WMBA
AMERICAS
WHOLESALE MARKETS BROKERS' ASSOCIATION

July 18, 2011

Richard Shilts
Acting Director
Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Core Principles and Other Requirements for Swap Execution Facilities

Dear Mr. Shilts:

With the recent closing of the comment period for the proposed rules related to core principles and other requirements for swap execution facilities ("SEFs"),[1] extended by the reopening and extension of comment periods for rulemakings (the "Proposed Rules"),[2] the Wholesale Markets Brokers' Association, Americas ("WMBAA")[3] appreciates the opportunity to provide the staff of the Commodity Futures Trading Commission ("Commission") with the following specific comments related to the Proposed Rules.

These suggestions are examples of substantive changes the WMBAA supports in revising the Proposed Rules before consideration by the Commission for implementation. The WMBAA offers these comments because of its concerns regarding the Commission's interpretation of the SEF definition and substantive provisions applicable to SEFs under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

As discussed in previous letters,[4] the WMBAA, while recognizing the staff's tremendous efforts, has serious reservations about the Commission's proposed SEF definition, which limits the permissible

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[1] *See* Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1,214 (January 7, 2011).

[2] *See* Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76. Fed. Reg. 25,274 (May 4, 2011).

[3] The WMBAA is an independent industry body representing the largest inter-dealer brokers operating in the North American wholesale markets across a broad range of financial products. The WMBAA and its member firms have developed a set of *Principles for Enhancing the Safety and Soundness of the Wholesale, Over-The-Counter Markets.* Using these principles as a guide, the WMBAA seeks to work with Congress, regulators and key public policymakers on future regulation and oversight of over-the-counter ("OTC") markets and their participants. By working with regulators to make OTC markets more efficient, robust and transparent, the WMBAA sees a major opportunity to assist in the monitoring and consequent reduction of systemic risk in the country's capital markets. For more information, please see www.wmbaa.org.

[4] *See*, *e.g.*, letter from J. Christopher Giancarlo, Chairman, WMBAA, to Securities and Exchange Commission ("SEC") and CFTC, dated July 29, 2010; *see also* letter from Julian Harding, Chairman, WMBAA, to SEC and CFTC, dated November 19, 2010; letter from Julian Harding, Chairman, WMBAA, to SEC and CFTC, dated November 30, 2010; letter from Julian Harding, Chairman, WMBAA, to SEC, dated January 18, 2011; letter from Stephen Merkel, Chairman, WMBAA, to CFTC, dated February 7, 2011; letter from Stephen Merkel, Shawn Bernardo, Christopher Ferreri, J. Christopher Giancarlo and Julian Harding, WMBAA, to CFTC, dated March 8, 2011; letter from Stephen Merkel,

modes of execution in apparent contradiction of the statutory text of the Dodd-Frank Act.[5] The WMBAA believes the changes suggested below will assist in better reflecting the market structure envisioned by Congress under the Dodd-Frank Act. The WMBAA looks forward to discussing these specific points with you in greater detail at your convenience.

- **Revise the SEF Definition to Permit Multiple Modes of Trade Execution for Clearable Swaps Made Available for Trading.** The SEF definition in the Dodd-Frank Act makes clear that trade execution through a SEF is permitted "through any means of interstate commerce." Congress was unambiguous that multiple modes of trade execution are permitted, so long as post-trade capture and reporting can be done electronically. This approach is consistent with the many methods of trade execution utilized by WMBAA members in global markets today, including a combination of voice and electronic systems ("hybrid systems"). Congress clearly demonstrated its appreciation of this market structure in the plain words in the legislative text, the iterations of the SEF definition which resulted in the final language, and the numerous meetings WMBAA members had with Congressional staff.

  The WMBAA feels strongly that the Proposed Rules do not reflect the Dodd-Frank Act's requirement that SEF transactions can be executed "through any means of interstate commerce," which allows for voice and hybrid transactions. Specifically, the CFTC's proposal, in restricting the use of voice-based systems only to the execution of block trades and certain other illiquid or bespoke swap transactions, runs counter to the principles behind the statutory text. This approach will inappropriately impair markets that rely on voice-based or hybrid systems by hindering the creation of liquidity and unnecessarily frustrate market participants transacting in these markets.

  To that end, the WMBAA supports the SEC's flexible approach to the SEF definition, permitting registration for trading systems or platforms that meet the statutory requirements set forth in the Dodd-Frank Act.

  While the WMBAA recognizes the value of pre-trade price transparency (where it is feasible and appropriate), promoting this principle should not be done at the expense of the explicit statutory requirement allowing for the execution of trades through any means of interstate commerce. Such an interpretation is contrary to Congressional intent and ignores the practical mechanics of the marketplace. The market will be better served by allowing for the evolution towards pre-trade price transparency through competition and innovation.

  Furthermore, by resolving issues surrounding permissible modes of trade execution, the Commission will go far in addressing the related concerns regarding block trades, order work-ups, request-for-quotes ("RFQs"), swap classification, and the 15 second delay requirement.

Chairman, WMBAA, to CFTC and SEC, dated June 3, 2011; letter from Stephen Merkel, Chairman, WMBAA, to the Honorable Michael Dunn, Commissioner, CFTC, dated June 21, 2011.

[5] There are certain proposed SEF provisions not mandated by the Dodd-Frank Act, and in fact, appear to be contrary to the statutory text. As such, there is concern that the regulations in question fall outside the bounds of reasonableness, and for that reason might exceed the agency's authority. This further exacerbates market uncertainty as any construct that defies the plain language of the statute risks being found as unreasonable, and thus impermissible.

The new regulatory regime should also provide that anonymous, auction-style, crossing mechanisms, such as BGC's Volume Match are permissible modes of execution on a SEF. Volume Match provides customers with efficient price discovery by using available information in the marketplace to establish a mid-price at which instruments may trade for a prescribed period of time, while protecting customer trading intentions as to side of market and size. These crossing sessions have been effective in fostering liquidity in virtually all asset classes and geographic regions. The WMBAA is concerned that the SEF rules may inhibit the development of such liquidity enhancement systems in the swaps marketplace. Appropriately classifying these types of innovative execution services as permissible SEF activity in the new regulatory landscape is essential for the maintenance of liquid markets, a primary goal of Title VII of the Dodd-Frank Act.[6]

- **Remove the Proposed Transaction Classification System.** The WMBAA does not believe that distinguishing between "Permitted" and "Required" swaps is beneficial to the continued operation of competitive, liquid OTC markets. Such artificial designations of swap transactions may result in perverse consequences to OTC swaps markets. Further, the proposed restriction for "Required Transactions" to only those traded on order books or RFQ systems is contrary to the CEA's permitted transaction of swaps "by ***any*** means of interstate commerce" (emphasis added). Under the current classifications, many of these methodologies are prohibited or face an uncertain future, as each would require individual analysis by the Commission for compliance with the core principles. While certain requirements should be mandated during trade execution (*i.e.*, audit trail, trade processing, and reporting), limitations on methodologies used in trade execution should be considered carefully and weighed against any potential implications on liquidity formation.

- **Remove the "15 Second Rule."** The WMBAA believes that a 15 second timing delay before a trader can execute against a customer's order or a SEF can execute two customers against each other is not contemplated by CEA, as amended by the Dodd-Frank Act, nor is it supported by legislative history. This concept, which seems to have originated in the futures exchange markets, will create uncertainty and risk in the market and jeopardize the Commission's balance of the need for pre-trade transparency with the market's liquidity needs. This requirement does not appear to be consistent with the protection of investors. Even asset management firms, acting on behalf of state and local government pension funds, endowments, ERISA funds, 401(k) and similar types of retirement funds, all of whom have a statutory fiduciary duty to their clients, are opposed to this requirement.[7] The WMBAA recognizes that this approach may work in the highly liquid futures market. However, the 15 second delay ignores the unique nature of the swaps markets and will have a detrimental impact on the liquidity.

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[6] The WMBAA also has significant concerns about the proper regulatory classification of bulk risk mitigation and portfolio compression services such as ICAP's Reset, ReMatch, and triReduce and Tullett Prebon's tpMatch, tpQuickDeal, and tpDeltaDeal platforms. These services are neither facilities nor systems for the trading of swaps. They are focused on reducing operational risk, reset or fixing risk, and jump to default risk. We encourage the Commission to clarify that bulk risk mitigation, portfolio compression and other similar risk reduction services/activities are valuable services and such services are not required to be registered as SEFs. Further, consistent with the comment letter filed on July 7, 2011 by ICAP, we recommend that the Commission include a narrowly drawn, non-exclusive safe harbor in the SEF final rules for bulk risk mitigation and portfolio compression services to promote clarity regarding the regulatory classification and treatment of these valuable services.

[7] *See, e.g.,* letter from Timothy W. Cameron, Esq., Managing Director, Asset Management Group, Securities Industry and Financial Markets Association, to CFTC, dated March 8, 2011.

- **Clarify that Impartial Access Only Extends to Market Participants.** The WMBAA requests that the Commission delete the provision in the Proposed Rules providing impartial access to SEFs for independent software vendors ("ISVs"). The WMBAA believes this requirement is beyond the legal authority granted in the CEA and expands the impartial access statute beyond "market participants" to include entities lacking any intent to transact in swaps. The Proposed Rules, as currently constituted, might allow competitor SEFs to qualify as ISVs and have access to competitors' systems or platforms, producing a result contrary to the Dodd-Frank Act's goal of promoting a marketplace of competitive swap execution venues. The resulting competitive harm to SEF registrants is unwarranted. There is no congressional intent or legislative history to indicate that the term "market participants" should be read beyond the commonly understood definition as used by the industry today.

- **Revise SEF Core Principles to Reflect Statutory Authority and Characteristics of OTC Markets.** As discussed in the WMBAA's March 8, 2011 letter to the Commission, many of the Proposed Rules' provisions implementing SEF core principles exceed the Commission's authority in Section 5(h) of the CEA. In other instances, the Proposed Rules contemplate requirements more appropriate for a futures exchange and impossible to perform in OTC markets. The WMBAA urges the Commission to review its March 8, 2011 letter for specific recommendations to ensure that final rules reflect that SEFs are solely execution platforms, and cannot meet requirements related to post-execution obligations.

- **Utilize a Principles-Based Approach**. Finally, the WMBAA suggests that core principles and related requirements be enforced through a principles-based regime that provides SEFs with reasonable discretion to develop and implement appropriate rules to carry out these obligations. The Commission's currently proposed SEF regulations reflect a restrictive rule-based based approach, particularly in the limitations on modes of execution, RFQ requirements, block trades rules, and the SEF core principles, which will hinder innovation and frustrate market participants. Instead, the Commission should utilize its proven "principles-based" approach in crafting final regulations for SEFs, which fosters competition and innovation in the market place.

The WMBAA thanks the Commission and its staff for its hard work and dedication in formulating the Proposed Rules and working to ensure that the next iteration accurately reflects market participant feedback through the notice and comment process.

We would be pleased to discuss these comments and our prior remarks with you and your colleagues.

Sincerely,

Stephen Merkel, Chairman