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March, 8, 2011

By Electronic Mail (http://comments.cftc.gov)

Mr. David Stawick
Secretary
Commodities Futures Trading Commission
1155 21st Street N.W.
Washington, D.C. 20581

Re: RIN Number 3038-AD18 – Notice of Proposed Rulemaking on the Core Principles and Other Requirements for Swap Execution Facilities

Dear Mr. Stawick,

Barclays Capital appreciates the opportunity to comment on the above Notice of Proposed Rulemaking and commends the CFTC for its efforts in comprehensively addressing a complex issue in the proposed rules.

Barclays Capital has a long history as a leader in providing clients with an electronic means of executing transactions in a range of cash and derivative products. For more than ten years Barclays Capital has developed electronic execution capabilities to serve our clients on our single dealer platform – "BARX" - and through the many Electronic Communication Networks that operate in these markets. Almost all of our clients transact with us through both voice and electronic channels and we fully recognize the value and operational efficiency that transacting through electronic venues brings. We support the objectives of the Dodd Frank Act to extend these advantages to standardized derivatives.

This letter is divided into five sections. The first sets out the statutory objectives of the Dodd Frank Act relating to derivatives, the second outlines how liquidity formation is differs between the futures and OTC derivatives markets, the third contains comments on the proposed rules based on the previous two sections and the fourth responds directly to some questions posed by the Commission in the Proposed Rules. And finally, we include comments on 'available to trade'.

Statutory objectives of Dodd Frank Act

The expressed purpose of Title VII of the Act – stated in Section 5 h (e) of the CEA - is both to promote "the trading of swaps on swap execution facilities" and "pre trade

transparency in the swaps market". We recognize that these are separate and independent objectives to which the Commission must give effect in its adopted rules but note that the two objectives can be incompatible since too great a degree of prescriptive pre trade disclosure will harm liquidity, which will disincline willing trading on SEFs. The statutory language recognizes the challenges the Commission faces in balancing these statutory objectives and provides the Commission with guidance, urging the Commission to have particular regard to the impact its proposed rules will have on liquidity in the market.

Providing the highest degree of flexibility consistent with the SEF definition and the Core Principles best serves the first objective of promoting trading of swaps on SEFs. But providing such flexibility does not necessarily come at the cost of compromising pre trade transparency. Migrating the market to SEFs will itself involve no small change to the availability of price information to participants. We take the view that the greater ease with which a participant will be able to access actionable prices when trading on a SEF relative to the manner in which this can be done currently is very significant, and no additional requirements are necessary to meet the "increasing pre trade transparency" objective beyond complying with the statutory definition of SEF and the Core Principles.

The Commission has recognized this by proposing a set of rules that gives some flexibility to the SEF to determine how to promote liquidity on its platform. We are, however, concerned that in a number of respects the Proposed Rules have swung the pendulum too far towards a narrow and prescriptive set of requirements for execution methods so that as a consequence participants may not have a natural incentive to transact on SEFs. We do not read the statutory language as requiring the imposition of such limitations. We acknowledge that the consequence to liquidity of narrowing the RFQ protocol as proposed is unknown but believe that the effect may be far reaching and damaging. It was expressly not Congress's intent to conform futures and OTC derivatives markets into one. We urge the Commission to make accommodations to permit sufficient flexibility in trading methods that reflect the very differing levels of liquidity that exist across the spectrum of derivative markets and the differing needs of market participants. We urge the Commission to allow SEFs the freedom to adopt trading protocols that, while consistent with the statute and the Core Principles, create a balance of incentives that achieves the desired level of pre trade transparency while also promoting execution of transactions on SEFs.

Sources of liquidity in derivative markets and the role of the Swap Dealer.

We see the process of liquidity formation in OTC derivatives as quite different from the equity and futures markets and urge caution in importing concepts from these sister markets to products that "are very different than those currently traded in the highly evolved equities and futures markets…and which serve a variety of different purposes".[1]

The swap market differs from equity and futures markets in that it depends for its liquidity largely on dealers that are willing to position risk that in many cases can only be

[1] Congressman Barney Frank – Letter to Chairmen Shapiro and Gensler, February 18, 2011

imperfectly hedged. It is this feature that distinguishes the OTC derivative market from futures and equities markets and defines the value that it brings to its users. Although the derivative market has evolved to the point where some spot instruments are traded with sufficient frequency to allow a party to trade in and out of risk on an intra day basis, many other instruments trade infrequently and require liquidity to be provided by dealers.

At present, unlike cash equity and futures markets, no swap market has continuously traded prices. This is evidenced by the fact that customer trades are seldom, if ever, matched. The average time interval between execution of even the most frequently traded swaps – US$ swaps in the five to the ten year maturity bucket – is in the order of once per minute.[2] On any given day many swaps or categories of swap (particularly in the credit and commodities markets) do not trade at all. Swaps with customized terms may only ever trade once.

Futures instruments have standard dates allowing liquidity to coalesce around a limited number of discrete contracts. The participant in the futures market is frequently indifferent to the particular dates of the contract because these contracts are often rolled forward before settlement to maintain the position. But these futures contracts seldom meet the precise needs of hedgers who require degrees of specificity that these contracts do not provide. Whereas the futures markets have many participants and relatively few traded instruments, the OTC derivatives markets have an endless number of instruments and relatively few participants. The OTC swap markets arose of out of the natural limitations of the futures markets to meet the particular needs of the OTC markets participants – principally hedgers of risk. It is this endless array of discrete instruments and risks that often prevents a dealer from being able to match precisely the risk it assumes in any given trade. The dealer will hedge those risks on a portfolio basis, almost always with a "proxy" or imperfect hedge until a more optimal hedge can be sourced from another client. Finding this more fully effective hedge may take weeks. Some complex categories of risk are held by dealers to maturity. The dealer minimizes the transaction execution cost for each client by attracting liquidity to its name (thereby increasing its probability of sourcing a more satisfactory hedge) and by building risk management tools that can properly evaluate complex risk. We expect that many of these swaps will be subject to mandatory clearing and according will be required to trade on SEFs if "made available to trade".

Warehousing risk is capital intensive for the dealer. Capital is a limited resource. So dealers must be selective in absorbing risk and mindful to service clients who promote liquidity and with whom firm wide relationships exist. The market making obligation arises out of the dealer's desire to maintain its reputation with its clients as being willing to absorb risk at a competitive price in all market conditions. Futures markets, by contrast, transact on an anonymous basis with a central limit order book protocol and largely in the absence of a market making obligation. A futures market depends for its sustained liquidity on the high number of participants engaged in the market. Many of

[2] See ISDA - "Trade Reporting in the interest rate and credit derivatives markets" – attached as copy to joint ISDA/SIFMA comment letter on Proposed Regulation RIN 3038 –AD08 (Real Time Reporting of Swap Transaction Data) dated February 7, 2011.

these participants transact only for very small sizes. Being anonymous, liquidity can of course be withdrawn without reputational consequence (for example in highly stressed markets). Since speed is so critical to generating an informational advantage to those who do make markets, automated trading plays an important role.

The Commission's Proposed Trading Method Rules

We applaud the Commission for issuing a proposed set of rules that sets a flexible framework which respects the differences between these markets and reflects Congress's intent.

We support that the market be given the choice of trading swaps under an order book protocol for those instruments and participant types that the market determines are best served by this protocol. However, we see no merit in prescribing such an order book as the only permitted protocol for any instrument and no criteria should be laid out, which, once met, requires exclusive trading on a central order book. The market is best positioned to decide when it is ready to move liquidity to such platforms, at which point liquidity in other venues will dissipate. We view the legislative history around the SEF definition in the Act as being conclusive on this point.

We applaud the Commission for recognizing the key differences between the OTC derivative and futures markets by allowing the name disclosed Request for Quote mechanism among the options a SEF may adopt as a trading protocol.

Within the "RFQ System" option, however, we note that the Commission has introduced a number of particular functional requirements that narrow the definition of permitted RFQ. We acknowledge the Commission's efforts to meet the "increasing pre trade transparency" objective by attempting to find a "middle ground" between a "standard" single name RFQ process, on the one hand, and the central limit order book on the other. We support several of these ideas but believe that others fail to strike the right balance between pre trade transparency and liquidity and accordingly are not consistent with the desire to promote trading on SEFs.

We set out our comments on the "RFQ System":

1. **The Proposed Rules (s37.9 (B)) introduce a "basic requirement" of providing a centralized electronic screen on which participants may enter firm or indicative prices on which other participants may execute or submit RFQs.**

We believe that in practice SEFs will establish such screens and that there is no need or benefit to requiring by rule that they do so. We support Commissioner Sommers' position that the Act does not require this.

Our comments in this section refer to streaming prices provided in a name disclosed "RFQ System".

We urge the Commission to confirm that the Proposed Rules allow (but do not require) firm and indicative prices to be streamed to less than the entire market if a participant so chooses. Any requirement that the same streaming firm (or indicative) prices must be streamed to every other participant in the SEF is, we believe, inconsistent with the statutory language. "Multiple to multiple" should not be read as "all to all" and this freedom applies equally to streaming prices and RFQ. A participant should be as free to stream prices to whomever he wishes as he is free to RFQ anyone he wishes. We interpret the term "impartial access to the market" in Core Principle 2 as meaning the SEF must not discriminate in deciding to whom it gives access to the platform. We respectfully submit that the words "impartial access" in the context of Core Principle 2 do not mean that every participant must see or receive the same price, either on a streamed price or in response to an RFQ.

The effect of being obliged to steam the same price to everyone would widen the price to the same extent as if we had to stream anonymously and will cause streaming prices to be in "one lots" purely to gain market information.

We also note that clearing at a particular CCP involves different credit risks than clearing at another CCP and accordingly will require commensurately different pricing to be streamed. While we recognize that credit risk is mitigated by clearing, we respectfully disagree with the statement in footnote 45 that 'there is no counterparty risk for swaps that are cleared". The counterparty on our trade is a CCP rather than a particular market participant but we still have credit risk. Also our house account market risk position will be not be the same at each CCPs and our streamed prices will reflect a directional preference that reduces our initial margin requirement at each CCP.

Indicative prices should similarly be permitted to be streamed on a directed basis since these are used for sourcing transactions by indicating axes.

We believe the final rules should make it clear that a SEF is at liberty to determine how to make the use of streaming quotes most effectively rather than prescriptively narrow their flexibility in this respect. Market forces will determine the preferred protocol for each individual instrument.

2. **The Requirement that a SEF cannot impose in its execution protocols a maximum on the number of other participants of whom an RFQ may be made.**

We support this as it empowers a participant to RFQ as many other participants as he believes will provide him with the optimal price, including the whole market if he chooses to do so. We note that as a practical point, the ability for any participant to transact with any other participant requires that that they have arrangements to clear at the same CCP, which may not be the case.

3. **An RFQ must be made of a minimum of five other participants**.

We do not believe that this requirement is consistent with the language of the Statute, which requires only that the SEF provide a participant with the *ability* to transact with multiple other participants. The preamble to the Proposed Rules state that the purpose for the requirement to RFQ a minimum of five other participants is "to ensure that multiple participants have the *ability* to reach multiple counterparties". We submit that a participant always has this ability.
We believe that the Statutory intent is met by the ability to RFQ a single other participant if a participant wishes to do so. We interpret the statutory definition as not requiring that each individual *transaction* must itself actually be subject to multiple actionable quotes provided by multiple participants. A participant should be able to engage with multiple participants to source several actionable quotes but should not be required to do so.

The proposed requirement comes at a considerable cost to the RFQ requester, especially in illiquid markets. Although in the most liquid markets the relationship between pre-trade transparency and liquidity may be such that having to expose the RFQ to four other participants may not materially affect the prices returned by respondents, we strongly take the view that it will in less liquid markets. The successful dealer faces the "winner's curse" of having prospective hedges immediately erode in value as the unsuccessful participants seek to benefit. The RFQ requester best knows where the balance lies between pre trade transparency and liquidity and should be permitted to choose to RFQ the number of participants that provides him with the optimal price. The choice should be with the requester.

Examples from the commodity markets illustrate the point, where producers and consumers of commodities face very specific underlying risks based on the commodity's particular specification, grade, volume and delivery location. These swaps may be clearable but these markets are extremely fragmented and there is a natural asymmetry in the size of producer and consumer hedging at the same time. Accordingly, dealers (of whom there may even be less than five in the relevant market), absorb substantial risk on behalf of clients and it likely is not possible immediately to hedge this risk entirely. Obliging an RFQ requester to advertise his interest/strategy to what may effectively amount to the whole market will result in a materially higher price being offered than had the RFQ been submitted discretely. In some cases there may be no willingness to offer a price at all, which clearly does not promote the trading of swaps on SEFs.

We note also that should a dealer not be permitted to know the number of participants receiving the RFQ the dealer will have no option but to assume a high number of other participants have been asked and price accordingly. The SEF could perhaps allow the RFQ requester the option of choosing whether the recipients are to receive this information, but we believe matters of such detail should be left to the SEFs to implement as they see fit and not be the subject of prescriptive rulemaking.

Accordingly we urge the Commission to omit the requirement to RFQ a minimum of five participants from the final rule.

4. The requirement that any bids or offers "resting on the trading system" pertaining to the same instrument be "taken into account" and communicated to the requester along with the responsive quotes. (Section 37.9 (A))

This provision has the laudable intention of expanding the universe of responses an RFQ requester receives to include resting bids or offers that are pertinent to the RFQ submitted. The requester, as we understand the Proposed Rule, receives the benefit of seeing quotes from participants that he did not RFQ and participants leaving competitive resting prices will benefit from having their price made visible to RFQ requesters.

Since we see no statutory requirement for such a rule, the provision must achieve either the "increase pre trade transparency" objective or the "promote swaps trading on SEFs" objective.

If "resting orders" means name-disclosed streaming prices in the RFQ System, these would already be visible to the RFQ requester and it seems unnecessary to infer that the requester needs to be reminded of the existence of these. Similarly, the RFQ requester has sight of all resting orders in the Order Book. Accordingly we believe the RFQ requester has the opportunity to execute on these visible actionable prices anyway and it serves no benefit to oblige him to do so if he has elected not to. Neither objective is achieved.

If redundancy is not reason enough to exclude the provision from the final rule, we have a number of concerns relating to this proposal. We note that under the Proposed Rule the SEFs are responsible for implementing a process that gives effect to this broadly stated rule. We agree with the Commission that there are a number of different ways to do this and we would expect the SEFs to implement these requirements in ways that benefit the market. Accordingly, we urge that any final rule give the SEFs the necessary flexibility to implement the rule so as not to have its effect run counter to the objectives of the Act. In particular, we see the following risks that need to be avoided in the adoption of any final rule:

a) that such rule not oblige SEFs to adopt protocols that can be used by RFQ requesters as a means solely to gain informational advantage by submitting very small notional RFQs across the whole pricing spectrum to gain visibility to resting orders they might otherwise not see;

b) that, reciprocally, small resting orders are not left in the market across the whole pricing spectrum solely for the purpose of exposing RFQs terms that have not been directed to the participant posting the resting order. This risk should be mitigated by requiring the resting order to be of a size at least as large as the RFQ request.

c) that care be taken in crafting any final rule having regard to the fact that this process may commingle participants whose activities are name-disclosed on the SEF with activities of participants acting anonymously (if such resting

orders include those in the Order Book in addition to streaming prices in the "RFQ System").

The Commission asks if such resting orders should be given preferred status in the execution hierarchy over RFQ responses. We oppose the introduction of such a requirement, which imports a mechanism appropriate in the time/price hierarchy of an order book to an RFQ process. An RFQ requester, fully aware of the availability of an equal or superior executable price relative to the RFQ responses received, should be free to trade with an RFQ respondent.

We also have the following additional concerns with introducing such an execution hierarchy:

a) The proposal fails to take account of the wide price differential that may exist between a price shown in response to an RFQ for the full size requested and the price that would be "resting" for a much smaller size. The OTC derivative markets do not have the same liquidity as exists in futures or cash equities. As a result, the RFQ responder, obliged to offer the whole size of the RFQ request, is more disadvantaged relative to the participant leaving the much smaller resting order than in other more liquid markets.

b) We believe that the result will be significant proliferation of ticket volumes and we are concerned whether the market has the infrastructural capability adequately to deal with such volumes at this time. Additionally one has to consider that many trades are subsequently parceled out through the allocation process. Unlike cash equity or futures transactions, derivative transactions do not terminate on settlement. Many of these transactions run for ten years or longer with hundreds of periodic payments and daily margin. The operational expense of administering a very small notional trade is no different than for a large notional trade. Ticket proliferation would introduce a considerable expense in to the market that does not exist currently. The OTC derivative markets typically trade large ticket sizes since it is not a retail market. We urge caution before introducing a requirement that obliges fractionalization of trades in any context.

5. The requirement to expose price to the market for 15 seconds (Rule 37.9 (b)(3))

We request clarification as to the scope of the application of this rule.

The preamble text that was issued in December, 2010, and the staff comments made during the related hearing, indicate that the intent of this rule is to extend to the SEF environment a "pre – trade communication" rule familiar to the futures market. Under that process, as we understand it, a participant can engage in a voice negotiation with another participant and "cure" the fact that that interaction did not occur on the Exchange by requiring the customer's order be exposed to the market for execution by a third party for a period of 5 seconds. The purpose of the provision is to extend the CEA's prohibition

on pre-arranged trades to the SEF. The corresponding rule for SEFs would require a 15 second exposure.

However, the language in the preamble and text published in the Federal Register is, in our view, ambiguous and appears to contemplate that this process may also apply to an RFQ submitted electronically through the SEF. The preamble states:

"SEFs must provide a general timing requirement applicable to traders such as brokers who have the ability to execute against a customer's order or are entering a trade for two customers on opposite sides of the transaction. Under the proposal, a broker would have to provide a minimum pause before entering the second side (whether for its own account or for a second customer), thus "showing" other market participants the terms of a request for quote from its customer, and providing other participants the opportunity to join in the trade. The Commission proposes to require a minimum pause of 15 seconds between entry of two potentially matching customer-broker swap orders or two potentially matching customer-customer swap orders on SEFs".

The text of the proposed rule reads:

"Swap execution facilities must require that traders who have the ability to execute against a customer's order or to execute two customer orders each against each other be subject to a 15 second timing delay between the entry of these two orders, such that one side of the potential transaction is disclosed and made available to other market participants before the second side of the potential transaction (whether for the trader's own account or for a second customer), is submitted for execution".

We request clarification that the 15 second delay, in the case of a dealer wishing to execute as principal with a client, applies only to the instance where the RFQ is received by voice (or otherwise) outside of the "RFQ System" itself, and that accordingly the rule does not apply in the case where an RFQ is received by a dealer in the ordinary course of the electronic RFQ process on the SEF. The footnote on page 1220 of the Federal Register appears to endorse the immediate execution of an RFQ response when submitted thought the RFQ System. It is evident that if a dealer, responding to an RFQ duly received through the RFQ System, is obliged to hold the response price firm for 15 seconds before the requester can execute on the price, and in the meantime allow any other participant to execute on that same price, the RFQ process is completely undermined.

We believe the proposed rule is more appropriate for a central limit order book environment than an RFQ environment and we recommend it be limited in its scope accordingly.

Responses to Specific 'Request for Comments" raised in the Proposed Rules relating to Trading Protocols (Federal Register page 1221)

Does the proposal properly implement the provision in the SEF definition regarding having the ability to execute or trade swaps "through any means of interstate commerce"?
The final rules need to make clear that Permitted Transactions do not need to trade on a "Voice System" as defined. (S 37.9 (c)). The Act states that any such transactions may trade "by any means of interstate commerce". Although a simple telephone connection meets the "Voice System" definition, such trades should be permitted also to trade on Single Dealer Platforms or by e mail or any other means of interstate commerce. The Commission's prior approval of such means is necessary and we urge that this requirement be removed from the final rule as counter to the provisions of the Statute.

What level of pre-trade transparency should be required to promote price discovery, competition and the trading of swaps on SEFs? Should the Commission consider requiring a request for quote method that provides for transparency in the request for quote process in addition to the posting of any resting bids/offers on its trading system or platform? Should all orders and quotes be displayed to all participants or should alternative engagement rules apply on a pre-trade basis?

We believe that allowing an order book where the market believes this to be the appropriate protocol plus giving a participant the ability to RFQ the entire market and execute on streaming prices directed to it achieves the necessary level of pre trade transparency.

Should SEFs be required to communicate executable bids/offers to issuers of requests for quotes? Also, should any such executable bids/offers be provided any priority during the request for quote process? Should market participants have an obligation to consider and/ or execute against an executable bid/offer if it is competitive?

As we understand the "RFQ System" executable bids and offers will already be displayed to participants on the central screen, along with streaming firm quotes. Accordingly we see no need for these to be additionally made available to an RFQ requester. See comments above regarding hidden resting orders and execution priority.

Should SEFs be required to make responses to requests for quotes transparent to all market participants? If so, when should this information be provided to the market? Prior to execution? At the time of execution? Subsequent to execution?

We understand the Commission to be asking whether it is desirable to require that responses to RFQs, whether or not executed upon, be made visible to all market participants as a matter of information (but not available to be executed upon). To have responses to RFQ be made visible to anyone other than the requester prior to execution deprives the RFQ requester of the right to keep control over the number of participants that see his RFQ. In illiquid markets this would betray an indication of interest to the whole market, which would oblige respondents to widen prices accordingly. Similarly exposing this information to the entire market immediately after execution or following a momentary time lapse after the RFQ request was made (if not executed) is tantamount to

informing the entire market of the RFQ and will commensurately oblige dealers in less liquid markets to widen prices shown to the RFQ requester. We see the post trade reporting requirements set out in Part 43 as being intended to perform the post trade price discovery function for executed trades. Although we agree that providing visibility of all unexecuted RFQ responses is additional information to the market, we take the view that this information is of little real value (and may be in fact be misleading) but doing so may have a very significant detrimental effect on the RFQ requester, who thereby has disclosed his interest to the entire market, which we read the statute as giving him the right withhold. Where such responses are averaged and presented in a composite indicative screen there is risk that such composite is colored by a respondent's "throw away" price.

Would the SEF provisions in the Dodd-Frank Act support a requirement that swaps that meet a certain level of trading activity be limited to trading through order books? If so, what level of trading activity would be the appropriate level at which to mandate trading exclusively on an order book? Should any such analysis be done on a product or asset-class basis?

No. The Statutory provisions do not support this. If Congress had intended to mandate order books as the only permitted trading protocol for any category of swap transactions they would have done so. The record of the legislative process makes it clear that they intended not to do so.

"Available to trade"

Given that SEFs are commercial enterprises operating under significant competitive pressure to be first to market and so require liquidity to move to their platform for a particular swap, prudence requires that the Commission itself make the determination as to when a swap has been "made available to trade" on any particular SEF. This is especially so since an RFQ process may afford considerable flexibility to accommodate within its process a great many instruments that are unready for streaming firm or indicative prices. We agree with the position taken by the SEC in their corresponding proposed rules for SB SEFs.

We also contend that once an instrument has been determined to be "available to trade" on a SEF, it should not be the case that 'substantially economically similar" swaps thereby automatically also become "available to trade". Only swaps that are identical – and would be fully fungible if they were futures contracts – should be covered by the decision. Clarity around this issue is paramount.

Given the criticality of this issue and the difficulty and arbitrariness of ascribing particular metrics as a test, we urge the Commission to consider whether or not a requirement that the product have had streaming firm prices flowing on the SEF from a number of participants on which a substantial number of transactions have been executed over an appropriate period of time might not serve as the foundation for the Commission to make the determination. It should not be sufficient that the product trade only via an

RFQ. A brief public comment period may also be appropriate to provide the Commission with complete information on which to base a decision.

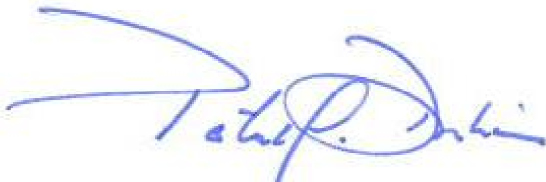
In addition to the frequency of transactions and open interest, should the Commission request. that SEFs consider the number of participants trading a particular swap? If so, should a minimum number of participants be required, for example, should the swap be traded by more than two participants? More than three?

We refer to our comments above but note that in market segments where there are few participants – and where liquidity needs to be sourced through active negotiation – we see no benefit to requiring such negotiation take place across a trading platforms designed for very different levels of trading activity**.**

Should the Commission request SEFs consider any other factors or processes to make the determination that swaps are "made available for trading"?

We refer to comments above that the Commission determines the issue, based on the instrument having traded by execution of on streaming prices on the SEF in appropriate frequency and size over an appropriate time period as being the relevant criteria.

Respectfully yours,



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