Deutsche Bank ◪

March 8, 2011

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

Dear Mr. Stawick:

Deutsche Bank AG ("**DBAG**" and, together with its affiliates, "**Deutsche Bank**")
appreciates the opportunity to provide comments on the Commodity Futures
Trading Commission's (the "**Commission**") proposal (the "**SEF Proposal**")
regarding core principles and other requirements for swap execution facilities
("**SEFs**").[1] The SEF Proposal was issued under Title VII of the Dodd-Frank Wall
Street Reform and Consumer Protection Act ("**Dodd-Frank**").[2]

I.   Introduction

Background. Under Title VII, as a general matter and subject to applicable
exemptions, swaps that the Commission determines are required to be cleared
must be cleared and, if a SEF or designated contract market ("**DCM**") makes such
a swap available to trade, such a swap must be executed on a DCM or SEF.

Dodd-Frank defines a SEF as "a trading system or platform in which multiple
participants have the ability to execute or trade swaps by accepting bids and offers
made by multiple participants in the facility or system, through any means of
interstate commerce, including any trading facility, that (A) facilitates the
execution of swaps between persons; and (B) is not a designated contract market."

The SEF Proposal would specify the types of trading systems that satisfy the SEF
definition, and therefore would be eligible to execute a swap subject to the
clearing and execution requirements. Under the SEF Proposal, one-to-one voice

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[1] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR 1214
(Jan. 7, 2011).

[2] Deutsche Bank is a member of SIFMA, ISDA, and other trade associations and has
participated in comment letters on the SEF Proposal written by trade associations of which it is a
member. In Deutsche Bank's view, the points included in this letter are of such critical
importance to the functioning of the swap markets that it has determined to expend its own
resources to highlight them directly.

and single dealer platforms would ***not*** satisfy the SEF definition.[3] The Commission proposes "to allow execution methods that may include voice" only for block trades, swaps not subject to the clearing and execution requirements, and illiquid or bespoke swaps.[4]

Guiding Principles. As discussed more fully below, as the Commission considers adopting final SEF rules, Deutsche Bank believes that the principles that guide implementation of Dodd-Frank must balance the goals of reducing systemic risk and increasing transparency against the risks of diminishing liquidity and increasing transaction costs for end-users of swap transactions for their hedging and investment purposes. Thus, final rules should facilitate the development of a SEF-based swap market by encouraging dealers to continue to provide liquidity for contracts that are relatively illiquid and for block trades in more liquid products. This is particularly the case where Congress went out of its way to avoid requiring swaps to be traded solely on a DCM by creating the SEF definition, recognizing the significant differences between over-the-counter markets and futures markets.

For these reasons, final SEF rules adopted by the Commission should:

- allow SEFs that provide request for quote ("**RFQ**") services ("**RFQ SEFs**")[5] to permit a participant to request a quote from the number of dealers that it chooses, rather than mandating a particular minimum number;
- clarify that responses to an RFQ do not need to be made public;
- clarify that RFQ participants may select the parties to whom streaming indicative or firm quotes are disseminated;
- not include a fifteen-second pause requirement;
- clarify that swaps that are not subject to the clearing and execution requirements are not required to be executed on a SEF and may be executed through any modality (including voice, electronic, and others); and
- allow the terms of a block trade to be agreed through any modality (e.g., voice-based, single dealer or other systems) so long as it is promptly reported to the relevant SEF or swap data repository ("**SDR**").

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[3] SEF Proposal, at 1219.

[4] *Id.*

[5] We note that RFQ SEFs may also offer additional models, such as an order book models, for executing trades.

II.   Discussion

   A.   Request for Quote SEFs

We support the Commission's inclusion of the RFQ model in its proposal. To facilitate the development of a robust SEF-based trading market for swaps and to maintain liquidity for end-users, we believe that it is critical that various models aside from an order book be permitted (and Congress has so provided) and that there is no liquidity threshold above which trades are mandated to trade on an order book. In many cases, an order book system would result in unacceptable information leakage of trading interest in swaps that are subject to the execution requirement or are voluntarily traded on a SEF. In addition, the Commission should not require RFQ SEFs and order book SEFs to be integrated. The operation of an RFQ system and order book system are incompatible in a variety of ways, including that (1) RFQs provide specified time periods for responses to a price while order books are updated in real time and (2) order books are anonymous while RFQs disclose the names of participants that request, and respond to requests for, quotes. It would be impracticable, if not impossible, to integrate resting bids and offers into an RFQ process because the acceptance of a resting bid or offer in partial size would require the requestor to resubmit the RFQ for the remaining size it wanted to execute. This could result in multiple RFQs, resulting in completion at different prices and in the information leakage the RFQ was seeking to prevent.

There Should Be No Minimum Number of RFQ Recipients. The SEF Proposal provides that RFQ systems with certain attributes would satisfy the SEF definition. Specifically, under the SEF proposal, an RFQ SEF must require that an RFQ be transmitted to at least five potential counterparties in the system. For the reasons discussed below, the Commission should revise its proposal to require that an RFQ need not be transmitted to any minimum number of recipients.

We believe that an RFQ system on which a participant can request a quote from a single dealer or multiple dealers, as the participant chooses, would provide market participants the flexibility to determine the best trading method for a particular trade (e.g., information protection may be more important for some market participants, while seeking the most possible sources of liquidity may be a priority for others, depending on trade size and liquidity for the transaction in question). We note that the Securities and Exchange Commission's (the "**SEC**") proposal regarding security-based swap execution facilities ("**SB SEFs**") recognizes this principle by stating that "Providing investors the choice to send a RFQ to only one dealer on a SB SEF – as long as they have the ability to send it to more than one if they chose to – may encourage investors to execute trades on a SB SEF even with respect to SB swaps that are not required to be traded on a SB SEF or

an exchange, thus supporting the development of trading on regulated platforms and venues in the United States, rather than in other jurisdictions."[6]

Allowing market participants to elect between sending an RFQ to a single or multiple potential counterparties is consistent with the statutory language of Title VII. As noted above, Dodd-Frank defines a SEF as a "a trading system or platform in which multiple participants have *the ability to* execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system." Thus, so long as an RFQ system provides the option of – even if it does not require – disseminating an RFQ to multiple market participants, the system would satisfy the SEF definition. Moreover, as noted in the SEC SB SEF Proposal, providing market participants with flexibility in executing swaps on SEFs is important to encourage the emergent SEF-based swap trading market, and will ultimately promote greater pre-trade transparency in the swaps market.[7]

Responses to RFQs Should Not Be Required to Be Public. The Commission should clarify that responses to an RFQ do not need to be made public. Requiring responses to RFQs to be made public likely would result in higher prices for end users, as dealers would need to provide pricing that accounted for the information leakage inherent in pre-trade dissemination of trading interest information, and resulting difficulty in hedging the transaction within quoted levels. In addition, in particular with respect to less liquid swaps, some dealers may decline altogether to respond to RFQs, which would be harm market liquidity.

Market Participants Should Be Able to Select Recipients of Streaming Indicative or Firm Quotes. The SEF Proposal defines an RFQ system as a trading system or platform that operates in one of two ways: (1) by allowing market participants to transmit an RFQ to other participants on the system, or (2) by allowing market participants to view real-time electronic firm and indicative quotes from multiple potential counterparties on a centralized screen. Market participants would have the option to complete a transaction by (1) accepting a firm streaming quote, or (2) transmitting a request based on an indicative streaming quote.

Providing market participants flexibility in determining the counterparties that receive information regarding firm and indicative trading interest is critical to the development of the SEF-based swaps trading market. Thus, for the same reasons as discussed above, the Commission should clarify that if a market participant elects to disseminate streaming indicative or firm quotes on an RFQ system, the market participant should be able to select the recipients that are able to receive

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[6] Registration and Regulation of Security-Based Swap Execution Facilities, Exchange Act Release No. 63825 (Feb. 2, 2011), 76 FR 10948, 10949 (Feb. 28, 2011), at n. 10. ("**SEC SB SEF Proposal**").

[7] *Id*.

such quotes. As a liquidity taker should have the flexibility to select the number and identity of recipients of RFQs, each participant should similarly have the ability to select and differentiate among the recipients of its pricing information. At the very least, the Commission should clarify that RFQ participants are not required to disseminate streaming indicative or firm quotes in order to participate on any RFQ system.

B.   The Commission Should Eliminate the Fifteen-Second Pause Requirement

Under the SEF Proposal, SEFs "must require that traders who have the ability to execute against a customer's order or to execute two customers against each other be subject to a 15 second timing delay between the entry of those two orders, such that one side of the potential transaction is disclosed and made available to other market participants before the second side of the potential transaction (whether for the trader's own account or for a second customer), is submitted for execution." This requirement is not required by Dodd-Frank, and the Commission's final rule should not include it.

If the Commission is concerned with pre-arranged principal cross trades being executed on a SEF without the benefit of public price competition, it could require swap dealers to segregate market-making activities from desks that introduce customer interest to SEFs. Requiring such segregation would ensure that information regarding the customer order is isolated from other desks at the swap dealer until the customer order reaches the SEF, thus preventing the swap dealer from directing a customer order to execute against in-house trading interest. At the same time, this approach would avoid the detrimental effect of causing a customer to miss an execution where the swap dealer is quoting the best price at a particular time and during the fifteen-second pause, the market moves against the customer. We note that this approach is consistent with interpretations under existing customer order protection rules applicable to cash equities trading.[8] In addition, if the Commission is concerned with agency cross-trades, there does not seem to be a net benefit to the market that justifies the proposed fifteen-second pause requirement because in many cases the fifteen-second pause would result in a better price for one customer, but an inferior price for the other.

Moreover, the fifteen-second pause would eliminate the flexibility otherwise provided by an RFQ system that allows a market participant to limit the number of potential counterparties that see the market participant's trading interest. The reasons discussed above, specifically, the statutory language that SEFs must

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[8] For example, under FINRA customer order protection rules, a firm is permitted to trade at prices that would satisfy customer orders if the firm implements appropriate information barriers to prevent proprietary desks from obtaining knowledge of customer orders held at the firm's market-making desk. *See* Notice to Members 95-43 (June 1995), 03-74 (Nov. 2003), and 06-03 (Jan. 2006).

provide "***the ability***" to interact with multiple participants, demonstrate that Title VII does not require the Commission to ***mandate*** a fifteen-second pause. Adopting a fifteen-second pause requirement would exceed Title VII's explicit requirements for SEFs and would deprive market participants of the trading flexibility that allows them to maintain information protection and provide efficient execution, which is critical for the development of a SEF-based swaps trading market.

   C. ***Trading Facilities for Swaps Not Subject to the Clearing and Execution Requirements Should Not Be Required to Register as SEFs; Market Participants Should Be Permitted to Agree to Block Trade Terms on Voice-Based and Single Dealer Systems***

Limits of the SEF Execution Requirement. Under the SEF Proposal, swaps not subject to the clearing and execution requirements and illiquid or bespoke swaps are eligible for execution on a voice system. However, the Commission's interpretation of the phrase "by any means of interstate commerce" could potentially be read to imply that trading systems for these swaps must register with the Commission as a SEF, and be subject to the proposed SEF regulatory framework.

The Commission should clarify that trades for these swaps need not be executed on a registered SEF, and therefore could be executed on any type of trading system, including a single dealer system. Of course, a trading system that complied with all of the proposed requirements for SEFs could ***voluntarily*** register as a SEF and trade swaps that are not required to be executed on a SEF.

This clarification would be consistent with the statement in the SEC SB SEF Proposal that security-based swaps that are not subject to Dodd-Frank's execution requirement "would not have to be traded on a registered SB SEF."[9]

Block Trades. In our experience, one of derivatives customers' most significant concerns is "liquidity in size." This was contemplated by the drafters of Title VII. The core principles governing SEFs and SB SEFs require that each such facility "establish rules governing the operation of the facility, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the facility, including ***block trades***." [10]

The SEF Proposal recognizes the need for special rules for block trades by allowing block trades to be executed on a voice-based system. We support allowing block trades to be executed on a voice-based system. In addition, we believe the Commission should clarify that the terms of a block could be agreed

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[9] SEC SB SEF Proposal**,** at n. 10

[10] Dodd-Frank, Sections 763(c) and 733. Emphasis added.

on a single dealer system, so long as the trade details are promptly reported to the SEF or the relevant SDR (including for purposes of the Commission's proposed swap transaction data reporting requirements).[11] As has been recognized in other financial markets, the needs of institutional investors, and the potential that block trades present for information leakage, require special execution and reporting requirements.[12] Allowing market participants to agree to the terms of block trades on a voice or single dealer system would help ensure that institutional investors are able to execute block trades without detrimental price impact and information leakage and therefore would preserve the market that exists today for the trading swaps in large size, which is important for institutional investors. The trade details of such block trades would promptly be reported to a SEF or the relevant SDR and, following appropriate delays to permit hedging by the liquidity provider, publicly disseminated, thus achieving post-trade transparency. Blocks in swaps that are not subject to the clearing and execution requirements or illiquid or bespoke swaps should not be required to be executed on a SEF, as discussed above.

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[11] Real-Time Public Reporting of Swap Transaction Data, 75 FR 76140, 76172 (Dec. 7, 2010) (proposing that "For block trades executed pursuant to the rules of a swap market, the reporting party shall satisfy its reporting requirement by reporting such trades to the swap market in accordance with the rules of the swap market.").

[12] *See* Regulation of Non-Public Trading Interest, Proposed SEC Rule, Exchange Act Release No. 60997 (Nov. 13, 2009), 74 Fr 61208, 61227 (Nov. 23, 2009) (noting that special block trading rules assist institutional investors with finding "contra-side trading interest for large size without causing price impact."); *see also* SEC Regulation NMS Rule 604(b)(4) (excepting block-size orders from the general requirement that market makers publicly display customer limit orders).

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We thank the Commission for the opportunity to comment on the topics discussed above and for the Commission's consideration of Deutsche Bank's views. In addition, we urge the Commission to coordinate with the SEC as both agencies adopt final rules applicable to SEFs. We would be happy to provide the Commission any additional information on any of the subjects discussed in this letter.

Please feel free to call either of the undersigned with any question or request for additional information that you may have.

Sincerely,

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