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Goldman Sachs

March 8th, 2011

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

RE: RIN: 3038-AD18, Notice of Proposed Rulemaking on Core Principles and Other Requirements for Swap Execution Facilities

Goldman, Sachs & Co. ("Goldman Sachs")[1] appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission") regarding the regulation of swap execution facilities ("SEFs") and the Commisions's proposed rules on Core Principles and Other Requirements for Swap Execution Facilities (the "Proposed Rules").[2]

The Proposed Rules set forth the standards that a trading system or platform would be required to satisfy in order to qualify as a SEF. We believe that the Proposed Rules are more restrictive than what is contemplated by Title VII of the Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act" or "Dodd-Frank") and are concerned that if they are adopted in the form proposed, these rules will limit the availability of derivatives (referred to herein as "swaps") and constrain liquidity in a manner inconsistent with Congressional intent. We also believe that the Proposed Rules raise questions in light of how swaps are transacted that are important for the Commission to consider.[3]

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[2] 75 Fed. Reg. 1214 (January 7, 2011) (the "Proposing Release").

[3] In this letter, we highlight certain key concerns on the Proposed Rules. For a more comprehensive discussion of the concerns raised by the Proposed Rules, we invite the Commission's attention to the letter on the Proposed Rules submitted by Robert Pickel, Executive Vice Chairman, International Swaps and Derivatives Association, Inc., to David A. Stawick, Secretary, the Commission, dated March 8, 2011 (the "ISDA Letter").

I. Swap Execution Facilities and the Dodd-Frank Execution Requirement

In enacting Title VII of the Dodd-Frank Act, Congress determined that swaps should continue to be available to the diverse range of participants that use and rely on them because of the important role that these products play in the capital markets and in the economy generally. At the same time, Congress mandated certain reforms for the swaps markets. In particular, section 723 seeks to reduce systemic risk by requiring certain swaps to be cleared by a registered derivatives clearing organization (a "DCO") (such requirement, the "Clearing Requirement"). Section 723 also seeks to promote transparency in swaps markets by requiring that swaps that are subject to the Clearing Requirement be executed on a designated contract market ("DCM") or SEF (the "Execution Requirement"), subject to certain exceptions.

While Congress included the Execution Requirement in Title VII, it took great care in crafting this requirement. Congress understood that imposing an overly restrictive Execution Requirement (either by virtue of its scope or the manner in which it may be satisfied) would undermine the broader reform objectives of the Dodd-Frank Act. Specifically, it recognized that an unduly restrictive Execution Requirement would deter many market participants from entering into transactions, thereby constraining liquidity, reducing competition, impairing transparency and, ultimately, undermining systemic risk reduction. It understood that swaps are different from listed futures contracts insofar as they are characterized by larger trade size and smaller trade volumes.

RFQ Standards

We believe that the Proposed Rules are inconsistent with Congressional intent in two key respects. First, the Proposed Rules contain an overly restricted definition of the types of systems and platforms that will qualify as SEFs. The statutory definition of SEF simply requires that the system or platform provide "multiple participants with the ability to execute or trade swaps by accepting bids and offers made by multiple participants." Proposed Rule ("PR") 37.9 imposes requirements that go well beyond the statutory standard by limiting qualifying "request for quote" or "RFQ" systems to those that (i) require that each quote request be transmitted to no fewer than five liquidity providers, (ii) operate a centralized electronic screen, and (iii) transmit to parties requesting quotes not only the responses provided by liquidity providers but also resting bids or offers.

The requirements in the Proposed Rule would unduly limit the choices available to market participants. The rules proposed by the Securities and Exchange Commission (the "SEC") with respect to security-based swap execution facilities, which is based on a definition that is almost identical to the SEF definition, allow a market participant to transmit a quote request to a single liquidity provider so long as it has the ability to transmit quote requests to more participants on the system.[4] Forcing a market participant to submit quote requests to a minimum number of liquidity providers may impair the quality of execution and is contrary to Dodd-Frank, which simply requires that participants have the ***ability*** but not the ***obligation*** to send quote requests to multiple participants.

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[4] See SEC Release No. 34-63825 (Feb. 2, 2011)76 Fed. Reg. 10948 (the "SEC Proposal") at 10953.

"Available to Trade" Condition

Our second concern relates to the "available to trade" condition to the Execution Requirement. This condition is designed to ensure that there is sufficient liquidity in the trading of a particular swap before it becomes subject the Execution Requirement. The mere listing of a swap does not cause that swap to be "available to trade."

Under PR 37.10, the determination as to whether a swap meets the "available to trade" standard is left to the SEF rather than the Commission. We believe that this is inconsistent with section 721(b)(2), which authorizes the Commission to define terms contained in any Dodd-Frank amendment to the Commodity Exchange Act. We also believe it appropriate for the Commission to retain this responsibility in light of the inherent conflict that would arise if the trading systems themselves were vested with the authority to determine whether swaps are required to be traded over their facilities, which would of course benefit their commercial interests.[5]

In order to ensure that this important standard performs the role contemplated by Dodd-Frank, we recommend that the Commission clarify that the Execution Requirement does not apply to a particular swap until (i) the Commission designates the swap as subject to the Clearing Requirement, (ii) a DCM or SEF lists the swap for trading on its facility on a voluntary basis, and (iii) the Commission has a data set of sufficient duration on which to conclude that the swap is "available to trade" on the DCM or SEF. An appropriate data set will be available only after swap data repositories are fully functional, and would have to be specific to the product type. As the post-Dodd-Frank swap markets mature, the Commission will then have the ability to continually evaluate whether the "available to trade" condition has been satisfied based on the experience it develops in administering this aspect of the rules.

II. <u>15-Second Delay</u>

PR 37.9(b)(3) requires a minimum delay of 15 seconds before a trader can execute as principal against a customer's order or, as agent, execute two customer orders against each other. We do not believe that such a requirement is appropriate in the context of an RFQ execution environment and we believe that it was included in the Proposed Rule based on the Commission's experience in dealing with pre-arrangement issues in the context of the listed futures markets, which of course involve a central order book. We respectfully request the Commission to clarify that the requirement applies only to SEFs that operate order books in which orders compete based on price-time priority and does not apply with respect to any RFQ system operated by a SEF.

If the Commission does impose a delay requirement on transactions to be executed through a SEF's central order book, then we suggest that it (i) set the delay at 1-3 seconds, depending on the complexity of the product, as determined by the Commission in consultation with market participants and SEFs; (ii) permit the modification or cancellation of a crossing order during or immediately following the trading pause if no other participants have price improved the order; (iii) clarify that an order presented during the delay may not be executed at

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[5] The SEC raised similar concerns in its security-based SEF proposal and consequently retained the authority to maket the "available to be traded" determination itself. See SEC Proposal at 10969.

the level presented but rather only at a level that reflects an improvement to the level presented; and (iv) allow traders involved in a crossing order to respond to quote requests or streaming indicative or firm bids and offers in the swap being crossed. Those changes would address material shortcomings that we have observed in markets that currently subject crossing orders to delays. Absent such modifications, the proposed delay would adversely affect the ability of a customer to obtain the best price, inasmuch as the delay would subject traders to undue market risk and to the risk of adverse selection and thereby discourage them from making a better price in the first place.

III. Impartial Access

We support the requirement contained in PR 37.202(a)(1) that SEF access criteria be "impartial, transparent, and applied in a fair and nondiscriminatory manner." We request that the Commission interpret this requirement in a manner consistent with similar rules applicable in the United States to SEC-regulated alternative trading systems and, in Europe, to multilateral trading facilities. Those rules generally do not require universal access but permit platforms to make access available to those firms that qualify under objective and fully transparent eligibility criteria.[6]

We recommend that the Commission allow different SEF models to evolve to suit the different needs of distinct market segments. Each SEF would have the flexibility to determine its own access criteria, provided that they are impartial, transparent, and applied in a fair and nondiscriminatory manner. Such a market structure would be consistent with the SEC's security-based SEF proposal.[7] It would also correspond to Dodd-Frank's grant of authority to SEFs to use "reasonable discretion" in establishing the manner of their compliance with the applicable core principles, including the impartial access requirement.[8]

IV. Other Execution Considerations

Whether and at which DCO a swap is cleared are key terms that will influence the cost and value of a swap. Accordingly, it is important that the non-cleared version of a swap be maintained for execution by a SEF separately from the cleared version of such swap and that a swap cleared by one DCO be maintained for execution by a SEF separately from the same swap that is cleared by another DCO. Market participants need to know which DCO will be used to clear swaps in advance of execution. DCOs maintain different risk management and margin policies, including how much margin is required to be posted and the types of collateral that may be used to satisfy such requirements. These policies and requirements may involve different cost structures that would cause participants to change the price of swaps depending on which DCO will clear them. In addition, a market participant may have a pre-existing position at a particular

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[6] See, e.g., SEC Release No. 34-40760 (Dec. 8, 1998), 63 Fed. Reg. 70844 (Dec. 22, 1998) at 70874 (discussing Regulation ATS's "fair access" requirements); MAR 5.3.1 of the FSA Handbook (merely requiring multilateral trading facilities to have "transparent rules, based on objective criteria").

[7] See SEC Proposal at 10962.

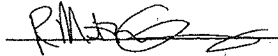
[8] Section 5h(f)(B) of the CEA.

DCO in relation to which the new trade may be additive or offsetting, either of which would affect how the market participant would price the swap to be executed. These considerations are particularly relevant in the context of potential transactions between a swap dealer or major swap participant ("MSP") on the one hand and a party that is neither a swap dealer nor MSP, on the other hand, insofar as Dodd-Frank provides the non swap dealer/MSP with the unilateral right to select which DCO will be used to clear trades.[9]

The Proposing Release acknowledges that, in light of the credit risk involved, market participants have an interest knowing the identity of their potential counterparty before they enter into swaps that are not subject to the Clearing Requirement (and therefore not subject to the Execution Requirement).[10] Depending on the manner in which a SEF complies with Core Principle 7 (regarding financial integrity of transactions), it may also be important to knowing the identity of potential counterparties for swaps that are subject to the Clearing and Execution Requirements. Even those swaps may involve material credit risk. As the Commission is aware, there are circumstances where a swap that is subject to the Clearing Requirement may not be accepted for clearing for credit or other reasons. In such cases and depending on the SEF's rules under Core Principle 7, parties that execute through the SEF would either face one another in an uncleared, bilateral transaction or potentially owe amounts arising from the trade not being accepted for clearing.

We would be pleased to discuss any of the comments or recommendations in this letter with the Commission staff in further detail.

Very truly yours,



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[9] Section 2(h) of the Commodity Exchange Act, 7 U.S.C. 2, as amended by the Dodd-Frank Act.

[10] Proposing Release at 1221.