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Via: <http://comments.cftc.gov>

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

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

Dear Mr. Stawick:

State Street Corporation (“**State Street**”)¹ appreciates the opportunity to comment on the Commodity Futures Trading Commission’s (the “**Commission**”) proposal (the “**SEF Proposal**”)² under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank**”) regarding core principles and other requirements for swap execution facilities (“**SEFs**”).

I. Introduction

As discussed more fully below, the Commission should revise the SEF Proposal to:

- clarify that trading systems for uncleared swaps do not need to register as SEFs;
- clarify that the terms of block trades are permitted to be negotiated on systems other than voice systems, such as single dealer systems;
- clarify that responses to request for quotes (“**RFQs**”) do not need to be publicly displayed;

¹ With over \$21.5 trillion of assets under custody and administration and \$2 trillion of assets under management at December 31, 2010, State Street is a leading specialist in meeting the needs of institutional investors worldwide. Our customers include mutual funds, collective investment funds and other investment pools, corporate and public retirement plans, insurance companies, foundations, endowments and investment managers. Including the United States, we operate in 25 countries and more than 100 geographic markets worldwide.

² Core Principles and Other Requirements for Swap Execution Facilities, 76 FR 1214 (Jan. 7, 2011).

- clarify that RFQ SEFs are not required to provide functionality for RFQs to be visible to the entire market;
- take a measured and deliberative approach to implementing SEF core principles that accounts for the nascent nature of the swaps trading markets under the Dodd-Frank regulatory structure;
- confirm that the Commission will not rescind temporary grandfather relief before (i) the Commission otherwise grants or denies an application for SEF registration and (ii) the clearing requirement becomes effective for the swap products traded on a grandfathered SEF; and
- provide that a trading system qualifies for grandfather relief so long as it files its application for registration no later than the date on which the clearing requirements for the swap products to be traded on that SEF becomes effective and the trading system agrees to be compliant with Part 37 within a reasonable time after submitting its SEF application and requesting the relief.

In addition, we note that we previously commented to the Commission that the SEF registration provisions should not be interpreted to capture swap processing systems.³ We appreciate that the SEF Proposal supports our position,⁴ and we urge the Commission to adopt this interpretation as a part of its final rules.

II. Discussion

A. Trading Systems for Swaps Not Subject to the Execution Requirement Should Not Be Required to Register as SEFs

Dodd-Frank provides for a new regulatory framework for swaps, one pillar of which is a requirement for central clearing and trade execution of standardized swaps. All swaps that the Commission determines are required to be cleared, must be cleared and, if a SEF or designated contract market (“DCM”) makes such a swap available to trade, such a swap must be executed on a DCM or SEF. The Commission has proposed rules regarding its process for reviewing swaps for mandatory clearing.⁵ The SEF Proposal sets out rules and interpretations that clarify the types of trading systems that qualify as SEFs, and therefore would be eligible to execute a swap subject to the clearing and execution requirement.

³ See Letter from David C. Phelan, State Street, to David A. Stawick, Secretary, Commodity Futures Trading Commission, and Elizabeth M. Murphy, Secretary, Securities Exchange Commission (Nov. 24, 2010), available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission13_112410-ss.pdf.

⁴ SEF Proposal at 1219 (“Commission believes that entities that operate exclusively as swap processors do not meet the SEF definition (and should not be required to register as SEFs)”).

⁵ Process for Review of Swaps for Mandatory Clearing, 75 FR 67277 (Nov. 2, 2010).

In addition, the Commission proposed separate rules regarding trading systems for block trades, swaps not subject to clearing, and bespoke or illiquid swaps, which are not subject to a mandatory SEF trading requirement. We believe the proposed SEF rules related to swaps not required to be executed through a SEF are unnecessary and contrary to Dodd-Frank, and could limit the types of execution platforms available for trading such swaps.

At a minimum, the Commission should clarify that a trading system is not required to register as a SEF if it only trades swaps not subject to Dodd-Frank's execution requirement, although such a SEF could register on a *voluntary* basis. We note that this clarification is consistent with the Securities and Exchange Commission's (the "SEC") statement in its proposal regarding security-based swap execution facilities ("SB SEFs"). The SEC said that it views the requirement to register as an SB SEF "as applying only to facilities that meet the definition" of SB SEF, and that security-based swaps that are not subject to Dodd-Frank's execution requirement "would not have to be traded on a registered SB SEF."⁶

B. Markets Participants Should Be Permitted to Negotiate Block Trade Terms Using Any Type of System

The SEF Proposal accommodates the special needs of market participants that engage in block trades by allowing block trades to be executed on voice systems. We support this approach. However, to facilitate liquidity for block size trading interest, the Commission should permit the use of any type of system, such as a single dealer electronic system, to negotiate the terms of a block trade, so long as such trade is ultimately reported pursuant to Commission rules.⁷

Block trades require special execution and reporting rules because of the heightened risk of information leakage attendant to executing a large trade on a public market.⁸ If market participants were able to negotiate the terms of a block trade using any type of system, such as a single dealer electronic system, they more likely would be able to execute the trade in a way that minimizes detrimental price impact and information leakage. These concerns are most acute for institutional investors. In addition, under our proposal, post-trade transparency would still be accomplished because the trade details of the block trade subsequently would be reported to a SEF.

⁶ Registration and Regulation of Security-Based Swap Execution Facilities, Exchange Act Release No. 63825 (Feb. 2, 2011), 76 FR 10948, 10949 (Feb. 28, 2011), at n. 10.

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

⁸ See Regulation of Non-Public Trading Interest, Proposed SEC Rule, Exchange Act Release No. 60997 (Nov. 13, 2009), 74 Fr 61208, 61227 (Nov. 23, 2009) (noting that special block trading rules assist institutional investors with finding "contra-side trading interest for large size without causing price impact."); see also SEC Regulation NMS Rule 604(b)(4) (excepting block-size orders from the general requirement that market makers publicly display customer limit orders).

C. RFQ SEFs

We support the Commission's proposal to allow RFQ systems with certain characteristics to satisfy the SEF definition. In our view, a strong RFQ functionality is important to the development of SEFs as execution platforms, with many types and tenors of swaps likely to trade through RFQ systems initially and migrate to an order book format as liquidity in the market for that swap type increases. Consequently, we encourage the Commission to adopt rules that support the development of RFQ SEFs.

RFQ Responses Do Not Need to Be Public. We note that the Commission asks whether SEFs should be required to make responses to RFQs transparent to all market participants.⁹

If responses to RFQs were public, liquidity providers would need to account for information leakage that occurs when trading interest is disseminated on a pre-trade basis. As a consequence, liquidity providers that respond to RFQs may either be less likely to provide quotes in less liquid or volatile swap contract types or more likely to provide less favorably priced quotes. This concern is particularly relevant for less liquid swaps, which are most likely to trade on RFQ SEFs. Thus, the Commission should not require responses to RFQs to be publicly disseminated.

RFQ SEFs Should Not Be Required to Provide Functionality for RFQs to Be Visible to the Entire Market. The SEF Proposal states that RFQ SEFs "should permit requesters the option of making a request for quote visible to the entire market."¹⁰ The Commission should clarify that an RFQ system is not *required* to provide functionality for making RFQs visible to the entire market, although it may *voluntarily* choose to do so. Under the SEF Proposal, order book systems provide market participants with the ability to transmit trading interest to the entire market. RFQ systems, however, are used by market participants when, for a variety of potential reasons, the market participant desires to limit the number of potential counterparties that see the market participant's trading interest. For example, a market participant may seek to avoid detrimental price impact attendant to publicly displaying trading interest in a relatively illiquid instrument. Thus, requiring RFQ SEFs to provide a market-wide request functionality is not necessary in light of the availability of order books systems and the narrow role of RFQ systems in the market.

D. The Commission Should Adopt a Regulatory Framework that Encourages the Development of a Robust Swaps Trading Market

Dodd-Frank outlines core principles for swap execution facilities and provides the Commission authority to adopt rules under those core principles.¹¹ The Commission has proposed a sweeping

⁹ SEF Proposal at 1221.

¹⁰ SEF Proposal at 1220.

¹¹ Dodd-Frank § 733; Commodity Exchange Act § 5H(f).

set of requirements that would subject SEFs to regulation almost on par with the regulatory framework for existing DCMs.

We believe various aspects of the SEF Proposal exceed the mandate of the statutory core principles set forth for SEFs. Narrowing these proposed requirements would facilitate the development of SEFs and the public trading markets for swaps. For example, Core Principle 2 requires a SEF 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.”¹² Under this Core Principle, the Commission has proposed that SEFs must have the authority to examine books and records for all market participants and must maintain a compliance staff to conduct “self-regulatory duties.”¹³ Another example of an extremely burdensome proposed requirement that goes beyond the statutory text of the Core Principles is the requirement to establish disciplinary panels and hearing procedures. The Commission notes that these proposed regulations “parallel the disciplinary procedures regulations for DCMs.”¹⁴ These non-statutory requirements would significantly deter SEF registration because they require developing staff and procedures to undertake, in the words of the Commission, “self-regulatory” duties.

The Core Principles do not mandate a self-regulatory role for SEFs. In fact, Title VII does not once use the term “self regulatory organization” in reference to SEFs. While Dodd-Frank does set forth certain core principles, it does not mandate the manner in which these principles are implemented. The Commission could satisfy the statutory Core Principles by adopting less burdensome rules that are less likely to impede the robust development of SEFs and the public trading markets for swaps. For example, the Commission could require SEFs to adopt and enforce rules that will deter abuses, without specifically requiring SEFs to engage in self-regulatory duties. This alternative approach would provide SEFs with flexibility to satisfy the Core Principles in a number of ways. The Commission could subsequently adopt a more extensive rule if, as the swaps trading market or a particular SEF develops, it determines such a rule is necessary. However, requiring all SEFs to act in a self-regulatory manner in the first instance would have the detrimental effect of impeding the development of the public swaps trading markets.¹⁵

Although we agree that the DCM regulatory framework is a helpful reference in developing rules for SEFs, and core principles are mandated by Dodd-Frank, we note that there are significant differences between the mature market for exchange-traded futures and the nascent swaps trading market. We therefore urge the Commission to take a measured and deliberative approach

¹² Dodd-Frank § 733; Commodity Exchange Act § 5H(f)(2).

¹³ SEF Proposal at 1223.

¹⁴ SEF Proposal at 1225, n. 73.

¹⁵ To the extent that self regulatory obligations are viewed as inherent in the core principles applicable to SEFs, the Commission should enable SEFs to delegate these obligations to an SRO like the National Futures Association, which already has the capability to supervise for violations of trading rules and ethical standards, and has disciplinary processes that can readily be applied to violations of SEF rules.

to avoid discouraging the development of a robust trading market for swaps. The SEF Proposal has the strong potential to stunt the development of SEFs, and thus the public trading market for swaps, because it would inappropriately impose on SEFs a DCM regulatory framework that has been developed in the context of a single dominant exchange trading market for a commodity future. The best way to achieve the key goals of Title VII, *i.e.*, facilitating trading of swaps on SEFs and promoting pre-trade price transparency in the swaps market, is to adopt a more flexible regulatory framework for SEFs that is designed to accommodate and encourage new entrants to the as-of-yet established market. As the swaps market develops and matures under the new Dodd-Frank framework, the Commission should carefully monitor whether SEFs should be subject to heightened requirements, and adopt any additional regulations that are warranted in these circumstances. The SEC took a similar measured approach to the development of alternative trading systems (“ATs”), which are prohibited from engaging in self-regulatory activity. A regulatory framework specifically for ATs was initially adopted in 1998, was revised in part in 2005 after the growth of the role ATs in the securities trading markets, and, most recently, the SEC sought public comment on whether additional revisions to ATs regulations are appropriate.¹⁶

E. Temporary Grandfathering Should Coincide with the Effectiveness of the Clearing Requirement and Provide Time for an Orderly Implementation of SEF Infrastructure

To facilitate a smooth transition under the new SEF registration regime required by Dodd-Frank, the Commission proposes to allow “grandfathering” of entities that will be required to register as SEFs in order to allow these SEFs to continue operating as of the effective date of the regulations, subject to specific conditions being satisfied. To provide market participants with certainty, the Commission should clarify that it will not rescind this temporary relief before (i) the Commission otherwise grants or denies an application for SEF registration and (ii) the clearing requirement becomes effective for the swap products traded on a grandfathered SEF.

In addition, the Commission proposes that to qualify for temporary grandfather relief, a trading system would need to certify in its application for registration that its operation on a temporary basis will meet the proposed requirements under Part 37. To provide trading systems with sufficient time to develop the necessary SEF infrastructure, the Commission should permit a trading system to qualify for grandfather relief so long as it files its application for registration no later than the date on which the clearing requirements for the swap products to be traded on that SEF becomes effective and, for trading systems requesting grandfather relief within a set period of time after the effectiveness of final rules, agrees to be compliant with Part 37 within a reasonable time after submitting its SEF application and requesting the relief. This phased approach would allow development of the required infrastructure and submission of applications for registration to proceed in an orderly manner, and would also benefit market participant by

¹⁶ See Regulation of Non-Public Trading Interest, Exchange Act Release No. 60997 (Nov. 13, 2009), 74 FR 61208 (Nov. 23, 2009) (proposing rule amendments that would apply to ATs); *see also* Concept Release on Equity Market Structure, Exchange Act Release No. 61358 (Jan. 14, 2010), 75 FR 3594 (Jan. 21, 2010) (seeking public comment on, among other things, whether the ATs “fair access” threshold should be lowered).

allowing them more time to understand how SEFs will function and how to integrate their trading into the new environment.

III. Conclusion

For the reasons discussed above, the Commission should clarify and revise the SEF Proposal. We believe that the clarifications and revisions we suggest would facilitate the development of a robust trading market for swaps, and therefore achieve Dodd-Frank's goal of increasing pre-trade transparency in the swaps market.

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We would be happy to discuss the foregoing at your convenience.

Sincerely,



David C. Phelan

cc: Jeffrey N. Carp, State Street Corporation, EVP and Chief Legal Officer
Stefan M. Gavell, State Street Corporation, EVP and Head of
Regulatory, Industry and Government Affairs