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## COMMENT

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

Re: RIN 3038-AD18  
RIN 3038-AD01

Dear Mr. Stawick:

ICAP North America Inc., on behalf of its U.S.-based operating subsidiaries and overseas affiliates (collectively, "ICAP"), appreciates the opportunity to comment on the Commodity Futures Trading Commission's (the "Commission") Notices of Proposed Rulemaking relating to SEFs: Core Principles and other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1214 (Jan. 7, 2011) and Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest, 76 Fed. Reg. 722 (Jan. 6, 2011) (collectively, the "Proposed Rules"). In conjunction with this submission ICAP has also joined in the submission of a more comprehensive comment letter on the Proposed Rules prepared by the Wholesale Market Brokers of America Association, of which it is a founding member. We write separately to provide our perspective given our position in the marketplace, and to highlight certain aspects of the Proposed Rules which are of particular interest and concern to us.

As explained more fully below, our principal concerns are: (1) The SEF trading rules are not consistent with Congressional intent; (2) SEFs should be provided reasonable discretion in determining block trade size; (3) SEFs should have reasonable discretion in implementing governance arrangements addressing conflicts of interest; (4) the proposed disciplinary program requirements for SEFs are too onerous; and (5) SEFs should be provided a longer implementation period than the currently proposed 90 days.

We recognize the vital importance of implementing effective regulation of the swaps market. Key to this is the availability of sufficient resources for those responsible for issuing rules and overseeing the marketplace and its participants to do the job well. ICAP supports the provision of required funding for the Commission that recognizes its new and added

responsibilities, and sufficient time for it to consider, issue and implement rules in an appropriately deliberative manner.

### ICAP's Role in the Marketplace

As the world's largest interdealer broker ("IDB"), intermediating over \$2.16 trillion in trading across all asset classes daily, we enable wholesale market participants to efficiently achieve their trading and hedging goals across the interest rate, credit, commodities, FX, emerging markets, equity and equity derivatives markets. Although these markets are very diverse many of them are correlated so that changes in their individual market structure and operation can have significant spillover effects – on costs of public and corporate funding as well as the capacity to manage price volatility and risk. The over-the-counter (OTC) swaps market, for example, developed and grew in large part because it offered institutional parties the ability to acquire and manage risks in a more efficient and customized manner than was available through other standardized, listed instruments such as futures and cash securities. The availability of all of these instrument types, properly regulated and overseen, contributes to innovative and robust financial markets and a healthy and vibrant economy.

ICAP owns and operates a number of trading platforms, some of which are pure electronic market places, others which are purely voice-brokered, and others that combine the attributes of voice brokerage with utilization of electronic screens (known as a "hybrid"). The development of these different modes of transacting has been and remains dynamic, evolving and responding to the changing preferences of market participants, advances in technology, and the characteristics of particular product markets. ICAP's business model is to provide its customers with the ability to transact however they prefer. We have no bias toward voice-brokered marketplaces, nor a bias toward electronic marketplaces – our bias is to operate marketplaces that meet the needs of our customers.

ICAP has served as the largest marketplace for trading OTC swaps globally. ICAP does not act as a swap dealer, but rather brokers swap transactions between institutional participants. Our voice and electronic broking businesses operated effectively and efficiently throughout the global financial crisis, facilitating the flow of liquidity in OTC transactions between commercial and investment banks and other major financial institutions around the world.

We recognize that the swap markets are fundamental to the proper functioning of the American and global economies, and we wholly support the efforts of Congress and the regulatory agencies to create a robust regulatory structure to ensure that these markets operate in a prudent, transparent, and efficient manner. ICAP has been at the forefront of a number of important initiatives over the years to reduce systemic risk and increase transparency including for example trade compression (for interest rate and credit default swap markets), portfolio reconciliation (for all asset classes) and pre-booking netting (for FX markets). We look forward to being an important part of the well-regulated marketplace that will soon emerge.

### The Dodd-Frank Act and Reform of the Derivatives Market

The implementation of the amendments to the Commodity Exchange Act in the Dodd-Frank Act (collectively, the "Act") will necessarily result in substantial changes to the OTC derivatives markets, which have been developing for over 30 years to meet the needs of their

participants. Many of the reforms brought about by the Act will benefit these markets. For example, clearing will add to the financial integrity of transactions, trade reporting will increase pre- and post-trade price transparency for market participants and regulators, regulation of market participants will establish legal standards to professionalize the markets, and the required execution of cleared swaps on SEFs or DCMs will ensure that transactions occur on well-regulated marketplaces. Moreover, the new SEF trading venue, if properly established and regulated, will provide a means whereby SEFs and exchanges can vigorously compete with each other to provide better execution services at lower cost to participants in the swaps market.

Changes to the markets became necessary as a result of market failures, and ICAP supports the Act's and the Commission's efforts to address these failures. These failures included in some cases lack of transparency for individual firms and their regulators as to the risks arising in certain transactions and with certain counterparties, which in turn created systemic risk. But these failures were not uniform across all firms and all markets. In many respects the OTC markets functioned very well. For example, the OTC markets did provide efficient and effective ways for institutional buyers and sellers to execute trades. In addition, the market for interest rate swaps, which constitutes by far the largest segment of the OTC derivatives market, performed well during the financial crisis and permitted end users, traders, and other participants in the market to efficiently acquire and hedge interest rate risk.

#### The Proposed Rules

In order to continue serving its customers when the SEF rules becomes effective, ICAP intends to establish and operate one or more swap execution facilities. ICAP believes that voice, electronic and hybrid execution methods can all be adapted to a SEF framework, and that the Commission should issue final rules which permit each SEF to offer any or all of these methods of trading in an economically efficient manner that is suited to the customers served by the SEF.

ICAP is concerned, however, that the Proposed Rules, if adopted in their current form, would instead impose a series of prescriptive requirements that would inhibit the ability of SEFs to operate in a flexible manner that is critical to their success and establishment as a viable marketplace for swaps trading. Specifically, our concerns are as follows:

- The Proposed Rules for SEFs will institute a number of positive and important reforms to how swap transactions are executed. However, ICAP believes that the Proposed Rules depart from Congress' intent in two fundamental, related ways:
  - First, Core Principle 1 of the Act provides for SEFs to have reasonable discretion in how they conform to the SEF Core Principles, absent a specific Commission rule. Notwithstanding this manifestation of intent to adopt a principles-based regulatory regime – akin to that in place for designated contract markets (“DCMs” or “Exchanges”) and upon which the SEF Core Principles are modeled – the Commission has chosen to promulgate extensive, specific and prescriptive rules for adhering to the SEF Core Principles. ICAP believes this will have the effect of imposing rigidity and uniformity on SEFs, rather than encouraging properly controlled innovation and competition, and that it will unnecessarily alter certain current market practices which are widely embraced and which do not pose systemic risk.

For example, the OTC markets that are being replaced by SEFs have developed trading protocols that have served these markets well in balancing price transparency and liquidity considerations. These protocols are different from those which have been used on DCMs, and include, for example, giving a right of first refusal to the best bid if another trader wishes to trade at the offer price, and to the best offer if another trader wishes to trade at the bid price. This protocol performs a valuable economic function in encouraging firm bids and offers by rewarding a party who is willing to post a bid or offer. Another trading protocol used in the OTC market is the “work-up.” This occurs when two parties agree on a trade and report it to the market. If one of these traders wishes to increase the amount of the trade at the same price, that intent is shown to the market participants, who can join in the trade in the order in which they agree to join, subject, however, to a right of first refusal by the trader who did the initial trade with the trader who is trying to increase the position. These protocols serve a useful purpose in the market, and it is unclear why the Commission believes it is important to replace them with conventions untested for these products.

- Second, rather than envisioning SEFs as a new type of well-regulated OTC marketplace, the Proposed Rules instead seek to force swap intermediaries to operate largely in the same manner as exchanges. Congress, however, deliberately created SEFs as a new type of regulated alternative to exchanges. SEFs, unlike DCMs, are supposed to be a professionals-only market – no retail investors – and the product offerings are limited to swaps. DCMs are subject to a specific Execution of Transactions core principle, reflecting the traditional view of DCMs as a price discovery marketplace in which retail investors participate and the price of underlying physical commodities is often determined. SEFs are not subject to a similar core principle. In addition, as a policy matter, swaps serve a different purpose than futures, have very different liquidity characteristics, and as evidenced by three decades of experience, may be poorly suited for an exchange-like platform.
- Given the magnitude of change that the Act will bring to the swaps market, ICAP urges the Commission to proceed cautiously and to observe how markets develop before insisting upon wholesale changes to well-accepted and proper practices. This is the Commission’s first, not last, opportunity to promulgate rules for the swaps markets, and an abundance of care at the outset will likely pay off with better rules and a better functioning market over the long term.
- ICAP believes the Commission should revise the Proposed Rules to reflect the following:
  - The SEF Definition Should Be Construed More Broadly. The Commission has created categories of “required” and “permitted” transactions and specified that certain transactions can or must be executed on platforms with particular types of characteristics, limiting for example the execution of non-block cleared trades to order books and RFQ platforms with certain characteristics. This specification of platform characteristics and delineation of tiered authorities for different platforms is not set forth in the Act. The Commission itself recognizes that voice brokerage satisfies the “multi to multi” requirement in the SEF definition for block trades. We believe that existing brokering protocols meet the multiple to multiple requirement for all trades but at different trade points than central order book exchanges. Since it

is very clear that Congress was permitting a continuation of voice brokering by SEF interdealer brokers and it is only a "goal" of Dodd Frank, as opposed to a statutory requirement or directive, to promote pre trade price transparency in SEF trading, we believe the CFTC's approach is too restrictive and not justified in light of statutory construction and Congressional intent. We ask that the Commission maintain an open mind and permit satisfaction of the "multiple to multiple" requirement by a flexible range of existing voice and other brokering protocols which work.

- Each SEF Should Be Permitted to Specify Its Own Methods of Execution. Unlike exchanges, which are subject to Core Principle 9 relating to Execution of Transactions, SEF Core Principle 2 requires only that SEFs develop trading rules. Consistent with Congress' creation of a principles-based regulatory regime, SEFs should instead be permitted reasonable discretion to develop trading rules appropriate to their platform and consistent with the Act. As the Commission knows, the SEF was intended by Congress to be the registration category for IDBs. The Act is very clear that SEFs are not limited solely to electronic trading platforms with central order books and Congress expressly permitted SEFs to continue the well known IDB practice of voice brokering swaps by including "by any means of interstate commerce" in the SEF statutory language. Congress thus provided flexibility to SEFs in establishing methods of execution, and did not limit them to an electronic order book system where every trade must be made through competing bids and offers posted in advance on a trading facility.
- SEFs Should Have Reasonable Discretion in Relation to Block Trades. In its rulemaking the CFTC has proposed a means test for determining block size. We believe that the regulators must use caution in setting block size in order not to impact market liquidity for all users. Perhaps a better notion would be to allow SEFs to be provided with reasonable discretion in determining their own block size. DCMs currently have such discretion, and SEFs will be best-positioned to determine the appropriate block size needed to maintain liquidity and optimum spreads as market indicators and activity change over time.
- SEFs Should Have Greater Flexibility in Establishing Governance Structures. In furtherance of mitigation of conflicts of interest, the Proposed Rules mandate certain equity ownership limits, governance committees, and independent board representation requirements for SEFs. The Commission should instead permit SEFs reasonable discretion as to the mechanisms they adopt to mitigate conflicts of interest, in recognition that the conflicts faced by a non-dealing SEF operator such as ICAP may be different than a SEF operator/owner that also trades.
- SEFs Should Be Permitted to Establish their own Rule Enforcement Mechanisms, Disciplinary Procedures and Sanctions. DCM Core Principle 13, entitled Disciplinary Procedures, requires a DCM to establish and enforce disciplinary procedures which authorize the DCM to discipline, suspend or expel members or market participants who violate the DCM's rules. DCM Core Principle 2, entitled Compliance with Rules, includes the requirement that a DCM have the capacity to detect, investigate and apply appropriate sanctions to any person who violates the DCM's rules. SEF core principles are very different. There is no Disciplinary Procedures core principle for SEFs, and SEF Core Principle 2, entitled Compliance with Rules, does not require

that SEFs have the capacity to conduct disciplinary proceedings or impose sanctions. Rather, there is a general requirement in SEF Core Principle 2 that a SEF have the capacity to detect, investigate and enforce its rules. As provided in the Act, SEFs should have discretion to establish procedures for enforcing the SEF's rules in a manner that is appropriate to the marketplace, asset class and market users. For example a SEF's enforcement mechanism could be limited to denying or limiting access to the SEF by persons who violate the SEF's rules. Moreover, a SEF should be permitted to establish procedures for referring matters to the CFTC or NFA for investigation or enforcement, rather than having to establish an elaborate disciplinary structure of its own.

- SEFs Should Have a Significant Time Period to Comply With the Final Rules. The Proposed Rules provide for the new SEF requirements to take effect 90 days after the issuance of the final rules, which is expected to occur by July 2011. Given the magnitude of change to be undergone by intermediaries accustomed to operating in the OTC markets for 30 years, SEFs should be provided with a significantly longer implementation period to permit them a reasonable amount of time to implement the new requirements.

#### Conclusion

For the foregoing reasons, ICAP requests that the Commission reconsider its Proposed Rules, and issue final rules which give SEFs the authority to use their reasonable discretion to comply with the core principles and to make changes in their procedures as needed to ensure the proper functioning of the markets.

ICAP appreciates the opportunity to submit this comment, and would be pleased to meet with the Commission or provide additional information to assist the Commission in arriving at final regulations for SEFs which will achieve the valid regulatory purposes of the Act while permitting the swaps markets to continue to perform their valuable economic functions.

Very truly yours,



John Nixon  
Executive Director  
ICAP plc

cc: Honorable Gary Gensler, Chairman  
Honorable Michael Dunn, Commissioner  
Honorable Bart Chilton, Commissioner  
Honorable Jill E. Sommers, Commissioner  
Honorable Scott O'Malia, Commissioner