

November 17, 2010

Mr. David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, DC 20581

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

Dear Ms. Murphy and Mr. Stawick:

UBS Securities LLC (“UBS”) is submitting this letter in response to the proposed rules published by the Commodity Futures Trading Commission (the “CFTC”) and the Securities and Exchange Commission (the “SEC” and together with the CFTC, the “Commissions”) under Sections 726 and 765 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”).<sup>1</sup> The proposed rules impose a 20% limitation<sup>2</sup> on the voting equity that any single member (and related persons) may own in a swap execution facility (“SEF”).<sup>3</sup> UBS believes that ownership limitations are neither necessary nor appropriate to improve governance of, or to mitigate systemic risk or conflicts of interest with respect to, SEFs. Such limitations are likely to reduce competition in the emerging marketplace for SEF-based execution of swaps, rather than promoting competition as intended.

A range of market participants across the industry have invested heavily for many years in developing execution facilities for a variety of asset classes to enhance market structure, facilitate trading and provide clients with improved service. In the US equities market, for example, a variety of alternative trading systems have developed, unfettered by ownership rules (since the ownership limitations imposed by the SEC on registered securities exchanges does not apply to alternative trading systems) – of the more than 30 alternative trading systems operating in the US market as of September 2010, more than half were owned by market makers and broker-dealers and the average daily trading volume of those facilities accounted for over 78% of the market. Note that we are not arguing for the removal of the 20% ownership limitation with respect to those securities exchanges seeking to offer security-based swaps for execution. Instead, we believe that the rules should permit a variety of ownership structures for SEFs in the same way as the SEC has allowed alternative trading systems, to which no ownership restrictions apply, and registered exchanges, to which a 20% ownership limitation applies, to coexist in the US equities space.

If imposed by the Commissions, the ownership limitations will undermine the incentives for market participants to develop innovative solutions for swap execution, since they will not likely be willing to deploy proprietary knowledge and technologies for a facility in which they are able to retain no more than a 20% voting equity interest. As a result, institutions with significant experience and proven track records in operating execution facilities similar to SEFs will be discouraged from contributing their expertise to this new area of the OTC derivatives market. Devising a regime that dissuades sophisticated market participants from contributing to the development of market infrastructure is not in the best interests of investors or the financial system generally and is likely to have a negative impact on

<sup>1</sup> The Notice of Proposed Rulemaking with respect to Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest published by the CFTC on October 1, 2010 and the Proposed Rule with respect to Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC published by the SEC on October 14, 2010

<sup>2</sup> In addition to SEFs, Sections 726 and 765 of Dodd-Frank, and the proposed rules, also address conflicts of interest with respect to derivative clearing organizations, designated contract markets, clearing agencies, and national securities exchanges. The comments we make in this letter, however, are limited to SEFs.

<sup>3</sup> For convenience, references in this letter to “swap” are also intended to include “security-based swap,” those to “swap execution facility” (and to “SEF”) are also intended to include “security-based swap execution facility,” and those to “swap dealer” are also intended to include “security-based swap dealer”.

competition in this market. Conversely, establishing rules that encourage investment from many sources and promote choice of execution models<sup>4</sup> will, we believe, result in increased competition, greater expertise and a broader range of swaps being made available for execution via SEFs. Indeed, the SEC recently noted the importance of permitting different types of trading venues to operate in the same market, and the positive impact that this can have on competition, by encouraging market participants "to create new products, provide high quality trading services that meet the needs of investors, and keep trading fees low."<sup>5</sup>

A more appropriate and effective way to mitigate conflicts of interest would be for the Commissions to require each SEF to establish rules addressing conflicts of interest and through compliance by each SEF, and enforcement by the Commissions, of those rules as well as the SEF Core Principles (from Sections 733 and 763 of Dodd-Frank). SEF conflicts of interest rules should focus on objective, transparent, and non-discretionary access and membership requirements. In addition, the Commissions should require each SEF to ensure that no equity owner would have an advantage over other liquidity providers on such SEF in terms of its ability to access or execute trades.<sup>6</sup> Reliance on core principles, oversight, monitoring, fair access and compliance practices are already very well established means by which both the Commissions and regulators in other jurisdictions regulate analogous facilities for trading other asset classes. We note, for example, that the CFTC does not currently place ownership restrictions on designated contract markets or derivatives transaction execution facilities and that the SEC does not place ownership restrictions on alternative trading systems. Similarly, member states of the European Union, under the Markets in Financial Instruments Directive, have addressed concerns with respect to conflicts of interest at exchanges and multilateral trading facilities by mandating organizational and administrative arrangements, rather than ownership restrictions.

Objective governance standards, rather than the blunt instrument of ownership limitations, are more effective at preventing conflicts of interest. The conflicts of interest rules should promote fair and open competition and permit voting control to be aligned with investment, provided such platforms comply with governance standards addressing conflicts of interest. Any facility in compliance with those standards should be capable of being owned and operated by a consortium of market participants, multiple unrelated investors, or indeed, an individual market participant, including an individual swap dealer.<sup>7</sup>

UBS would like to thank the CFTC and the SEC for the open manner in which you have addressed the issues arising in connection with the implementation of Dodd-Frank. We would welcome the opportunity to provide any additional information regarding our view of the proposed rules and any other issues that would be useful to you in implementing Dodd-Frank.

Respectfully submitted,



James B. Fuqua  
Managing Director, Legal



David Kelly  
Managing Director, Legal

<sup>4</sup> Our intent in this letter is not to provide comments on the SEF definition, but to focus only on the impact of the ownership limitations and the alternate means available to the CFTC and the SEC to mitigate conflicts of interest and improve governance.

<sup>5</sup> Concept Release on Equity Market Structure, Securities Exchange Commission Release No. 34-61358 (January 14, 2010) at p 11.

<sup>6</sup> For a SEF owned by a market participant, we would expect that the Commission would require that its SEF operations be segregated from its trading businesses, with strict information barriers, segregated management and supervision, objective trading mechanics, transparent information flow and non-discretionary access and membership requirements. We do not believe that a SEF that favors its equity owners (be it through price, data, trading mechanics, access or otherwise) should be permitted.

<sup>7</sup> We note that the CFTC has asked whether it should consider instituting a waiver procedure that would permit a SEF or its members to seek an exemption from the ownership limitations. Although we believe that the ability to obtain a waiver from the ownership limitations (if applied in a consistent manner by both Commissions) would be indispensable should the Commissions ultimately conclude that limitations on ownership must apply to SEFs, it is our strong belief that ownership limitations are neither necessary nor appropriate to improve governance of, or to mitigate systemic risk or conflicts of interest with respect to, SEFs, and should not be implemented.