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FINANCIAL MARKETS LAWYERS GROUP
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NEW YORK, NY 10045-0001

August 7, 2000

COMMENT

VIA ELECTRONIC MAIL

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Exemption for Bilateral Transactions & Regulatory Reinvention

Dear Ms. Webb:

The Financial Markets Lawyers Group ("FMLG") respectfully submits this letter in response to the issuance by the Commodity Futures Trading Commission (the "Commission" or the "CFTC") of three separate proposed rulemakings. The first proposed rulemaking seeks to modify the current swaps exemption (the "Bilateral Transactions Proposal").[1] The second proposal offers a new regulatory framework for multilateral transaction execution facilities, intermediaries and clearing organizations (the "MTEF Proposal"),[2] and the third proposal would provide a new regulatory framework for clearing organizations (the "Clearing Proposal").[3]

The FMLG greatly appreciates this opportunity to comment on these three proposals. The FMLG was formed in 1994 under the sponsorship of the Federal Reserve Bank of New York, and includes senior lawyers from many of the leading domestic and foreign commercial and investment banks that are active in the foreign exchange ("FX") and OTC derivatives markets. The FMLG also supports the work of The Foreign Exchange Committee ("FXC") which was likewise organized under the

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1 65 F.R. 39033-39039 (Jun. 22, 2000) (17 C.F.R. Part 35).

2 65 F.R. 38985-39008 (Jun. 22, 2000) (17 C.F.R. Parts 1, 5, etc.).

3 65 F.R. 39027-39033 (Jun. 22, 2000) (17 C.F.R. Part 39).

sponsorship of the Federal Reserve Bank of New York. The FXC is made up of representatives from many of the most significant participants in FX trading in the United States.

The FMLG applauds the Commission's decision to propose its new regulatory framework. Currently, the OTC foreign exchange markets in the United States rely principally on the Treasury Amendment for the legal assurance that such transactions are not subject to the Commodity Exchange Act (the "CEA"). As you know, Congress is currently considering legislation that would clarify the scope of the Treasury Amendment so that it more clearly excludes electronic OTC foreign exchange trading from the CEA, especially where elements of trade execution, clearing and/or settlement are automated. In the meantime, the Part 35 Proposal, and other aspects of the proposed new regulatory framework, should prove a useful source of additional legal certainty that transactions in Treasury Amendment products, even if executed through automated facilities and/or submitted for clearing, are generally exempt from the CEA. We, therefore, welcome the CFTC's proposal for providing an alternative basis for legal certainty with respect to the electronic trading of FX and other Treasury Amendment products.

The Bilateral Transactions Proposal

We would like to commend the Commission for its decision to propose simplifying the eligibility criteria and expanding the scope of the current Swaps Exemption.[4] As noted by the President's Working Group on Financial Markets ("PWG") in its 1999 Report,[5] concerns have persisted about the unnecessarily narrow scope of the exemption. For instance, the current Swaps Exemption only provides relief for transactions that meet the exemption's definition of a "swap agreement." Yet, financial and technological innovations in the OTC markets since 1993 have made this definition and other aspects of the Swaps Exemption outdated. Under the Commission's Bilateral Transactions Proposal, the Swaps Exemption would be expanded to cover all bilateral contracts, agreements and transactions between eligible participants. It would also eliminate some unnecessary exemptive criteria and permit exempted transactions to be cleared.

We strongly support the CFTC's proposed changes to the current Swaps Exemption. The FMLG believes that the Treasury Amendment already provides that FX transactions not traded on an organized exchange are excluded from coverage under the CEA by the Treasury Amendment. Therefore, as it relates to bilaterally negotiated OTC

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4 Exemption for Certain Swap Agreements, 58 Fed. Reg. 5587 (Jan. 22, 1993) (codified at 17 C.F.R. pt. 35).

5 "Over-the-Counter Derivative Markets and the Commodity Exchange Act," Report of the President's Working Group on Financial Markets, (Nov. 9, 1999) (hereinafter, the "PWG Report").

FX transactions, we do not necessarily view the proposed Bilateral Transactions Exemption as essential.

Nevertheless, we appreciate the CFTC willingness to provide the OTC FX markets with as much legal certainty as possible, and we support the Commission's attempt to modernize its rules and regulations. With respect to the Bilateral Transactions Proposal, we believe the proposal closely tracks the recommendations contained in the PWG Report. The proposal greatly enhances legal certainty, especially because it eliminates the unnecessary requirement that an agreement or transaction not be fungible or standardized as to its material economic terms. It would also help reduce some of the legal risks associated with OTC derivatives activities by expressly providing that a participant in OTC transactions does not have the right to repudiate its obligations based solely on the failure of the transaction to comply with the proposed Bilateral Transactions Exemption. Taken together, these changes would go a long way toward ensuring that the legal certainty provided by the current Swaps Exemption is more broadly available.

The Exempt MTEF Proposal

The FMLG would also like to commend the Commission for its willingness to expressly exempt the electronic trading of OTC derivatives and Treasury Amendment products from the CEA. Taken together with the Bilateral Transactions Proposal, the Exempt MTEF Proposal offers important relief for electronic trading systems including those used to execute transactions in Treasury Amendment products such as FX.

However, the FMLG remains concerned about the lack of legal certainty surrounding the meaning of the term "board of trade" as it is used in the Treasury Amendment.[6] The Commission emphasizes in its release that the proposed MTEF definition is not intended to "modify, alter, amend or interpret" any provision of the CEA including the meaning of the term "board of trade" as defined in the CEA[7] and used in the Treasury Amendment.[8] However, the Commission also acknowledges that a facility that meets the definition of an MTEF may nevertheless *not* be a board of trade for purposes of the Treasury Amendment.

We believe strongly that the Commission's position on this issue is correct and should be more fully reflected in the final rules or adopting release. Additional guidance from the CFTC on what it considers as the specific differences between the

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[6] See 7 U.S.C. 2(a)(1)(A)(ii).

[7] See 7 U.S.C. §1a(1).

[8] See 7 U.S.C. 2(a)(1)(A)(ii).

MTEF definition and the "board of trade" definition would be useful for newly emerging trading systems for Treasury Amendment products. It would also help implement the PWG's recommendation that "the scope of electronic trading permitted outside the CEA [should] be broader for Treasury Amendment instruments than for other financial instruments."[9]

The PWG Report called for the removal of legal obstacles to innovations that have the potential to not only reduce systemic risk but also increase efficiency, transparency and liquidity in our OTC markets. The Commission's Exempt MTEF Proposal and Clearing Proposal are laudable attempts to implement these important objectives, and we appreciate the Commission's willingness to broaden the scope of the Swaps Exemption to cover electronic trading in Treasury Amendment products. However, we would respectfully remind the Commission that this is only a temporary solution. The PWG Report unanimously recommended that the Treasury Amendment be clarified by replacing the term "board of trade" in the Treasury Amendment with the term "organized exchange," and we hope that the Commission continues to work with the other members of the PWG in encouraging the United States Congress to promptly enact legislation addressing this issue.

The Clearing Proposal

Finally, we welcome the changes recommended in the Commission's Clearing Proposal. The fact that a swap or other bilateral OTC transaction is cleared should not affect its exempt status under the CEA. Such clearing systems should be encouraged since they facilitate netting, reduce counter-party credit exposures and generally help reduce systemic risks during periods of market stress. The PWG Report made three important recommendations in this area: (i) allow CFTC supervised futures clearing organizations to also clear OTC products (unless the OTC products are securities, such as securities options); (ii) allow SEC regulated securities clearing agencies to also clear OTC derivatives (unless the contract involved a non-financial commodity with a finite supply); and (iii) require all other OTC clearing systems to be organized as a bank, bank affiliate, or Edge Act company and be supervised by the Federal Reserve or the Office of the Comptroller of the Currency. The Clearing Proposal is consistent with these recommendations. It allows OTC transactions covered by Part 35 and Part 36 to be cleared by a CFTC recognized futures clearing organization, a SEC supervised securities clearing agency, and a supervised bank or bank affiliate. We,

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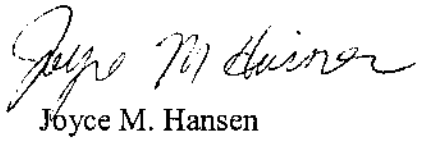
[9] See PWG Report at 26 (emphasis added). For instance, the PWG Report notes that under its proposal, which the CFTC supported, "an electronic system for Treasury Amendment products that allows the execution of transactions through agents would be excluded from the CEA as long as it did not also serve (or arrange for another entity to serve) a self-regulatory function." PWG Report at 26, note 53.

therefore, applaud the Commission for broadly implementing the PWG's recommendations.

Conclusion

In closing, the FMLG believes that the Commission has done an outstanding job at coming up with a more rational exemptive and regulatory framework for the OTC markets. The proposed improvements to the Swaps Exemption coupled with the Commission's Exempt MTEF Proposal and Clearing Proposal also have the potential to provide additional legal certainty to those products and markets that are currently excluded from coverage under the CEA by the Treasury Amendment. If you have any questions or would like further information regarding this letter, please feel free to contact the undersigned at (212) 720 -5024 or Michael S. Nelson at (212) 720-8194.

Sincerely,



Joyce M. Hansen
Chairman

cc: The Honorable Thomas J. Erickson
The Honorable Barbara P. Holum
The Honorable James E. Newsome
The Honorable William J. Rainer
The Honorable David D. Spears