial market utility, including a registered clearing agency, designated as systemically important is required to file 60 days advance notice of changes to its rules, procedures or operations that could materially affect the nature or level of risk presented by the financial market utility.

[7] *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping,* RIN 3038-AD46, Release No. 33-9338, *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister071012c.pdf (July 18, 2012); *Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations*, Release No. 34-67286, 77 FR 41602 (July 13, 2012)
available at http://www.gpo.gov/fdsys/pkg/FR-2012-07-13/pdf/2012-16233.pdf ("Process for Submissions Adopting Release").

[8] *See* Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, and David A. Stawick, Secretary, CFTC, dated June 10, 2011.

trading, should be mandated. The Commission similarly would need data to define appropriately block trade thresholds and applicable time delays, which we address more fully below.

Following the rules on SDRs and reporting of SB swaps data, the SEC expects compliance with rules pertaining to mandatory clearing and clearing agency standards.[9] In the Statement, the SEC recognizes the importance of communicating in a timely manner the SB swaps that will be required to be cleared. The SEC proposes that one way in which the SEC could assist in facilitating clear and timely communication to market participants as to which SB swaps will be required to be cleared is to require the mandatory clearing of SB swaps only some specified period of time after publishing its determination. We strongly support the SEC providing a sufficient period of time after it has made its mandatory clearing determination public before market participants are required to clear those swaps. This additional time would facilitate an orderly transition into clearing of those swaps. We appreciate the Commission's recent agreement that "determination of when and how a clearing requirement should be implemented will depend on the particular product" and with the "importance of ensuring that clearing agencies and market participants are given an appropriate amount of time and guidance to comply with a clearing mandate."[10]

The SEC then expects to adopt rules pertaining to SBSDs and MSBSPs in the areas of registration, business conduct standards, trade acknowledgement and verification of SB swap transactions, capital, margin and segregation requirements, and reporting and recordkeeping requirements. The SEC anticipates that the rules implementing the regulation and registration of SB swap execution facilities ("SEFs") would be sequenced later in the process than other rules implementing SB swap provisions. Finally, the SEC expects there would be no mandatory exchange or SB SEF trading of SB swap transactions until the SEC has determined that SB swaps are required to be cleared and the clearing requirement has become operative and the SEC has adopted the standards for determining when an SB swap has been "made available to trade," an SB swap has been determined to be "made available to trade" pursuant to such standards, and such "made available to trade" determination has become effective. We generally support this sequencing of adoption of final rules and of the compliance dates. With respect to trading requirements, the SEC must coordinate carefully the sequencing of those rules to avoid forcing market participants to scramble to have the necessary agreements and contracts among various parties in place before a mandated deadline.

As noted above, given the significant new regulatory responsibilities on market participants, we urge the Commission to provide an appropriate and realistic timeframe for implementation. To better

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[9] The compliance date for the swap submissions will be 60 days after the date the SEC issues its first written determination of whether an SB swap is required to be cleared (*e.g.,* SB swaps listed for clearing by a clearing agency as of the enactment of the Dodd-Frank Act). *See* Process for Submissions Adopting Release, *supra* note 7.

[10] *See* Process for Submissions Adopting Release, *supra* note 7 at 41613.

accommodate operational, technological, data and other challenges facing market participants upon full implementation of the new regulatory framework, the SEC should propose specific, staggered timeframes for compliance for each set of rules based on the type of asset class and market participant.

Some asset classes have substantial levels of standardization, liquidity and existing market infrastructure. Other asset classes are on the opposite end of the spectrum while still others fall somewhere along the continuum. Starting with the most liquid, standardized and cleared asset classes should provide for a smoother transition to the new regulatory framework and help inform the process for other asset classes. The Commission also should consider whether there are certain asset classes that typically trade as a unit and therefore should be phased in together. The transition similarly would be facilitated by providing a period of time between a product being approved for clearing and its clearing being mandated.

As with asset classes, there are meaningful differences between market participants with respect to resources, readiness and swaps market experience. For example, swap dealers in certain products already have been using central clearing for some time and undoubtedly have greater resources and experience for adapting to the new regulatory framework than many market participants. Requiring SBSDs and MSBSPs to comply with the rules and develop experience for each asset class at an earlier date than other market participants is appropriate and would help inform the process for other market participants. Phasing within a class of market participants also is warranted based on structural differences. Each category of market participant, for example, faces different compliance burdens. Those market participants managing subaccounts must negotiate and modify a series of documents and open accounts under the new rules – processes that will take significant time to complete.

Importantly, all market participants should be permitted, but not required, to comply with the rules concurrent with deadlines for dealers or major swap participants.[11] Equal access is necessary to allow all market participants an equivalent opportunity to participate in the development of the clearing, execution and reporting infrastructure and systems. Smaller entities, for example, may have unique issues that need to be accounted for before systems are hardwired.[12] Many swap market participants are small entities; it is important to ensure that these entities and their liquidity are not squeezed out of the swaps markets.

Further, the phase in should allow market participants to transition in an economically and commercially sensible manner. Being able to clear liquid swaps may present advantages for their

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[11] ICI has endorsed the CFTC's approach that any effective dates that are set for clearinghouses and trading platforms must provide for client clearing and access at the same time for all participants who wish to use the platform. Likewise, customer clearing systems should be built concurrent with dealer systems. *See supra* note 8.

[12] Without regulatory guidance, dealers may be less willing to expend time and resources to assist smaller market participants with testing and "on-boarding" until they have completed such processes with larger market participants.

customers (*e.g.*, lower counterparty risk). Some market participants, including funds, have an obligation to treat their customers the same. Finally, there is the competitive landscape to consider, and no market participant should be disadvantaged if it is able and interested in complying with the rules before it is required to comply with them. To address all of these concerns, ICI recommends a voluntary period for compliance before the rules are mandated for each category of market participant.

Block Trades

With respect to defining block trade thresholds for purposes of delayed SB swap reporting, the SEC intends to propose specific block trade thresholds simultaneously with the adoption of final rules on SB swap data reporting. Recognizing that the current data on the nature and size of SB swap transactions reflect a market that is not yet subject to any of the requirements to be adopted under the Dodd-Frank Act, the SEC is considering various methods of establishing block trade thresholds and requests comment on different approaches to defining block trades. We strongly support the approach being considered by the SEC to establish an initial period during which information regarding SB swaps would be reported on a delayed basis. We also support the SEC re-opening for comment certain issues related to block trades – such as the required time delays – in connection with the future SEC proposal regarding how to define block thresholds.

Establishing the appropriate criteria for determining minimum block sizes that would be subject to a time delay from real-time public reporting is critical to funds and their shareholders. Block trades enable funds (on behalf of their shareholders) to engage in large transactions with minimal disruptions to the swaps market.[13] Counterparties to these transactions, which are typically dealers, are willing to provide this liquidity to funds if the dealers can offset the risks of the resulting positions at a reasonable cost. Knowledge of a block trade by other market participants before a dealer has an adequate time to lay-off those risks could provide an opportunity for those seeking to profit from this knowledge to attempt to extract a higher premium from the dealer to offset those positions. As a result, those offsetting transactions may become more difficult and costly, potentially increasing the costs of market making. This risk may cause dealers to raise the costs of block trades to compensate for the difficulty in hedging their positions in the market. This higher cost, in turn, will be passed on to funds and their shareholders. To avoid this outcome, funds may be forced to break up block trades into smaller orders, which will create market inefficiencies and potentially diminish liquidity. In addition, opportunistic market participants may piece together information about a fund's holdings or trading strategy, leading to front running of a fund's trades.

[13] We have made similar suggestions to the CFTC regarding block trades. *See* Letter from Karrie McMillan, General Counsel, ICI, to David A. Stawick, Secretary, CFTC, dated May 14, 2012; Letter from Karrie McMillan, General Counsel, ICI, to David A. Stawick, Secretary, CFTC, dated Feb. 7, 2011.

Although mindful of the transparency benefits that real-time reporting would bring to the swaps market, we believe the SEC must be careful to find the right balance of transparency and impact on market liquidity.[14] We agree with the SEC that it should defer its proposed rulemaking regarding block thresholds until after SDRs register with the SEC and the SEC begins to receive and analyze data required to be reported under the final rules or until after SB swap transaction information begins to be publicly reported. Any data on which the SEC could rely currently to develop a methodology for determining minimum block trade sizes will not adequately represent or reflect the swaps market once the Dodd-Frank requirements (including public reporting of swap data) are fully implemented. The lack of accurate information and the potentially changing swaps landscape caution against adopting procedures for determining block trade sizes that cannot accommodate the swaps market that may evolve over time. Therefore, we recommend that the SEC analyze the data it will receive from SDRs to develop the methodologies for setting appropriate minimum block sizes for each swap category and the appropriate time delays for block trades.

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We appreciate the opportunity to comment on the Statement. We generally support the proposed sequencing of the SB swap rules and recommend that staggered compliance dates be adopted depending on the type of asset class and entity engaged in a swap transaction. We believe sufficient time for compliance (particularly for entities that do not engage in a significant level of swap transactions to be required to be registered as SBSDs and MSBSPs) must be provided to prevent disruptions in the swaps market and to ensure a smooth transition to the new regulatory framework. We also support a measured approach to adopting rules regarding block trades. Given the potential risk of damaging market liquidity severely if the threshold for the minimum block trade is set too low or time delay too short, we believe it would be prudent to move progressively towards greater transparency. If you have any questions on our comment letter, please feel free to contact me at (202) 326-5815, Sarah Bessin at (202) 326-5835, or Jennifer Choi at (202) 326-5876.

Sincerely,

/s/

[14] *C.f., Consolidated Audit Trail*, 77 FR 45721 (Aug. 1, 2012) (in the context of a consolidated audit trail, the SEC determined that the majority of the regulatory benefits gained from the creation of an industry-wide consolidated audit trail did not require real-time reporting particularly in light of significant costs involved).

Karrie McMillan
General Counsel

cc: The Honorable Mary L. Schapiro
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes
The Honorable Daniel M. Gallagher

Norm Champ, Director, Division of Investment Management, SEC
Robert W. Cook, Director, Division of Trading and Markets, SEC

The Honorable Gary Gensler
The Honorable Jill E. Sommers
The Honorable Bart Chilton
The Honorable Scott D. O' Malia
The Honorable Mark Wetjen