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March 15, 2019

Honorable Commissioners
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st St NW
Washington, DC 20581

Re: Swap Execution Facilities and Trade Execution Requirement, RIN# 2028-AE25

Dear Commissioners,

On behalf of more than 500,000 members and supporters of Public Citizen, we offer the following comment on the Commodity Futures Trading Commission (CFTC) proposed rule regarding “swap executive facilities and trade execution requirement,” RIN# 2028-AE25.

In general, we oppose this proposal because it will raise costs of swap trading.

The CFTC’s proposal addresses the basic operation of the swap execution facility, or SEF. A SEF is a platform for trading financial derivatives. The SEF provides pre-trade information, akin to the posted prices on an item in a grocery store. SEFs are regulated both by the CFTC and the Securities and Exchange Commission. The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act provided for SEFs as a means of promoting transparency and pricing competition in this complex area of trading. The financial crash of 2008, to which Congress responded with Dodd-Frank’s reforms, revealed not only that financial derivatives exacerbated the credit risks they were advertised as containing, but also that regulators and participants knew little about the dimensions of these market. For example, purveyors sold credit default swaps as a type of bond insurance. Yet many buyers didn’t own the underlying bonds. And when the bonds defaulted, regulators were caught off guard about the liabilities of certain purveyors, such as AIG. Finally, the crash revealed that many participants suffered abusive pricing for derivatives as the market lacked an auction or other pricing transparency mechanism so that buyers could “shop” in discriminatory ways.

The proposal put forward by the CFTC would effectively nullify the requirement that swaps be traded following a request for a quote from at least three market participants. This conflicts with the statutory

mandate under Dodd-Frank that requires bids and offers by “multiple participants.”¹ The statute also requires SEFs to establish rules that forbids discrimination among market participants. Discrimination in swaps markets can lead to domination by the largest banks, which already command an outsized share of transactions.

The current CFTC proposal is a “solution” without a problem—it ignores available information that the current system is thriving. Instead, the proposal simply hypothesizes that more flexible methods of trading will be beneficial.

The SEF’s launched under CFTC rules have worked to increase transparency, lowering prices for users. One study from economists at the CFTC found that credit default swap (CDS) index trade costs have fallen with the use of SEFs.² Another study found that competition has increased for interest rate swaps, leading to a reduction in costs.³ A third study found better prices in the dealer-to-customer market.⁴

The swap execution regulations that currently exist have led to greater competition, liquidity, price transparency and savings for users. By returning the system that prevailed before this reform, where most transactions were conducted by telephone between a relatively few number of traders, expenses would rise.

We oppose this proposal.

For questions, please contact Bartlett Naylor at bnaylor@citizen.org

Sincerely,

Public Citizen

¹ 7 U.S.C. 1a(50).

² Lynn Riggs, Esen Onur, David Reiffen, Haoxiang Zhu *Swap Trading after Dodd-Frank: Evidence from Index CDS*, CFTC (Jan. 26, 2018) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3047284

³ Evangelos Benos, Richard Payne & Michalis Vasios, *Centralized trading, transparency and interest rate swap market liquidity: evidence from the implementation of the Dodd-Frank Act*, BANK OF ENGLAND, (May 2018) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2716066

⁴ Pierre Collin-Dufresne, Benjamin Junge & Anders B. Trolle, *Market Structure and Transaction Costs of Index CDS*. SWISS FINANCE INSTITUTE (Sept. 12, 2017) https://www.eurofidai.org/sites/default/files/pdf/parismeeting/2016/Collin_Dufresne_2016.pdf