

July 22nd, 2011

Mr David A. Stawick
Secretary
Commodities Futures Trading Commission
Three Lafayette Center
1153 21st Street, NW
Washington, DC 20581

Re: Comments On Proposed Rule 17CFR Part 1 – Further Definition of a Swap
File Number S7-16-11

Dear Mr Stawick,

This letter provides input to the Commodity Futures Trading Commission's (Commission's) rule-making on behalf of Alice Corporation, specifically in regard to the definition of a swap as outlined in Proposed Rule 17CFR Part 1, RIN 3038-AD46.

INTRODUCTION

An overview of Alice Corporation and its derivatives trading design is contained in our prior submission dated May 31, 2011. This letter comments specifically on:

- The need to clarify the distinction between financial futures and single-period swaps;
- The need to clarify the status of derivatives that are constructed from simple futures and options but may have the characteristics of swaps or loans;
- The need to clarify the status of certain insurance-linked instruments; and
- The need to create a concept document providing overall guidance on derivatives.

CLARIFY THE DISTINCTION BETWEEN FUTURES AND SINGLE-PERIOD SWAPS

We noted in a prior submission that the definition of swap provided in the Dodd-Frank act does not appear to exclude single-period, cash-settled contracts that may be equivalent to a futures contract. Specifically, the definition in 47(A) iii defines a swap as any instrument that:

“ provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind ...”

A financial futures contract can be viewed as a special case of this with a single payment. Under the Commodity Futures Modernization Act, all contracts involving “excluded” commodities (essentially all financial derivatives and event contracts) were exempt from the provisions of the Commodity Exchange Act if they involved Eligible Contract Participants and were not traded on an exchange. Further, contracts so exempted were deemed swaps. Thus a contract with the same economic characteristics could be deemed a future if traded on a Designated Contract Market (DCM) and a swap if traded over-the-counter. This did have the benefit of clearly confining the term “future” to exchange-traded, regulated products.

Dodd Frank brings swaps under the control of the Commodity Exchange Act and requires standardized swaps to be cleared and traded on DCMs or Swap Execution Facilities (SEFs). Given that swaps are being brought back into the regulatory fold and are increasingly standardized, it seems appropriate to clarify the status of single period swaps. The exclusions from the swap definition in 47 (B) of Dodd Frank list “any contract of sale of a commodity for future delivery” but do not make clear whether such commodities means excluded commodities. It would appear possible for a SEF to trade swaps constructed to mimic financial futures.

The Futures Industry Association has raised similar issues in their letter to the Commission dated June 10, 2011.

CLARIFY THE STATUS OF DERIVATIVES CONSTRUCTED FROM SIMPLE FUTURES AND OPTIONS

As noted in our prior submission, the Alice design permits complex derivatives to be established using simple event contracts that collectively cover outcomes for an underlying. The constructed profiles may emulate a range of derivatives including a single period swap, a put, a call, or a zero-coupon bond. Alice may establish a single contract to cover the component contracts but the underlying components remain basic event contracts that are identical to exchange-traded event contracts. Further, the overall contract may be subsequently disaggregated for purposes of clearing.

Construction of instruments that emulate swaps using simple futures instruments is common. For example, the Chicago Mercantile Exchange encourages the construction of multi-year interest rate swaps using multiple interest rate futures contracts.

It should not matter whether an effective swap is constructed using one contract or many. If the underlying component contract is regulated as a future or option, the aggregate contract should be.

CLARIFY THE STATUS OF CERTAIN INSURANCE-LINKED INSTRUMENTS

The proposed rule outlines general requirements for insurance linked instruments to be exempted from regulation as swaps. We believe the Commission should, in addition, provide explicit guidance on specific products that are widely employed now.

Based on the requirements outlined in the proposed rule, certain insurance-linked products, such as exchange-traded catastrophe futures and over-the-counter catastrophe derivatives (event loss swaps), should not be eligible for exemption as they require no insurable interest.

The status of other insurance-linked products is less clear. Industry loss warrants (“ILWs”) are a contingent instrument and there is a secondary market for them, albeit not a very liquid one. However, they are currently treated as a reinsurance product and require an insurable interest.

Catastrophe bonds (“cat bonds”) may reference a specific insured portfolio or a set of parameters and may be traded in a secondary market. They behave like a coupon bond if there is no triggering event but have a contingent element since some or all of the principal may be lost if the referenced event or loss occurs.

There have been at least two attempts to establish electronic markets for ILWs and cat bonds, including by an interdealer broker, ICAP, that has indicated it will be registering as a Swap Execution Facility (“SEF”) for other products. Catastrophe futures are already electronically traded by Designated Contract Markets (“DCMs”) and there will no doubt be SEFs and DCMs who propose trading standardized forms of event loss swaps. Providing support for the secondary trading of cat bonds and ILWs on the same venues may be attractive.

Participants seeking to hedge against insurance losses may use a combination of the insurance linked instruments. Investors in these instruments include many of the same institutional investors who participate in the swaps markets more generally.

Given the similarity of the instruments to other swaps, the overlap in the investor base and the merit in providing common electronic platforms for trading these instruments, it makes sense to bring them under the same Federal regulatory umbrella and treat them as swaps or security-based swaps depending on the particular characteristics of the instrument.

CREATE A CONCEPT DOCUMENT PROVIDING OVERALL GUIDANCE ON DERIVATIVES

The current definitions in the legislation and rules reflect a complex legislative history and fragmented regulatory structure. As noted above, some definitions reflect the desire to keep some instruments under regulatory oversight in the wake of the CFMA. Now that swaps are being brought under the regulatory umbrella, it would appear that all derivatives are now under the purview of market regulators. It seems appropriate for the Commissions to step back and take a broader view of the derivatives market and provide guidance to participants at a conceptual level.

If one were able to create a regulatory regime from the ground up, it could define derivatives as a class overall and not differentiate between swaps, futures and options or at least differentiate them purely based on economic characteristics rather than who currently trades them or what they are currently called.

Once derivatives are defined at a conceptual level based on economic characteristics, the focus should turn to the types of trading venues available. The characteristics of specific products should determine whether they should be traded on DCMs, less regulated trading facilities or over-the-counter. A guiding principle should be that products should be traded on the most transparent and widely accessible venues possible and the decision should be made by regulators based on the degree of standardization and liquidity. Some products may be available only on contract markets and others on less regulated markets. The rules thus far published do seem to embody some of these concepts but the discussion has been restricted to swaps and doesn’t encompass derivatives as a whole.

We suggest that the Commission should create a concept document that defines derivatives at a broad level and then characterizes them by economic characteristics. Derivatives can then be mapped to types of trading venues.

Sincerely,

A handwritten signature in black ink, appearing to read 'Ian K. Shepherd', is centered on a light gray rectangular background.

Ian K. Shepherd
Managing Director

Alice Corporation Pty Ltd
UB 4440 (Level 4)
800 Bourke Street
Docklands, Victoria, 3008
Australia
www.alicecorp.com

Contact:

Barbara.Vegh@alicecorp.com

Telephone: 011 61 3 9670 6090

Cc:

Ms Elizabeth M. Murphy, Secretary, Securities and Exchange Commission