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Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

November 2, 2011

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

Dear Mr. Stawick:

UBS Securities LLC appreciates the opportunity to submit comments to the Commodity Futures Trading Commission (the "**Commission**") in response to the Commission's proposed rule on Core Principles and Other Requirements for Swap Execution Facilities (the "**Proposed Rule**")[1] and related rules. This letter is a follow-up to the meetings held with Commission staff on July 20, 2011 and Chairman Gensler and Commissioner O'Malia on September 14, 2011.

It is widely expected that a number of swap execution facilities ("**SEFs**") will be established as the trading of swaps migrates to regulated markets. In a market environment with a significant number of SEFs, each with varying membership and connectivity requirements[2], customers will rely on market intermediaries, such as introducing brokers and futures commission merchants ("**FCMs**") registered with the Commission, to provide services enabling customers to efficiently locate liquidity and achieve best execution. However, absent further clarity from the Commission, we are concerned that a lack of legal certainty may result in SEFs or other liquidity platforms taking actions that prevent market intermediaries from performing this fundamental role on behalf of customers transacting in swaps. We strongly urge the Commission to expressly provide in the final SEF rules that SEF members have the ability to provide customers with indirect access to the liquidity available on the SEF and allow customers to view and transact against available liquidity across multiple sources in a single location. With access to the liquidity available on SEFs, market intermediaries may then, in compliance with the core principles of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"), route and execute requests for quotes and orders on behalf of customers, either on a disclosed or undisclosed basis (a market intermediary acting in such capacity, a "**Customer Agent**"). As a result, customers will have an important cost-saving alternative to incurring the financial, technological and operational burdens associated with connecting directly to a number of SEFs in a fragmented market.

It is our view that this trading model is permitted by both the Dodd-Frank Act and the Proposed Rule[3], a view that the Securities and Exchange Commission ("**SEC**") also appears to support in its proposed rule on security-based swap execution facilities.[4] In addition, a market intermediary acting as Customer Agent is consistent with the core principles of impartial access and best execution, and is analogous to activities of

[1] Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1214 (January 7, 2011).
[2] See, for example, our earlier comment letter on trade execution submitted to the Commission on December 15, 2010.
[3] See, for example, the commentary to the Proposed Rule noting that "[s]wap execution facilities that permit intermediation must prohibit customer-related abuses" and "the Commission is interested to know whether additional regulations are necessary to ensure that a SEF can assert jurisdiction over any person or entity executing swaps on the SEF, either for their own account or on behalf of another's account". Proposed Rule at 1223 and 1242.
[4] See Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10948, 10963-65 (February 28, 2011) ("eligible contract participants that are not participants could access a SB SEF indirectly through a participant" and "participants that provide sponsored access to SB SEFs would be required to register with the [SEC] as a broker").

intermediaries in other markets regulated by the Commission that are relied upon by customers in order to locate liquidity and achieve best execution. However, we believe that it would be helpful to market participants for the Commission to expressly acknowledge as part of the final SEF rules that an FCM acting as Customer Agent is one of the accepted trading models for swaps traded on SEFs, particularly given the fact that many customers have already expressed a strong desire for these types of services.

In addition, we urge the Commission to consider the clarifications and amendments discussed below, particularly given their relevance to market participant costs, market efficiency and competition, elements that are crucial to the Commission's statutorily required analysis of the Proposed Rule. Under the Administrative Procedure Act, the Commission must examine relevant data and articulate a satisfactory explanation for its actions before promulgating a new rule.[5] In addition, the Commission has a statutory obligation under the Commodity Exchange Act to consider the costs and benefits of a proposed rule and specifically must examine such costs and benefits in light of, among other things, (a) the impact of the proposed rule on the efficiency, competitiveness and financial integrity of the relevant market and (b) sound risk management practices.[6] The Commission is required to assess the economic impact of a proposed rule, including quantifying the costs associated with the proposed rule where possible[7], and, in doing so, we urge the Commission to remain cognizant of the importance of the Proposed Rule in the evolution of the swaps market and the need to ensure that the Proposed Rule promotes efficiency, competition and capital formation while enabling customers to cost-effectively access the new risk mitigation elements of the market infrastructure for swaps, such as SEFs.

Distinction Between a Market Intermediary Acting as Customer Agent and a SEF

As a threshold matter, we urge the Commission to clarify that an FCM enabling customers to view and transact against available liquidity across multiple sources in a single location and acting as Customer Agent does not fall within the definition of a SEF or a designated contract market ("**DCM**") and does not trigger a requirement to register as a SEF or a DCM. In the role of Customer Agent, the FCM is aggregating and distributing information available from trading platforms registered with the Commission, information that is used by the customer to determine the best execution venue for a particular transaction. Once located, the specific transaction is executed on the relevant execution venue's platform, either by the customer directly or by the Customer Agent on behalf of the customer, either on a disclosed or undisclosed basis. Since the FCM is not providing a facility where execution occurs, no "facility for the trading or processing of swaps" within the meaning of Section 5h(a)(1) of the Commodity Exchange Act or "trading system or platform in which multiple participants have the ability to execute or trade swaps" within the meaning of Section 1(a)(50) of the Commodity Exchange Act should be considered to exist.[8] Instead, the FCM is only acting as an agent to a counterparty to a swap transaction.

An FCM acting as Customer Agent should not be required to register as a SEF or a DCM regardless of the number of SEFs for which the Customer Agent is a member or whether any price improvement options are also available to customers. Potential price improvement options offered by the Customer Agent could include locating other sources of available liquidity on the customer's behalf by internalizing customer orders or connecting fellow customers with one another. These types of services benefit customers while assisting FCMs in fulfilling their obligation to seek to obtain best execution of customer orders. Finally, with respect to services provided for swaps that are not subject to the mandatory execution requirement, we urge the Commission to clarify, as the SEC has already done in respect of the registration requirement in Section

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[5] See 5 U.S.C. § 706(2)(A); Business Roundtable v. S.E.C., No. 10-1305, 2011 WL 2936808, at *2 (D.C. Cir. July 22, 2011).

[6] See 7 U.S.C. § 19(a).

[7] Although there are no cases addressing the scope of Section 15(a) of the Commodity Exchange Act, the D.C. Circuit has interpreted similar statutory requirements under the Securities and Exchange Act of 1934 and the Investment Company Act of 1940 as requiring the SEC to rigorously examine the economic impact of rules promulgated under those statutes. See Business Roundtable, 2011 WL 2936808, at *5 (finding that the SEC's failure "to estimate and quantify the costs," combined with its failure to "claim estimating those costs was not possible," meant that it "neglected its statutory obligation to assess the economic consequences of its rule"); Chamber of Commerce of U.S. v. S.E.C., 412 F.3d 133, 142-44 (D.C. Cir. 2005) (observing that the SEC has the "statutory obligation to determine as best it can the economic implications of the rule it has proposed").

[8] See, for example, the Commission's focus on entities that engage in trade execution in the commentary to the Proposed Rule. Proposed Rule at 1219. We believe similar principles should apply for purposes of analyzing the term "designated contract market".

3D(a)(1) of the Securities Exchange Act of 1934,[9] that the registration requirement in Section 5h(a)(1) of the Commodity Exchange Act[10] only applies to facilities that meet the definition of a SEF and does not apply to facilities that allow for the trading of swaps that are not subject to the mandatory execution requirement.

A Market Intermediary Acting as Customer Agent is Entitled to Impartial Access

An important component of the Dodd-Frank Act's principles-based approach to the regulation of SEFs is the requirement that SEFs must provide market participants with impartial access to the market. This principle is codified in §37.202 of the Proposed Rule and is specifically applied to eligible contract participants and independent software vendors ("**ISVs**"). We urge the Commission to clarify that the provision of impartial access by a SEF includes not discriminating among SEF members on the basis of the types of trading engaged in by a SEF member or the services offered by a SEF member to its customers. As a result, SEFs should not be able to limit a SEF member's access to the market (including, without limitation, by requiring the execution of overly restrictive licensing and confidentiality agreements) simply due to the fact that such SEF member is acting as Customer Agent and aggregating prices so as to enable customers to view and transact against available liquidity across multiple sources in a single location. This outcome is consistent with the goals of the Dodd-Frank Act for providing customer access, promoting competition and ensuring best execution.

The Commission's specific inclusion of ISVs indicates that the Commission believes entities performing functions such as price aggregation and smart order routing should also receive the benefit of impartial access to SEFs.[11] We request the Commission confirm the view expressed by Chairman Gensler at the September 14th meeting that, consistent with the goals of the Dodd-Frank Act for providing customer access and promoting competition, a SEF member acting as Customer Agent should be treated comparably to ISVs for purposes of the impartial access requirement. We note the Commission's commentary in the Proposed Rule that the purpose of the impartial access requirements is to prevent a SEF from using discriminatory access requirements as a competitive tool against certain participants and request that the Commission equally apply to SEFs its commentary in the proposed rule on Core Principles and Other Requirements for Designated Contract Markets that "[a]ccess to a DCM should be based on the financial and operational soundness of a participant, rather than discriminatory or other improper motives."[12] Finally, we urge the Commission to specifically consider, as part of its statutorily required analysis of the Proposed Rule, the economic effects on customers if SEFs are permitted to discriminate against particular trading models under proposed §37.202 and prevent a customer from accessing liquidity in a manner that may be the most advantageous and cost-effective alternative for that customer. Preventing SEF members from acting as a Customer Agent in the manner described above will result in significant financial, technological and operational costs for customers transacting in swaps and may limit the benefits of the new risk mitigation elements of the market framework for swaps.

In connection with the above, the Commission should ensure that market participants have a meaningful opportunity to provide comments on SEF registration applications and subsequent changes to the rules of a SEF. Consistent with current Commission practice with respect to derivatives clearing organization applications, we believe the Commission should specifically include reference to a public comment period in proposed §37.3 (*Requirements for registration*). In addition, we urge the Commission to ensure that the requirements in newly effective §40.5 (*Voluntary submission of rules for Commission review and approval*) and §40.6 (*Self-certification of rules*) for the relevant registered entity to post on its website a copy of any submission to the Commission regarding rule changes are applied in a manner that enables market participants to have adequate notice and the ability to provide feedback on changes to the rules of a SEF. Given the important role of SEFs in the rapidly evolving swaps market and the commercial incentives of each SEF to consolidate as much liquidity as possible on their specific platform, public

[9] See Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10948, 10949 (February 28, 2011).
[10] Section 5h(a)(1) specifies that no person may operate a facility for the trading or processing of swaps unless the facility is registered as a SEF or as a designated contract market.
[11] See Proposed Rule at 1222.
[12] See Core Principles and Other Requirements for Designated Contract Markets, 75 Fed. Reg. 80572, 80579 (December 22, 2010). The commentary to the Proposed Rule contains similar language but is characterized as only an example of a permitted method for determining access to a SEF (Proposed Rule at 1223).

comment may be a crucial resource for the Commission, particularly in key areas, such as access, membership and governance.

Application of the Existing Regulatory Regime

In the context of analyzing the impact of the Proposed Rule, we urge the Commission to remain cognizant of the fact that SEF membership will not be limited to entities that are required to register with the Commission, making it imperative that the Commission ensure that market intermediaries registered with the Commission, such as FCMs and swap dealers, acting in a Customer Agent capacity are not held to a higher standard than, and therefore are not at a competitive disadvantage compared to, other SEF participants. As part of the Commission's statutorily required analysis of the Proposed Rule's potential effects on competition, we urge the Commission to consider the potential impact of the many components of the existing FCM regime and the proposed swap dealer regime on the ability of market intermediaries to act as a Customer Agent, including capital requirements and any rules that the Commission decides to adopt that would impose additional controls and procedures on registered entities that access SEFs.

In connection with the above and with the expansion of the FCM regime to swaps more generally, we also believe it is necessary for the Commission to consider the various different trading models that FCMs may engage in and the corresponding services offered to customers designed to maximize liquidity and achieve best execution. Given the lack of vertical integration between execution and clearing venues for swaps, more than one registered entity may be involved on each side of a specific transaction before it is successfully cleared and it is possible that a specific FCM will only be involved in a Customer Agent role. We believe that the Commission's regulatory regime should recognize when a registered entity is acting as Customer Agent and, regardless of whether the entity is also registered with the Commission in other capacities such as an FCM or swap dealer, apply rules that are designed to facilitate access to liquidity and achieve best execution for the customer. Specifically, we believe the Commission should consider the following:

- Given that certain customers have preferences regarding anonymity when routing and executing requests for quotes and orders, we believe that the Commission should permit an FCM acting in the role of Customer Agent the flexibility to agree with the counterparties to the trade (a) timings around any disclosure of the customer's identity[13] and (b) the allocation of responsibility for satisfying certain regulatory requirements, such as trading documentation and reporting. We note that the possibility of a Customer Agent executing on behalf of an undisclosed principal potentially affects a variety of Commission proposed rules, such as the Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants[14], as identities of the counterparties to the transaction might not be disclosed to each other at the time of execution. As a result, it may be necessary for the Customer Agent to have a role in fulfilling these regulatory requirements on behalf of the customer and/or other counterparty.

- With the aim of providing customers with the best execution possible, a certain amount of flexibility should be afforded Customer Agents regarding the types of services offered to customers.

  For example, we urge the Commission to follow the SEC's proposed SEF rules in allowing customers the flexibility to select the number of participants from whom to request a quote, particularly for products where there is limited available liquidity. We also request the Commission clarify that where requests for quotes are required to be submitted to more than one market participant, such submissions can be allocated across multiple SEFs and, depending on the quotes received, a customer or its Customer Agent can achieve best execution by partially filling several of those received quotes rather than being forced to select only one.

[13] Pre-trade disclosure of the customer's identity should not be required in order for the FCM to be acting in an agency capacity as Customer Agent on behalf of the customer. Instead, the Commission should not disturb the contractual agreement reached between the parties to the transaction regarding the proper allocation of responsibility.

[14] Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 6715 (February 8, 2011).

Customer Agents should also be permitted to offer customers price improvement options prior to executing on a SEF, such as locating other sources of available liquidity on the customer's behalf by internalizing customer orders or connecting fellow customers with one another, as long as best execution is achieved and all transactions are executed on a SEF and reported in real-time. Where a matched order results from these types of activities, we do not believe that a Customer Agent should be subject to a minimum pause[15] or be considered to be engaging in an abusive trading practice subject to prohibition under proposed §37.203(a), as long as the Customer Agent is acting with the intent of achieving execution at the most favorable terms reasonably available for the customer under the circumstances (i.e. best execution). In this context, we urge the Commission to acknowledge the time and price discretion permitted to be exercised upon customer request by intermediaries in other markets regulated by the Commission and to ensure that such flexibility is also available to swaps customers.

Finally, we reiterate our concern regarding the Commission's proposed rules on the Implementation of Conflicts of Interest Policies and Procedures for FCMs, introducing brokers, swap dealers and major swap participants.[16] We urge the Commission to consider the economic benefits and efficiencies achieved by enabling an FCM to offer a full-service package of execution, clearing and reporting services to customers that recognize the broader relationship synergies that may exist. Requiring the establishment of disproportionately onerous barriers between trading and clearing services would jeopardize the ability of registered entities to efficiently and effectively manage customer accounts to the detriment of customers.

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UBS is grateful for the open manner in which the Commission has addressed issues arising in connection with the implementation of the SEF rules. We welcome the opportunity to provide additional information regarding our views on this topic, as well as any other issues related to the Dodd-Frank Act, and urge the Commission to continue working with the SEC to arrive at a consistent regulatory framework for SEFs.

Respectfully submitted,

David Kelly
Managing Director

Paul Hamill
Executive Director

[15] See proposed §37.9.
[16] See our earlier comment letter on conflicts of interest submitted to the Commission on January 18, 2011.