

**The Financial Markets Lawyers Group  
33 Liberty St., 7th Floor  
New York, NY 10045**

Commodity Exchange Act Sections 2(a)(13) and 4s  
Commission Regulations Part 23

November 21, 2012

Gary Barnett  
Director, Division of Swap Dealer and Intermediary Oversight  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581

Re: Financial Markets Lawyers Group – Request for Interpretative Letter for  
Swap Dealers in Connection with Foreign Exchange Prime Brokerage<sup>1</sup>

Dear Mr. Barnett:

The Financial Markets Lawyers Group (“**FMLG**”)<sup>1</sup> is seeking interpretative guidance from the Commodity Futures Trading Commission (the “**Commission**”) and the staff, in the context of foreign exchange prime brokerage (“**FX Prime Brokerage**”), regarding application of the external business conduct standards (the “**Business Conduct Standards**”).<sup>2</sup> Unless this relief is granted, FX Prime Brokerage, as currently structured, will not be able to continue as of January 1, 2013 because, without allocation of responsibilities under the Business Conduct Standards between a prime broker and an executing dealer, swap dealers providing FX Prime Brokerage services will not be able to satisfy the regulatory standards. The FMLG’s proposal provides for satisfaction of all of the Business Conduct Standards (within the time frames designated by the Commission) and provision of the customer protections contemplated by the Commission’s Regulations. The FMLG’s proposal differs from the Commission’s structure only in that responsibility for certain of the duties is allocated between prime brokers and executing dealers. We ask that the Commission and staff grant this relief by December 31, 2012<sup>3</sup> and that the relief cover swap dealers’ obligations in respect to uncleared, over-the-counter transactions in foreign currencies that constitute swaps, as defined in Section 1a(47) of the Commodity Exchange Act (the “**Act**”) and Commission Regulation 1.3(xxx) (“**FX Swaps**”) and over-the-counter physically-settled foreign exchange forwards and swap agreements that have been exempted from the definition of swap by the U.S. Department of the Treasury (“**Exempt FX Transactions**”) and together with FX Swaps, “**FX Transactions**”).<sup>4</sup> Although Exempt FX Transactions are not subject to the clearing mandate that applies to FX Swaps, the Treasury Exemption provides that any registered swap dealer or

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<sup>1</sup> FMLG is composed of lawyers who support foreign exchange and other financial markets trading in leading worldwide financial institutions. The FMLG includes members from the following institutions signing onto this Letter: Bank of America, N.A.; BNP Paribas; Citigroup Global Markets Inc.; Deutsche Bank; Goldman, Sachs & Co.; HSBC Securities (USA) Inc.; JP Morgan Chase & Co.; Morgan Stanley; Royal Bank of Canada; State Street Bank and Trust Company; The Bank of New York Mellon; UBS AG; U.S. Bank National Association; and Wells Fargo. The FMLG is sponsored by the Federal Reserve Bank of New York and advises on legal issues relevant to the global foreign exchange and foreign exchange swaps markets. Although FMLG is sponsored by the Federal Reserve Bank of New York, this interpretative letter request is not endorsed by the Federal Reserve Bank of New York or the Federal Reserve System.

major swap participant offering or transacting in Exempt FX Transactions must comply with the Business Conduct Standards.<sup>5</sup>

## I. Introduction

A large portion of the FX Transactions entered into by FMLG Members with counterparties that are not swap dealers, major swap participants, security-based swap dealers, or major security-based swap participants (“**Counterparties**”) are carried out under FX Prime Brokerage arrangements. In an FX Prime Brokerage arrangement, a Counterparty establishes a direct relationship with a prime broker that intermediates trades between the Counterparty and a wide variety of dealers with whom the prime broker (but not the Counterparty) has a direct credit relationship. As discussed in more detail in Part III below, the arrangement allows the Counterparty, on its own behalf or through an asset manager or other entity representing one or more Counterparties (a “**Counterparty Representative**”), to seek bids for a specified type of FX Transaction from one or more executing dealers, based on parameters that have been pre-approved by the prime broker, and to negotiate an FX Transaction with an executing dealer, on behalf of the prime broker as principal (an “**ED-PB Swap**”). After acceptance of the ED-PB Swap, the prime broker establishes an FX Transaction, having identical material economic terms and conditions, with the Counterparty (the “**Counterparty Mirror Swap**”). In many cases, the executing dealer will never know the identity of the Counterparty or Counterparties to whom the FX Transaction is allocated because the Counterparty Representative will negotiate the terms of the ED-PB Swap with the executing dealer on behalf of a number of Counterparties and allocate the FX Transaction to the Counterparties only after execution of the Counterparty Mirror Swap.<sup>6</sup>

It would be difficult for prime brokers and executing brokers, which play fundamentally different roles with respect to the Counterparty relationship and execution of the FX Transaction, each to comply fully with the Business Conduct Standards because the entities have access to different information at different points in time. The prime broker maintains detailed credit and other portfolio information regarding each Counterparty. Accordingly, it is in the best position to take responsibility for compliance with “know-your-counterparty” and related responsibilities (“**Relationship-Level Business Conduct Standards**”). The executing dealer, on the other hand, will often not know the identity of the underlying Counterparties, since the Counterparty Representative, which is negotiating with the executing dealer, will not allocate the trades until after execution of the Counterparty Mirror Swap. Conversely, the executing dealer, but not the prime broker, will have access to timely trade information and information about the inherent risks relating to the ED-PB Swap (and, by extension, the Counterparty Mirror Swap). As a result, the executing dealer is in a better position to provide pre-trade mid-market quote, risk disclosures and other required disclosures relating to the FX Transaction (“**Transaction-Level Business Conduct Standards**”).

## II. Request for Interpretative Letter

The FMLG requests that the Commission’s Division of Swap Dealer and Intermediary Oversight (“**SDIO**”) issue an interpretative letter stating that, in the context of FX Prime Brokerage, (i) the Relationship-Level Business Conduct Standards and the Transaction-Level Business Conduct Standards shall be allocated as provided in the proposal below and (ii) compliance with anti-fraud, fair dealing and other general conduct requirements (“**General Business Conduct Standards**”) will be required for both the prime broker and the executing dealer.

Relief would be conditioned on the following: (i) allocation of responsibilities under this framework would not be optional or subject to negotiation between the parties; (ii) the prime broker and the executing broker would each be registered with the Commission as a swap dealer; (iii) the ED-PB

Swap and the Counterparty Mirror Swap would have identical material economic terms and pricing; (iv) the prime broker would provide to each Counterparty or Counterparty Representative, in the prime brokerage agreement or otherwise in writing, clear, plain English disclosure describing the allocation of Business Conduct Standards between the prime broker and each executing dealer;<sup>7</sup> (v) the Counterparty or Counterparty Representative would designate the prime broker as a recipient of the ISDA August Dodd-Frank Protocol<sup>8</sup> (“**ISDA Protocol**”) and protocol questionnaire from the Counterparty or Counterparties providing all information required to be collected by a swap dealer from a Counterparty under the Business Conduct Standards or provide to the prime broker, representations and undertakings with respect to Business Conduct Standards similar to those contained in the ISDA Protocol, in a form acceptable to the prime broker; and (vi) the Counterparty or Counterparty Representative would provide the executing dealers limited representations and undertakings relating to the executing dealer’s responsibilities (*e.g.*, communicating the Counterparty’s election of a form of delivery method for disclosures) under FMLG’s allocation proposal (“**Alternative DF Undertakings**”) or designate the executing dealer as a recipient of the ISDA Protocol.<sup>9</sup>

### **III. Description of FX Prime Brokerage**

To establish an FX Prime Brokerage relationship, a Counterparty opens an account with a prime broker, enters into an ISDA Master Agreement, Schedule and Credit Support Annex and a prime brokerage agreement with the prime broker. In connection with the documentation, the prime broker grants the Counterparty limited agency powers to enter into FX Transactions for the prime broker with approved executing dealers, subject to specified limits and parameters.<sup>10</sup> The prime broker conducts due diligence and know-your-customer reviews and establishes credit limits and collateral requirements with respect to the Counterparty prior to approving and entering into a prime brokerage relationship.

The prime broker enters into “give-up” arrangements with the executing dealers, who are authorized by the prime broker. Under these arrangements, executing dealers agree to negotiate FX Transactions with the Counterparty or Counterparty Representative, as agent for the prime broker, within the specified parameters and to face the prime broker as a counterparty on the ED-PB Swaps. A give-up agreement between the prime broker and the executing dealer typically specifies the procedures for acceptance and rejection of an ED-PB Swap by the prime broker.

Under FX Prime Brokerage, the Counterparty or Counterparty Representative will seek bids for a desired FX Transaction from one or more of the approved executing dealers. The FX Transaction must satisfy the parameters established by the prime broker. Once the Counterparty or Counterparty Representative and executing dealer agree on terms, the Counterparty or Counterparty Representative and the executing dealer will each provide notice of the terms of the ED-PB Swap to the prime broker. As a matter of custom and practice and, in many cases, as a matter of contract, the prime broker is required to accept the ED-PB Swap provided the ED-PB Swap is with an approved executing dealer, the Counterparty or Counterparty Representative and the executing dealer have committed to the material terms of the ED-PB Swap and the ED-PB Swap is within the designated parameters provided to the Counterparty and the executing dealer. After acceptance of the ED-PB Swap, the prime broker will enter into an identical transaction (*i.e.*, the Counterparty Mirror Swap) with the Counterparty. The Counterparty Mirror Swap may be allocated by a Counterparty Representative among various Counterparties.

If the prime broker determines that the terms of the proposed ED-PB Swap are not within the pre-established parameters, it may reject the FX Transaction. Unlike securities prime brokerage, the rejected transaction is then cancelled and, unless otherwise agreed by the parties, would generally not be re-booked as a new trade between the executing dealer and the Counterparty.

In accordance with general market practice, if the executing dealer and the Counterparty agree to amend the ED-PB Swap, then the prime broker and the Counterparty will mirror that amendment in the Counterparty Mirror Swap.<sup>11</sup>

The Counterparty is typically charged a standard servicing fee by the prime broker in connection with the prime brokerage services. The fee is pre-agreed between the prime broker and the Counterparty and is billed periodically to the Counterparty.<sup>12</sup>

A diagram of the FX Prime Brokerage transaction structure is set forth at Exhibit A.

#### **IV. Allocation Proposal for Business Conduct Standards in FX Prime Brokerage**

In light of the bifurcated structure of FX Prime Brokerage, executing dealers and prime brokers need to allocate responsibilities for compliance with the Business Conduct Standards between the two entities. Because the allocation would be fully disclosed, the Counterparty would be able to bring an action against the executing dealer, in respect to the responsibilities it has, or the prime broker, in respect to the responsibilities it has, as may be the case under prevailing facts and circumstances, for failure to satisfy its obligations to the Counterparty. Although the Counterparty does not have a contractual relationship with the executing dealer, because the allocation framework would be mandated by this Interpretative Letter, the Counterparty would have recourse against the executing dealer pursuant to general anti-fraud provisions under the Act, since the executing dealer is the swap dealer to whom the responsibilities are delegated by the Commission and staff.<sup>13</sup> A chart summarizing the allocation of responsibilities under the FMLG proposal is attached at Annex B.

The FMLG's allocation proposal does not address Business Conduct Standards that relate to cleared Swaps, since FX Prime Brokerage arrangements do not apply to cleared swaps.<sup>14</sup>

##### **A. General Business Conduct Standards – Allocated to both the Prime Broker and the Executing Dealer**

Compliance with these General Business Conduct Standards would be allocated to both the prime broker and the executing dealer. The prime broker would be allowed to rely on the executing dealer to comply with executing dealer's obligations, and the executing dealer would be allowed to rely on the prime broker to comply with the prime broker's obligations. Neither the prime broker nor the executing dealer would have liability for non-performance by the other.

##### **1. Policies and Procedures: § 23.402(a).**

A swap dealer must have written policies and procedures that are reasonably designed to ensure compliance with the requirements of the Business Conduct Standards and to prevent a swap dealer from evading, participating in or facilitating an evasion of any provision of the Act or any regulation thereunder. Allocating compliance responsibilities to both ensures that both the executing dealer and the prime broker develop policies and procedures that are tailored to the business role each plays in the FX Prime Brokerage arrangement.

##### **2. Record Retention: § 23.402(g).**

Given the allocation of responsibilities and need to provide for a clear audit trail, the FMLG recommends that both the prime broker and executing dealer be required to maintain records evidencing compliance with the requirements with the Business Conduct Standards.

**3. Prohibition on Fraud, Manipulation, and Other Abusive Practices: § 23.410(a); Counterparty Confidential Information Protections: § 23.410(c); Communications—fair dealing: § 23.433.**

The Regulations and underlying requirements are designed to maintain market integrity and, thus, appropriately are imposed on all swap dealer participants in FX Prime Brokerage.

**4. Counterparty Consent to Form and Manner of Disclosures: § 23.402(e)-(f).<sup>15</sup>**

Under the allocation of responsibilities contemplated by the FMLG's proposal, both the prime broker and the executing broker would be required to deliver disclosures to the Counterparty, directly or through the Counterparty Representative. As a result, the Counterparty will need to inform each of the dealers separately what type of delivery system or systems should be used. Because the timing for the different types of disclosures may vary, the Counterparty may elect different delivery methods for the prime broker and the executing dealers.

**B. Relationship-Level Business Conduct Standards – Allocated Solely to Prime Broker**

Compliance with these Relationship-Level Business Conduct Standards would be allocated solely to the prime broker. Under the FMLG's proposal, the executing dealers would be allowed to rely on the prime broker to comply with its obligations and would not have liability for the non-performance of the prime broker.

**1. Know-Your-Counterparty: § 23.402(b); Client True Name and Owner: § 23.402(c); Counterparty Confidential Information Waiver: § 23.410(c)(2); Obtaining Representations/Safe Harbors: §§ 23.402(d); 23.430(d); 23.434(b); 23.440(b).<sup>16</sup>**

A swap dealer must obtain and retain, a record of the essential facts, including name and address, regarding each Counterparty whose identity is known to the swap dealer prior to the execution of an FX Transaction.<sup>17</sup> The prime broker is in the best position to evaluate these essential facts concerning the Counterparty since it enters into a contractual relationship with the Counterparty and, when dealing with a Counterparty Representative, the prime broker will have information regarding each of the underlying principals for which the Counterparty Representative is acting under the FX Prime Brokerage arrangement. The prime broker will generally rely on the safe harbors included in the Business Conduct Standards (the “**Safe Harbors**”) to obtain the necessary representations regarding essential facts relating to the Counterparty.<sup>18</sup>

The executing dealer, on the other hand, typically does not have a contractual relationship with the Counterparty and, in connection with an ED-PB Swap that will be the basis for a Counterparty Mirror Swap that is allocated among different Counterparties, will not know the identities of the underlying Counterparties (since allocation will not be done until after completion of the Counterparty Mirror Swap, which often is significantly after completion of the ED-PB Swap). Under the Business Conduct Standards, a swap dealer may disclose or use material confidential information provided by a Counterparty if such disclosure or use is authorized in writing by the Counterparty. Since the prime broker will be responsible for obtaining and retaining all Counterparty-specific information in connection with establishment of the FX Prime Brokerage relationship, compliance with this requirement should rest with the prime broker. In most cases, prime brokers would seek to comply with the Safe Harbors and would expect to receive the representations from the Counterparties or Counterparty Representatives (on behalf of the Counterparties) that are necessary to comply with the applicable Safe Harbors. Executing dealers would rely on the fact that the FX Prime Brokerage arrangement would be conducted in

accordance with the Safe Harbors. In the unusual situation where a prime broker elects to accept a Counterparty or not to suspend an existing trading relationship under FX Prime Brokerage with a Counterparty that does not provide the information necessary to rely on the applicable Safe Harbors, the prime broker would be required to notify the executing dealers of this fact and provide the required information to the executing dealers to allow them to comply with the Business Conduct Standards, assuming they agree to act as executing dealers without relying on the Safe Harbors.<sup>19</sup>

**2. Notice of Right to Receive Scenario Analysis: § 23.431(b)(1).**

This disclosure relates to the general rights a Counterparty will have under the FX Prime Brokerage relationship. As a result, it is appropriately provided to the prime broker in connection with initiation of the FX Prime Brokerage relationship. The prime broker would be required to include disclosure explaining that the executing dealer would prepare and provide the analysis, if requested by the Counterparty.

**3. Delivery of Post-Trade Daily Mark and Methodology: § 23.431(d)(2)-(3).<sup>20</sup>**

Since the prime broker will be a party to the Counterparty Mirror Swap, it is appropriate that the prime broker be responsible for providing the Counterparty with a post-trade, daily mark as well as the assumptions underlying this daily mark. Allocation of responsibility for post-trade delivery of the daily mark is consistent with the prime broker's on-going responsibility to carry and margin the Counterparty Mirror Swap.

**C. Relationship-Level Business Conduct Standards – Allocated to the Prime Broker in all cases and to the Executing Dealer as well in certain limited cases**

Compliance with these Relationship-Level Business Conduct Standards would be allocated solely to the prime broker in most cases. The executing dealers would be allowed to rely on the prime broker to comply with its obligations and would not have liability for the non-performance of the prime broker. As a practical matter, the executing dealer will need to rely on the prime broker in these situations because it will not have a relationship with the Counterparty and, in many cases, will not know the identity of the Counterparty because it is negotiating with a Counterparty Representative, who typically will not disclose the identities of the underlying Counterparty or Counterparties.

In less typical situations where an executing dealer itself both actually knows the identity of the Counterparty (i.e., because it is negotiating with the Counterparty or because Counterparty Representative discloses the identity) and has a customer relationship with the Counterparty, the executing dealer must comply with these requirements as well. A customer relationship is a direct, fully-disclosed, foreign exchange trading relationship directly with the Counterparty that is reflected on the books and records of the executing dealer itself.

**1. Disclosure of Material Incentives and Conflicts of Interest: § 23.431(a)(3)(ii);<sup>21</sup>  
Political Contributions: § 23.451.<sup>22</sup>**

Since the prime broker will be a party to the Counterparty Mirror Swap, it will always know the underlying Counterparty and be in a position to monitor compliance with these Business Conduct Standards. In most cases, an executing dealer will not actually know the identity of the underlying Counterparty or Counterparties but, even if the identity or identities are known, the executing dealer itself will have no foreign exchange trading customer relationship with the Counterparty or Counterparties and

no practical ability to obtain identifying information. In this situation, the executing dealer would not be able to disclose potential conflicts because they would not be aware of the conflicts.

In cases where the executing dealer itself has actual knowledge of the identity of the Counterparty and has a foreign exchange trading customer relationship with the Counterparty such as it knows what conflicts of interest are inherent in the relationship directly between the executing dealer and the Counterparty, the executing dealer would be subject to this disclosure requirement.

## **2. Recommendations to Counterparties – Institutional Suitability: § 23.434.<sup>23</sup>**

In the context of FX Prime Brokerage, the prime broker and the executing dealer typically do not “recommend” FX Transactions or trading strategies involving an FX Transaction to a Counterparty or Counterparty Representative. In most cases, Counterparties are large institutional investors that are represented by experienced trading advisors that are unaffiliated with either of the swap dealers. As a result, suitability obligations generally are not applicable in connection with FX Prime Brokerage.

In certain situations, however, a prime broker or executing dealer may recommend an FX Transaction or trading strategy involving an FX Transaction to a Counterparty or Counterparty Representative. In these situations, the FMLG expects that the dealer recommending the FX Transaction would typically not have a suitability obligation because prime brokers and, if the executing dealer itself knows the identity of the Counterparty and has a foreign exchange trading customer relationship with the Counterparty, then the executing dealer as well, would obtain representations from the Counterparty sufficient to rely on the Safe Harbor from the suitability requirements.

In situations where the executing dealer itself does not have both actual knowledge of the identity of the Counterparty and a foreign exchange trading customer relationship with the Counterparty, the executing dealer would rely on the prime broker to obtain all information necessary to satisfy the Safe Harbors. Unless the prime broker expressly notifies the executing dealer to the contrary, the executing dealer would be able to assume that the prime broker is relying on and complied with all obligations necessary to rely on the Safe Harbor. In the unusual circumstance where the prime broker elects to accept a Counterparty or not to suspend dealing lines for a Counterparty notwithstanding that the Counterparty does not provide the representations necessary for the prime broker and the executing dealer to rely on the Safe Harbor (assuming that the executing dealer is not obligated to independently obtain such information, because the executing dealer itself does not know the identity of the Counterparty and have a foreign exchange trading customer relationship with the Counterparty), the prime broker would have an affirmative obligation to notify the executing dealer that the particular Counterparty did not provide representations necessary to satisfy the Safe Harbor.<sup>24</sup>

## **3. Verification of Status as an Eligible Contract Participant<sup>25</sup> or Special Entity<sup>26</sup>: § 23.430(a)-(c).<sup>27</sup>**

The prime broker serves as a swap counterparty to the Counterparty and, as a result, must obtain these representations in order to transact with the Counterparty. The executing dealer will typically not know the identity of the underlying Counterparties because it is negotiating with a Counterparty Representative or, if it does know the identity, it will not have a foreign exchange trading customer relationship with the Counterparty sufficient to obtain the information required to comply with this requirement. Under these circumstances, the executing dealer will be able to rely on the prime broker to have verified the Counterparty’s status as an eligible contract participant (as a condition to acceptance of the Counterparty into the FX Prime Brokerage relationship) and to rely on the prime broker to have verified the Counterparty’s status as a non-Special Entity. To the extent that the Counterparty is a Special

Entity, the prime broker will be responsible for notifying the executing dealer (although the prime broker may also elect to exclude these Counterparties from participation in FX Prime Brokerage).

If an executing dealer itself has actual knowledge of the Counterparty's identity and has a foreign exchange trading customer relationship with the Counterparty such that it knows or should know the Counterparty's status, the executing dealer would be required to provide the Counterparty with the same disclosures and protections as it would if it were entering into an FX Transaction directly with the Counterparty.

**4. Requirements for Swap Dealers Acting as Counterparties to Special Entities: § 23.450.<sup>28</sup>**

Since the prime broker is the party to the Counterparty Mirror Swap with the Counterparty, it is required to satisfy these obligations to the Counterparty. Because the executing dealer will establish the economic terms of the Counterparty Mirror Swap through its negotiations with the Counterparty or Counterparty Representatives, it too must negotiate with the Counterparty in a manner that complies with the Business Conduct Standards. The executing dealer will usually not know the identity of the underlying Counterparties because it is negotiating with a Counterparty Representative or, if negotiating directly with the Counterparty, will not have sufficient access to the Counterparty to obtain information (*i.e.*, this will be the case when the executing dealer itself does not have a foreign exchange trading customer relationship with the Counterparty). Under these circumstances, the executing dealer will not have responsibility for providing special protections to the underlying Counterparty because it will not have actual knowledge of the Counterparty's status.

To the extent that the executing dealer itself has actual knowledge of the Counterparty's identity and has a foreign exchange trading customer relationship with the Counterparty and, thus, knows the Counterparty's status, however, the executing dealer would be required to provide the Counterparty the same disclosures and protections as it would if it were entering into an FX Transaction directly with the Counterparty.

**5. Duties When Acting as an Advisor to a Special Entity: § 23.440(c).<sup>29</sup>**

As a general matter, prime brokers and executing dealers will not agree to act as advisors to their Special Entity Counterparties. However, to the extent the prime broker were acting as an advisor to a Special Entity Counterparty, the prime broker would be required to verify the Counterparty's status as a Special Entity and determine that the FX Transactions entered into are the best interests of the Special Entity. In this situation, the executing dealer would not have any separate responsibilities.

To the extent that the executing dealer itself has actual knowledge of the Counterparty's identity and has a foreign exchange trading customer relationship with the Counterparty, it would independently be required to verify the Counterparty's status as a Special Entity or non-Special Entity and determine whether the executing dealer is itself acting as advisor to the Counterparty. In the event that the Counterparty were a Special Entity and the executing dealer were acting as an advisor, then the executing dealer too would be subject to these responsibilities.<sup>30</sup>



**D. Transaction-Level Business Conduct Standards -- Allocated Solely to the Executing Dealers**

Compliance with these Transaction-Level Business Conduct Standards would be allocated solely to the executing broker. The prime broker would be allowed to rely on the executing dealer to comply with its obligations and would not have liability for the non-performance of the executing dealer.

**1. Disclosure of Swap Material Risks § 23.431(a)(1); Disclosure of Swap Material Characteristics § 23.431(a)(2).<sup>31</sup>**

Under the FMLG allocation proposal, the executing dealer would be responsible for providing disclosure to the Counterparty or Counterparty Representative regarding risks inherent in the ED-PB Swap as well as regarding the material characteristics of that FX Transaction. Because the terms of the ED-PB Swap will establish the material terms and conditions of the Counterparty Mirror Swap, the appropriate time to provide risk and term information to the Counterparty is prior to execution of the ED-PB Swap and at a time sufficiently in advance of execution of the ED-PB Swap so that the Counterparty or Counterparty Representative has an opportunity to negotiate with the executing dealer regarding the terms and conditions.<sup>32</sup> Since the executing dealer is the party for whom the Counterparty is structuring the ED-PB Swap, the executing broker is in the best position to provide the Counterparty with the required disclosures regarding the material risks and terms of the FX Transaction. The prime broker would not know the terms of the ED-PB Swap until after the Counterparty and the executing dealer have agreed on terms and the executing dealer has forwarded the ED-PB Swap to the prime broker for approval.

When the executing dealer is negotiating the ED-PB Swap with a Counterparty Representative, the executing dealer would provide the risk disclosure to the Counterparty Representative and rely on the Representative to appropriately evaluate the risks inherent in the FX Transaction and to determine whether the FX Transaction is suitable and within the investment guidelines and risk tolerance established by the Counterparty. The executing dealer would also rely on the Counterparty Representative to explain to the Counterparty the structure of the FX Prime Brokerage arrangement, including the fact that the ED-PB Swap will determine the economics of the Counterparty Mirror Swap. As part of the account opening process, the prime broker will be required to establish the authority of the Counterparty Representative to act for Counterparty and to receive disclosures on behalf of and as agent for the Counterparty. For Special Entities, the authority and qualifications of the Counterparty Representative will be established in the ISDA Protocol or in the Alternative DF Undertakings provided to the executing dealer.<sup>33</sup>

**2. Disclosure of the Price of the Swap and the Pre-Trade Swap Mid-Market Mark: § 23.431(a)(3)(i).**

Because the executing dealer is the party with whom the Counterparty or Counterparty Representative negotiates pricing and structure regarding the ED-PB Swap, which, in turn will determine the terms of the Counterparty Mirror Swap, the executing dealer is in the best position to provide the Counterparty with the required disclosures regarding the terms of the Counterparty Mirror Swap. The prime broker will not know the terms of the ED-PB Swap transaction until after the Counterparty or Counterparty Representative and the executing dealer have finalized negotiations regarding the FX Transaction. As a result, the prime broker would not be able to satisfy these requirements without becoming involved in negotiations around the ED-PB Swap, which would undermine many of the efficiencies and benefits offered by the Standard Swap Prime Brokerage model.

**3. Development and Delivery of Scenario Analysis (if requested): § 23.431(b)(2)-(4).**

Prior to entering into a Swap with a Counterparty but solely if requested by the Counterparty, a swap dealer must provide the Counterparty with a scenario analysis and disclose all material assumptions and methodologies used to perform the analysis. Since the executing dealer is the party with whom the Counterparty or Counterparty Representative negotiates regarding the economic terms of the ED-PB Swap, which, in turn, will determine the structure of the Counterparty Mirror Swap, the executing dealer is in the best position to provide the Counterparty or Counterparty Representative with the scenario analysis regarding the terms of the Counterparty Mirror Swap. The prime broker will not know the terms of the ED-PB Swap transaction until after the executing dealer and the Counterparty or Counterparty Representative have finalized negotiations. As a result, the prime broker would not be able to satisfy these requirements without becoming involved in negotiations around the ED-PB Swap which would undermine many of the efficiencies and benefits offered by the FX Prime Brokerage model.

**V. Public Policy Benefits**

The requested relief preserves the FX Prime Brokerage model, promotes uniformity and reduces unnecessary, duplicative documentation and disclosures. By allocating responsibility for compliance with the Business Conduct Standards between the prime broker and the executing broker, the approach ensures that Counterparties are provided with the full benefit of the Business Conduct Standards from the swap dealer or dealers in the best position to provide the protections. As a result, the FMLG's allocation proposal provides for compliance by swap dealers in an efficient manner, that should not increase costs to Counterparties and that will allow Counterparties to continue to conduct their FX Transactions under a model that allows them to obtain favorable pricing from a counterparty with whom they may not have a credit relationship while carrying FX Transactions and any related collateral with a swap dealer with which they do have a credit relationship.

**VI. Conclusion**

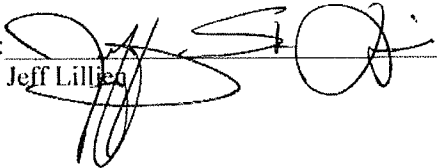
Neither the Commission nor the staff has previously issued an exemptive, no-action or interpretative letter regarding the application of Part 23 to swap dealers in connection with FX Prime Brokerage. The FMLG notes that the SEC has previously granted no-action relief with respect to derivative arrangements involving "mirror transactions" with third-party dealers in an unrelated context. Although the logic of that SEC No-Action Letter is applicable only by analogy, the framework of the SEC No-Action Letter is similar to that proposed by the FMLG in this request for relief and may provide a useful reference point for the Commission and its staff to consider.<sup>34</sup>

FMLG requests that, if SDIO denies this request for an interpretative letter, it consider granting alternative relief or an alternative position to alleviate the duplicative burdens placed on prime brokers and executing dealers seeking to comply with the Business Conduct Standards in the context of FX Prime Brokerage.

Please do not hesitate to contact the FMLG's representative member, Jeff Lillien, of Deutsche Bank AG, at (212) 250-2699 or [jeff.lillien@db.com](mailto:jeff.lillien@db.com) should you have any questions regarding our request.

Sincerely,

**THE FINANCIAL MARKETS LAWYERS GROUP**

By:  \_\_\_\_\_  
Jeff Lillien

cc: Hon. Gary Gensler, Chairman  
Hon. Jill E. Sommers, Commissioner  
Hon. Bart Chilton, Commissioner  
Hon. Scott D. O'Malia, Commissioner  
Hon. Mark P. Wetjen, Commissioner  
Commodity Futures Trading Commission  
1155 21st Street NW  
Washington, DC 20581

**UNDERTAKING AND CERTIFICATION**

I, the undersigned, a representative member of the FMLG, who has been duly appointed to sign this Undertaking and Certification on behalf of the FMLG, hereby undertake that I will notify the U.S. Commodity Futures Trading Commission staff promptly if any of the representations made in connection with or related to FMLG's Request for Interpretative Letter, dated November 20, 2012, cease to be true or correct, or become incomplete or misleading.

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I hereby certify that the material facts set forth in the attached Letter are true and complete to the best of my knowledge.

Signed ..... 

Name..... Jeff L. Viren

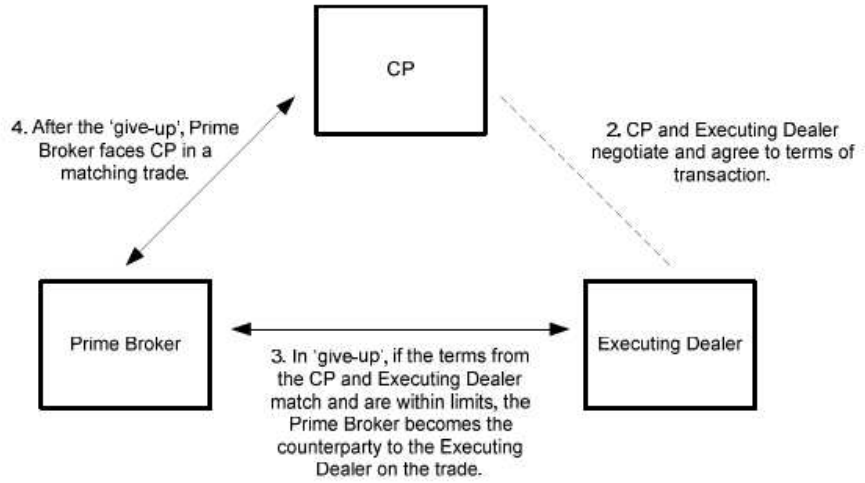
Date..... November 29, 2012

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# ANNEX A

## Diagram of Typical Prime Brokerage Transaction

1. CP and Prime Broker execute Prime Brokerage Agreement; Prime Broker and Executing Dealer execute Give-Up Agreement; Prime Broker sends designation notice to Executing Dealer with CP limits.



**ANNEX B**

<b>Business Conduct Standard</b>	<b>Responsibilities of Prime Broker</b>	<b>Responsibilities of Executing Dealer</b>
Policies and Procedures (§ 23.402(a))	Prime broker must have written policies and procedures designed to ensure compliance with the Business Conduct Standards.	Executing dealer must have written policies and procedures designed to ensure compliance with the Business Conduct Standards.
Record Retention (§ 23.402(g))	Prime broker is required to maintain records evidencing compliance with the requirements with the Business Conduct Standards.	Executing dealer is required to maintain records evidencing compliance with the requirements with the Business Conduct Standards.
Counterparty Consent to Form and Manner of Disclosures (§ 23.402(e)-(f))	Prime broker is responsible for obtaining with respect to disclosures by the prime broker.	Executing dealer is responsible for obtaining with respect to disclosures by the executing dealer.
Prohibition on Fraud, Manipulation, and Other Abusive Practices (§ 23.410(a))	Prohibition imposed on prime broker.	Prohibition imposed on executing dealer.
Counterparty Confidential Information Protections (§ 23.410(c))	Protections imposed on prime broker.	Protections imposed on executing dealer.
Communications – Fair Dealing (§ 23.433)	Fair dealing requirement imposed on prime broker.	Fair dealing requirement imposed on executing dealer.
Know-Your-Counterparty (§ 23.402(b))	Prime broker must obtain.	N/A
Client True Name and Owner (§ 23.402(c))	Prime broker must obtain.	N/A
Counterparty Confidential Information Waiver (§ 23.410(c)(2))	Prime broker must obtain.	N/A
Obtaining Representations/Safe Harbors (§§ 23.402(d); 23.430(d); 23.434(b); 23.440(b))	Prime broker must obtain.	N/A
Notice of Right to Receive Scenario Analysis (§ 23.431(b)(1))	Prime broker must give notice and disclose that the executing dealer would prepare and provide the analysis, if requested by the Counterparty.	N/A
Delivery of Post-Trade Daily Mark and Methodology (§ 23.431(d)(2)-(3))	Prime broker must provide the Counterparty with a post-trade, daily mark as	N/A

<b>Business Conduct Standard</b>	<b>Responsibilities of Prime Broker</b>	<b>Responsibilities of Executing Dealer</b>
	well as the assumptions underlying the daily mark.	
Disclosure of Material Incentives and Conflicts of Interest (§ 23.431(a)(3)(ii))	Prime broker has responsibility to disclose in all cases.	Executing dealer has responsibility to disclose in cases where it has actual knowledge of the identity of the underlying Counterparty or Counterparties and has a foreign exchange trading customer relationship with such Counterparty.
Political Contributions (§ 23.451)	Prime broker has responsibility to comply with prohibitions in all cases.	Executing dealer has responsibility to comply with prohibitions in cases where it has actual knowledge of the identity of the underlying Counterparty or Counterparties and has a foreign exchange trading customer relationship with such Counterparty.
Institutional Suitability (§ 23.434)	Generally not applicable, but a prime broker would be allowed to rely on the suitability safe harbors to satisfy their suitability obligations in instances where they recommend a swap or trading strategy to the Counterparty. If the prime broker does not obtain the representations necessary to satisfy the Safe Harbors but it accepts the Counterparty into its FX Prime Brokerage business, it must notify the executing dealer of this fact.	An executing dealer would be allowed to rely on the prime broker to obtain representations from the Counterparty necessary to rely on the suitability Safe Harbors unless the executing dealer has actual knowledge of the identity of the underlying Counterparty or Counterparties and has a foreign exchange trading customer relationship with such Counterparty, in which case the executing dealer must independently obtain the representations. If the prime broker does not obtain the representations it will notify the executing dealer and the executing dealer will, if it trades with the Counterparty (which it may elect not to), be required to refrain from making recommendations or independently obtain information from the Counterparty sufficient to provide a suitable recommendation.
Verification of Status as an Eligible Contract Participant or Special Entity (§ 23.430(a)-(c))	Prime broker must verify these statuses.	Executing dealer may rely on the prime broker to verify these statuses unless the executing dealer itself knows the identity of the Counterparty and has a foreign

<b>Business Conduct Standard</b>	<b>Responsibilities of Prime Broker</b>	<b>Responsibilities of Executing Dealer</b>
		exchange trading customer relationship with the Counterparty, in which case the executing dealer will be responsible for verifying the Counterparty's status.
Requirements for Swap Dealers Acting as Counterparties to Special Entities (§ 23.450)	Prime broker is responsible for satisfying these requirements.	Executing dealer may rely on the fact that the prime broker has confirmed that the entity is not a Special Entity unless the executing dealer itself knows the identity of the Counterparty and has a foreign exchange trading customer relationship with the Counterparty, in which case the executing dealer will be responsible for verifying Special Entity status and complying with the specified duties.
Duties When Acting as an Advisor to a Special Entity (§ 23.440(c))	Prime broker is responsible for determining whether an advisory relationship exists between itself or its affiliates and the Counterparty and, if one does exist in respect to FX Transactions, complying with the regulatory standards.	Executing dealer may rely on the fact that the prime broker has fully complied with these requirements unless the executing dealer itself knows the identity of the Counterparty and has a foreign exchange trading customer relationship with the Counterparty, in which case the executing dealer will be responsible for determining whether it or its affiliates act as advisor to the Special Entity and satisfying the specified duties.
Disclosure of Swap Material Risks and Material Characteristics (§§ 23.431(a)(1) and 23.431(a)(2))	N/A	Executing Dealer is responsible for disclosing material risks and material characteristics of a swap to the Counterparty.
Disclosure of the Price of the Swap and the Pre-Trade Swap Mid-Market Mark (§ 23.431(a)(3)(i))	N/A	Executing dealer is responsible for providing the Counterparty with the required disclosures regarding the terms of the Counterparty Mirror Swap.
Development and Delivery of Scenario Analysis (if requested) (§ 23.431(b)(2)-(4))	N/A	Executing dealer must provide a scenario analysis if requested by the Counterparty.
Clearing Disclosures	N/A	N/A
Notice of Right of Daily Mark	N/A	N/A



## END NOTES

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<sup>1</sup> This Request for an Interpretative Letter is being submitted simultaneously with a parallel request to the Division of Market Oversight seeking a Request for Interpretative Letter in respect to allocation of responsibilities between prime brokers and executing dealers relating to swap reporting in the context of certain swap prime brokerage arrangements.

<sup>2</sup> See 17 C.F.R. § 23.400 et seq. See also Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 Fed. Reg. 9734 (Feb. 17, 2012) (the “**Business Conduct Release**”).

<sup>3</sup> Many, if not all, of the financial institutions represented by FMLG will be required to register with the Commission as swap dealers by December 31, 2012 in accordance with Section 4s(a) of the Commodity Exchange Act and Part 23 of the Commission’s Regulations, which implements Section 4s. As a result these financial institutions will be required to comply with the Business Conduct Standards in the context of FX Prime Brokerage beginning on January 1, 2013.

<sup>4</sup> On November 16, 2012, pursuant to authority granted in Section 1a(47)(E) of the Act, the U.S. Department of the Treasury exempted physically-settled currency forwards and physically-settled currency swaps from the definition of “swap” (the “**Treasury Exemption**”). See Department of the Treasury, Determination of Foreign Exchange Swaps and Foreign Exchange Forwards under the Commodity Exchange Act, <http://www.treasury.gov/press-center/press-releases/Pages/tg1773.aspx> (“**Treasury Exemption Release**”).

<sup>5</sup> See Treasury Exemption Release at p. 46 and Section 1a(47)(E)(iv) of the Act.

<sup>6</sup> This will be the case even though the Counterparty Representative will provide the executing dealer with information about all of the Counterparties represented by it through delivery of a questionnaire under the ISDA Protocol or delivery of Alternative DF Undertakings since the Counterparty Representative generally will not disclose the identity of the principals for which it acting until it allocates the Counterparty Mirror Swap. This type of structure is similar to that followed in connection with agency securities lending where dealers will have a list of all of the principals for which an agent is acting but will typically not know at the time of the trade the identity of the principal who is acting as lender under a particular trade. Under the FMLG proposal, the Counterparty Representative would not be allowed to allocate some or all of the Counterparty Mirror Swap to an underlying Counterparty unless the Counterparty Representative has confirmed to the prime broker and the executing dealer that it has provided all required information regarding the underlying Counterparties to executing dealer. In addition, for purposes of this Letter, although we refer to the Counterparty Mirror Swap in the singular, in actuality, after allocation by the Counterparty Representative, the Counterparty Mirror Swap will be comprised of a number of separate FX Transactions, each of which will have a separate Counterparty designated by the Counterparty Representative.

<sup>7</sup> This disclosure may be provided electronically, through a website or through other means appropriate to effect delivery to the Counterparty or Counterparty Representative.

<sup>8</sup> Information regarding the ISDA Dodd-Frank Protocol is available at: <http://www2.isda.org/functional-areas/protocol-management/protocol/8>. The result of this requirement will be to ensure that the executing broker has sufficient information about the Counterparties to evaluate the risk information provided to the Counterparty or Counterparty Representative and to either make a specific suitability determination or to know when it will not be required to make a suitability determination (*i.e.*, because the swap dealer and the Counterparty have exchanged representations that: (i) the Counterparty is capable of independently evaluating investment risks with regard to the recommended FX Transaction, (ii) the Counterparty is exercising independent judgment and is not relying on the recommendation of the executing dealer, (iii) the executing dealer is not undertaking to assess the suitability of the FX Transaction or trading strategy for the Counterparty; and (v) if the Counterparty is a Special Entity, the executing is complying with the requirements of § 23.440).

<sup>9</sup> These representations and undertakings would include at a minimum information required for the executing dealers to comply with (i) the Institutional Suitability Business Conduct Standard (Commission Regulation 23.434); (ii) the Counterparty Consent to Form and Manner of Disclosures Business Conduct Standard (Commission Regulation 23.402(e)-(f)); (iii) the Verification of Status as an Eligible Contract Participant or Special Entity Business Conduct Standard (Commission Regulation 23.430(a)-(c)); (iv) the Requirements for Swap Dealers Acting as counterparties

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to Special Entities Business Conduct Standard (Commission Regulation 23.450); and (v) the Duties when Acting as an Advisor to a Special Entity Business Conduct Standard (Commission Regulation 23.440(c)).

<sup>10</sup> These include size of trade, type of trade, notional or other risk-based limits and general trading parameters.

<sup>11</sup> In the event that the ED-PB Swap is allocated, through the Counterparty Mirror Swap to a number of different Counterparties, adjustments to the Counterparty Mirror Swap dictated by changes made by the ED to the ED-PB Swap are implemented on a pro rata basis across the range of FX Transactions between the Counterparties and the prime broker that comprise the Counterparty Mirror Swap.

<sup>12</sup> The prime brokerage service fee reflects the service costs of the credit intermediation role played by the prime broker as well the cost of the substantial back-office and middle-office administrative services that the prime broker must perform in connection with booking, reconciling, settling, maintaining and adjusting the two mirror FX Transactions and handling collateral. Although substantially all FX Transactions involve straight through processing and, as a result, costs may be lower for FX Prime Brokerage than for prime brokerage arrangements involving other asset classes, the prime broker does incur costs in connection with the booking and administration of the matched FX Transactions. These costs are reflected in the service fee.

<sup>13</sup> See Section 22 of the Act (providing that any person who violates the Act is liable for damages in a private right of action brought by “any other person...who...placed through such person an order for the purchase or sale of...a swap.” (7 U.S.C. § 25 a(1)(C)(iv)); see also Section 4s(h) of the Act (“each registered swap dealer and major swap participant shall conform with such business conduct standards as prescribed in paragraph (3)”) (7 U.S.C. § 6s(h)).

<sup>14</sup> For this reason, FMLG’s proposal does not discuss the requirements set forth in Commission Regulation 23.431(d)(1) (“Notice of Right to Daily Mark”) and in Commission Regulation 23.432 (“Clearing Disclosures”), which apply exclusively to FX Transactions that are subject to central clearing.

<sup>15</sup> Under Commission Regulation 23.402(e), a swap dealer may provide the information required under the Business Conduct Standards by any reliable means agreed to in writing by the Counterparty.

<sup>16</sup> To the extent that an executing dealer has independently received information necessary to satisfy any or all of these requirements, including information necessary for a swap dealer to satisfy its obligations for Obtaining Representations/Safe Harbors, the executing dealer would be able to rely on the information delivered directly to it by the Counterparty or Counterparty Representative and, to the extent liability could otherwise be imposed on an executing dealer as a result of a prime broker’s failure (which, as a general matter, should not be possible since the responsibility for collecting the information would, by virtue of the relief requested, be the exclusive responsibility of the prime broker), avoid any such potential contingent liability.

<sup>17</sup> Essential facts are those that are necessary for conducting business with such Counterparty and include (i) information regarding the Counterparty that is necessary to comply with applicable laws, regulations and rules; (ii) facts required to implement the swap dealer's credit and operational risk management policies if the swap dealer were to enter into transactions with the Counterparty; and (iii) information regarding the authority of any person acting for such Counterparty. See Commission Regulation 23.402(b). Under Commission Regulation 23.402(c), a swap dealer must obtain and retain, prior to the execution of an FX Transaction, a record showing the true name and address of the Counterparty if the Counterparty’s identity is known to the swap dealer. The swap dealer must also obtain and retain, prior to execution of an FX Transaction with the Counterparty: (i) verification of the principal occupation or business of the Counterparty, (ii) the name and address of any person guaranteeing the performance of the Counterparty, and (iii) the name and address of any person exercising any control with respect to the positions of the Counterparty.

<sup>18</sup> Commission Regulations 23.402(d), 23.430(d), 23.434(b), and 23.440(b) permit a swap dealer to rely on written representations of a Counterparty to satisfy its due diligence requirements under the Business Conduct Standards. The Commission Regulations also provide safe harbors from specific requirements if certain conditions are met.

<sup>19</sup> The prime broker should be authorized to provide any such information to the executing dealers since the information would be required, in the case of an election to accept a Counterparty that does not operate in compliance with the Safe Harbors, for the executing dealers to comply with the Business Conduct Standards.

<sup>20</sup> Under Commission Regulation 23.431(d)(2), a swap dealer must provide the Counterparty, daily, with a mid-market value for each uncleared, bi-lateral FX Transaction entered into with the Counterparty. This “daily mark”

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must be provided to the Counterparty as of the close of business each business day or at such other time as the parties agree in writing. Similarly, under Commission Regulation 23.431(d)(3), a swap dealer must disclose to the Counterparty for each Swap with respect to which a mid-market value is required (i) the methodology and assumptions used to prepare the daily mark and any material changes made during the term of the FX Transaction (other than any confidential, proprietary information about any model used to prepare the daily mark); and (ii) any other information concerning the daily mark that would be required in order to provide a fair and balanced communication.

<sup>21</sup> Under Commission Regulation 23.431(a)(3)(ii), a swap dealer must disclose any compensation or other incentive from any source other than the Counterparty that the swap dealer may receive in connection with an FX Transaction.

<sup>22</sup> Under Commission Regulation 23.451, a swap dealer may not offer to enter into or enter into a Swap or a trading strategy involving a Swap with a Counterparty that is a governmental Special Entity within two years after any contribution to an official of such governmental Special Entity was made by the swap dealer or its management or by employees who solicited the governmental Special Entity or by such employee's supervisors.

<sup>23</sup> Under Commission Regulation 23.434, a swap dealer that recommends an FX Transaction or trading strategy involving an FX Transaction Swap to a Counterparty must undertake reasonable diligence to understand the potential risks and rewards associated with the recommended FX Transaction or trading strategy. The swap dealer must also have a reasonable basis for believing that the recommended FX Transaction or trading strategy is suitable for the Counterparty.

<sup>24</sup> In the rare situation where an FX Prime Brokerage Counterparty were not able or willing to provide the representations necessary to allow the prime broker or the executing dealer to waive its suitability obligations and the prime broker or executing dealer proposed to provide a recommendation to the Counterparty, the prime broker and executing dealer, as applicable, would be required either to refrain from making the recommendation or to obtain sufficient information about the underlying Counterparty to provide a suitable recommendation.

<sup>25</sup> Eligible Contract Participant is defined in Section 1a(18) of the Act and Section 1.3(m) of the Commission's Regulations.

<sup>26</sup> A "Special Entity" is defined in Commission Regulation 23.401(c) to include: (1) a federal agency; (2) a state, state agency, city, county, municipality, other political subdivision of a state, or any instrumentality, department, or a corporation of or established by a State or political subdivision of a state; (3) any employee benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"); (4) any governmental plan, as defined in Section 3 of the ERISA; (5) Any endowment, including an endowment that is an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986; or (6) Any employee benefit plan defined in Section 3 of ERISA, not otherwise defined as a Special Entity, that elects to be a Special Entity by notifying a swap dealer of its election prior to entering into a swap with the particular swap dealer.

<sup>27</sup> Under Commission Regulation 23.430, a swap dealer must verify that a Counterparty is an eligible contract participant and determine whether the Counterparty is a Special Entity, before offering to enter into or entering into an FX Transaction with that Counterparty.

<sup>28</sup> Commission Regulation 23.450 requires a swap dealer that offers to enter or enters into an FX Transaction with a Special Entity (other than employee benefit plan subject to Title I of ERISA) to have a reasonable basis for believing that the Special Entity has a representative that: (i) has sufficient knowledge to evaluate the transaction and risks; (ii) is not subject to a statutory disqualification; (iii) is independent of the swap dealer; (iv) undertakes a duty to act in the best interests of the Special Entity it represents; (v) makes appropriate and timely disclosures to the Special Entity; (vi) evaluates, consistent with any guidelines provided by the Special Entity, fair pricing and the appropriateness of the Swap; and (vii) in the case of a Special Entity that is a state or governmental plan, is subject to restrictions on certain political contributions. A swap dealer may reasonably rely on representations from the Special Entity that it has complied with its policies and procedures to ensure that it has selected a representative that meets these requirements provided that it also obtains a written representation from the representative designated by the Special Entity that it has policies and procedures to meet these requirements. If the swap dealer initially determines that it does not have a reasonable basis for believing that the representative meets these requirements, it must make a written record of the basis for such determination and submit such determination to its chief compliance officer for review to ensure that the swap dealer has a substantial, unbiased basis for the determination.

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<sup>29</sup> A swap dealer that acts as an advisor to a Special Entity has a duty to make a reasonable determination that any FX Transaction or trading strategy involving an FX Transaction recommended by the swap dealer is in the best interest of the Special Entity.

<sup>30</sup> To the extent that the prime broker were an advisor to the Counterparty but the executing dealer was not, the prime broker may more easily be able to conclude that the Counterparty Mirror Swap satisfies the “best interests” standard because the independent pricing mitigates the impact of the conflict of interest that arises by virtue of the prime broker’s advisory relationship with the Counterparty. Reliance on an independent third party to provide pricing and economic terms in the context of an advisory relationship with the swap dealer has been recognized by the Securities and Exchange Commission (“SEC”) as an effective means of addressing conflicts of interest in the derivatives context. *See* Credit Suisse First Boston LLC, SEC No-Action Letter (Aug. 31, 2005) (providing no action relief from the trade-by-trade customer consent requirements under Section 206(3) of the Investment Advisers Act of 1940 for over-the-counter options transacted by a discretionary adviser for its customers with an affiliate of the adviser based exclusively on pricing and terms provided by mirror transactions with third-party dealers.) (the “**SEC No Action Letter**”).

<sup>31</sup> Under Commission Regulation 23.431(a)(1), a swap dealer must disclose to each Counterparty, at a time reasonably sufficient prior to entering into an FX Transaction with the Counterparty, the material risks of the particular FX Transaction. These risks include market, credit, liquidity, currency, legal, operational and other risks presented not only by the type of FX Transaction but also by the specific FX Transaction.

<sup>32</sup> Given the fast moving markets and the sophistication of the Counterparties and Counterparty Representatives engaged in FX Prime Brokerage, FMLG believes that this time period could, depending upon the particular circumstances, be a matter of minutes prior to agreement on the ED-PB Swap terms.

<sup>33</sup> *See* ISDA AUGUST 2012 DF SUPPLEMENT, Schedules 4, 5 and 6.

<sup>34</sup> In the SEC No Action Letter mentioned above, the SEC granted relief under Section 206(3) of the Investment Advisers Act of 1940 from the trade-by-trade consent requirements under that statute for derivative transactions between a dealer and the advisory customer when pricing and terms for the derivative transaction with the customer mirrored a derivative established with a third-party dealer. Although the relief provided in that SEC No-Action Letter did not relate to the Business Conduct Standards, the relief did address conflicts of interest involving dealers and determined that intermediation of the independent dealer through mirror transactions mitigated conflicts of interest with a dealer that was also acting as an adviser to the customer-counterparty. In that letter, the SEC agreed that customer consent that would normally be required for a discretionary adviser to obtain in order to trade with the customer as principal could be waived in situations where the pricing and terms of the principal trade were determined exclusively by a mirror trade with an unaffiliated, third-party dealer.