sifma

Invested in America

March 8, 2011

COMMENT

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)

Dear Mr. Stawick:

The Asset Management Group (the "**AMG**") of the Securities Industry and Financial Markets Association ("**SIFMA**") writes in response to the Notice of Proposed Rulemaking (the "**CFTC Release**"), published by the Commodity Futures Trading Commission (the "**CFTC**") on January 7, 2011, regarding the CFTC's proposed rule (the "**CFTC Proposed Rule**") relating to core principles and other requirements for swap execution facilities ("**SEFs**").[1] The AMG previously provided the CFTC and the Securities and Exchange Commission (the "**SEC**" and, together with the CFTC, the "**Commissions**") with its views on SEF requirements in a pre-comment letter dated November 24, 2010[2] and on block trading definitions and reporting issues in a comment letter dated February 7, 2011.[3]

The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, state and local government pension funds, endowments, ERISA funds, 401(k) and similar types of retirement funds and private funds such as hedge funds and private equity funds. In their role as asset managers, AMG member firms, on behalf of their clients, engage in transactions, including transactions for hedging and risk management purposes, that are classified as "swaps" or "security-based swaps" ("**SB swaps**" and, together with CFTC-regulated

---

[1] Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1,214 (proposed January 7, 2011) (adding 17 CFR Pt. 37).

[2] *See* November 24, 2010 AMG Comment Letter, *available at* http://www.sec.gov/comments/df-title-vii/mandatory-facilities/mandatoryfacilities-23.pdf.

[3] *See* February 7, 2011 AMG Comment Letter, *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27614&SearchText.

"swaps," "**Swaps**") under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**").

This letter provides the AMG's comments with respect to the CFTC Proposed Rule, including the following points: (i) the comment period for the CFTC Release should remain open during the comment period for the SEC's Notice of Proposed Rulemaking (the "**SEC Release**")[4] relating to security-based swap execution facilities ("**SB SEFs**"); (ii) the CFTC should adopt a more flexible approach to permissible forms of trade execution, particularly with respect to request for quote ("**RFQ**") systems; (iii) the allowable execution methods for Permitted Transactions generally should not be restricted; (iv) the "available to trade" determination should be made by the CFTC and subject to a specific prescribed set of objective criteria; (v) the rules and amendments self-certified by SEFs should be preceded by robust opportunities for public comment; (vi) the CFTC should require SEFs to establish policies and procedures to prevent any terms of a swap from being modified without the express consent of the counterparties; (vii) the reach and scope of SEFs' information gathering, examination and enforcement authority with respect to market participants should be curtailed; (viii) certain packaged swap transactions should be exempt from mandatory execution on a SEF; and (ix) the relationship between the confirmation requirements embedded in the CFTC Proposed Rule and the CFTC's separate Confirmation, Reconciliation and Portfolio Compression Rule Proposal should be clarified.

The comment period for the CFTC Release should remain open during the comment period for the SEC Release relating to SB SEFs to promote consistent rulemaking.

Coordination between the CFTC and the SEC, and harmonization of their respective rules, is essential to carrying out the goals of Dodd-Frank in a way that is workable for the Swap markets. In a proposal parallel to the CFTC Release, the SEC published a proposed rule on SB SEFs on February 28, 2011, with a comment period scheduled to close on April 4, 2011, nearly one month after the expiration of the CFTC comment period. Because of the similarities between swaps and SB swaps in the marketplace and their common statutory mandate under Title VII, and because of the discrepancies between the CFTC and SEC Proposed Rules discussed below, the AMG believes that the CFTC should leave open its comment period under the CFTC Proposed Rule until the close of the SEC comment period.

In a letter from Congressman Barney Frank to Chairpersons Mary Schapiro and Gary Gensler, Congressman Frank recently stressed the need for such harmonization and coordination between the Commissions for Dodd-Frank rulemaking.[5] Congressman Frank specifically expressed a concern regarding unnecessary differences between the Commissions' rules, which would "drive up the cost of implementation, without

---

[4] Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10,948 (proposed February 28, 2011) (amending 17 CFR Pts. 240, 242 and 249).

[5] Letter from Barney Frank, Ranking Member, H.R. Comm. on Fin. Servs., to Hon. Mary L. Schapiro, Chairman, Sec. Exch. Comm'n, and Hon. Gary Gensler, Chairman, Comm. Fut. Trade Comm'n (Feb. 18, 2011).

improving the regulatory structure."[6] The letter cited discrepancies in the approaches taken by the CFTC Proposed Rule for SEFs and the SEC-proposed rule (the "**SEC Proposed Rule**" and, together with the CFTC Proposed Rule, the "**CFTC and SEC Proposed Rules**") for SB SEFs with respect to RFQ systems, voice brokerage systems and the treatment of block trades.[7] Congressman Frank surmised that, although there are differences between the existing equity and futures markets, those differences do not justify differing treatment between swaps, on the one hand, and SB swaps, on the other.[8] Recognizing that swaps and SB swaps "are very different products than those currently traded in the highly-evolved equities and futures markets," Congressman Frank suggested that the rules for trading swaps and SB swaps should not be based on the equities and futures markets or differences in those markets.[9] Moreover, the letter urges the Commissions to "reconcile and coordinate those differences" with the goal of "maintain[ing] liquidity and stability in these new markets and reduc[ing] costs."[10]

Congressman Frank's concerns are consistent with President Barack Obama's recent Executive Order, in which he requested that federal agencies undertake greater coordination to avoid redundant, inconsistent or overlapping regulations.[11] Similarly, in a speech Commissioner Sommers delivered to the Institution of International Bankers, Commissioner Sommers voiced her "concern[] that the CFTC is moving out of step in time, substance, or both with the SEC and the rest of the world in implementing trade execution requirements for standardized swaps."[12]

In its initial review of the SEC Proposed Rule, the AMG has noticed significant disparities between the Commissions' Proposed Rules in areas beyond those highlighted by Congressman Frank. For example, as further discussed below, the Commissions take different approaches to the question of who determines whether a Swap has been "made available to trade," – i.e., the SEF or SB SEF or the relevant Commission – and very different approaches to what constitutes an acceptable RFQ system. Given our concerns

---

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *Id.*

[11] *See* Executive Order, "Improving Regulation and Regulatory Review" (Jan. 18, 2011) (recognizing that, generally speaking for all regulatory agencies, "[s]ome sectors and industries face a significant number of regulatory requirements, some of which may be redundant, inconsistent, or overlapping" and "[g]reater coordination across agencies could reduce these requirements, thus reducing costs and simplifying and harmonizing rules"). Although the Executive Order is not binding on the CFTC, its principles would still seem highly relevant to the CFTC coordinating with the SEC on rulemaking related to swaps and SB swaps.

[12] *See* Commissioner Jill E. Sommers, Remarks before the Institute of Int'l Bankers, Annual Washington Conference (Mar. 7, 2011) (the "**IIB Speech**"), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opasommers-13.html.

regarding the significant discrepancies between the CFTC and SEC Proposed Rules, the AMG requests that the CFTC keep the comment period for the CFTC Release open until at least April 4, 2011 to allow market participants time to provide, and both Commissions sufficient time to consider, public comments on the CFTC and SEC Proposed Rules. Accordingly, the AMG requests that the CFTC exercise its discretion to review meaningful market participant comments that are filed prior to the expiration of the SEC comment period.

The CFTC should adopt a more flexible approach to permissible forms of trade execution.

As explained in our November 24, 2010 letter, the AMG believes that flexibility in trading methods is necessary to achieve the two Congressional goals of promoting pre-trade price transparency and the trading of swaps and SB swaps on SEFs and SB SEFs.[13] In particular, the AMG believes that the CFTC should not restrict permissible SEF execution methods for Required Transactions (as defined in CFTC Proposed Rule 37.9(a)(iv)) to just RFQs and central limit order book systems ("**Order Books**"). A preferable approach, like the one proposed by the SEC, would leave open numerous acceptable execution methods for transactions, subject to certain principles, guidelines and minimum objective criteria.[14] Such an approach will allow appropriate execution methods to grow and develop with the evolving swap markets.

At a minimum, the statutory definitions of "swap execution facility" and "security-based swap execution facility" should be read to include highly flexible RFQ systems that ***allow***, but do not require, multiple liquidity seekers to individually request quotes from multiple liquidity providers. The AMG believes that, unlike the SEC, the CFTC has taken an overly restrictive, and what the AMG believes to be impractical, view of the "multiple-to-multiple" statutory requirement. Specifically, the CFTC Proposed Rule's imposition of a five-market participant requirement, a minimum 15-second delay and a requirement for RFQ requesters to "take into account" bids or offers resting on the trading system or platform will restrict, rather than promote, liquidity and pre-trade price transparency. These restrictions will dilute the effectiveness of an RFQ execution model to the point where it no longer resembles what is commonly known as an RFQ system today. Thus, the AMG recommends that the CFTC eliminate all three of these restrictive requirements since they (i) are not required by the statute, (ii) do not further Dodd-

---

[13] *See* November 24, 2010 AMG Letter, *supra* n.2 at 1-2; CEA Section 5H(e).

[14] *See* SEC Release at 10,953 (stating

> rather than proposing a rule that would establish a prescribed configuration for SB SEFs that would meet the statutory definition of SB SEF, the Commission proposes to provide baseline principles interpreting the definition of SB SEF, consistent with the requirements of the Exchange Act, as amended by the Dodd-Frank Act, which any entity would need to be able to meet to register as a SB SEF. Such an approach is designed to allow flexibility to those trading venues that seek to register with the Commission as a SB SEF and to permit the continued development of organized markets for the trading of SB swaps. This more flexible approach also would allow the Commission to monitor the market for SB swaps and propose adjustments, as necessary, to any interpretation that it may adopt as this market sector continues to evolve).

Frank's two goals of promoting price transparency and trading of swaps on SEFs and (iii) will likely raise costs for end users.

The CFTC should eliminate the requirement that RFQs be transmitted to five or more market participants which is likely to result in increased costs for end users.

The AMG respectfully recommends that the CFTC eliminate the five-market participant requirement from its definition of RFQs.[15] Dodd-Frank amended the Commodity Exchange Act ("**CEA**") to require that multiple participants on a SEF "***have the ability*** to execute or trade swaps by accepting bids and offers made by multiple participants."[16] The AMG believes that the SEC more closely adhered to congressional intent by interpreting the statutory requirement as requiring that a SEF merely ***allow for*** market participants to disseminate an RFQ to "one or more dealers."[17] Likewise, Commissioner Sommers, in her IIB Speech, recognized the disparity between the SEC and CFTC Proposed Rules whereby the SEC "would allow [RFQs] to be sent to a single dealer, or to multiple dealers depending on the end-user's preference [while] [t]he proposal issued by the CFTC would require RFQs to be sent to at least five dealers."[18] Commissioner Sommers has expressed her disagreement with the CFTC Proposed Rule's approach to RFQ requirements in both her dissent to the CFTC Proposed Rule and in the IIB Speech.[19]

In addition to a lack of statutory support for a five-market participant requirement, the AMG sees several practical difficulties with this requirement. First, as the AMG explained in detail in connection with narrow block trading exceptions in its letters dated November 24, 2010[20] and February 7, 2011, a minimum five-market participant requirement will result in significantly more expensive hedging to the original counterparty – i.e., end users – due to the signaling of trading strategies to the market, whether or not the trade is a block trade.[21] Requiring the dissemination of an RFQ to a

---

[15] The CFTC Proposed Rule provides for execution through an RFQ system: (i) that allows for a market participant to transmit an RFQ "to no less than five market participants, to which all such market participants may respond"; (ii) that allows for an RFQ (with the same five-market-participant requirement) as a potential response in a trading system that allows for "real-time electronic streaming quotes, both firm and indicative, from multiple potential counterparties on a centralized electronic screen"; or (iii) by "[a]ny such other trading system or platform as may be determined by the [CFTC]." *See* CFTC Proposed Rule 37.9(a)(ii).

[16] CEA Section 1a(51) (emphasis added).

[17] *See* SEC Release at 10,951 n.27.

[18] *See* IIB Speech, *supra* n.12.

[19] *See* Commissioner Jill E. Sommers's Dissent, CFTC Release at 1,259; *see also* IIB Speech, *supra* n.12.

[20] *See* the November 24, 2010 AMG Comment Letter, *supra* n.2 at 3-5 (stating that the problems of a winner's curse and "front running" arise when there are narrow block trading definitions and "more generally in a trade execution platform that offers RFQ").

[21] *See* the February 7, 2011 AMG Comment Letter, *supra* n.3 at 3-4. The AMG believes that the CFTC real-time reporting block trading definitions are extremely narrow. If the CFTC adopts its proposed definition of block trades, a large number of trades will not qualify for delayed (...continued)

minimum of five market participants could cause the dealer to pay a higher price for, or lose entirely, the second side of the transaction because other opportunistic traders may be able to "front run" the second side of the transaction based on information provided by the initial RFQ. This issue is further exacerbated by the proposed 15-second minimum delay requirement, discussed below. End users, including clients of the AMG's member firms, will likely be forced to bear this cost, as dealers may pass this cost along in the form of a wider bid-ask spread.

Second, the CFTC Proposed Rule's five-market participant requirement could hinder the development of a robust exchange-traded swap market because, for certain less liquid and low-volume swap instruments, there may not be five potential liquidity providers to receive the RFQ. Even for transactions where there are five potential liquidity providers, certain types of customers may face restrictions that disallow transactions with some or most of these market participants. For example, absent an exemption, ERISA accounts generally are prohibited from transacting with affiliated dealers.

Third, managers should retain the right to transact with the counterparties of their choice without the imposition of artificial requirements to reach out to any minimum number of potential counterparties. Asset managers choose dealers based on a combination of factors and for a variety of business reasons, including rebates, best execution and concentration limits. In addition, some customers impose upon their asset managers "single-dealer guidelines," which require that trades be executed only with specific dealers. For example, many customers participate in commission recapture programs with specific dealers through which they receive rebates based on the percentage of trades they execute through those dealers, and accordingly, may get better overall pricing when trading with those dealers. In other cases, clients have directed brokerage agreements whereby asset managers are permitted to execute transactions only through a single dealer. Asset managers should retain the freedom to select which dealers to transact with.

Finally, the credit risk of potential counterparties is also a concern to AMG members. Despite the fact that Required Transactions will be subject to mandatory clearing, many customers of AMG member firms are still concerned about the credit risk of their dealers, particularly as it is uncertain what would happen when a designated clearing organization ("**DCO**") rejects a swap transaction subject to mandatory clearing.

In sum, because of the lack of statutory support for the CFTC's interpretation of the multiple-to-multiple requirement and the practical problems that will result from such a narrow reading, the AMG believes that market participants should, at a minimum, be able to assess the best interests of clients in seeking the best possible price, including how many dealers receive RFQs. The AMG strongly believes that the statutory mandate is

---

(continued...)

real-time reporting rules and will be forced onto SEFs for execution. If these trades are not treated as a block, requiring the submission of an RFQ to a minimum of five participants (and subjecting them to a 15-second pause) will only exacerbate information leakage and the other problems described in the AMG letter.

satisfied by a SEF offering market participants the ability to communicate an RFQ to more than one market participant if they so choose.[22]

The minimum 15-second timing delay requirement should be eliminated because any imposed minimum pause requirement may result in increased costs to clients of the AMG's member firms.

The AMG believes that the CFTC Proposed Rule's 15-second minimum delay requirement should be eliminated. Under the CFTC Proposed Rule, the SEF must require that "***traders*** who have the ability to execute against a customer's order or to execute two customers against each be subject to a 15-second timing delay between the entry of those two orders . . . before the second side of the potential transaction (whether for the trader's own account or for a second customer), is submitted for execution."[23] The CFTC Release states the purpose of this requirement is to "'show[]' other market participants the terms of a request for quote from its customer, and provid[e] other market participants the *opportunity to join in the trade.*"[24]

Requiring a minimum delay creates ambiguity in numerous scenarios, which the CFTC would need to identify and address in its final rulemaking. It is unclear whether the proposed 15-second delay was intended to apply to RFQs.[25] If the 15-second rule applies, must the requester keep the RFQ open for 15 seconds even if the market moves? If so, the AMG questions why this would be necessary as firm quotes that are posted on an Order Book or transmitted in response to an RFQ would already be exposed to the market and robust pre-trade price transparency.

As explained above in the context of the five-market participant requirement – and in the previous AMG letters referenced in that subsection – the AMG believes that this requirement will have significant negative effects on end users of Swaps. During the proposed 15-second pause after a broker or dealer enters the first side of a transaction, there is a possibility that the market will move against the original counterparty, as opportunistic third-party market participants can act in the marketplace on the basis of the information signaled by one-sided trade information. This will result in significantly more expensive hedging to the original counterparty. Consequently, initial transaction costs will increase as initial bids and offers are adjusted to pass along these costs. Ultimately, these increased costs could be borne by buy-side users and, consequently, discourage them from transacting in swaps on SEFs. The AMG does not see adequate justification for the 15-second delay – particularly in the case of RFQs and Order Books that are already exposed to the market and subject to pre-trade price transparency – to

---

[22] The AMG also requests clarification of whether the CFTC Proposed Rule allows market participants to inform certain dealers of their intent to put out an RFQ, provided that the requester satisfies the other requirements for an RFQ.

[23] CFTC Proposed Rule 37.9(b)(3) (emphasis added).

[24] *See* CFTC Release at 1,220 (emphasis added).

[25] The CFTC Proposed Rule is unclear whether the minimum 15-second pause requirement applies to every transaction or only to prearranged transactions. The AMG believes that the CFTC Proposed Rule is intended to apply only to prearranged trades; however, the CFTC Proposed Rule could be read more broadly without clarification.

offset the risk that the market moves against the requester in the intervening 15 seconds (or within any minimum imposed pause).

Besides the potential for significant increased costs for end users, the CFTC Proposed Rule is unclear as to ***whom*** the delay applies. The CFTC Release states that this pause would be "applicable to traders such as brokers" and also states that "[u]nder the proposal, a broker would have to provide a minimum pause . . . ."[26] It is unclear whether the term "traders" is intended to apply more broadly than to just dealers. The AMG believes that the proposed minimum delay requirement is intended to only apply to dealers executing orders on behalf of clients, and, if the CFTC does not eliminate the minimum delay requirement entirely, at a minimum, the CFTC should clarify that this delay requirement does not apply to trades executed by asset managers on behalf of their clients that may inadvertently cross each other on a SEF.[27]

Finally, the AMG believes that this requirement is inconsistent with Congress's desire to promote trading on SEFs and SB SEFs. As with the five-market participant requirement, Dodd-Frank does not mandate a minimum delay requirement, and the SEC has not imposed any parallel requirement in its Proposed Rule. The AMG believes that a 15-second delay requirement is overly prescriptive, punitive and arbitrary. Therefore, the AMG strongly encourages the CFTC to strike the minimum delay requirement from the final rule and instead leave it to market participants to set their own time limits on quotes.

The CFTC should eliminate the requirement for market participants to "take into account" bids or offers resting on the trading system or platform.

The AMG believes that the CFTC Proposed Rule's requirement for market participants to "take into account" resting bids or offers should be eliminated. The CFTC Proposed Rule requires respondents to an RFQ to communicate such resting bids and offers when providing a responsive quote to allow the requester to take into account "[a]ny bids or offers resting on the trading system or platform pertaining to the same instrument."[28] The CFTC Proposed Rule also requires resting bids and offers to be taken

---

[26] *See* CFTC Release at 1,220.

[27] Specifically, AMG members do not believe that any minimum pause requirement should apply towards asset managers. AMG members are concerned for the situation where a single asset manager, trading on behalf of separate clients, inadvertently matches or crosses the trades before satisfying an imposed minimum pause requirement. In this situation, the asset manager should not be deemed as violating the minimum pause requirement, especially as such trades may be subject to best-execution standards, specified asset allocations and/or concentration limits. AMG believes little is achieved by applying a minimum pause requirement on an asset manager.

[28] CFTC Proposed Rule 37.9(a)(ii)(A) (stating that one permissible RFQ is

> [a] trading system or platform in which a market participant must transmit a request for a quote to buy or sell a specific instrument to no less than five market participants in the trading system or platform, to which all such market participants may respond. Any bids or offers resting on the trading system or platform pertaining to the same instrument must be taken into account and communicated to the requester along with the responsive quotes).

into account by a person submitting an RFQ based upon an indicative real-time electronic streaming quote.[29]

If this requirement were not removed for RFQs, the CFTC Proposed Rule would need to be clarified and amended significantly to be workable. First, under either of the permissible uses of RFQ mentioned above, the CFTC Proposed Rule does not provide guidance as to ***how*** the requester "takes into account" these resting bids and offers.[30] As discussed above, there are many considerations, other than pricing, that enter into the calculus of selecting a market participant with which to transact. This decision should be left solely, and with unfettered discretion, to market participants. Second, the AMG believes that the SEF should inform the RFQ requester of the relevant resting bids and offers but that the information sharing should be one-way. The SEF should not inform the providers of resting bids and offers of the other relevant RFQs; otherwise, the RFQ system would be subject to market abuse by opportunistic third parties seeking market information. This would also open up RFQs beyond the minimum number of required participants and make the RFQ system resemble an Order Book, which would be inappropriate for certain swaps.

The AMG is also concerned about the potential for market abuse with respect to third parties that have merely provided indicative bids or offers. The concern is that market participants providing only indicative prices (and potentially misleading information) could be on a "fishing expedition" which would distort the market, as opposed to seeking executable trades. Market participants always have the right to contact a dealer directly to ask for indicative prices, so including them is unnecessary and confusing. Accordingly, the CFTC should clarify that "resting bids and offers" do not include indicative prices.

Thus, the AMG encourages the CFTC to adopt Commissioner Sommers's alternative language to the CFTC Proposed Rule, which would eliminate this requirement as it pertains to market participants responding to an RFQ.[31] The AMG also suggests

---

[29] CFTC Proposed Rule 37.9(a)(ii)(B)(1)–(2) (stating that another permissible RFQ is where

> multiple market participants must have the ability to [v]iew real-time electronic streaming quotes and [h]ave the option to complete a transaction by (i) [a]ccepting a firm streaming quote, or (ii) [t]ransmitting an [RFQ] to no less than five market participants, based upon an indicative streaming quote, taking into account any resting bids or offers that have been communicated to the requester along with any responsive quotes).

[30] The AMG assumes that if "resting bids and offers" will be required to be taken into account by the requester, this requirement would only apply to bids and offers of the same size as the underlying swap that the RFQ was put out on.

[31] *See* Statement of Commissioner Sommers, CFTC Release at 1259 (stating that one of the RFQ execution methods should include

> [a] trading system or platform in which a market participant transmits a request for a quote to buy or sell a specific instrument to more than one potential counterparty. Upon receipt of responsive quotes from any of the potential counterparties, the

(...continued)

eliminating the response requirement when made by a requesting market participant who sent an RFQ based upon an indicative real-time electronic streaming quote. Eliminating the requirement for an RFQ submitter to take into account resting bids and offers would also make the CFTC Proposed Rule consistent with the SEC Proposed Rule. The AMG believes that the "taking into account" requirement serves only to introduce uncertainty into the Swap markets.

The CFTC Proposed Rule should not place any limit on the available execution methods on SEFs for Permitted Transactions that market participants voluntarily choose to execute on a SEF.

CFTC Proposed Rule 37.9(a) defines "Permitted Transactions" as block trades, swaps not subject to mandatory clearing and execution requirements and illiquid or bespoke swaps.[32] CFTC Proposed Rule 37.9(c) limits the execution of these transactions to an Order Book, RFQ, a voice-based system or any system for trading which the CFTC may permit.[33] The AMG believes that the CFTC should not limit execution modalities available to market participants who voluntarily choose to execute Permitted Transactions on a SEF. No statutory basis exists in Dodd-Frank for regulatory execution requirements for Permitted Transactions since Dodd-Frank amended the CEA to explicitly state that "[f]or all swaps that are not required to be executed through a [SEF] . . . such trades may be executed through ***any other available means*** of interstate commerce."[34] If parties choose to execute a Permitted Transaction on a SEF, the final rule should not impose any restrictions on allowable execution methods on SEFs besides the general requirement that the execution methods must meet the requirements of the core principles applicable to all SEFs. In addition, the CFTC should clarify that only the core principles applicable to all SEFs will apply to Permitted Transactions executed on a SEF.

The determination of "available to trade" should be made by the CFTC, and not SEFs, based on well-defined, objective criteria.

Under Dodd-Frank, Swap counterparties must execute all transactions subject to mandatory clearing on a DCM or a SEF (or SB SEF) unless no DCM or SEF (or SB SEF) "makes the [S]wap available to trade."[35] The CFTC Proposed Rule delegates to SEFs the responsibility of deciding whether a swap has been made available to trade. In exercising this power, SEFs must make, and electronically submit to the CFTC, annual assessments of which swaps it considers available for trading. This assessment may consider factors

---

(continued...)

original requester may accept a responsive quote and complete a transaction with any one of the responsive counterparties.)

[32] CFTC Proposed Rule 37.9(a).

[33] CFTC Proposed Rule 37.9(c).

[34] CEA Section 5H(d)(2) (emphasis added).

[35] *See* CEA Section 2(h)(8).

that the CFTC may deem relevant. The two examples of such factors included in the CFTC Proposed Rule are "frequency of transactions" and "open interest."[36]

The effect of a Swap being made available for trading is far-reaching. Under the statute, once any SEF or SB SEF determines that a Swap has been made available to trade, all SEFs and SB SEFs must treat the Swap and any economic equivalents of that Swap as being made available for trading, and that Swap transaction and its economic equivalents may no longer be executed in a bilateral transaction away from the SEF or SB SEF. Under the CFTC Proposed Rule, this limits the execution methods for that swap to those deemed appropriate for Required Transactions.[37]

SEFs and SB SEFs may find it in their interest to prematurely make Swaps available for trading, which would limit the flexibility of market participants entering into such Swap transactions. Specifically, a SEF or SB SEF may have an incentive to make a Swap available for trading to create liquidity on its trading platform or to limit liquidity in Swaps where they may benefit from execution methods that are only available for Permitted Transactions.[38]

The SEC Release recognizes that granting SB SEFs the discretion to determine which SB swaps are available for trading carries significant consequences. A determination by one SB SEF that an SB swap has been made available to trade means that the SB swap may no longer trade over-the-counter, "making the determination of what it means for an SB swap to be 'made available to trade,' as well as the decision as to who makes such a determination, central to the implementation of [Dodd-Frank]."[39] Thus, the SEC Release recognizes that a determination by a single SB SEF "could have unintended consequences for the trading of such SB swap." [40] With these unintended consequences in mind, the SEC Proposed Rule requires that this decision be made by the SEC rather than by one or a group of SB SEFs pursuant to objective measures to be established in future rulemaking.

The AMG believes that the SEC has adopted the appropriate approach and urges the CFTC to implement a similar rule whereby the determination of when a swap has become available to trade is made by the CFTC and not a SEF or group of SEFs. In lieu of the two somewhat vague and nonexclusive factors currently proposed by the CFTC (i.e., frequency of transactions and open interest), the AMG recommends that the final rule specify a set of exclusive objective factors, such as: minimum frequency of trading, minimum number of market participants actively trading a transaction and minimum transaction sizes. Imposing minimum thresholds, with the goal of measuring the liquidity

---

[36] *See* CFTC Proposed Rule 37.10.

[37] *Compare* CFTC Proposed Rule 37.9(c) (allowing for Permitted Transactions to be executed "by an Order Book, Request for Quote System, a Voice-Based System, or any such other system for trading as may be permitted by the Commission") *with* CFTC Proposed Rule 37.9(b) (limiting Required Transaction execution to "an Order Book or a Request for Quote System").

[38] *See Id.*

[39] SEC Release at 10,968.

[40] *See* SEC Release at 10,969.

of a particular swap, upon the "available to trade" determination is necessary since products that trade in very small or insignificant notional sizes do not warrant mandatory SEF execution. In addition, because these factors measure the relative liquidity of a particular swap, these tests should not be done on a one-time annual basis – as the CFTC Proposed Rule seems to suggest by requiring the submission of annual assessments only – but repeatedly to make sure that the product continues to meet the applicable thresholds.

The AMG has several related concerns. First, the AMG is concerned about the CFTC Proposed Rule's lack of a notification system to inform market participants when a swap has become available to trade on a SEF. Without such a system, market participants may not know to cease over-the-counter transactions in these swaps, stifling compliance with applicable rules. Second, the AMG requests clarification on how quickly other SEFs must make a swap available after one SEF determines that a swap has been made available for trading. Third, it is unclear what happens if a SEF cannot support a product that has been made available for trading on a separate SEF. Lastly, market participants will need to understand how quickly they must comply with the SEF execution requirement.

The AMG also believes that, as a matter of sequencing and implementation, the CFTC should not allow any swaps to be considered available for trading (thereby limiting the permissible execution methods for these swaps to those allowed for Required Transactions) until appropriate information has become available to make the liquidity determinations described above.

Because registered entities may self-certify rules and amendments under Dodd-Frank, the CFTC should promulgate rules that maximize the opportunity for public input regarding such rules, amendments and user agreements.

Dodd-Frank amended the CEA to implement a new framework for self-certification and approval procedures for new products, rules and amendments submitted to the CFTC by registered entities, such as SEFs.[41] After such a submission, the new rule or amendment becomes effective within ten business days after the CFTC receives the self-certified rule or amendment.[42] The CFTC may stay the certification under certain limited circumstances,[43] which would trigger a review period of up to 90 days from the date of the notification of the stay, including a 30-day public comment period.[44] Dodd-

---

[41] *See* CEA Section 5c(c) *and* Provisions Common to Registered Entities, 75 Fed. Reg. 67,282 (proposed November 2, 2011) (amending 17 CFR Pt. 40) (implementing the amended procedures for self-certification of rules mandated by Section 745 of Dodd-Frank, which amended Section 5c(c) of the CEA, by codifying amended self-certification procedures in Proposed Rule 40.6).

[42] *Id.*

[43] *Id.* (CFTC Proposed Rule 40.6(c)(1) would stay the certification of a rule if the CFTC determines that the new rule or amendment raised one of three issues, including: if the rule or amendment "present[s] novel or complex issues that require additional time to analyze, the rule is accompanied by an inadequate explanation or the rule is potentially inconsistent with the Act or the Commission's regulations thereunder.").

[44] *Id.* at 40.6(c)(1)-(2).

Frank also amended the CEA to give the CFTC broad regulatory powers with respect to the trading of swaps, including the ability to promulgate rules that define the swaps that can be executed on a SEF and expansive authority over SEFs in general.[45]

The AMG believes that the rules and amendments that a small number of SEFs and SB SEFS will promulgate through self-certification will affect the Swap market to the same degree as many of the CFTC and SEC Proposed Rules themselves. Recognizing the importance of public comment to the development of swap markets, the CFTC and SEC have both made it a priority thus far to request, procure and analyze closely market participant opinions. The AMG believes that the same level of review is necessary for SEF and SB SEF rules and amendments. Thus, the AMG requests that the CFTC utilize its authority to implement robust opportunities for public comment with respect to SEF rules and amendments by implementing the three requirements described below.

First, the AMG recommends that the final rule revise the SEF self-certification submission process to require that SEFs: notify the public of any intent to self-certify a rule or amendment; provide this notice a reasonable amount of time before the submission of self-certification to the CFTC; include in a self-certification submission any and all objections voiced by market participants; and, finally, expand the circumstances under which the CFTC may issue a stay of the SEF rule or amendment to include on the basis of any material market participant objections provided in the self-certification submission. These requirements would supplement the stay requirements and procedures under the CFTC Proposed Rule for Provisions Common to Registered Entities.

Second, as a means of establishing compliance with SEF Core Principle 13 – Financial Resources, each SEF should be required to submit to the CFTC and make available for public comment evidence demonstrating that the SEF will have in place sufficient legal, business and technological resources (including appropriate systems, policies and procedures and adequate personnel) to process user applications and accommodate the transactional flow of the numbers of market participants that it reasonably estimates will become users of the SEF over time. If SEFs are not fully equipped to handle all potential users, asset managers and their clients with relatively small market shares could be disadvantaged. Inadequate or materially delayed access to SEFs – when execution on SEFs is mandatory – could lead to significant pricing distortions and market disruptions in the relevant swap markets and would be contrary to the statutory goal of promoting the trading of swaps on SEFs.[46]

Finally, the CFTC should require SEFs to submit for public comment prior to self-certification the forms of user agreements, all terms to be incorporated into such user agreements and all business and technological requirements for market participants. Market participants should have an opportunity to comment on these user agreements and will need sufficient time to understand the related business and technological requirements for trading on a SEF before being bound by a SEF's terms.

---

[45] *See, e.g.*, CEA Sections 5h(d) and 5c(c)(5)(C)(iii).

[46] *See* November 24, 2010 AMG Letter, *supra* fn.2 at 1-2; CEA Section 5H(e).

The CFTC should require SEFs to establish policies and procedures reasonably designed to prevent any provision in a valid swap transaction from being invalidated or modified without the express consent of the counterparties.

The AMG believes that there are no circumstances under which a swap transaction should be modified or cancelled by a SEF without express consent from the counterparties at the time of such modification or cancellation. Accordingly, the AMG believes the CFTC should require SEFs to establish policies and procedures reasonably designed to prevent any provision in a valid swap from being invalidated or modified as a result of being executed on, or otherwise processed by, a SEF. The AMG would find it unacceptable for a SEF to seek to reserve in its standard user agreements the power to unilaterally modify or cancel the terms of validly executed swaps, for example, through a provision that each SEF user is deemed to have accepted any modifications made to the terms of their swaps executed on the SEF, so long as the SEF gives notice of the change in terms. Accordingly, the AMG believes the Commissions should require SEFs to establish policies and procedures reasonably designed to prevent any provision in a valid swap transaction from being invalidated or modified through the utilization of, or execution on, a SEF without the express consent of the counterparties given at the time of the modification or cancelation.

Express consent of both counterparties should be required for modification or invalidation even when the terms of an agreement or confirmation contain errors. However, the CFTC Proposed Rule would allow a SEF to "adjust trade prices or cancel trades when necessary to mitigate market disrupting events caused by malfunctions in its electronic trading platform(s) or errors in orders submitted by members and market participants."[47] Instead, the final rule should clarify that such transactions must be preserved and only canceled or modified with the consent of the counterparties. If the parties so choose, they themselves can agree to cancel the transaction and re-enter into a swap that conforms with the requirements for the Required Transaction. This clarification is essential to facilitate certainty and promote confidence in the swap markets.

Finally, if the counterparties give the SEF express consent to adjust the terms of a cleared swap, then it is imperative that the relevant entities involved in clearing – along with executing brokers, DCMs and middleware platforms – make the appropriate adjustments as well.

The reach and scope of SEFs' information gathering, examination and enforcement authority under the CFTC Proposed Rule is overly broad and should be curtailed.

The AMG is concerned with the CFTC Proposed Rule's ambiguous use of the terms "participants," "market participants" and "members" when discussing the entities SEFs must regulate, collect information from, monitor and, in certain situations, discipline. In the CFTC Proposed Rule, SEF regulatory authority is said to apply not only to swap dealers who execute the transactions, but also to market participants generally. For example, the CFTC Proposed Rule would require a SEF to "have rules that allow it to collect information on a routine basis, allow for the collection of non-

[47] CFTC Proposed Rule 37.202(e).

routine data from its ***participants***, and allow for its examination of books and records kept by the traders on its facility."[48] If these duties are interpreted broadly to apply to customers of dealers, asset managers and their clients will be subjected to onerous reporting and regulatory requirements of multiple SEFs.

Under CFTC-regulated futures trading today, examination of books and records and audits is limited solely to registered entities, such as futures commission merchants ("**FCMs**"). Furthermore, if the FCM is a member of more than one exchange, it is subject to examination and audit only by a single self-regulatory organization – either the National Futures Association ("**NFA**") or the FCM's Designated Self-Regulatory Organization ("**DSRO**"). Neither the NFA nor a DSRO has the authority to conduct audits or examinations of the FCM's customers.

The AMG recommends that the CFTC clearly define which entities the SEF must regulate, as the SEC has done in its proposed rule, so as not to result in too expansive an interpretation. The SEC Proposed Rule clearly defines the term "participant" as a person that is permitted to directly effect transactions on an SB SEF.[49] The AMG requests clarification that the regulatory reach of SEFs will not extend beyond the entities that actually execute the transactions on the SEF.[50]

In addition, the CFTC Proposed Rule requires SEFs to establish and enforce rules to collect and evaluate data regarding, among other things: an individual trader's market activity on an ongoing basis, swap terms and conditions, the adequacy of deliverable supply and non-routine information contained in the books and records of traders.[51] This broad authority to acquire information is granted throughout the CFTC Proposed Rule, in connection with topics such as Monitoring of Trading and Trade Processing, Ability to Obtain Information and Access Requirements.[52] Recognizing that providing information to SEFs and their affiliates has associated risks, the CFTC has proposed Rule 37.7, which prohibits the use "for business or marketing purposes [of] any ***proprietary data*** or personal information it collects or receives . . . for the purpose of fulfilling its regulatory obligations."[53] Even with this protection, the AMG believes that it is inappropriate for

---

[48] CFTC Proposed Rule 37.502 (emphasis added); *see also*, examples *supra* text surrounding n.51.

[49] SEC Proposed Rule 242.800. The SEC Proposed Rule also defines the terms "person associated with a participant" and "related person."

[50] In the case of introducing brokers and sponsored entities, the CFTC's rulemaking should make clear that the SEF's regulatory authority only covers these entities and does not extend to the next level of participants.

[51] CFTC Proposed Rule 37.401(a), 37.402(a)(1), 37.402(a)(2) and 37.502.

[52] *See, e.g.*, CFTC Proposed Rule 37.202 (stating that "[a] [SEF] must have arrangements and resources for effective enforcement of its rules. Such arrangements must include the authority to collect information and documents on both a routine and nonroutine basis, including the authority to examine books and records kept by the [SEF's] members ***and by market participants***.") (emphasis added).

[53] See CFTC Proposed Rule 37.7 (emphasis added).

SEFs to access this information at all. The term "proprietary data" is too narrow to adequately protect trading information that SEFs could obtain. Even if the definition were appropriately expanded, the AMG believes there is risk that proprietary information could be improperly disclosed, and it would be impractical to sufficiently monitor a SEF's proper use of this information. The CFTC Proposed Rule also allows SEFs to share this information with SEF members, other SEFs and DCMs. The information shared in this process could inadvertently be leaked to, or improperly obtained by, third parties.

The CFTC final rules should contain exceptions from mandatory execution on a SEF for certain packaged swap transactions.

Some AMG members engage in "packaged" or "combination" Swap transactions which combine into a single transaction two or more component transactions. These components can consist of other Swaps, futures, cash market transactions or other financial instruments. Because the pricing and economic rationale of the packaged Swap transaction depends on the pricing of its components, such packaged Swap transactions have unique pricing, trading and credit characteristics.

Requiring a swap component of such a transaction to be executed on a SEF because that component, when traded independently, is available for trading on a SEF would impair the viability of the packaged swap transaction. Decoupling the packaged swap transaction and requiring it to be executed on a SEF may not reflect the true price of the packaged instrument and does not promote accurate pricing information to market participants trading such instruments. Similarly, the AMG believes that the entire combination instrument should be excluded from the SEF execution requirement. When asset managers execute packaged swap transactions on behalf of their clients, they seek the best price on the overall transaction, and not just looking at its component parts. Similarly, the SEF rules should look at these packaged products on the basis of the overall transaction, and not its component parts.

This is especially true where certain packaged Swap transactions are already subject to, and governed by, DCM regulations. For example, some AMG members may engage in Exchange for Risk ("**EFR**") or Exchange for Physical ("**EFP**") trades involving a future and a swap. Current CFTC rules exempt these packaged transactions from mandatory execution on DCMs, so long as the transactions meet special exchange rules[54] that allow them to be executed off-exchange, such as a block trade. It would be inconsistent for the CFTC to allow these transactions to be executed off the futures exchange but not off SEFs. The AMG believes that the final CFTC rules should explicitly exempt packaged swap transactions from the SEF trade execution requirements.

The AMG is uncertain of how certain of the CFTC Proposed Rule provisions relate to the separate CFTC Confirmation, Reconciliation and Portfolio Compression Proposal.

---

[54] *See, e.g.*, Market Regulation Advisory Notice, RA1006-5, CME, CBOT, NYMEX & COMEX Rule 538 (June 11, 2010), http://www.cmegroup.com/rulebook/files/RA1006-5.pdf.

This CFTC Proposed Rule requires that executed swap transactions include written documentation memorializing all the terms of the transaction that legally supersede any previous agreement, and this must take place at the time of execution.[55] The AMG is unsure of whether this requirement applies to an executing dealer and what the relationship is between this provision and the provisions in the CFTC's Confirmation, Reconciliation and Portfolio Compression Rule Proposal.[56] Thus, the AMG requests that the CFTC clarify how the rules will operate together when they become effective.

[55] CFTC Proposed Rule 37.6(b).

[56] *See* Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. 81,519 (proposed December 28, 2010) (adding 17 CFR Pt. 23); *see also* February 7, 2011 AMG Comment Letter, *available at* http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission18_011811-7.pdf.

* * *

The AMG thanks the CFTC for the opportunity to comment on proposed rulemaking concerning the core principles and other requirements for swap execution facilities under Title VII. The AMG would welcome the opportunity to further discuss our comments with you. Should you have any questions, please do not hesitate to call the undersigned at 212-313-1389.

Respectfully submitted,

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

cc: Chairman Gary Gensler, CFTC
Commissioner Bart Chilton, CFTC
Commissioner Michael Dunn, CFTC
Commissioner Scott D. O'Malia, CFTC
Commissioner Jill E. Sommers, CFTC
Chairman Mary L. Schapiro, SEC
Commissioner Luis A. Aguilar, SEC
Commissioner Kathleen L. Casey, SEC
Commissioner Troy A. Paredes, SEC
Commissioner Elisse B. Walter, SEC