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Office of the Commissioner

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The Honorable Jeffrey Zients
Acting Director
Office of Management and Budget
The White House
1650 Pennsylvania Avenue
Washington, D.C. 20500

Dear Director Zients:

I am writing to request that the Office of Management and Budget (OMB) review the cost/benefit analysis of the **Swap Dealer and Major Swap Participant Recordkeeping and Reporting, Duties, and Conflict of Interest Policies and Procedures; Futures Commission Merchant and Introducing Broker Conflicts of Interest Policies and Procedures; Swap Dealer, Major Swap Participant, and Futures Commission Merchant Chief Compliance Officer Rule** (the "Internal Business Conduct Rules") voted on by the Commodity Futures Trading Commission (the "Commission" or "CFTC") earlier today. It is my concern that the Commission's cost-benefit analysis has failed to comply with the standards for regulatory review outlined in OMB Circular A-4, Executive Order 12866, and President Obama's Executive Orders 13,563 and 13,579.

I believe the Commission has failed to carefully and precisely identify a clear baseline against which the Commission measured costs and benefits and the range of alternatives under consideration in this rule. Specifically, the Commission's cost-benefit analysis with regard to this rule fails to comply with the basic direction in OMB Circular A-4 (the "Circular") to establish an appropriate baseline that includes an evaluation of the pre-statutory baseline in light of the range of Commission discretion as to the manner in which the rules implement the statutory goals of section 4s.[1] The Circular also directs the Commission to consider alternatives available "for the key attributes or provisions of the rule."[2] The Circular goes on to recommend that, "It is not adequate simply to report a comparison of the agency's preferred option to the chosen baseline. Whenever you report the benefits and the costs of alternative options, you should present both total and incremental benefits and costs."[3] It is at this most basic level of

[1] OMB Circular A-4 at 15-16.

[2] Id. at 16.

[3] Id.

analysis where the Commission has failed to provide alternative options for consideration or has failed to justify its choice of regulation with a specific cost-benefit analysis.

In two examples articulated by the Commission, the Internal Business Conduct Rules dismiss out of hand, and without specific justification the concerns raised by two commenters: (1) the Federal Home Loan Banks who raised concerns regarding compliance burdens and duplicative nature of regulations for comparably regulated entities; and (2) The Working Group of Commercial Energy Firms, which raised concerns that the rules failed to provide benefits with regard to risk management and compliance that matched, much less exceeded, the cost of compliance. Both concerns were dismissed without consideration of alternatives and without any attempt to quantify the cited costs.

With regard to recordkeeping requirements, the Internal Business Conduct Rules impose a substantial burden on Swap Dealers ("SDs") and Major Swap Participants ("MSPs") to maintain extensive audio recordings including the requirement to tag each taped conversation and make it searchable by transaction and counterparty. Understandably, section 4s(g) does require the maintenance of such daily trading records for each counterparty and that they be identifiable with each swap transaction. However, in spite of enormous technological challenges it is unclear as to whether or not the Commission undertook any independent effort to determine the technical challenges of implementing such a system, including, whether such technology currently exists, the costs of acquiring and installing such technology, and whether such a system could be developed and/or installed within the timetable set by the Commission. The Commission has failed the fundamental test in OMB Circular A-4 to establish an appropriate baseline and consider a range of alternatives with associated costs and benefits. Although the Commission modified its original proposal to not require each telephone record to be kept as a single file, it fails to quantify the specific cost of complying with a costly and technically challenging mandate. Moreover, in determining that such audio recordings are to be maintained for a one-year period, the Commission provides no analytical support for this retention period over a more reasonable six-month period other than to say that such period will be "most useful for the Commission's enforcement purposes."[4]

Further, the Commission also ignored commenters' requests to allow firms to rely on swap data repositories ("SDRs") for recordkeeping requirements. The analysis states:

> The Commission considered this alternative to its recordkeeping rules, but determined that it is premature at this time to permit SDs and MSPs to rely solely on SDRs to meet their recordkeeping obligations under the rules. ... At present, SDRs are new entities

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[4] See Swap Dealer and Major Swap Participant Recordkeeping and Reporting, Duties, and Conflicts of Interest Policies and Procedures; Futures Commission Merchant and Introducing Broker Conflicts of Interest Policies and Procedures; Swap Dealer, Major Swap Participant, and Futures Commission Merchant Chief Compliance Officer, Final Rule, 77 Fed. Reg. [ ] ([ ]), at Section IV of the Preamble.

> under the Dodd-Frank Act with no track record of operations; and, for particular swap asset classes, SDRs have yet to be established.[5]

In addition to finalizing rules governing registration standards, duties and core principles for SDRs[6], the Commission has already voted on the final rules that establish and compel the reporting of swap transaction information to SDRs for purposes of real-time public reporting (the "Real-Time Reporting Rule") and to ensure that complete data concerning swaps is available to regulators throughout the existence of the swap and for fifteen years following termination.[7] In addition, the track record of entities that will likely be our first registered SDRs is considered proven as data from these repositories in both rates and credit have been used to establish the foundation for today's re-proposal of Procedures to Establish Appropriate Minimum Block Sizes For Large Notional Off-Facility Swaps and Block Trades; Further Measures to Protect the Identities of Parties to Swap Transactions (the "Block Proposal").

If the Commission truly has doubts as to the fidelity and reliability SDR data, than it ought not to have relied upon it in a proposed rulemaking. That being said, although the analysis seems to indicate that the Commission considered alternatives, it is curious as to how the Commission came to the conclusion that the Internal Business Conduct Rules are cost-effective, given that they require firms to keep duplicative and redundant trade records when all trades must be reported to an SDR and stored by the SDR for the life of the swap, plus an additional fifteen years—which is ten years more than our rules require that such records be kept by registrants.

I would also point out that the Real-Time Reporting Rule provides that a party to a publicly-reportable swap transaction satisfies its real-time reporting requirements by executing the swap on or pursuant to the rules of an exchange or swap execution facility.[8] That is, SDs and MSPs, among others, may rely on exchanges and swap execution facilities to report all on-exchange trades; there is no mandated separate reporting requirement. However, the Internal Business Conduct Rules undermine this relief by requiring redundant recordkeeping and by mandating that SDs and MSPs save all transaction records and by failing to trust our own regulatory-creation to actually serve as a repository for all trade data as envisioned by Dodd-Frank Act. I have serious concerns about the Commission's ability to monitor and reconcile two sets of records, which is the rationale put forth in this final rule.

Ironically, the SDRs were created in the Dodd-Frank Act to facilitate market transparency and reporting. The Commission could provide greater transparency into its own cost-benefit analysis

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[5] Id.

[6] Swap Data Repositories: Registration Standards, Duties and Core Principles, 76 Fed. Reg. 54,538 (Sept. 1, 2011) (to be codified at 17 C.F.R. pt. 49).

[7] Real-Time Public Reporting of Swap Transaction Data, 76 Fed. Reg. 1,182 (Jan. 9, 2012) (to be codified at 17 C.F.R. pt. 43); Swap Data Recordkeeping and Reporting Requirements, 76 Fed. Reg. 2,136 (Jan. 13, 2012) (to be codified at 17 C.F.R. pt. 45).

[8] Real-Time Public Reporting of Swap Transaction Data, 76 Fed. Reg. 1,182, 1,244 (Jan. 9, 2012) (to be codified at 17 C.F.R. pt. 43).

by disclosing its assumptions and data to support its conclusions. Circular A-4 outlines standards for transparency with the following direction, "A good analysis should be transparent and your results must be reproducible. You should clearly set out the basic assumptions, methods and data underlying the analysis and discuss the uncertainties associated with your estimates."[9] It goes on to recommend that, "To provide greater access to your analysis, you should generally post it, with all the supporting documents, on the internet so the public can review the findings."[10] The Commission has not provided any insight into its economic analysis, which is inconsistent with OMB Circular A-4.

I believe the directives in Circular A-4 provide for a fully transparent cost-benefit analysis. However, the Commission has failed to follow OMB direction and has not shared its supporting documentation to validate and replicate its conclusions. I hope that you will direct the OMB to undertake a complete review of this rulemaking to determine whether or not this rule fully complies with Executive Orders 12866, 13563, and 13579 and OMB Circular A-4. To the extent that OMB finds any concerns with the Commission's cost-benefit and other regulatory analyses, I hope you will provide specific recommendations as to how the Commission can improve its methodologies and analytical capabilities.

Finally, I would like to share with you my concerns with regard to the OIRA Major/Nonmajor Rule Determination. The Commission has shared with OMB its determination that the Internal Business Conduct Rules "*may* have an annual effect on the economy of more than $100 million." It is interesting to me that this document makes such a claim without including a single dollar figure to support its conclusion and the costs are not delineated in the rule that would support such a conclusion. I would appreciate an explanation as to how this estimate was developed and the data your staff used in concurring with the Commission's determination. Since this decision provides the foundation under the Congressional Review Act, I am also interested to know what, if any, supporting data was provided to Congress to validate this analysis.

President Obama was very clear in his two Executive Orders that he expected the highest standards of analysis to validate the necessity of government rulemaking to ensure we don't impose undue and unfounded economic burdens on market participants and the public as a whole. I don't believe the Commission's rulemakings comply with this directive or OMB Circular A-4. I hope you will undertake a review of the Internal Business Conduct Rules to determine whether or not the Commission has set the appropriate baseline, included appropriate alternatives, and used proper economic analysis that can be reproduced.

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[9] OMB Circular A-4 at 17

[10] Id.

Thank you for your immediate attention to this important matter.

Sincerely,

Scott O'Malia