

March 21, 2011

Via E-mail (www.comments.cftc.gov)

Commodity Futures Trading Commission
c/o David A. Stawick, Secretary
Three Lafayette Center
1155 21st Street, NW
Washington, D.C. 20581

**Re: RIN 3038-AD18 Core Principles and Other Requirements
for Swap Execution Facilities (76 FR 1214)**

Dear Mr. Stawick:

The undersigned firms¹ submit this letter to express their views on the Commission's proposed regulations, guidance and acceptable practices for swap execution facilities ("SEFs").²

The undersigned firms trade their own capital in the exchange-traded and cleared swaps markets. We engage in manual, automated and hybrid methods of trading and are active in a variety of asset classes, such as futures, equities, foreign exchange, commodities and fixed income. The undersigned firms are a critical source of liquidity in these markets, allowing users of these markets to manage their business risks (including commercial end-users) to enter and exit the markets efficiently.

Depending on the eventual structure of the developing market for cleared swaps, the undersigned firms anticipate continuing to trade, and potentially expanding their trading in cleared swaps markets. These firms provide important liquidity, counterparty diversification, and competition in the cleared swaps market. However, the willingness and ability of firms to provide liquidity in cleared swaps will depend on a number of factors, including the costs associated with registering as, and complying with requirements applicable to, swap dealers, the absence of other barriers to entry to the cleared swap market, and the ability to compete in that market on a level playing field.

¹ These firms include: Allston Trading, LLC; Atlantic Trading USA LLC; Bluefin Trading LLC; Chopper Trading LLC; DRW Holdings, LLC; Eagle Seven, LLC; Endeavor Trading, LLC; GETCO; Hard Eight Futures, LLC; HTG Capital Partners; IMC Financial Markets; Infinium Capital Management LLC; Kottke Associates, LLC; Liger Investments Limited; Marquette Partners, LP; Nico Holdings LLC; Optiver US LLC; Quantlab Financial, LLC; RGM Advisors, LLC; Traditum Group LLC; WH Trading; XR Trading LLC.

² 76 Fed. Reg. 1214 (Jan. 7, 2011) (the "SEF Release").

Currently, the swap market is dominated by a small number of large banks. The market is opaque. Participants do not publicly disseminate firm quotes at which they would be willing to transact in swaps, nor do they publicly disseminate the prices at which their swap trades are executed. It is not as competitive as it could or should be as entities other than the large dealers are limited in their ability to participate because access to the trading and clearing venues is restricted.

In enacting the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), Congress intended to make fundamental changes in how the swap market operates. The legislation was enacted to reduce systemic risk, to increase pre-trade and post-trade transparency, and to promote market integrity. The Dodd-Frank Act requires (with certain exceptions) that standardized swaps be cleared through a regulated central counterparty. It also requires that swaps that are subject to mandatory clearing be traded either on a designated contract market (“DCM”) or a SEF, unless no DCM or SEF makes the swap available to trade.

The Commission is proposing the new rules, guidance and acceptable practices set forth in the SEF Release in order to implement these statutory provisions. In general, the undersigned firms support the Commission’s proposals and believe that they are consistent with the letter and spirit of the Dodd-Frank Act.³ Our comments below will focus on the following subjects: (1) the importance of fair, open, and transparent markets, (2) permitted execution methods, (3) how requests for quotes (“RFQ”) should operate, (4) appropriate restrictions on pre-arranged crosses, and (5) a limited exception for block trades.

Importance of Fair, Open, and Transparent Markets

We agree with the Commission that the definition of a SEF in conjunction with the core principles for SEFs set forth in the Dodd-Frank Act establish minimum requirements that all SEFs must satisfy. Among other things, a SEF must provide multiple participants with the ability (i) to make bids and offers to other multiple participants and (ii) to execute against the bids and offers posted by other participants. These provisions further the intent of the Dodd-Frank Act to open the swap market to competition and transparent pricing. We also agree with the Commission’s conclusion that one-to-one voice broker services and single-dealer platforms cannot qualify as SEFs under the statutory definition.⁴

Core Principle 2 requires a SEF to establish and enforce rules “to provide market participants with impartial access to the market.” As noted by the Commission, the purpose of the impartial access requirement is “to prevent a SEF’s owners or operators from using

³ As an exception to this statement, we believe for the reasons discussed below that the Commission’s proposal with respect to requests for quotes is not consistent with the purposes of the Dodd-Frank Act.

⁴ SEF Release at 1219.

discriminatory access requirements as a competitive tool against certain participants.”⁵ Accordingly, proposed Regulation 37.202 requires a SEF to provide impartial access for all eligible participants to its markets and market services, including any indicative quote screens or pricing data displays. The undersigned firms strongly support this requirement. We believe that impartial access is a prerequisite to having an open market in which eligible participants can compete on a level playing field. Moreover, the participation of additional liquidity providers in the swap market will add competition and improve the pricing and efficiency of that market, and reduce systemic risk by expanding the pool of liquidity providers to include participants in addition to the large banks.

Permitted Execution Methods

Under proposed Regulation 37.9, a SEF must use either an Order Book or a Request for Quote System (or both) for the execution of Required Transactions. The term “Required Transactions” is defined to mean transactions (i) that are required by the Dodd-Frank Act to be executed on a DCM or a SEF, (ii) that the SEF has made available for trading, and (iii) that are not block trades. The undersigned firms support the concept of mandating that Required Transactions be executed through an order book or an RFQ system.

We believe that a central order book market structure, in which all but the very largest transactions (over a reasonable block trade threshold) are required to go into a central order book, has two important benefits. First, such a market will provide more accurate valuation and risk measures for the central counterparty responsible for clearing and managing the risks of open swaps positions, which would lower systemic risk. Second, a SEF with a central order book would result in better prices and significant savings in transaction costs to market participants.

In contrast, allowing dealers to internalize their customers’ orders outside of a competitive market reduces the efficiency of, and results in less accurate, worse prices on, the central market. Moreover, because internalized trades are often priced off the benchmark central market, worse prices on the central market will result in worse prices for trades executed outside of the central market as well. For these reasons, as discussed below, we believe that the Commission’s proposed rules for RFQs are overly permissive and would lead to swap markets that are less open, less competitive, and less efficient than they should be.

Requests for Quotes

The Commission’s proposal would allow a SEF to offer an RFQ system for market participants, provided that the SEF requires market participants to transmit an RFQ to at least five potential counterparties. As the Commission recognizes, its proposal would permit a market participant “to interact with a limited number of market participants (*i.e.*, fewer than the entire

⁵ SEF Release at 1223.

market).”⁶ The undersigned firms believe that the Commission’s proposal in this regard is inconsistent with the Dodd-Frank Act. By allowing semi-private “side deals” to take place on a SEF, which exclude all market participants except those who were favored to receive the RFQ, SEF participants would be allowed to undermine the proposed impartial access requirements for SEFs. For example, a large swap dealer could limit its RFQ to a relatively small group of other large dealers and deny other SEF participants the ability to provide a competing quote for a particular order, even if those participants may be willing to offer better prices than the five counterparties who were sent the RFQ. Such private deals are the antithesis of the type of open, fair, competitive, and transparent markets that are called for under the Dodd-Frank Act.

Private transactions are customary in today’s swap market, but we believe that they should not be permitted in the new market structure being designed for the subset of non-block trades that are Required Transactions. The Commission did not articulate any rationale for permitting such private transactions in the new market structure. In today’s swap market, it is reasonable for a swap participant to restrict the number of counterparties with which it is willing to deal because of potential concerns about the creditworthiness of possible counterparties. However, that concern does not apply to Required Transactions, which by definition only include swaps subject to the clearing requirement between counterparties to which an exception to the clearing requirement does not apply.⁷ Therefore, the clearing organization would step between the buyer and seller and eliminate the credit risk associated with a possible default by the other party.

Another possible reason for not requiring RFQs to be disseminated to the entire market is the concern that a party, by disseminating its trading interest to the entire market, might enable other participants to use that information to the disadvantage of the party disseminating the RFQ. We share that concern if the RFQ is for an order of sufficient size that it could move the market. However, in that situation the exception for block trades (discussed below) would apply, and the proposed transaction would not be a Required Transaction. The undersigned firms believe that there is no valid justification for not disseminating RFQs for normal-sized orders to the entire market.

Market participants could use the Commission’s RFQ proposal to prevent transparent and competitive pricing. For example, six large swap dealers could disseminate RFQs only to each other. Such an arrangement would allow these dealers to maintain a dominant share of the market, creating a substantial barrier to entry to the swap market. The undersigned firms believe that the costs and risks of permitting private RFQ markets are high, and that the Commission should revise its proposal so that RFQs for Required Transactions be disseminated to all eligible

⁶ SEF Release at 1220.

⁷ Transactions are required to be executed on a DCM or a SEF if they involve a swap subject to the clearing requirement under Section 2(h)(1) of the CEA and the exception to the clearing requirement under Section 2(h)(7) of the CEA for end users does not apply.

participants in the market. Such a requirement would enhance liquidity by enabling market participants other than the largest banks to respond to RFQs.

Restrictions on Pre-Arranged Crosses

In order to preserve an open and competitive market, restrictions should be placed on a trader's ability to execute against a customer's order that he is holding (*i.e.*, internalize the order) or to execute two customers' orders against each other without full exposure of the proprietary or agency cross on the SEF and the ability for other SEF participants to provide a better price for the cross. If such crosses could be executed without restriction, the customer orders would not be exposed to the market, and other participants in the market would be deprived of an opportunity to provide a better price for the customer orders. In recognition of this concern, proposed Regulation 37.9 would mandate that SEFs shall require a trader to wait 15 seconds after entering a customer order before executing against that customer order himself or executing it against another customer order. The undersigned firms strongly support this requirement as being necessary to maintain fair and open markets. We believe that a 15-second exposure period is appropriate and is consistent with similar exposure periods that are required in the futures markets.⁸ In addition, we believe that the applicable SEF rules must provide a meaningful opportunity for other market participants to execute against one or both sides of the proposed cross.

Limited Exception for Block Trades

The Commission has recognized that the rules for trades of regular size may not be appropriate for large trades. In an earlier release, the Commission proposed special rules for the public reporting of block trades of swaps.⁹ In that release, the Commission proposed that a swap transaction would qualify as a block trade if the notional or principal amount of the transaction is equal to or greater than the "minimum block size" for that category of swaps. The "minimum block size" would be the greater of the numbers derived from (1) a "distribution test" that determines the size level that is greater than 95% of the transaction sizes for that category of swaps and (2) a "multiple test" that determines the average size¹⁰ of transaction for that category of swaps and then multiplies it by five. Once the "minimum block size" for a category of swaps has been determined, it would be published so that all market participants would know which

⁸ See, e.g., CME Rule 539.C.

⁹ 75 Fed. Reg. 76140 (Dec. 7, 2010) (the "Reporting Release").

¹⁰ To be more precise, this test would use the greatest of the mode, median, and mean transaction sizes.

trades would qualify as block trades. The “minimum block size” would be recalculated annually.¹¹

The Commission also proposed that the public reporting of block trades and their prices would be delayed for up to 15 minutes after the time of execution.¹² This delay is intended to give the parties to a block trade an opportunity to hedge or otherwise offset the risk of their large positions before their positions are reported. The undersigned firms support the Commission’s proposal to delay public reporting of block trades of swaps. We note that it is similar to how block trades are treated in the U.S. futures markets.¹³ Because block trades are executed privately, they are an exception to the usual rules requiring order exposure and interaction on a DCM, and we recognize that the same treatment could be accorded to blocks executed on a SEF. In light of the fact that block trades are not subject to the regular transparency and access rules, we believe that the scope of the block trade exception should be limited to those trades of a size that truly would have significant market impact if the trade were reported on an immediate basis. We think it might be useful, however, for the Commission to consider two different time delays for transaction reporting of blocks of different sizes – a five-minute delay for block trades of minimum block size, and a 15-minute delay for significantly larger block trades (say, four times larger than the minimum).

* * * *

The undersigned firms appreciate the opportunity to provide comments to the Commission regarding the regulation and operation of SEFs.

Sincerely,

Allston Trading, LLC
By: /s/ Carlton Jones, CEO

Atlantic Trading USA LLC
By: /s/ Matt Joyce, CEO

Bluefin Trading LLC
By: /s/ Arthur Duquette, Managing Member

¹¹ Reporting Release at 76161-63.

¹² Reporting Release at 76166.

¹³ *See, e.g.*, CME Rule 526 (block trades in most futures must be reported within five minutes of the time of execution; block trades in certain futures must be reported within 15 minutes of the time of execution).

Chopper Trading LLC
By: /s/ Raj Fernando, CEO

DRW Holdings, LLC
By: /s/ Donald R. Wilson, Jr., CEO

Eagle Seven, LLC
By: /s/ Stuart Shalowitz, General Counsel

Endeavor Trading, LLC
By: /s/ Justin Serbinski, Managing Partner

GETCO
By: /s/ Stephen Schuler, Co-Founder and CEO

Hard Eight Futures, LLC
By: /s/ Francis Wisniewski, Managing Director

HTG Capital Partners
By: /s/ William McNeill, Managing Director

IMC Financial Markets
By: /s/ Robin Van Boxxel, Managing Director

Infinium Capital Management LLC
By: /s/ Charles Whitman, CEO

Kottke Associates, LLC
By: /s/ J. Michael Crouch, Vice-President

Liger Investments Limited
By: /s/ Trevor Gile, Principal

Marquette Partners, LP
By: /s/ James Heinz, Managing Partner

Nico Holdings LLC
By: /s/ Peter J. Meyer, CEO

Optiver US LLC
By: /s/ Sebastiaan Koeling, Managing Director

Commodity Futures Trading Commission
March 21, 2011
Page 8

Quantlab Financial, LLC
By: /s/ Cameron Smith, General Counsel

RGM Advisors, LLC
By: /s/ Richard B. Gorelick, CEO

Traditum Group LLC
By: /s/ Michael Creadon, Managing Partner

WH Trading
By: /s/ William Hobert, Managing Member

XR Trading LLC
By: /s/ Matthew W. Haraburda, Head of Operations

cc: Honorable Gary Gensler, CFTC, Chairman
Honorable Michael Dunn, CFTC, Commissioner
Honorable Jill E. Sommers, CFTC, Commissioner
Honorable Bart Chilton, CFTC, Commissioner
Honorable Scott O'Malia, CFTC, Commissioner
Riva Spear Adriance, Associate Director, CFTC, Division of Market Oversight
Mauricio Melera, Attorney-Advisor, CFTC, Division of Market Oversight