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February 13, 2012

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

Re: (RIN Number 3038–AD18) Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade

Dear Mr. Stawick:

FX Alliance Inc. ("FXall") welcomes the opportunity to submit its comments on RIN number 3038–AD18, Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade (the "Proposed Rule")[1] as proposed by the Commodity Futures Trading Commission (the "Commission") to establish a process for making swaps available to trade, as referenced in section 723(a)(3) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "DFA").[2]

## I. FXall BACKGROUND

FXall is a public company listed on the New York Stock Exchange. FXall operates an electronic trading system for foreign exchange ("FX") spot and various FX derivative instruments that serves over 1,000 institutions globally ranging from industrial companies, asset managers, governments, international agencies and other financial institutions. FXall facilitates competitive pricing, internal trading controls, risk management and a granular audit trail. We have succeeded in improving efficiency and transparency and reducing risk for an important FX market to the U.S. and the world economy. FXall's peak daily volumes exceed $125 billion in notional contract value. Today, a large part of the FX market is traded on electronic systems such as FXall – including less liquid or infrequently traded instruments customized by end users to meet their specific commercial requirements. FXall is presently operating as an exempt board of trade and intends to register one of its trading platforms as a SEF for those FX contracts that must be executed on a SEF or if an FXall participant otherwise chooses to execute such FX contract on the SEF.

## II. EXECUTIVE SUMMARY

We support the goals of clearing swaps and moving the execution of them onto regulated platforms. However, we believe that the proposed method of determining which swaps are made available to trade (the "MAT determination") and therefore required to be executed on a swap execution facility ("SEF") or designated contract market ("DCM") (if the swap is subject to

[1] Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA, 76 Fed. Reg. 58186 (published Sept. 20, 2011).

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010).

mandatory clearing) will result in a burdensome process that creates unintended consequences, market confusion and uncertainty. Market participants as well as SEFs and DCMs must know in clear and certain terms which swaps are required to be executed on a SEF or DCM. We believe this can only be achieved if the Commission made the final MAT determinations based on objective standards instead of a multitude of SEFs and DCMs making these determinations themselves. These matters are further complicated because the Commission has proposed to require all "economically equivalent" swaps to the MAT determined swap to be traded on a SEF or DCM. The Proposed Rule does not adequately define what economically equivalent means, how these determinations will be made, or how market participants will know which swaps are economically equivalent. In order to bring efficiency and regularity to this process, and in order to avoid any conflicts of interest in the MAT determination process, we urge the Commission to determine under objective standards and with public input which swaps are made available to trade.

Regardless of whether or not the Commission makes MAT determinations, though, we believe that the Commission should modify the MAT determination process in several ways in order to protect the liquidity of the swaps market. Specifically, we recommend that the Commission:

(a) only begin making (or accepting) MAT determinations after swap data repositories ("SDRs") have collected at least 6-12 months of data[3] regarding the entire market so that MAT determinations can be based on objective standards of liquidity to be enumerated in a final MAT rule, and using a sufficient amount of collected and reported data, including the factors laid out in the Proposed Rule;

(b) require for the same 6-12 month period any swap subject to mandatory clearing to be traded on a registered SEF or DCM, but permit such swaps to be executed as "Permitted Transactions" under the SEF rule (*i.e.*, not require them to be traded at this stage on the "mandatory" side of the SEF designed for "Required Transactions")

(c) permit the public to comment on MAT determinations for a reasonable period of time, at least 30 days, because these determinations will have a significant impact on the market and all market participants; and

(d) continue, as proposed, to separate MAT determinations from mandatory clearing determinations because they require different types of analysis and, as history has shown, a contract may be listed for clearing by a DCO with little or no liquidity.

## III. THE COMMISSION SHOULD MODIFY THE MAT PROCESS IN ORDER TO PROTECT LIQUIDITY

MAT determinations will have a significant effect on all market participants by forcing all trading in a given clearable product (and its economic equivalents) to occur on a SEF or DCM.[4] For

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[3] This would also be at least 6-12 months from the date of effectiveness of the regulatory reporting rules. *See* Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2136, 2194-96 (Jan. 13, 2012).

[4] The consequence of MAT designation is twofold: first, the contract that is MAT must trade on a SEF or a DCM (*i.e.*, it cannot be executed over-the-counter between the parties unless an end user exemption applies); and, second, if such contract was traded on the "permitted transaction" (as defined in the proposed SEF rule) side of the SEF platform (*e.g.*, where RFQ to one or some other permissive method of trading on a SEF is allowed), such contract will need to be moved to the "required transaction" side of the SEF platform, where the contract can only be traded via the restrictive RFQ to at least 5 system or the order book. Therefore, if there was a robust and liquid market in RFQ to one contracts on a "permissive" side of the SEFs, after the MAT is made, these types of contracts may suffer in

even relatively liquid products, a MAT determination will change the economics of the swap's trading because additional costs will be incurred (*e.g.*, restrictive execution methods, changed pricing, and new fees). For less liquid products, MAT determinations have the potential to virtually eliminate liquidity in an instrument if market participants are disadvantaged by the prescribed SEF execution methods and/or transparency requirements. Further, a broad scope to the determination of "economic equivalent" swaps could ensnare many vulnerable illiquid or sporadic swaps in the MAT determination. We therefore urge the Commission to consider the methods of execution which will be permissible under the final SEF rule when creating a final rule regarding the MAT process, which will dictate the types of instruments subject to mandatory trading, and *vice versa*. The less prescriptive the rules regarding SEF execution methods are, the more willing participants will be to use those methods of execution, particularly for less liquid swaps. As a result, MAT determinations could be made for a wider variety of instruments without harming liquidity.

As currently written, however, the requirements to send any RFQ to at least 5 recipients and to delay certain trades for 15 seconds,[5] combined with the possible requirement to link an order book and RFQ system for "Required Transactions," could have detrimental effects on the liquidity of many less liquid instruments. Regardless of whether the Commission makes MAT determinations itself or requires SEFs and DCMs to make MAT determinations, therefore, we urge the Commission to modify the Proposed Rule in the following ways:

a. <u>The Requirement to Trade Swaps that are MAT on a Restricted RFQ or Order Book Should be Delayed</u>

Because MAT determinations could have such a significant impact on the market generally and the liquidity of many swaps, we believe that the Commission should ensure these decisions will be based on an informed analysis of a sufficient amount of market-wide data, not guesses, and it will take time to acquire and analyze this data. As explained further below, SEFs and DCMs will not have access to market-wide data, so we believe that it makes sense for the Commission to make these determinations. Regardless of who makes MAT determinations, however, we note that there is not a substantial amount of standardized useful data for many types of swaps, and this will not be available until after regulatory reporting becomes mandatory, which is currently projected to begin in July of 2012.[6]

We therefore believe that the Commission should only begin making (or accepting) MAT determinations after swap data repositories ("SDRs") have collected at least 6-12 months of data regarding the entire market rather than relying on only the activity on an individual SEF or DCM. At that time, we believe the Commission should phase in the MAT determinations in the same way that the regulatory and real-time reporting requirements will be phased in (*i.e.*, by type of participant and asset class).[7] In this way, as the DFA rules take effect, market participants will trade certain swaps on platforms where it makes economic sense to do so. The Commission can then analyze this data for making final MAT determinations. This is preferable

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liquidity if they are not amenable to the restrictive RFQ or limit order book trading. *See* Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. at 1241.

[5] *See* Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1214.

[6] *See* Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2136, 2194-96 (Jan. 13, 2012).

[7] *See* Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. at 2194-96.

to having market participants' trading decisions being controlled by the potential market perversions of bad MAT determinations.

Importantly, however, we support the goals of the DFA and do not wish to unnecessarily delay the benefits that it will provide through increased transparency, electronic execution and reduction of systemic risk. We therefore believe that Commission-designated swaps should be mandatorily cleared and traded on electronic platforms as soon as possible, but do not believe they should be subject to strict requirements regarding the method of execution at an early stage. Doing so could win the battle only to lose the war if instruments that are not suited for certain methods of execution become subject to a MAT determination which was based on insufficient data.

We therefore propose that the Commission initially require any swap subject to mandatory clearing to be traded on a registered SEF or DCM, but permit such swaps to be executed as "Permitted Transactions" under the SEF rule (*i.e.*, not require them to be traded at this stage on the "mandatory" side of the SEFs designed for "Required Transactions").[8] In this way, the Commission would protect the liquidity of relatively illiquid swaps (and the market participants who rely on entering into those swaps), while obtaining transparency, regulatory data, and reducing systemic risk.

b. MAT Determinations Should be Subject to Public Comment

Under the Proposed Rule, MAT determinations would only be subject to public comment if: (i) the determination is submitted under Part 40.6; and (ii) the Commission issues a stay within 10 days of submission.[9] We believe that these important determinations should always be subject to public comment, and that providing an opportunity for public comment is all the more critical if SEFs and DCMs, rather than the Commission, make the MAT determinations. Public comment would provide an important check on the MAT determinations to ensure that they are made accurately and not for inappropriate reasons.

We note that the determination that a swap should be subject to mandatory clearing will always be subject to public comment. Before a contract will be subject to mandatory clearing determination, a derivatives clearing organization ("DCO") must file a submission with the Commission (or the Commission can make a determination on its own volition), which will be subject to a 30-day comment period.[10] The Commission will then have 90 days to review that submission, and has broad discretion to approve or deny such submission.[11] This will therefore involve a sufficiently lengthy process, and such determinations will be mandatorily subject to public comment.

It is unclear why the process for making MAT determinations should differ in such significant respects from the clearing determinations given that as explained below clearing and execution of swaps are related but separate concepts and processes. We believe that MAT

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[8] *See* Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1214, 1241 (to be codified at 17 C.F.R. § 37.9(c)) (Jan. 7, 2011).

[9] *See* Proposed Rule, 76 Fed. Reg. at 77731; 17 C.F.R. §§ 40.5, 40.6.

[10] *See* Process for Review of Swaps for Mandatory Clearing, 76 Fed. Reg. 44464, 44473 (to be codified at 17 C.F.R. § 39.5) (July 26, 2011).

[11] *See id.* (to be codified at 17 C.F.R. § 39.5(d)(5).

determinations are at least as important as mandatory clearing determinations because MAT determinations may have a direct impact on a contract's liquidity. Therefore, we believe that all MAT determinations should be subject to public comment of at least 30 days.

c. MAT Determinations Should be Independent from Mandatory Clearing Determinations

At the roundtable relating to the Proposed Rule held on January 30, 2012, many panelists discussed whether or not MAT determinations should be joined together with mandatory clearing determinations. As we stated at the roundtable, we believe it would be more efficient to group these determinations together if it were possible, but we also believe that MAT determinations will necessarily be more granular than mandatory clearing determinations, and will involve different considerations.

While liquidity is one factor in making a mandatory clearing determination,[12] these determinations will also be largely based on whether the swaps are standardized enough to be cleared.[13] In contrast, we believe that MAT determinations should be based primarily on an analysis of the effect that mandatory SEF or DCM execution will have on the liquidity of the product (as proposed[14]), which will require a more granular analysis. For example, while a non-deliverable forward ("NDF") on U.S. dollars to Pakistan Rupees could be standardized enough to be cleared, it may trade so infrequently and by so few market participants that the transparency requirements of mandatory SEF execution could effectively eliminate the benefit of entering into such transactions and kill liquidity in the product. Similarly, while it may be possible to clear NDFs regardless of the tenor or maturity date, a market participant entering into an NDF with odd maturity dates[15] may require flexibility in the method of execution used because that particular instrument trades so infrequently (*i.e.*, to be able to trade on the "permissive" side of the SEF as opposed to the "mandatory" side of the SEF that is exclusively dedicated to "Required Transactions").

We therefore believe that although liquidity is not critical to a determination that a swap should be subject to mandatory clearing, empirically supported data showing sufficient liquidity should be critical to any MAT determination. As a result, we urge the Commission to require these determinations to be made separately.

## IV. THE COMMISSION SHOULD MAKE THE FINAL DETERMINATION ON WHEN A SWAP IS MADE AVAILABLE TO TRADE IN ORDER TO ENSURE THAT MAT DETERMINATIONS ARE APPROPRIATE AND INFORMED

As we stated in our comment letter in response to the Commission's proposed compliance and implementation schedule,[16] we believe that the Commission, not SEFs and/or DCMs, should make the final determination when a swap is made available to trade. The Commission opted

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[12] *See* Process for Review of Swaps for Mandatory Clearing, 76 Fed. Reg. at 44473(to be codified at 17 C.F.R. § 39.5(b)(3)(ii)(A)).

[13] *See id.* (to be codified at 17 C.F.R. § 39.5(b)(3)(ii)(B)).

[14] *See* Proposed Rule, 76 Fed. Reg. at 77732.

[15] Each business day of the year is a potential maturity date, resulting in the possibility of thousands of MAT determinations for NDFs.

[16] *See* Letter from FXall to the Commission, 9-10 (Nov. 4, 2011).

not to do so in the Proposed Rule, stating only that the proposed approach, "whereby a DCM or SEF—the facilities that may be most familiar with the trading of these swaps—has responsibility to make a swap available to trade, while the Commission has a role in reviewing such determination," is a "balanced approach."[17]

We respectfully disagree with this approach because we believe that it will result in a burdensome process that creates market confusion and uncertainty. While individual SEFs will be familiar with the trading of swaps, particularly those on their market, they may not have the expertise or information to accurately calculate the effect that a MAT determination will have on the market overall or on various types of participants. Indeed, while SEFs and DCMs will have access to trading data for the swaps executed on their platforms, they will not likely have access to market-wide or aggregate data on every swap in the same "economically equivalent" category. We believe that MAT determinations should be based on yet to be determined objective standards of liquidity, that must be enumerated in a final MAT rule, and market-wide trading patterns in order to ensure that MAT determinations do not have unintended effects.[18] Therefore, we do not believe that SEFs and DCMs will be well-suited to make the final MAT determinations, albeit (as is the case with DCOs for the clearing determination) SEFs and DCMs should make the applications to the Commission with requests to designate specific contracts as MAT.

Moreover, we also do not believe that the proposed approach to determining which swaps are MAT will result in balanced results in practice. First, each SEF or DCM will likely give different weight to each of the proposed relevant factors, causing the proposed test to be applied differently. Second, as Commissioner Sommers noted during her remarks on the Proposed Rule, the Commission's ability to review MAT determinations is so limited under Part 40 that MAT determinations submitted to the Commission are not likely to be disapproved. For example, if a MAT determination is submitted pursuant to Rule 40.6, the Commission will only have 10 days to review it. The Commission will have 30 days to review a submission if it is submitted pursuant to Rule 40.5 (we believe there will be few of these). In either case, this is still not a significant amount of time, especially if hundreds or thousands of MAT determinations are submitted at the same time by multiple SEFs. Of particular significance, the Commission may only decline to approve the submission if it is inconsistent or appears to be inconsistent with the CEA or the Commission's regulations.[19] Given the lack of a need to meet any specific mandatory objective criteria in the Proposed Rule, this does not give the Commission sufficient ability to disapprove of a MAT determination, particularly if mandatory SEF or DCM execution will harm liquidity in the product.

Additionally, we believe that permitting SEFs and DCMs to have broad latitude (if not unfettered discretion) in making MAT determinations could cause MAT determinations to be made for anti-

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[17] *See* Proposed Rule, 76 Fed. Reg. at 77731.

[18] For example, imagine that a product is commonly traded between dealers using an order book on one platform, but other participants such as end-users commonly use another platform because it provides more ability to customize the swaps through, for example, one to one RFQs. If the platform used by dealers sees a large amount of liquidity and standardization on its platform, it may determine that the product should be MAT. However, a MAT determination may kill liquidity in that product for all participants who need to customize their trades. The first order book platform would have no ability to predict this outcome if it did not have access to market-wide data, and further, has no incentive to consider the effect on competitors and various types of participants. However, the Commission does have this obligation.

[19] *See* Proposed Rule, 76 Fed. Reg. at 77731.

competitive reasons. Specifically, once a swap becomes subject to mandatory clearing, a SEF or DCM could attempt to force all trading in that product onto its platform by making a MAT determination in order to secure a monopoly until other SEFs or DCMs are able to trade the contract. We note that the Commission proposed to delay the mandatory trading requirement for 30 days following any MAT determination (or until the compliance date for the clearing requirement).[20] We urge the Commission to extend this delay to at least 90 days in order to enable other SEFs and DCMs to be able to trade the product if they choose to do so. However, even if a 90-day delay eliminates the ability for any SEF or DCM to create a monopoly, some SEFs and DCMs may still be incentivized to make MAT determinations in order to drive up volume artificially and secure more transaction fees on their platform, even if these contracts are illiquid, especially as first movers to capture client connections and market share (which may cause reduced liquidity as we discuss in footnote 3 and Section III of this letter).

The potential for misuse of this system would be increased by the complications surrounding the requirement to trade all "economically equivalent" swaps on a SEF or DCM.[21] SEFs need to know with certainty which swaps are MAT and which are economically equivalent so that they do not permit participants to trade them on the wrong side of the platform. This will likely prove to be difficult because the MAT determinations and (theoretically) the economically equivalent determinations will be made by multiple entities (*i.e.*, SEFs and DCMs) as opposed to one central body, such as the Commission. It may prove to be even more difficult, though, because each SEF or DCM may have a different opinion as to which swaps are economically equivalent to a given swap. Furthermore, these determinations may change over time and liquidity may move from one SEF or DCM to another.

The implications could be grave if SEFs, DCMs, and market participants do not know with precision which swaps are MAT. SEFs, for example, could be subject to enforcement actions if they permit a "Required Transaction" to trade as a "Permitted Transaction." Additionally, the Proposed Rule may present more opportunity for SEFs and DCMs to use the MAT system to their competitive advantage if they can discreetly force swaps onto their platform through economic equivalency determinations, especially if such determinations are so loosely defined and not subject to public notice.[22] We do not believe that the Commission should create rules which could create significant confusion for market participants (and other SEFs). This is further complicated by the fact that the Proposed Rule does not provide the procedure for removing the MAT determination from a swap when its liquidity drops below a certain point. We refer to this as a process to "de-MAT" a swap.

As we stated at the January 30, 2012 roundtable, we believe that it will be important to have a "de-MAT" process in place. Particularly if the de-MAT application is made by a SEF other than the one that filed for the MAT determination in the first place. We believe that the de-MAT

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[20] *See* Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA, 76 Fed. Reg. 58186, 58195 (to be codified at 17 C.F.R. § 38.11(a)) (Sept. 20, 2011).

[21] *See* Proposed Rule, 76 Fed. Reg. at 77732; Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1214, 1241 (Jan. 7, 2011).

[22] The Commission requested comment on whether SEFs and DCMs should be required to submit economically equivalent determinations pursuant to Part 40, *see* Proposed Rule, 76 Fed. Reg. at 77733, so it is unclear whether or not this will be required. In any event, however, submissions under Rules 40.5 and 40.6 provide for a certain amount of public *notice*, but no assurance that there will be an opportunity for public *comment*, as discussed above. We believe the economically equivalent determinations should be submitted together with the MAT submission and the final determination made by the Commission as discussed above.

process should be objective so that the process is transparent and impartial. We suggest a mirror image of our suggested MAT process with a 30 day public comment period. We also believe that the process should be controlled by the Commission with final determination by the Commission, instead of the multitude of SEFs and DCMs, because of the potential for confusion. Specifically, we believe that determining which swaps are subject to mandatory trading could become undesirably complicated if certain swaps go back and forth between being MAT and not MAT because SEFs and DCMs are permitted to play "tug-of-war" over the MAT designation.

## V. CONCLUSION

For all of these reasons, we believe it would be best if the ultimate and affirmative determination as to which swaps are MAT and which swaps are economically equivalent to others were made by the Commission and that it should modify the process for determining that a swap is made available to trade in several ways in order to preserve liquidity. Further, a sufficient time period should pass after the "must clear" designations and regulatory reporting have taken effect in order to observe liquidity and other MAT factors in practice before making the MAT determination. Otherwise, these important determinations may: (i) be based on a limited amount of data instead of market-wide data; (ii) be more difficult to follow because the determinations will be made by several entities instead of a central source; (iii) be implemented in an unorganized and inefficient manner; and (iv) foster abuses of the system.

FXall appreciates the opportunity to provide the Commission with its perspective on the Proposed Rule. If you have any questions regarding our comments, please contact the undersigned at (202) 261-6538.

Respectfully submitted,

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