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March 8, 2011

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

Re: (RIN number 3038-AD18) Core Principles and Other Requirements for Swap Execution Facilities

Dear Mr. Stawick:

FX Alliance Inc. ("FXall") welcomes the opportunity to submit its comments on RIN 3038-AD18 Core Principles and Other Requirements for Swap Execution Facilities,[1] the Commodity Futures Trading Commission ("Commission" or "CFTC") proposed new rules (the "Proposed Rules") to implement Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "DFA")[2] as applied to the registration and operation of a swap execution facility ("SEF").

I. FXall Background

FXall operates an electronic trading system for foreign exchange ("FX") spot and FX derivative instruments.[3] Approximately 1,000 institutions globally trade FX spot and derivative instruments in over 500 currency pairs through FXall. These institutions include a range of industrial companies, fund managers, banks, other financial institutions and government and international agencies all over the world. FXall does not have any retail customers. FXall facilitates competitive pricing, internal trading controls, risk management and a granular audit trail. It has succeeded in improving efficiency and transparency and reducing risk for an important market. FXall's peak daily volumes currently reach $125 billion in notional contract value. Today, a large part of the FX market is traded on electronic systems such as FXall – including less liquid or infrequently traded instruments customized by end users to meet their specific commercial requirements. FXall presently

[1] 76 Fed. Reg. 1214 (proposed Jan. 7, 2011).
[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, (2010) (to be codified as an amendment to the CEA).
[3] FXall expects that foreign exchange spot trades will not be required to be cleared and/or traded through a SEF or DCM because such instruments will be excluded from the definition of a swap under the DFA. Under Section 721(a)(21) of the DFA, the Secretary of the Treasury has been empowered to determine whether foreign exchange swaps and forwards will be excluded from the definition of swap, and thereby from the clearing and trading requirements. FXall offers these comments in anticipation of trading additional instruments that may be deemed to be swaps under the DFA.

intends to register a trading platform as a SEF. Based upon its extensive experience, FXall believes that it is able to provide a valuable perspective on the impact of the Proposed Rules specifically affecting existing platforms that have operated heretofore without being registered.

II. Executive Summary

FXall supports the important stated goals of Congress to enhance transparency and accountability and to promote market integrity to protect against manipulative behavior in the financial system, as set forth in the amendments to the Commodity Exchange Act (the "CEA")[4] enacted by Section 733 of the DFA. FXall is concerned, however, that some of the Proposed Rules: (1) go beyond the DFA's specific statutory requirements applicable to SEFs; (2) apply onerous designated contract market ("DCM") standards to SEFs that are inappropriate for SEFs; (3) are overly prescriptive, failing to provide SEFs with sufficient operational flexibility to accommodate differences in the various markets to be served by SEFs; and (4) will adversely affect the ability of SEFs to serve market participants effectively and efficiently.

As discussed further below, FXall respectfully asks the Commission to consider the following comments on the Proposed Rules:

- SEFs should have flexibility to determine which execution methods to use, including an RFQ only system and should not be required to provide an order book system.

- SEFs should not be required to have RFQs sent to at least five market participants, but should be able to give participants the choice to send an RFQ to as few as one market participant.

- When a broker is facilitating the execution of a customer order or solicits another customer willing to take the other side, the broker should not be required to delay entering the other side of the order for fifteen seconds, but SEFs should be able to use discretion in determining the appropriate duration of the delay, taking into account the particular characteristics of the market.

- The requirements in the Proposed Rules, which prescribe a full surveillance, investigation and enforcement program for SEFs and essentially obligates SEFs to become self-regulatory organizations ("SROs"), creates a barrier to entry for new SEFs. This is particularly the case with respect to start-ups as compared to DCMs and affiliates of existing DCMs (who can leverage the existing compliance, surveillance and enforcement infrastructure and resources of the affiliated DCM), effectively lessening the potential for competition among SEFs and with DCMs or their affiliates.

- SEFs will not be the entities to have the requisite market-wide data that would be necessary to form a coherent picture of participants' market activities to conduct meaningful compliance oversight. Therefore, FXall believes that SEFs are not the

[4] Commodity Exchange Act, 7 U.S.C. 1 *et seq.*

proper regulated entities to perform all of the surveillance, investigation and enforcement tasks the CFTC has proposed.

- SEFs should not be burdened with onerous financial surveillance obligations, and should be permitted to delegate their financial surveillance functions to the Joint Audit Committee to the extent that its members are registered with the National Futures Association, and with respect to non-NFA members, SEFs should be permitted to delegate to another joint regulator or outsource this function.

- The term "senior officer" should be defined to mean the SEF's chief executive officer, chief legal officer, chief risk officer or other senior officer with supervisory authority for the SEF.

- The chief compliance officer should not be required to have supervisory duties within the SEF. The annual compliance report should be certified by the SEF's senior officer, not the chief compliance officer.

- The annual compliance report requirements should be streamlined so that SEFs provide sufficient detail and analysis to satisfy the DFA's requirements while conserving the resources of SEFs and the Commission. The board or senior officer should be permitted to make changes to the annual compliance report without submitting an objection to the Commission.

III. Overview of the Proposed Rules

FXall is concerned that, in many instances, the over reaching and overly prescriptive requirements set forth in the Proposed Rules and the costs associated with compliance with those requirements will prove to be prohibitively and unnecessarily burdensome and expensive. SEFs likely will be forced to pass those costs of compliance on to their participants, which may have the unintended consequence of discouraging trading on SEFs or encouraging market participants to move their trading business to less expensive foreign venues. This is contrary to the intent of Congress to encourage the movement of swaps transactions onto regulated markets. Moreover, the Proposed Rules may create barriers to entry for new SEFs, particularly with respect to start-ups as compared to affiliates of existing DCMs (who can leverage the existing compliance, surveillance and enforcement infrastructure and resources of the affiliated DCM), effectively lessening the potential for competition among SEFs and with DCMs or their affiliates. We want to highlight the fact that SEFs will be competing with each other for the trading of the same products by common market participants. This is fundamentally different than the situation that exists with DCMs, who receive the monopolistic benefit of being the sole market for the trading of their products. This is an unfair advantage that the CFTC will be making greater by placing DCM standards on SEFs and asking them to openly compete for business. SEFs will be forced to compete and innovate, which will be difficult if they are subject to overly prescriptive and onerous rules

Further, FXall notes that the Proposed Rules fail to recognize that a "one-size-fits-all" approach may not be appropriate for all SEFs, given that different SEFs will be trading different products and will employ different market mechanisms. Each SEF needs to "have reasonable discretion in establishing the manner in which the swap execution facility

complies with the core principles."[5] By adopting overly prescriptive Proposed Rules that essentially would require every SEF to comply with the statutory core principles in the same way, the Commission will hinder the ability of SEFs to innovate and differentiate themselves in the market place and to compete effectively. The Proposed Rules do not make appropriate distinctions between swap markets and futures markets, the regulatory needs of such markets and the responsibilities of trading platforms for such markets.

Of particular concern are the requirements in the Proposed Rules which prescribe a full surveillance, investigation and enforcement program for SEFs that is almost indistinguishable from that which is required of DCMs. Congress could have required that swaps be executed on or subject to the rules of a DCM, but it did not do so. Congress specifically recognized the differences between products, participants, market structure, methods of execution and levels of regulation applicable to swap and futures trading platforms.

By authorizing the creation of SEFs, Congress intended that swaps be traded on facilities that function to meet the specific attributes and requirements of swap markets, while those facilities meet operational and regulatory requirements appropriate for that market and its participants. Much of a DCM's regulatory program is tailored to protect the interests of retail customers. Members of a SEF are required to be eligible contract participants ("ECPs"), and thus, retail customers will not be market participants on SEFs. ECPs trading on a SEF do not require the same level of protection as is afforded to retail customers trading on a DCM. This additional level of unnecessary protection will come at a price, which will be passed on to the participants, who do not require the protection.

IV. SEF Definition – The CFTC Should Not Interpret the SEF Definition To Require All SEFs to Provide an Order Book

FXall believes that the DFA was intended to be flexible enough to allow various methods of execution for each market, consistent with the Core Principles for SEFs. Under the DFA, the term "swap execution facility" means "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."[6] The Proposed Rules are much more restrictive than what is contemplated by the DFA and prescribe a limited trade protocol focused on an order book requirement. Unlike the Proposed Rules, FXall believes that the DFA's SEF definition permits a SEF to employ only an RFQ system if it determines that is the best trading model for its business.

FXall is concerned that the CFTC's requirement in the Proposed Rules that a SEF "*must* provide market participants with the ability to make a bid, make an offer, hit a bid, or lift an offer,"[7] and "*must* provide market participants with the ability to post both firm and indicative quotes on a centralized screen such that they can be executed or traded against

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[5] See DFA Section 733(5)(h)(f)(1)(B).
[6] CEA Section 1(a)(50).
[7] Proposing Release, 76 Fed. Reg. at 1219.

by other multiple market participants"[8] is a *de facto* requirement that every SEF must utilize an order book system. In addition, the Commission states "that an acceptable SEF platform or system must provide at least a basic functionality to allow market participants the ability to make executable bids or offers and indicative quotes, and to display them to multiple parties, including all other parties participating in the SEF, if the market participants wish to do so" (emphasis added).[9] The Commission then refers back to this "basic functionality" when it states that *"[i]n addition to this basic functionality* whereby market participants would have the ability to access all other market participants, a SEF *could* also provide a multiple-to-multiple request for quote trading system for those market participants that do not wish to display their bids, offers, or requests to all other market participants"(emphasis added).[10] FXall believes that read together these statements have the effect of requiring every SEF to provide an order book, while it "could" also provide an RFQ system. This CFTC requirement goes beyond the DFA's "multiple participant to multiple participant" requirement for the SEF to give a participant the ability to access multiple other participants. The CFTC definition as proposed does not allow for a SEF to only provide the ability for a participant to send an RFQ to all liquidity providers on the SEF to satisfy the SEF requirement.

Under Section 723 of the DFA, all swaps that are required to be cleared are generally required to be traded through a SEF or DCM. The ability to clear swaps and the ability to trade swaps are related: the liquidity and price transparency engendered by efficient trading mechanisms will facilitate risk management by clearing houses and ultimately enable more swaps to be cleared. FXall believes that it is in the public interest and consistent with the goals of the DFA for SEFs to be permitted to employ the most efficient trading mechanisms so that the largest portion of the over-the-counter ("OTC") swaps market may be effectively cleared and traded on regulated SEFs. In many cases, this would necessitate permitting SEFs to offer RFQ services only, without also requiring them to provide an order book.

Congress could have specified the types of platforms it intended to be SEFs, or specified the manner of execution on SEFs, but Congress instead provided broad criteria that allows various platforms and methods to be utilized. If the CFTC requires that every SEF must have some form of an order book, it will push the trading of many products off SEFs because the order book trading method is just not compatible with some derivative markets. The users of these products will either move their trades to foreign markets or not participate in the market. For example, unlike many futures markets which typically list products that trade frequently and thus have continuous bid/offer quote streams, the transaction flow in many swap markets is less liquid and more discontinuous in nature, i.e., transaction sizes tend to be larger and trades are more infrequent. A central order book is a less efficient execution mechanism than an RFQ mechanism for such markets.

The traditional RFQ model is consistent with the definition of a SEF in the DFA. Congress intentionally used expansive language to define a SEF. Indeed, FXall believes that one of the DFA's objectives (and an objective that should be reflected in the CFTC's regulations implementing the DFA) is to maximize the amount of trading that takes place on a

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[8] *Id.* (discussion of Trading Systems or Platforms). See also Proposing Release, 76 Fed. Reg. 1241, Section 37.9(b)(2).
[9] Proposing Release, 76 Fed. Reg. at 1219 (discussion of SEF Definition).
[10] *Id.*

regulated SEF, thereby improving price discovery, competitive markets, and market surveillance. Section 733 of the DFA (addressing SEFs specifically) states that its goal is "to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market."[11] FXall believes that this goal is best served by maximizing competition, innovation and trading through SEFs. To do so, SEFs should be allowed reasonable discretion to determine their specific trade protocols.

If Congress had intended to require SEFs to offer trading functionality that required that bids and offers be open to multiple participants, Congress could have simply incorporated the existing CEA definition of "trading facility" in its SEF definition.[12] However, Congress specifically chose not to do so.[13] The difference between the SEF definition and the trading facility definition is both intentional and critical. The phrase *"that are open to multiple participants"* which is included in the definition of trading facility is conspicuously absent from the definition of a SEF. The SEF definition contemplates that bids and offers be "made by" multiple participants, but does not mandate that they be "open to" multiple participants as does the definition of trading facility. Congress chose to exclude the trading facility "open to multiple participants" requirement in defining a SEF. Accordingly, an interpretation by the Commission that bids and offers on a SEF must always be open to multiple participants on an order book contradicts Congressional intent and undermines the purposes of the DFA, one of which is the promotion of the migration of OTC derivatives to regulated trading platforms.

To that end, it is critical that market participants and SEFs be allowed to use a variety of trade execution protocols, consistent with the DFA definition of a SEF, to accommodate the diverse range of end-user requirements in the OTC derivatives market. For example, to meet the varied needs of participants in the FX markets, FXall currently offers four methods of trading, ranging from RFQ to a traditional central limit order book, depending on the particular characteristics of the product, the liquidity of the market and the commercial needs of participants. Competition and innovation among SEFs with respect to trading mechanisms will help ensure that SEFs collectively provide efficient markets for the greatest range of OTC derivatives instruments and participants.

FXall agrees that "Congress intended a broad model for executing swaps on SEFs, both cleared, uncleared, liquid or bespoke," and that the best way to achieve the goals under the DFA to promote the trading of swaps on SEFs and promote pre-trade price transparency is to "adopt a model that provides the maximum amount of flexibility as to the method of trading."[14] In order to satisfy the definition of a SEF, a system or platform should not need to be handcuffed to only one type of trading model – *i.e.,* always providing

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[11] DFA Section 733(5)(h)(e).

[12] "Trading facility" is defined in the CEA (in relevant part) as "...a facility or system in which multiple participants have the ability to execute or trade agreements, contracts, or transactions – (i) by accepting bids or offers made by other participants *that are open to multiple participants* [emphasis added] in the facility or system; or (ii) through the interaction of multiple bids or multiple offers within a system with a pre-determined non-discretionary automated trade matching and execution algorithm."(i.e. an order book). CEA Section 1(a)(51).

[13] In at least one draft during the development of the DFA, the text of the bill provided that a SEF was a "trading facility." The Conference Committee rejected that language and replaced it with the current SEF definition.

[14] Proposing Release, 76 Fed. Reg. at 1259.

an order book. In our experience, there are some products in which participants do not want to trade under an order book protocol. To force a SEF to build an order book system that the participants don't want or use is wasting resources and raising costs with no benefit. FXall believes that the Proposed Rules should be modified to make it clear that an entity that wishes to register as a SEF could operate different trading models for different swap products, as long as each trading platform on its own meets the interpretation of the definition of SEF. For example, a SEF could operate both a multi-dealer RFQ mechanism for the trading of one particular swap product and a separate limit order book for the trading of a different swap product.

V. Request For Quote System

FXall provides an RFQ system that is available to all participants who can choose to send RFQs to one or multiple participants on a disclosed basis by specifying the exact terms that the participant requires, such as expiration, strike, and so forth. Each participant has access to multiple liquidity providers. These liquidity providers will send the original inquirer bids and offers which the inquirer may accept through the system. The responses are only disclosed to the requestor. The requestor then chooses to execute with one or more of the responders, or even none.

The RFQ mechanism is chosen by participants in many electronic trading systems because it is both flexible and competitive. Using an RFQ, participants have the ability to tailor the deal terms to meet their exact commercial requirement or best hedge their risk. This flexibility is important because of the expansive range of potential deal terms such as value dates, exercise prices, currency pairs and so on. At the same time, an RFQ is competitive. Before dealing, a participant may choose to obtain quotes from multiple parties contemporaneously, and also has the ability compare quotes with reference prices for benchmark or on-the-run instruments, thus providing pre-trade price transparency in the swaps market. The RFQ mechanism as used today meets the needs of the marketplace and is proven to provide excellent liquidity in instruments that are customized or that do not trade every day, but when traded, do so in large aggregate volumes.

FXall believes that the current commonly used RFQ system meets the requirements of the DFA and comports with the practice of the foreign currency market and is similar to the operation of RFQ trading protocols in other derivative markets. The RFQ system is well established and understood by the market and market participants. RFQ has been widely implemented and accepted for many years in electronic over-the-counter markets and is broadly supported by both the buy-side and sell-side of swap transactions. The currently existing major RFQ platforms provide high quality pre-trade transparency, as each provides indicative levels at which standard lot size trades can be executed. However, in the Proposed Rules the CFTC's definition of the RFQ model is inconsistent with what the industry currently recognizes and uses as an RFQ trading method.

A. The CFTC RFQ Definition Does Not Provide Needed Flexibility

The CFTC's RFQ definition does not meet the market participants' need for a flexible trading method. Under Proposed Rule 37.9(a)(ii), in order for an RFQ system on a SEF to be compliant: (1) a market participant must transmit a request for a quote to buy or sell a specific instrument to no less than five market participants in the SEF, (2) all the market

participants receiving the request for a quote must be able to respond, and (3) the SEF must "take into account" and communicate to the requester any bids or offers "resting" on the SEF pertaining to the same instrument along with any "responsive quotes." As stated above, under current RFQ trading methods there is no notion of a "resting" bid or offer unless the RFQ system is combined with a limit order book. Therefore, FXall believes the requirement that the SEF must "take into account" and communicate to the requester any bids or offers "resting" on the SEF pertaining to the same instrument along with any "responsive quotes" is unduly restrictive and implicitly mandates that a SEF maintain an order book for all instruments it lists.

B. RFQ Transmitted to a Minimum of Five Market Participants Should be Changed to One

The CFTC has not articulated a clear basis for setting the minimum number of market participants to whom an RFQ must be disseminated at five, nor why a lower number would be insufficient. FXall believes that a more reasonable and flexible interpretation would allow a SEF to offer functionality to participants enabling them to choose to send a single RFQ to any number of specific liquidity providing participants on the SEF, including to just a single liquidity provider.

FXall agrees that SEF participants must have the ability to access multiple other participants who are sources of liquidity. However, that is not inconsistent with allowing a participant to choose to request a quote from as few other participants as it chooses. The definitional phrase "have the ability to" [trade with multiple participants] should not preclude a SEF participant from having the ability to choose a few or even one counterparty for a particular trade inquiry out of the many counterparties accessible through the SEF. RFQ participants sometimes choose to send their quote requests to only one or two counterparties to minimize the potential market impact of their request in volatile or illiquid market conditions. The fact that sophisticated institutional participants sometimes choose to ask only one or two counterparties when they have the opportunity to ask more is an indication that this choice is valued by market participants. The CFTC's definition of RFQ should not deprive market participants of this choice.

An RFQ system should allow customers to choose the desired degree of exposure of their inquiry. FXall believes that providing market participants the flexibility to choose one or many counterparties is a way to balance the DFA goal of encouraging swap trading to move onto regulated markets with the goal of promoting greater transparency in the trading of these instruments. Providing market participants as much choice as possible in determining how to route an RFQ on a SEF may incentivize them to trade more on a SEF when they otherwise might not have made that choice. Since those market participants that have a fiduciary duty must seek best execution for a transaction, they may have an incentive to route to multiple dealers. However, this incentive may be impacted by the liquidity characteristics of the particular swap.

Over the last ten years, FXall has gained much experience in migrating OTC foreign currency trading (which was once 100% phone traded) from the phone to our transparent electronic trading system. Based on this experience, FXall has found that many market participants, including dealers and buy-side customers, are concerned about too much pre-trade disclosure of material swap terms. If other market participants know the terms of

a trade prior to the time it is executed, those other market participants could attempt to profit from the information to the detriment of the initiator by frontrunning the trade. In addition, requiring a broad level of pre-trade disclosure, particularly for illiquid products, may not lead to better prices and in certain circumstances may lead to worse prices being provided by dealers if the dealers' hedging is made more difficult because their intent to trade has been displayed to the market. Therefore, particularly for illiquid swaps, a market participant may determine that it is in its best interest not to disclose its trading intention, and may choose to send an RFQ to just one liquidity providing participant on the SEF. Providing investors the choice to send an RFQ to only one liquidity providing participant on the 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 SEF even with respect to swaps that are not required to be traded on a SEF, thus supporting the development of trading on regulated platforms and venues in the United States, rather than in other jurisdictions.

C. Treatment of Responses and "Resting" Orders

FXall believes that pre-trade price transparency means that participants can obtain an accurate indication of the price at which a trade may be done on the SEF. In the case of RFQ trading, pre-trade price transparency is achieved through a participant's ability to access competitive and indicative quotes prior to dealing. Pre-trade price transparency should not, however, mean that SEFs must disclose RFQs, or responses to RFQs, to other participants. SEFs and their participants should be allowed to maintain the confidentiality of their inquiries to minimize the potential for market impact or to protect proprietary strategies.

The Proposed Rules require that the SEF must "take into account" any bids or offers "resting" on the trading system pertaining to the same instrument for which a market participant made a request for a quote. As stated above, we do not believe order books and "resting" orders should be mandated under the RFQ definition. The Proposed Rules creates an affirmative obligation on the SEF to inform the requester of not only responsive quotes, which the requester received from one or all of the market participants to which the requester sent a request, but also any other bids or offers that have been made by any other market participant for the same instrument. The CFTC states that the objective of these requirements is to "ensure that any competitive resting bids or offers be taken into account and communicated to the requester."[15] Our experience shows that participants want the ability to choose what services and information is provided as they feel is needed. Rather than create an affirmative obligation on the SEF to inform the requester, FXall believes that in this case both the order book and the RFQ responses would be available to the participant requesting the RFQ to determine how much information the requester wishes to "take into account".

As the Proposed Rules do not define "take into account," the rule could be interpreted to obligate the SEF to inform the resting bidder or offeror of the RFQ made, thus making the RFQ available beyond the minimum five market participants. This interpretation would insert a resting bidder or offeror into the negotiations between the requester and the recipient market participants, and would also allow any market participant to see what RFQs had been made by other market participants by making a token bid or offer for that

[15] See Proposing Release, 76 Fed. Reg. at 1220.

particular instrument. This rule could undermine the RFQ system to form a default multiple-to-multiple facility where certain market participants, such as high frequency traders, could game the system to front run RFQ users. As a result, the majority of current users of RFQ systems would abandon the SEF platform for less restrictive jurisdictions. FXall believes the rule should be clarified so that, if the final rule does impose an affirmative obligation on the SEF, it does not require that the resting bidder or offeror be informed of the RFQ, but rather only that the requestor be informed of the resting order.

In addition, the CFTC requested comment on a requirement to obligate the requester to execute against an executable bid or offer of another market participant, if it is competitive, in executing its RFQ, effectively creating a trade-through rule which the SEF would have to enforce. FXall believes the requester should have the choice to ignore these quotes for execution if that is his decision. We do not believe that the RFQ trading method is compatible with such a requirement because users of RFQ consider a variety of elements, such as information leakage, liquidity, and processing costs, besides price that are important to them for an execution. Mandating a trade-through rule would force the requesting customer to disclose market information to the resting order that may disadvantage the requesting customer. In addition, forcing multiple executions of the trade raises processing and "ticket" costs for the requesting customer. It would also be a disincentive to dealers to provide liquidity by forcing them to expose market information that can be used to their detriment.

VI. Fifteen-Second Requirement for Certain Brokered Transactions

Proposed Rule 37.9(b)(3) requires that brokers who are executing transactions against a customer's order or entering a trade for two customers on opposite sides of the transaction pause for fifteen seconds between the entry of the buy and the sell orders to allow other market participants to participate in the trade.[16] FXall believes that fifteen seconds is too long for swaps markets. Such a delay will render the market risk to be too high for brokers who wish to facilitate their customers' trades in an electronic, fast-moving market. This proposal takes away the incentive for brokers to facilitate customer orders. FXall believes the CFTC should reduce the duration of the pause to a point which balances the ability for other market participants to compete with the market risk placed on the broker. FXall believes that this requirement is based upon similar requirements in the listed options markets. The listed options markets have lowered their delays from 30 seconds a decade ago to just one second currently. FXall believes that each market should be able to decide the appropriate delay, taking into account the particular characteristics of that market.

Also, FXall believes that the rule should not apply to the matching of customer orders if the broker has not solicited one of the orders. This is a permitted exception in the listed options markets. A broker's unsolicited customer matches should be permitted to be immediately executed when entered on the SEF.

[16] Proposing Release, 76 Fed. Reg. at 1241,

VII. Core Principle 2 – Compliance with Rules

As stated above, the requirements in the Proposed Rules prescribe a full surveillance, investigation and enforcement program for SEFs that is almost indistinguishable from that which is required of DCMs and essentially obligate SEFs to become SROs. In essence the CFTC would be creating dozens of regulators with overlapping jurisdiction over the same group of participants. In the current regulated markets a common theme of both registered entities and the regulators is finding efficient ways to oversight the same participants and lessen the burden on firms of constant responses to a myriad of regulators with basically the same objective. The Proposed Rules would be undoing all of the progress made in that area. In addition, Proposed Rule 37.207 states that a SEF must provide in its rules that when a swap dealer or a major swap participant enters into or facilitates a swap transaction that is subject to the mandatory clearing requirement of Section 2(h) of the CEA, the swap dealer or major swap participant shall be responsible for compliance with the mandatory trading requirement for that swap under Section 2(h)(8) of the CEA. It appears from this language that the SEF will be responsible for policing the conduct of swap dealers and major swap participants generally, not only with respect to their trading on such SEF.

It is not clear how the SEF would be able to detect the violation of this provision by swap dealers and major swap participants unless the SEF reviews and audits every swap entered by swap dealers and major swap participants. However, under the several proposals for implementation of the DFA, SEFs will not be the entities to have the requisite market-wide data that would be necessary to form a coherent picture of participants' market activities to conduct meaningful compliance oversight. SEFs will be providing data to swap data repositories, not collecting data. Imposing this requirement on a SEF would be impractical and should not be included in the Proposed Rules. Therefore, FXall believes that SEFs are not the proper regulated entities to perform all of the surveillance, investigation and enforcement tasks the CFTC has proposed. FXall believes a centralized regulator with access to all of the market data that will be required under the market reforms is the logical choice for carrying out these functions. Further, this will relieve the regulated firms of the burden of responding to dozens of overlapping SEF regulators.

A. Rule Enforcement Program – Proposed Rule §37.203

Under the CEA as amended by the DFA, SEFs must have the capacity to detect and investigate trading abuses, and must have the means to capture information that may be used in establishing whether rule violations have occurred.[17] In implementing this statutory mandate, Proposed Rule §37.203 provides that a SEF must have the authority to collect information and documents on both a routine and non-routine basis, including the authority to examine books and records kept by the SEF's members and by market participants. FXall is concerned that this may be read to require SEFs to conduct a full regulatory examination program with regard to their members and market participants, which is not necessary to accomplish the goals of detecting, and having the ability to investigate, trading abuses. FXall recommends that the Commission modify Proposed Rule §37.203 to make it clear that a SEF will have the authority to examine the books and

[17] CEA Section 5h(f)(2)(B).

records kept by the SEF's members and by market participants, either on a routine or non-routine basis, but shall not have an obligation to do so except as may be necessary to investigate a specific potential rule violation that the SEF has detected in the ordinary course of its trade practice surveillance routine or has otherwise been brought to its attention.

B. Disciplinary Procedures and Sanctions - Proposed Rule §37.206

The Commission's Proposed Rules addressing disciplinary procedures for SEFs[18] are essentially identical to those applicable to DCMs.[19] There is no statutory basis for this parallel treatment of SEFs and DCMs. Although there is a specific statutory core principle in the DFA that DCMs must "establish and enforce disciplinary procedures that authorize the [DCM] to discipline, suspend, or expel members or market participants that violate the rules,"[20] there is no parallel statutory core principle applicable to SEFs requiring SEFs to do the same. SEFs are only required under the statutory core principle to "establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules."[21] This statutory requirement does not contemplate or require implementation of the same disciplinary procedures for SEFs as are required for DCMs. Furthermore, the mandate set forth in the DFA for SEFs to deter trading abuses is fully satisfied by the procedure set forth in Proposed Rule §37.203, which prescribes a separate procedure for detecting and investigating abusive trading practices.[22]

FXall notes that Congress clearly intended to differentiate between SEFs and DCMs when it declined to include a core principle applicable to SEFs in the DFA explicitly requiring SEFs to establish procedures to discipline, suspend or expel member of a SEF. Much of a DCM's trade practice enforcement program is tailored to protect the interests of retail customers. Members of a SEF are required to be ECPs, and thus, retail customers will not be market participants on SEFs. ECPs do not require the same level of protection as is afforded to retail customers of a DCM. This additional level of unnecessary protection will come at a price, which will be passed on to the participants, who do not require the protection. Accordingly, FXall believes that requiring SEFs to maintain extensive disciplinary procedures, as if they are DCMs, is contrary to the Congressional intent to distinguish between SEFs and DCMs in this respect. In addition, FXall believes that the ability to suspend or expel member of a SEF is of limited deterrent when the participant can continue trading on a competing SEF. It is a greater deterrent on a DCM, where the participant would be unable to trade the product because it only exists on that DCM. FXall believes this is another reason that a central regulator with market wide authority should conduct the enforcement program for swap market oversight. FXall recommends that SEFs be afforded the flexibility to establish a more streamlined disciplinary process that permits, for example, SEFs to enforce trading, trade processing, and participation rules through summary proceedings and sanctions (including warning letters, fines, and restrictions or suspensions of access) administered by SEF staff rather than through formal disciplinary hearings.

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[18] Proposing Release, 76 Fed. Reg. at 1244, Section 37.206.
[19] Proposing Release, 75 Fed. Reg. at 80619-80622, Sections 38.700-38.716.
[20] DFA Section 735(d)(13).
[21] DFA Section 733(5)(h)(f)(2)(B).
[22] Proposing Release, 76 Fed. Reg. at 1242, Section 37.203.

C. General Financial Integrity - Proposed Rule §37.702

The DFA requires a SEF to "establish and enforce rules and procedures for ensuring the financial integrity of swaps entered on or through the facilities of the swap execution facility, including the clearance and settlement of the swaps pursuant to section 2(h)(1)."[23] Under Proposed Rule §37.702(a), a SEF must establish financial standards for its members by requiring, at a minimum, that members qualify as ECPs. Under Proposed Rule §37.703, a SEF must monitor members' compliance with the SEF's minimum financial standards and must routinely receive and promptly review members' financial information.

For purposes of comparison, under the core principles applicable to DCMs, DCMs must also establish and maintain minimum financial standards for their members and must have additional rules regarding the segregation of customer and proprietary funds, custody, investment standards, intermediary default procedures and related recordkeeping.[24] In addition, DCMs must monitor their members' compliance with the minimum financial standards and must continuously monitor member positions.[25]

Thus, both SEFs and DCMs are obligated to monitor their respective members' compliance with financial standards. However, under Commission Regulation 1.52 and the procedures established by the Joint Audit Committee ("JAC"),[26] DCMs are permitted to delegate their responsibilities for monitoring and auditing financial information for compliance with minimum financial standards by coordinating with other DCMs and the National Futures Association (the "NFA") for the efficient financial surveillance of their members. The Commission does not appear to have provided SEFs with a similar ability to delegate their responsibilities for purposes of monitoring the financial soundness of their members. In order to provide SEFs with the same resource efficiencies as are available to DCMs, to the extent that a SEF member is required to be registered with the NFA, either as a futures commission merchant ("FCM"), swap dealer or major swap participant, SEFs should be permitted to join the JAC and delegate their financial surveillance functions with respect to such members to the JAC. For the financial surveillance of non-NFA members, SEFs should be permitted to either delegate this function to the members' primary financial regulator or outsource this function by contracting with third party service providers as described under Proposed Rule §37.204.

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[23] See DFA Section 733(5)(h)(f)(7).
[24] Proposing Release, 75 Fed. Reg. at 80618, Sections 38.602 and 38.603.
[25] *Id.*, Section 38.604.
[26] The Joint Audit Committee is a representative committee of U.S. DCMs and regulatory organizations which participate in a joint audit and financial surveillance program that has been approved and is overseen by the Commission. The purpose of the joint program is to coordinate amongst the participants numerous audit and financial surveillance procedures over registered futures industry entities. Each registered futures entity is thus allocated a "Designated" Self-Regulatory Organization, known as the DSRO, which is responsible for, among other things, conducting periodic audits of that entity and sharing any and all information with the other regulatory bodies of which the firm is a member. The JAC attempts to provide a coordinated audit and surveillance effort in an effective and efficient regulatory forum. By standardizing the audit function and avoiding duplication, the JAC attempts to streamline the financial surveillance oversight function.

VII. Core Principle 15 – Designation of Chief Compliance Officer

A. "Senior officer"

The DFA and the Proposed Rules require each SEF to designate an individual to serve as a chief compliance officer ("CCO"), and for the CCO to "report directly to the board or to the senior officer of the facility."[27] The term "senior officer" is not defined in the DFA and the Commission has requested comment with respect to whether "senior officer" should be a defined term. FXall believes that it should. If the term "senior officer" is left undefined, it may be read to mean any department head, and may include officers who, due to the nature of their business roles, have responsibilities that are too far removed from the compliance activities of the SEF to justify their oversight of the CCO's duties. It is also possible that an officer's goals with respect to his or her position may create a conflict of interest with respect to such person's oversight of the CCO's responsibilities. It is the CCO's duty to resolve any conflicts of interest that may arise between the compliance requirements and business considerations; thus, any officer in a role that may be in conflict with the SEF's compliance requirements should not have responsibility for the resolution of any such conflicts. The senior officer should be a person whose position within the SEF has clear authority to supervise the SEF's business units or personnel and whose goals with respect to his or her position coordinate with such person's oversight of the CCO's responsibilities. Therefore, FXall proposes defining the term "senior officer" to include the SEF's president, chief executive officer, chief legal officer or other officer with ultimate supervisory authority for the SEF entity.

B. CCO Lacks Supervisory Power

Unless revised, the Proposed Rules will cause the CCO to be deemed a business-line supervisor. The Proposed Rules inappropriately burden the CCO with supervisory responsibilities within the SEF without providing adequate supervisory authority for such a role. In other financial services industry contexts, the CCO traditionally acts as an independent advisor to the firm's business-line supervisors, who have the authority to supervise the firm's business activities and are ultimately responsible for making sure that the firm's employees act in compliance with applicable law. By eliminating the traditional separation between supervision and compliance, the Proposed Rules would put an end to the independence necessary to perform the CCO function effectively, and would undermine the long-standing regulatory principle that it is the business managers who have the ultimate supervisory responsibility in the firm, not the CCO.

As is the case with the many regulated firms providing OTC derivative markets today, the CCO and the compliance function will provide unique and critical services to the SEF, supporting management's performance of its supervisory responsibilities and the SEF's efforts to comply with applicable law. The SEF's compliance personnel will monitor management responses to indications of improper activity, conflicts or interest or failures to supervise, escalating matters to senior levels (up to and including the senior officer and/or the Board) if the response appears to be inadequate. In performing each of these functions, compliance personnel and the CCO act as advisors to, not as supervisors of, the SEF's business units or personnel. The CCO cannot enforce compliance with policies

[27] CEA Section 5h(15)(B)(1).

and procedures by the firm's employees and cannot hire or fire employees or set their compensation. The CCO can only escalate compliance issues to the SEF's senior business management or the Board. In comparison, supervisors run the business, with the power to hire, fire, compensate, and discipline employees who do not comply with firm procedures or applicable law.

In interpreting CFTC Rule 166.3 as applicable to the supervisory duties of FCMs, the Commission stated that, "to establish that an individual supervisor violated regulation 166.3 . . . it is necessary to show either that respondent had knowledge of wrongdoing and failed to take reasonable steps to correct the problem, or that respondent failed to discharge specific responsibilities of supervision,"[28] and it must first be proven that they "occupied positions that triggered a duty to supervise."[29] The CCO does not have these powers outside of the compliance department. Supervisory control over the business resides with those who run the business, from the CEO to business unit managers. The CCO advises and assists them in carrying out their roles and complying with the core principles and the Commission's rules (including escalation), but supervisors decide whether, and if so how, to implement and enforce them. Imposing supervisory responsibilities on CCOs without bestowing the requisite business-line authority would make them a police officer without a badge. This is the reason that the broker-dealer compliance model contains numerous provisions making clear that the firm's CEO, not the CCO, is the person ultimately responsible for the firm's compliance with applicable law.

C. The Annual Compliance Report

The Proposed Rules require the CCO to prepare a written report annually ("Annual Report") that covers the SEF's most recently completed fiscal year, and provide it to the Board or the senior officer.[30] While FXall agrees that a CCO's annual report to the Commission should thoroughly address the DFA's requirements in order to enhance the transparency of the SEF's operations and its adherence to the provisions of Section 733 of the DFA, there are several critical issues with respect to the annual compliance report requirements that FXall asks the Commission to address in its rulemaking.

1. The CEO, Not the CCO, Should Certify the Required Annual Report.

The Proposed Rules – but not the DFA – require the Annual Report to include a certification by the CCO that, "to the best of his or her knowledge and reasonable belief, and under penalty of law, the information contained in the annual report is accurate and complete." While it is clear from the DFA that the CCO must complete and sign the Annual Report, the DFA does not specifically state or mandate that the required certification must itself be made by the CCO, but only that a certification be included in the report. Consistent with the financial services industry model and, as stated above, the fact that it is the SEF's CEO that has the ultimate authority to supervise the activities of the firm and its employees, the Proposed Rules should specify that the required certification should be made by the CEO, not the CCO.

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[28] *Bunch v. First Commodity Corp. of Boston*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25352 at 39,168-39,169 (CFTC Aug. 5, 1992).
[29] *Smith v. Betty*, [2007-2009 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,605 (CFTC Aug. 15, 2007).
[30] Proposing Release, 76 Fed. Reg. at 1252, Section 37.1501.

2. Content Requirements of the Annual Compliance Report

The Proposed Rules' content requirements for the annual compliance report go well beyond those set forth in the Section 733 of the DFA, which, in addition to a certification requirement, specifies only that the report contain a description of the firm's compliance with respect to the CEA and a description of each SEF policy and procedure (including its code of ethics and conflict of interest policies).[31] In contrast, the Proposed Rules specify seven far more detailed items to be included in the report.[32] The degree of detail required by the Proposed Rule to be included in the report is extensive and greatly exceeds the scope of the requirements set forth in the DFA. For instance, the second of the Commission's seven proposed requirements sets forth that the report must contain a review of the Commission's regulations that are applicable to SEFs, each subsection thereof, and each of the 15 core principles, including each of the six duties of the CCO, and then (i) identify each of the SEF's policies and procedures that ensure compliance with each of those enumerated items, (ii) provide a self-assessment as to the effectiveness of the SEF's policies and procedures, and (iii) discuss areas for improvement and recommend potential or prospective changes or improvements to its compliance program and resources. The DFA's requirement that SEFs must provide a description of their policies and procedures does not necessarily contemplate such a detailed treatment of the SEF's compliance program and does not require a self-assessment and discussion of areas for improvement. These requirements go well beyond the DFA's requirements.

Compiling the information required to be included and preparing the annual compliance report in a timely manner annually will prove to be a herculean task for SEFs to undertake and will consume considerable resources. Likewise, it will likely prove to be a massive task for the Commission's staff to thoroughly review each report it receives annually and to actively use those reports to verify whether each SEF is in compliance with the DFA and the Commission's regulations. The requirements are burdensome, overly detailed and will consume a disproportionately large amount of a SEF's resources.

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[31] DFA Section 733(5)(h)(f)(15)(D).

[32] The report is required to contain: 1) a description of the SEF's policies and procedures, including the code of ethics and conflict of interest policies; 2) a review of applicable Commission regulations and each subsection and core principle of Section 5h of the CEA, and with respect to each, (i) indentifies the policies and procedures that ensure compliance with each subsection, core principle and each duty of the CCO, (ii) a self-assessment of the effectiveness of these policies and procedures and (iii) a discussion of areas for improvement and recommendations as to possible changes or improvements to the compliance program and resources; 3) a list of any material changes to policies and procedures since the last annual compliance report; 4) a description of the financial, managerial and operational resources set aside for compliance with the CEA and the Commission's regulations, including a description of the SEFs self-regulatory program's staffing and structure, a catalogue of investigations and disciplinary actions taken, and a review of the performance of the disciplinary committees and panels; 5) a description of any material compliance matters and how they were resolved; 6) any objections to the report by persons with oversight responsibility for the CCO; and 7) a certification by the CCO that, to the best of his or her knowledge and reasonable belief, and under penalty of law, the annual compliance report is accurate and complete. See Proposing Release, 76 Fed. Reg. at 1252, Section 37.1501.

As an alternative, FXall proposes that, in accordance with the DFA, annual compliance reports be required to contain: (1) a description of the SEF's policies and procedures, including the code of ethics and conflict of interest policies; (2) a list of any material changes to policies and procedures since the last annual compliance report; 3) a description of how the policies and procedures address the DFAs requirements for SEFs; 4) a description of any material compliance matters that have arisen since the last report and how they were resolved; and 5) a certification by the CEO of the SEF.

3. Policies and Procedures Must "Ensure" Compliance

Under Proposed Rule §37.1501(e)(2), the annual compliance report is required to contain, among other things, a review of applicable Commission regulations and each subsection and core principle of Section 5h of the CEA, and with respect to each, identify the policies and procedures that *ensure* (emphasis added) compliance with each subsection, core principle and each duty of the CCO.

FXall does not believe that the Proposed Rules should (or can) require a firm to identify policies and procedures that "ensure" or guarantee compliance with "each subsection, core principle and each duty of the CCO". Because it is impossible to actually ensure compliance, a point made clear by the Proposed Rules' requirement to describe non-compliance issues identified by the SEF, FXall believes that in using the phrase "ensure compliance" in DFA Section 733(5)(h)(f)(15)(B)(v), Congress was referring to the implementation of compliance policies, procedures and programs that are *reasonably designed to result in compliance* with the CEA and Commission rules, and FXall suggests that the requirement be amended to reflect this. In other words, "ensure" should be understood to mean verify and facilitate, as opposed to assure or guaranty.

4. Prohibition Against Changes to the Annual Compliance Report

Under the Proposed Rules, prior to submitting the annual compliance report to the Commission, the CCO must provide the annual compliance report to the SEF's board, or to the senior officer if the SEF does not have a board, for review, but not for approval.[33] The Proposed Rule explicitly provides that members of the board and the senior officer may not require the CCO to make any changes to the report, but that they may provide the Commission with any objections they may have to the report.

The CCO will report directly to either the board or to a senior officer of the SEF. The board or a senior officer must oversee the CCO's duties, approve the CCO's compensation, and may remove and replace the CCO. Given this authority, it is incongruous that the board or senior officer, as the case may be, is barred from making changes to the annual compliance report submitted to the Commission by the CCO. This puts the CCO in the no-win situation of being the stalwart regulatory enforcer with, as stated above, no real business authority within the SEF. It's untenable to make the CCO the supervisor of his superiors. While FXall understands that the Commission's intent is to allow the CCO to make a complete and accurate assessment of the SEF's compliance program, FXall believes, given the compliance oversight responsibilities of the board, that the board or senior officer should be permitted to make changes to the annual compliance

[33] Proposing Release, 76 Fed. Reg. at 1252.

report without submitting an objection to the Commission. This stance accords with our belief stated above that the senior officer as head of the SEF make the annual certification rather than the CCO.

VIII Proposed Alternative Regulatory Program

In the interest of creating a regulatory program that fully complies with the statutory requirements and the intent of the DFA while maximizing value and efficiency, FXall suggests that the Commission propose rules for the surveillance, investigation, enforcement and CCO requirements that are more flexible, providing SEFs with the level of discretion contemplated by the DFA.[34] Maximizing flexibility in the structure of the CFTC's regulatory framework applicable to SEFs will also promote the harmonization and compatibility of that framework with the Securities and Exchange Commission's ("SEC") proposed rules for trading security-based SEFs ("SB SEFs"). This more flexible approach also would allow the CFTC to monitor the market for swaps and make any needed adjustments to interpretations that it may adopt as this market continues to evolve.

Generally, the SEC's surveillance, investigation, enforcement and CCO requirements for SB SEFs are more flexible than those proposed by the CFTC. The SEC's financial surveillance requirements for SB SEFs are more general than the CFTC's corresponding rules and do not include requirements to monitor member credit arrangements and collateral for non-cleared transactions or to routinely review member financial information, as SEFs are required to do under the CFTC proposal. The rules for SB SEFs regarding surveillance and investigation of rule violations is much less prescriptive than the corresponding CFTC rule, which requires, for example, ongoing monitoring and formal annual evaluations of the SEF's compliance staff resources and their workloads, and specific procedures for conducting and reporting investigations. The enforcement and disciplinary procedures under the CFTC's proposed rules are also more prescriptive and less flexible than the SEC rule, which is more flexible and allows the SB SEF to authorize its staff to establish the enforcement procedures so long as they are fair and non-arbitrary. The SEC's proposed CCO requirements for SB SEFs are less prescriptive than those of the CFTC and more closely follow the Dodd-Frank parameters without going much beyond them.

The SEC's approach to regulating SB SEFs is generally less prescriptive and more flexible than the CFTC's Proposed Rules. The SEC's approach will provide greater regulatory flexibility to an evolving SEF market structure. Comparing the SEC's approach to the CFTC's approach is instructive. For example, although the same core principle regarding the financial integrity of transactions is applicable to both SEFs regulated by the CFTC and SB SEFs regulated by the SEC, the SEC's proposed rule for SB SEFs is more general than that proposed by the CFTC. For security-based swaps that will not be cleared, an SB SEF "may permit a participant to take into account counterparty credit risk."[35] In contrast, the CFTC's Proposed Rule for non-cleared swaps requires that SEFs must require their members to demonstrate that they have entered into a credit arrangement for the transaction, have the ability to exchange collateral, meet any credit

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[34] See DFA Section 733(5)(h)(f)(1)(B), providing that SEF's "shall have reasonable discretion in establishing the manner in which the swap execution facility complies with the core principles described in this subsection."

[35] *Id.* at p. 431-432.

filters adopted by the SEF, and comply with any additional safeguards required by the CFTC, going far beyond the requirements of the DFA and the SEC's approach.

FXall encourages the CFTC to harmonize its regulatory approach to SEFs with the SEC's more flexible approach. FXall believes that the CFTC's Proposed Rules should be modified so that they are less prescriptive to accommodate evolving market structures and promote consistency with the SEC's proposed rules for SB SEFs.

IX Conclusion

As discussed above, while FXall endorses the Commission's efforts to create a comprehensive set of regulations to implement the statutory requirements applicable to SEFs, FXall believes that the Proposed Rules establish requirements for SEFs that, in several instances, go well beyond the mandates set forth in the DFA. The Proposed Rules will result in unintended consequences, with a negative impact on the competitiveness and efficiency of SEFs and the swap markets.

FXall appreciates the opportunity to provide the Commission with its perspective on the Proposed Rulemakings. If you have any questions regarding our comments, please contact the undersigned at 202-261-6538.

Thank you for the opportunity to comment on the SEF rulemaking.

Respectfully submitted,

Wayne Pestone
Chief Regulatory Officer