

March 8, 2011

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

Re: Core Principles and Other Requirements for Swap Execution Facilities; RIN 3038-AD18.
76 FR 1214 (January 7, 2011)

Dear Mr. Stawick:

Bloomberg L.P. appreciates the opportunity to provide the Commodity Futures Trading Commission (“Commission”) with our comments with respect to the proposed rules in the above-referenced release (“Release”). The Commission seeks comment on proposed rules, guidance, and acceptable practices applicable to the registration and operation of a swap execution facility (“SEF”) under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). Bloomberg intends to register as a SEF in order to continue to facilitate trading in the swap markets under the new regulatory regime.

Bloomberg Background

Bloomberg is a leading, privately-held independent platform for electronic trading and processing of over-the-counter (“OTC”) derivatives. Bloomberg’s core business is the delivery of analytics and data on approximately 5 million financial instruments, as well as information and news on almost every publicly traded company through the Bloomberg Professional service. The Bloomberg Professional service provides comprehensive coverage on all major asset classes and currencies, including all varieties of mortgage-related securities. More than 300,000 professionals in the business and financial community around the world are connected via Bloomberg’s proprietary network.

Virtually all major central banks and virtually all investment institutions, commercial banks, government agencies and money managers with a regional or global presence are users of the Bloomberg Professional service, giving Bloomberg extraordinary global reach to all relevant financial institutions that might be involved in swap trading.

Bloomberg employs over 12,900 employees around the world, including more than 2,300 news and multimedia professionals at 146 bureaus in 72 countries, making up one of the world’s largest news organizations.

I. Proposed Rule 37.9 - Execution Methods and Venues

Our OTC derivatives electronic trading platform was built on the idea of adding transparency to the market by creating electronic functions that streamline trading in swaps and provide efficient access to swap pricing. Bloomberg has hosted various “request for quotes” (“RFQ”) systems for OTC derivatives for the past five years. Furthermore, our Bloomberg Bond Trader System, a competitive multi-dealer RFQ platform for U.S. and foreign government securities, has been active for more than 13 years. We are confident that these models are the correct paradigms for a SEF.

Bloomberg fully supports the Commission’s efforts to create a swap marketplace that achieves the goals of Dodd-Frank. We believe that the Dodd-Frank mandatory clearing and reporting requirements will significantly mitigate systemic risk, promote standardization and enhance transparency.¹ Of an equal but different importance is the creation of the newly regulated SEF marketplace.² While all three of the foregoing areas are critical under the new Dodd-Frank regulatory regime, we believe that swap clearing and reporting activities benefit from legal certainty and specificity provided by detailed prescriptive rules. The proposed SEF trading protocols, however, would benefit from more flexible rules. While we believe the Commission has appropriately defined the execution methods for swaps (*i.e.*, an RFQ system and an electronic platform for firm and indicative quotes), we do not believe the Commission should mandate the quote and trade protocols associated with these execution methods. Instead, providing guidance and acceptable practices for trade protocols would be more beneficial to our U.S. markets. Our concerns are reflected below.

A. Request for Quotes

As discussed above, one of the methods of swap execution provided under Proposed Rule 37.9 is an RFQ system. Under this execution method, a liquidity seeker (*e.g.*, institutional investors and investment managers) would use a SEF to transmit a request for quote to buy or sell a specific instrument to no less than five liquidity providers (*e.g.*, swap dealers). In our view, the Commission should not mandate transmission of an RFQ to a minimum or maximum number of liquidity providers and should modify the requirement so that the liquidity seekers have the flexibility to choose the number of quotes to request from liquidity providers.³

In our experience, liquidity seekers tend to vary their strategies as to the number of liquidity providers they will include on an RFQ. Their strategies typically depend on the particular instrument (and its relative liquidity), the direction (long or short), and the size of the transaction they are seeking to execute. For example, on the Bloomberg RFQ system for interest rate swaps, volume is sharply higher among customers seeking inquiries on certain instruments from a small number of dealers as compared to a large number of dealers.

¹ See *Financial Resources Requirements for Derivatives Clearing Organizations*, 75 FR 63113 (October 14, 2010); *Swap Data Recordkeeping and Reporting Requirements*, 75 FR 76574 (December 8, 2010).

² The two stated goals of creating a SEF are the promotion of trading on a SEF and pre-trade price transparency in the market. See *Commodity Exchange Act Section 5h(e)*.

³ From a design perspective, Bloomberg’s SEF trading platform will be able to accommodate a wide-range of trading protocols whether required by rule or dictated by market forces.

While many reasons may explain a given liquidity seeker's request for a small number of quotes, a common reason cited is that some liquidity seekers believe that they receive more competitive pricing when they avoid the "information leakage" that can result from sending an RFQ to a large number of dealers. When many liquidity providers are notified of a desire to trade, the losing liquidity providers know of the recent request and that they did not participate in the transaction, which constitutes the information leakage.

In some cases, the losing bidders, aware that a transaction recently occurred, can "get ready" for the winner's lay-off transactions by widening the market spread. In these instances, the winning liquidity provider may confront market deterioration when it attempts to hedge or lay off its risk, thereby suffering a "winner's curse." To avoid a liquidity provider's making less aggressive bids to hedge against the winner's curse that follows information leakage, some liquidity seekers may choose to elicit quotes from a smaller number of liquidity providers.

Given Bloomberg's experience that the liquidity/competitiveness balance depends on numerous factors that may vary based on specific circumstances, Bloomberg believes that the liquidity seeker – the customer in common parlance – is in the best position to determine on any given transaction the optimal number of liquidity providers from which to seek bids. Accordingly, the Commission should allow the liquidity seeker to choose the number of bids it would like to request without limiting that discretion by imposing either a floor or a ceiling on the number of requisite bids.

B. Trading Venue for Swaps Not Subject to the Clearing Requirement

Commodity Exchange Act ("CEA") Section 5h(1) states that "[n]o person may operate a facility for the trading or processing of swaps unless the facility is registered" as a SEF. Under the CEA, swaps subject to the clearing requirement set out in 2(h)(1) of the CEA must be traded on a SEF or a designated contract market ("DCM") unless no SEF or DCM makes the swap "available for trading."⁴ The Congressional intent underlying Dodd-Frank appears to be clear: swaps subject to the mandatory clearing requirement of CEA Section 2(h)(1) are intended to be executed on a SEF. This mandate is consistent with the goal of establishing a liquid, regulated, electronic swap market with the transparency and corresponding risk reduction associated with mandatory clearing. But the language of Dodd-Frank and the Commission's Release is not as clear regarding whether or not swap transactions that are not subject to the mandatory clearing requirement must be traded on a SEF.⁵

The requirement in Section 5h(1) to register as a SEF is drafted so broadly that it could be applicable to all swaps, not merely those swaps subject to the clearing requirement. If Congress intended that all swaps be traded on a SEF or DCM then a provision such as Section 2(h)(8) that requires that swaps subject to the clearing requirement be traded on a SEF or DCM would not be necessary.⁶

⁴ CEA Section 2(h)(8). While swaps may also be traded on a DCM, the comments in this letter are limited to the proposed rules with regards to SEFs.

⁵ The Commission notes that market participants may voluntarily conduct swaps not subject to the clearing requirement on a SEF in order to avail themselves of certain benefits of trading on a SEF (e.g., automated confirmation of trades, straight-through processing). See Release, p.1222.

⁶ See e.g., CEA Section 2(h)(8) that mandates execution on a DCM or SEF only for swaps subject to the mandatory clearing requirement that are not otherwise exempt from the execution requirement. See also CEA 5h(d) providing

We urge the Commission to resolve this conflict by defining and interpreting “swaps” in Section 5h(1) to mean “swaps subject to the mandatory clearing requirement under Section 2(h)(1).” We believe that swaps not subject to the mandatory clearing requirement should be allowed to be executed on a bilateral OTC basis, subject only to the applicable Dodd-Frank swap reporting and business conduct requirements.⁷ A contrary interpretation would be inconsistent with Dodd-Frank and would, in effect, make all swaps subject to the mandatory SEF trading requirement even if the swaps were not subject to the mandatory clearing requirement.

II. Core Principles

A. Proposed Rule 37.204 - Third-Party Regulatory Service Provider

We applaud the Commission for its proposed codification of the role that a third-party regulatory service provider can serve in a SEF environment. Proposed Rule 37.204 would allow a SEF to use a third-party regulatory service provider to “assist in complying with [its] core principles, as approved by the Commission.” The Commission further states that a SEF may utilize “the services of a registered futures association or another registered entity for assistance in performing certain self-regulatory functions.”⁸ Under the proposed rule a SEF would retain ultimate responsibility for the execution of these functions and the related SEF Core Principles. The Commission notes some of the SEF self-regulatory functions that may be appropriate for outsourcing include:⁹

- Trade practice surveillance
- Market surveillance
- Real-time market monitoring
- Investigations of possible rule violations; and
- Disciplinary actions

We believe the Commission should take an expansive view of the functions that a third-party regulatory service provider could perform. Title VII of Dodd-Frank creates an entirely new regulatory regime for the previously unregulated OTC swap market. The proposed rulemaking detours from the principles-based approach historically applied to the futures market and moves more toward a prescriptive, rules-based regime that will have a major transformative effect on the swaps (and DCM) marketplace. The ability of SEFs to broadly avail themselves of a third-party regulatory service provider with an established and credible infrastructure would allow SEFs to meet the proposed aggressive effective dates as well as allow SEFs to more efficiently focus on integrating the entire gamut of new rules and policies imposed on SEFs. The value of being able to enlist the expertise of an established third-party service provider should not be underestimated in terms of the Commission being able to

authority for the Commission to define the “universe of swaps” that can be executed on a SEF and providing that “other swaps” may be executed through any other available means of interstate commerce.

⁷ The OTC market continues to be an appropriate venue for illiquid, unique swaps where participants actively manage their risks.

⁸ Release, p. 1224.

⁹ Release, p. 1224, fn. 67.

facilitate the expeditious and reliable introduction of SEFs into the newly constituted swaps marketplace envisioned by Dodd-Frank.

In addition to those functions noted above, the Commission should permit a third-party regulatory service provider to provide SEFs with a broad suite of services including:¹⁰

- Providing qualified staff that would be counted for the purposes of the requirement that a SEF have sufficient enforcement staff necessary to effectively prosecute possible rule violations (Proposed Rule 37.203)
- Providing administrative support and, consistent with composition requirements, providing staff for required disciplinary and appellate panels (Proposed Rule 37.206)
- Assisting in the Rule Enforcement Program –Trade Practice Surveillance (Proposed Rule 37.203)
- Assisting in monitoring for member position limits (Proposed Rule 37.600)
- Providing real time monitoring tools to assist in implementing risk controls (Proposed Rule 37.405)

B. Proposed Rules 37.700 and 37.703 - Monitoring the Financial Integrity of Transactions and Member Financial Soundness

Under the Commission’s proposed rules a SEF would be required to enforce rules designed to ensure the financial integrity of transactions executed on its facilities and establish minimum financial standards for its members. The Commission acknowledges that a SEF can determine the financial integrity of a transaction subject to the mandatory clearing requirement by ensuring that each member meets the definition of “eligible contract participant” and the SEF has the capacity to route a transaction to a derivatives clearing organization (“DCO”) (with the corresponding risk management afforded by a DCO).¹¹ We believe that a SEF should be able to determine a market participant’s ability to meet any minimum financial standards by virtue of confirming that participants have access to a DCO either as members or through an intermediary. We do not believe it is necessary to set separate, duplicative financial requirements at the SEF level that are redundant to the exhaustive financial requirements that will be associated with access to a DCO. A SEF should be able to rely on related DCO financial requirements imposed on its clearing members, including disclosed credit or collateral arrangements, in order to meet the requirement to establish and review a member’s financials.

C. Proposed Rule 37.800 - Emergency Authority

Proposed Rule 37.800 requires a SEF to adopt rules to provide for the exercise of emergency authority to, among other things, “liquidate or transfer [member] open positions” in any swap. A SEF

¹⁰ Regardless of the scope or nature of the functions outsourced, a SEF would need to comply with proposed Rule 37.204 that requires a SEF to “retain exclusive authority in all substantive decisions made by its regulatory service provider, including but not limited to decisions involving the cancellation of trades, the issuance of disciplinary charges against members or market participants, denials of access to the trading platform for disciplinary reasons, and any decision to open an investigation into a possible rule violation.”

¹¹ Release, p. 1229. As proposed, a DCO must have sufficient financial resources (capital accumulated through a number of sources including member deposits and margin, the DCO’s own capital, a guaranty fund, and default insurance) to be able to cure the default of one of its members. 75 FR 63113 (October 14, 2010).

will not hold a member's swap positions. We believe that the Commission should instead only require a SEF to adopt rules requiring it to coordinate with a DCO to facilitate the liquidation or transfer of positions during an emergency.

D. Proposed Rule 37.202 - Access Requirements

Proposed rule 37.202(b) under Core Principle 2 requires that a SEF obtain consent to the SEF's jurisdiction from each eligible contract participant. We urge the Commission to clarify to which entities this requirement would apply. The term "eligible contract participant" encompasses the whole universe of entities eligible to trade swaps on a SEF. The explanatory text in the Release suggests that the requirement to consent to the jurisdiction of a SEF applies both to members of the SEF and market participants. The term "market participant" is not defined, but the Release's explanation of rule 37.202(b) mentions "market participant" and "member" separately. This suggests that the Commission may also expect a SEF to have jurisdiction over customers of members whose orders are executed on the SEF. We submit that to achieve the goals stated in Core Principle 2, it is sufficient for the SEF to obtain jurisdiction only over its members, *e.g.*, entities with which the SEF has a contractual relationship and which have trading privileges on the SEF. Rather than subject all market participants to a SEF's jurisdiction, it is more practicable to require each SEF member to provide to the SEF specific information about that member's customers that could be necessary to achieve the goals of Core Principle 2.

III. International Harmonization

Dodd-Frank provides that derivatives provisions of the statute that are administered by the Commission will not apply to activities outside of the United States unless the activities "have a direct and significant connection with activities in, or effect on, commerce of the United States" or violate the Commission's anti-evasion rules. Further, the Commission has indicated that it will not require registration of persons whose activities have "no connection or effect of any kind, direct or indirect, whether through affiliates or otherwise, to U.S. commerce."¹² The Commission has also noted, however, that that a person who "engages in swap dealing activities and regularly enters into swaps with U.S. persons" would likely be required to register as a swap dealer.¹³

Section 752 of Dodd-Frank requires the Commission to, as appropriate, "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation" of swaps. The Commission has acknowledged with regards to its regulation in the area of swaps that it is important to consider the role that "international comity" plays in determining the proper scope of extraterritorial application of federal statutes.¹⁴

The swaps marketplace is a global business. A large percentage of transactions on Bloomberg's swap platform today involve non-U.S. banks. As an entity seeking to register as a SEF under Dodd-Frank, Bloomberg believes it is critically important for there to be harmonization of efforts among U.S.

¹² See *Registration of Swap Dealers and Major Swap Participants*, 75 FR 71379, 71382 (November 23, 2010).

¹³ *Id.*

¹⁴ *Id.*

and foreign regulatory authorities. In particular, there is a need to have consistent standards applicable to both SEF participants and SEFs across different jurisdictions. Even with a requirement to have participants consent to its jurisdiction, a SEF may be put in the untenable position of enforcing rules against certain participants that are inconsistent, or worse, conflicting with foreign rules. Moreover, without harmonized and consistent standards a SEF could be required to have one set of rules for U.S. and another set of rules for non-U.S. participants with a further set of transaction-level rules (*i.e.*, based on the counterparties or underlying instruments). All of this would lead to confusing, disparate rules and requirements that could lead to unintended consequences associated with an uneven playing field, such as regulatory arbitrage, that would be at odds with regulatory goals of Dodd-Frank and the financial interests of the United States.

We ask that the Commission consult with its foreign regulator counterparts prior to finalizing its proposed SEF rules in an effort to avoid regulations that may ultimately be inconsistent or incompatible with regulations in foreign jurisdictions regarding the same swap trading activity.

IV. Appropriate Effective Date For Final Rules

The Commission invited comment as to whether the proposed effective date is appropriate.¹⁵ Bloomberg is comfortable with the implementation timelines proposed for compliance with Dodd-Frank. We are confident we can make the technological, structural and compliance enhancements required to meet those timelines. However, we understand market participants, both liquidity providers and liquidity seekers, are concerned with the multiple layers of proposed rules, the scope of the changes required from them in terms of trading behavior and technological changes that the proposals imply. We therefore urge the Commission to consult and review the proposed implementation timelines with general market participants.

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We appreciate the opportunity to provide our comments on the proposed rules, and would be pleased to discuss any questions that the Commission may have with respect to this letter.

Very Truly Yours,



Ben Maedonald
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Bloomberg L.P.

¹⁵ The Release notes that the statutory deadline for final regulations is July 15, 2011. The Commission is proposing that the effective date for the proposed regulations be 90 days after publication of final regulations in the Federal Register.