

March 2, 2020

Mr. Christopher Kirkpatrick
Secretary of the Commission
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Post-Trade Name Give-Up on Swap Execution Facilities: Proposed Rule – RIN 3038-AE79, 84 Fed. Reg. 72262 (Dec. 31, 2019)

Dear Mr. Kirkpatrick:

JPMorgan Chase & Co. and its affiliates, on behalf of its Corporate and Investment Bank (collectively, “J.P. Morgan”)¹ appreciate the opportunity to provide the Commodity Futures Trading Commission (the “Commission” or “CFTC”) with comments on the Proposed Rule to ban post-trade name give-up (“PTNGU”) for swaps executed anonymously on a swap execution facility (“SEF”) that are intended to be cleared. We submit this letter because we are deeply concerned that the proposed PTNGU ban risks significantly diminishing market liquidity and quality for made available to trade (“MAT”) swaps and related products—a risk that the Commission should not take, particularly considering the high quality of the swap market structure it has created post-Dodd-Frank and especially at a time when the market will be undertaking a tremendous transition away from the London Inter-bank Offered Rate. Our views are informed by the following considerations:

- **The Current MAT Swap Market Structure Is Well-Tailored to the Unique Characteristics of MAT Swaps.** The Commission has tailored the existing market structure for MAT swaps to reflect the unique characteristics of those swaps, including in particular the episodic nature of liquidity and importance of the role played by well-capitalized dealers who can assume larger amounts of risk from customers and manage that risk over time.
- **The Current Swaps Market Structure Works Very Well and Does Not Exhibit a Need For Structural Change.** As there is a well-functioning market, the Commission should not ban a practice in widespread use, such as PTNGU, on the assumption that it violates impartial access simply because some market participants prefer an alternative protocol. The same logic could be used to support a ban on fully anonymous SEFs, considering that most market participants currently choose not to use them.
- **Banning PTNGU Would Create Significant Risks for the Market.** PTNGU is neither an “ancillary post-trade protocol”² nor an access restriction, and it has many legitimate uses beyond managing counterparty credit risk: it helps dealers predict their hedging costs and tailor their pricing on request-for-quote (“RFQ”) SEFs; it is integral to the workup trading

¹ The above-captioned proposed rule (the “Proposed Rule”) would have a disproportionate effect on our registered swap dealers, J.P. Morgan Securities LLC, JPMorgan Chase Bank, N.A., and J.P. Morgan Securities PLC.

² Proposed Rule, 84 Fed. Reg. at 72265.

protocol on central limit order book (“CLOB”) SEFs; and it supports effective execution of package transactions. Banning PTNGU would in turn risk worsening pricing and liquidity dealers are able to offer buy-side and end user customers on RFQ SEFs and for non-MAT swaps hedged over CLOB SEFs, impairing workups, and making it difficult to execute package transactions.

- **There Is No Evidence, But There Is Reason to Doubt, That Banning PTNGU Would Attract Material Additional Liquidity to CLOBs or Improve Overall Market Quality.** CLOB SEFs offering fully anonymous protocols continue to be available for trading today, but they attract almost no activity, even from those who advocate for banning PTNGU. These advocates merely speculate that banning PTNGU would change this dynamic but point to no relevant evidence for their claims. There also are several reasons to doubt their claims. First, dealers use CLOB SEFs to hedge, not to make markets, so it is unclear what liquidity would exist in CLOB SEFs to induce others to use them. Second, as noted above, a PTNGU ban would impair workups and package transactions, causing dealers possibly to pull back from CLOB SEFs and from the market overall. Third, today RFQ SEFs generally provide better prices and more efficient execution of larger size trades than CLOB SEFs,³ so it is unclear why buy-side customers would migrate to CLOB SEFs. Fourth, even if banning PTNGU led alternative liquidity providers to join CLOB SEFs, experience in other markets such as Treasuries leaves us with doubts that this development would improve overall market quality. Finally, commercial end users, who per Congressional mandate do not trade cleared swaps on SEFs, will be harmed because of reduced dealer liquidity available to them.
- **Banning PTNGU Is Not Mandated by Nor Consistent with the Commodity Exchange Act (“CEA”).** For the reasons noted above, banning PTNGU is unlikely to increase trading on SEFs or competition *within* SEFs, but by definition it would reduce competition *among* SEFs, which the CEA mandates the Commission to promote. A PTNGU ban also is not necessary to preserve privacy of swap data reporting or ensure impartial access. Moreover, a PTNGU ban would effectively restrict available methods of execution, an action that the Commission has only found authority to take in connection with MAT swaps, and in that case only to satisfy the multiple-to-multiple requirement in the statutory SEF definition and goals of promoting pre-trade price transparency and trading of swaps on SEFs, none of which would be accomplished by a PTNGU ban.
- **The Proposed Rule’s Cost-Benefit Analysis Is Not Sufficiently Robust and Further Study Is Required.** The Commission should carefully weigh the promised benefits of a PTNGU ban in terms of increased trading and competition on certain SEFs against the costs and risks of disrupting a market structure that works well today and one upon which other important markets rely. Proponents of changing the market structure must bear the burden of demonstrating why the Commission should believe that these promised benefits will

³ Collin-Dufresne, P., et al., *Market Structure and Transaction Costs of Index CDSs* (Sept. 12, 2017) (“Collin-Dufresne”) at 17, n. 30 (noting that, conditional on being capped, the average size of dealer-to-client trades is larger than the average size of dealer-to-dealer trades based on trading data gathered for two credit indices); *see also* Letter from Financial Services Forum, dated March 2, 2020 (“FSF Letter”), Appendix A.

materialize. To date, no directly relevant and meaningful data has been provided as proof. The Commission should take a much more data driven, deliberative, and cautious approach.

- **The Commission Should Consider Less Drastic Alternatives.** There are other alternatives that the Commission should consider before adopting any PTNGU ban.

I. The Current MAT Swap Market Structure Is Well-Tailored to the Unique Characteristics of MAT Swaps

Relative to traditional listed markets such as futures and equities, swap markets have many fewer participants, of which institutional participants constitute a far larger proportion, much lower trading frequency, far greater variation in tradeable products, and much larger typical trade sizes. These unique characteristics inform today's swap market structure.⁴

The CFTC has narrowly tailored this market such that MAT swaps can only trade via two execution methods—RFQ-to-three and CLOBs. This limitation is reflected in the way that customers trade, which is overwhelmingly with dealers through RFQ SEFs.⁵ Then dealers hedge their residual inventory risk through brokers who use CLOBs with PTNGU as well as mid-market matching and workup protocols. Even for bespoke swaps that are not MAT, dealers often hedge such swaps in the MAT swaps market (*e.g.*, a dealer trading a bespoke rate swap will hedge through a combination of swaps spreads and curve trades). Therefore, any damage to the MAT swaps market would have ripple effects on the broader swaps market.

The business model for most dealers in the swap market is straightforward. Dealers offer customers the ability to execute with immediacy and scale by taking the risk from customer trades onto their balance sheet and managing such accumulated risk over time. When providing balance sheet capacity in this way, dealers must allocate capital. A customer's trade is therefore priced based on a spread that is expected to achieve a given rate of return on that capital inclusive of the anticipated hedging cost to exit the risk taken on from the customer. Thus, a dealer's business model and competitiveness revolves around effectively managing hedging costs over time and pricing liquidity accordingly, which, as we will describe in Part III, is facilitated by PTNGU. We do not view trading on CLOB SEFs with PTNGU as an important

⁴ See, *e.g.*, Giancarlo, J. C., *Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank* (Jan. 29, 2015) at 12 (“[C]orporate end-users of swaps and other buy-side traders recognize the risk that, at any given time, a particular swaps market will not have sufficient liquidity to satisfy their need to acquire or dispose of swaps positions. As a result, these liquidity ‘taking’ counterparties turn to sell-side dealers and other market makers (*i.e.*, liquidity makers) with large balance sheets that are willing to take on the liquidity risk for a fee . . . Dealers price their customer trades based on the cost of hedging those trades in [dealer-to-dealer] markets.”).

⁵ See FSF Letter, Appendix A (providing that (1) more than 90% of credit default swaps (“CDS”) measured using notional are executed on RFQ SEFs; and (2) approximately 70% of interest rate swaps (“IRS”) measured using notional are executed on RFQ SEFs). Moreover, the proportion of CDS and IRS traded on RFQ SEFs has increased over time. See *id.* (providing that (1) an average of 91.3% of CDS measured using notional traded on RFQ SEFs in 2019 (as compared to 85.4% in 2014); and (2) an average of 73.9% and 70.7% of IRS measured using notional and DV01, respectively, traded on RFQ SEFs in 2019 (as compared to 42.5% and 43.5% in 2014)).

revenue generator, in and of itself; rather, trading on those CLOB SEFs helps us to provide liquidity to customers via RFQ and off-facility.

Liquidity providers in other, more liquid asset classes can have a somewhat different business model. These other liquidity providers, who are frequently hedge funds or principal or high frequency trading (“HFT”) firms⁶, provide liquidity in smaller size and hedge their positions quickly either in other venues or in correlated instruments. They tend to provide arbitrage liquidity, or informational intermediation, rather than traditional risk capital driven liquidity provision.

All types of intermediation and liquidity provision can be valuable at different times, for different products, and in different market environments. Swaps market liquidity and stability is optimized not by limiting protocol choice, but by encouraging a diverse set of market participants to engage in diverse execution protocols in order to allow the market to find the best place and method of execution for any given transaction.

II. The Current Swaps Market Structure Works Very Well and Does Not Exhibit a Need For Structural Change

The current swaps market structure provides for tight pricing and stable liquidity via RFQ platforms, which are supported by efficient hedging on CLOB SEFs. Indeed, academic studies and our own experience show that RFQ pricing is better than what is available in CLOB SEFs, including CLOB SEFs with PTNGU. For example, in one of the studies cited by Commissioner Berkovitz in his dissent against the Commission’s 2018 proposal to amend its SEF rules (the “2018 SEF Proposal”), the authors found that in the context of the CDS market, “prices customers obtained in the dealer-to-customer market through the RFQ system often were better than the prices that were available on the interdealer [CLOB].”⁷ The authors found this to be the case approximately 96% of the time and further noted that “the current market structure delivers very low transaction costs.”⁸ They conclude that their analysis finds “that clients who value immediacy could not get better execution by sending marketable orders to the interdealer market”⁹ and that, as a result, the current market structure “constitutes a viable alternative to all-to-all trading.”¹⁰

One reason that the market works so well today is that it allows for choice, such that both those seeking and those facilitating liquidity flows of all types can choose where and how to transact.

⁶ Javier, E., *Why PTF Matters to HFT (No, Really!)*, <https://www.cnbc.com/2015/07/16/why-ptf-matters-to-hft-no-really.html> (noting that the terms “HFT firms” and “principal trading firms” are both frequently used but are essentially interchangeable).

⁷ *Appendix 5—Dissenting Statement of Commissioner Dan M. Berkovitz, [SEFs] and Trade Execution Requirement*, 83 Fed. Reg. 61946 (Nov. 30, 2018) (discussing Collin-Dufresne).

⁸ Collin-Dufresne at 6.

⁹ *Id.* at 38.

¹⁰ *Id.* at 6.

Currently, customers have access to RFQ SEFs and CLOB SEFs offering both PTNGU and fully anonymous protocols. They have overwhelmingly chosen RFQ SEFs because the RFQ execution method provides superior pricing, the ability to move large amounts of risk immediately without significant price impact, and the ability to leverage dealer relationships during periods of market stress, when well-capitalized dealers can hold onto risk overnight or longer until they find a suitable exit. This preference is further explained in the above referenced academic study, which notes that “a limit order book arguably works best when trading is continuous” whereas for the swaps market, “it is not necessarily optimal [as] trading is more episodic.”¹¹

Further, there is no evidence to support the notion that PTNGU is what makes trading on fully anonymous CLOB SEFs unattractive given that customers have the ability today, but still choose not to, trade in them. Customers simply prefer RFQ SEFs for the reasons laid out above. There is also no evidence to support nor reason to believe that eliminating PTNGU will reverse this preference.

III. Banning PTNGU Would Create Significant Risks for the Market

The Proposed Rule as well as comments in opposition of the practice of PTNGU are based on a misconception that PTNGU’s only utility is to mitigate bilateral credit risk in the uncleared swap markets, which leads the Commission to question whether PTNGU has any *bona fide* role to play in the cleared swaps markets. In reality, in a market with only two narrowly prescribed permissible methods of execution, RFQ and CLOBs, PTNGU directly supports the RFQ market as it helps a dealer manage its market risk and is integral to the workup trading protocol and effective execution of package transactions, as described below. While, on the one hand, we know that PTNGU is a key part of the current swaps market, which is highly functioning, on the other hand, we do not know what will happen if the practice of PTNGU is prohibited. The Commission must weigh the purported benefits of a PTNGU ban against the potential risks, which are significant.

A. Banning PTNGU Would Worsen Pricing and Liquidity on RFQ SEFs and In Non-MAT Swaps Hedged Over CLOB SEFs

PTNGU is a hybrid protocol that blends the streaming attributes of anonymous CLOBs with non-anonymous execution attributes of RFQ in a way that meets the unique needs of and promotes engagement by dealers in the swaps market, just as RFQ does for traditional buy-side participants. Contrary to what has been spuriously asserted by some seeking a PTNGU ban, the protocol’s value is not in policing the market or in providing information to retaliate against customers who might opt to trade in a CLOB.¹² While dealers provide liquidity to customers via RFQ or bilaterally, they generally take liquidity from the PTNGU CLOBs to hedge such customers’ aggregated residual risk. As explained in Part I above, dealers satisfy their

¹¹ *Id.* at 6, n. 10.

¹² *See, e.g.*, Letter from Laura Harper Powell, Associate General Counsel, Managed Funds Association, dated March 15, 2019 (“MFA Letter”) at 4; Letter from Americans for Financial Reform, dated March 15, 2018 at 4; Letter from Joanna Mallers, Secretary, FIA Principal Traders Group, dated March 14, 2019 at 1.

customers' needs to execute swaps with immediacy and scale by being willing to take risk onto their balance sheet and manage that risk over extended periods of time.

Given that the hedging occurs over time and usually on an aggregated, portfolio-wide basis, PTNGU helps a dealer predict its hedging costs so it can provide the most tailored pricing possible to its customers desiring immediate execution. PTNGU facilitates this by providing general information over time regarding who is trading in the CLOB SEFs. This way, if, for example, a dealer receives an RFQ from a counterparty the dealer frequently sees trading in the CLOBs, the dealer knows there is a greater likelihood that the RFQ requester is, and may continue to be, also seeking liquidity in the CLOBs and that such liquidity will not be available to the dealer to hedge. Conversely, the same RFQ from someone the dealer does not see frequently in the CLOB signals to the dealer that there will likely be a relatively greater opportunity to hedge the trade. The dealer can then respond to the RFQ accordingly, expecting that it will be more expensive to hedge the resulting trade from the customer that is more active in the CLOB and less expensive for the customer that is less active. This information enables a dealer to tailor its pricing such that the same expected rate of return on the capital provided for a trade is achievable regardless of the trading behavior of its customers.¹³ Without PTNGU, dealers would need to price customer RFQ trade enquiries assuming hedging costs at their worst, likely increasing costs and reducing the liquidity available for most customers via RFQ.

As the Commission has acknowledged, “dealers base their prices on the cost of hedging . . . in the dealer-to-dealer markets.”¹⁴ Therefore, increased hedging costs caused by banning PNTGU would translate to wider spreads and less depth in the rest of the market. The Commission also acknowledged that, “without [the dealer-to-dealer] market, liquidity in the dealer-to-client market may suffer because the inherent risks of holding swaps inventory could arguably disincentivize participation by dealers in the dealer-to-client market.”¹⁵ The Commission then goes on to provide that, “[a]bsent the supply of liquidity providers, non-dealers who are liquidity takers would have difficulty executing swaps at competitive pricing.”¹⁶ Additionally, limiting the availability of an attractive protocol by which dealers are comfortable hedging their customer flows may invite less deep and stable liquidity and greater volatility for customers trading on an RFQ basis or bilaterally, particularly during stress events, as has been seen in other markets where dealers willing and able to take principal risk on behalf of their customers have increasingly been replaced by HFT liquidity.¹⁷ Non-dealer liquidity providers do not carry as much capital, so they need to face a liquidity taker on the other side of a trade with the same and opposite risk soon after providing liquidity. Therefore, they cannot warehouse risk profitably

¹³ See, e.g., Osborn, T., *How to Game a SEF: Banks Fear Arrival of Arbitrageurs*, Risk.net (Mar. 19, 2014) (“Osborn”) (quoting former head of matched principal fixed-income trading at UBS, “If I know who you are, I can price risk accordingly, based on whether you are the end risk-taker or not.”).

¹⁴ 2018 SEF Proposal, 83 Fed. Reg. at 61995.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ See, e.g., Salem, M., et al., *Where Have All the Cowboys Gone?* (Aug. 14, 2019) (noting that HFT firms tend to retract liquidity sooner than other types of market participants during periods of high volatility).

and tend to pull back liquidity during market volatility and stress events. Notably, these issues would affect the swap market generally—not just MAT swaps—because dealers frequently hedge in the MAT swap market when they provide customers with liquidity in non-MAT swaps, including even bespoke swaps.

Given that commercial end users rely on their dealer relationships to access the swaps market, they would particularly be negatively impacted if dealers lost the ability to hedge efficiently in the MAT swaps market. Unlike other types of market participants (*e.g.*, hedge funds, asset managers and proprietary traders), commercial end users would not and frequently could not access CLOB SEFs offering fully anonymous protocols where the purported benefits of a PTNGU ban might conceivably materialize.

B. Banning PTNGU Would Impair the Workup Trading Protocol

In addition, PTNGU is an integral part of the workup trading protocol, which is available for most trading on CLOB SEFs.¹⁸ Once a dealer is matched in a SEF's CLOB, the SEF may offer the dealer the ability to transact in greater size with its original counterparty at the original execution price. A dealer's willingness to offer greater size through this protocol depends on who its counterparty is, in particular whether the counterparty is likely to be able to execute on the full size that the dealer is willing to offer. This private negotiation period may be followed by a public period, but during the public period the dealer's full trading interest is not necessarily disclosed. These workup sessions promote liquidity formation. Banning PTNGU would reduce dealers' ability to hedge via workup protocols, make CLOBs overall much less effective venues for hedging, and reduce available liquidity on RFQ SEFs.

C. Banning PTNGU Would Create Challenges for Package Transactions

Package transactions are an extremely important part of the swap market, frequently comprising a majority of trading volume on CLOB SEFs. For instance, for interest rate swaps, spreadover package transactions represented 67% of the risk traded across PTNGU CLOB SEFs in 2019 and in certain months in 2019 represented as much as 85% of the risk traded.¹⁹ PTNGU serves a crucial role for package transactions. Certain package transactions involving securities or non-cleared swaps typically necessitate PTNGU to address the risks associated with the legs of those transactions that are not cleared swaps. The argument that is most often provided in support of a ban on PTNGU, that counterparty identities are not relevant for swaps that are intended to be cleared given the absence of bilateral credit risk, does not apply to package transactions involving an uncleared transaction. Further, even where both legs of a package transaction are cleared, the clearing infrastructure for other types of instruments, including certain securities, can require clearing firm details to be disclosed (unless the SEF itself is or is affiliated with a clearing firm). These other instruments also are not subject to pre-trade credit check requirements or *void ab initio*. Banning PTNGU would accordingly inject unwanted challenges to the execution of package transactions.

¹⁸ Collin-Dufresne at 5 (noting that a material portion of the trading on CLOB SEFs is executed away from the order book via workup and matching protocols).

¹⁹ See FSF Letter, Appendix A (further noting that spreadover package transactions represented only 2% of the risk traded on RFQ SEFs).

IV. There Is No Evidence, But There Is Reason to Doubt, That Banning PTNGU Would Attract Material Additional Liquidity to CLOBs or Improve Overall Market Quality

A. The Promised Benefits of a PTNGU Ban Depend on Dealer Behavior and Entrance of Alternative Liquidity Providers

The Proposed Rule is premised on the fact that in order for the promised benefits of a PTNGU ban to materialize, dealers must remain committed to such CLOBs post-ban given the lack of activity on fully anonymous CLOBs. Therefore, the Commission must have complete confidence that this will occur or face the result that a PTNGU ban reduces trading on CLOB SEFs relative to today's levels while at the same time damaging RFQ liquidity as discussed in Part III.A. We have several reasons why we believe that the Commission should not have this confidence.

First, there seems to be a misconception that most dealers are currently providing liquidity on CLOB SEFs with PTNGU. In reality, they mostly take liquidity on CLOB SEFs in order to hedge their customer trades. Therefore, even if dealers did move their activity from CLOB SEFs with PTNGU to CLOB SEFs with fully anonymous protocols, they would mostly be looking to take liquidity on such SEFs, not provide it. Given that this is the case, and CLOB SEFs are not populated by market makers or other liquidity providers, it is not clear why others would opt to trade on CLOB SEFs.

Second, for the reasons noted in Part III above, banning PTNGU would impair workups and create challenges for package transactions, which together comprise a majority of the volume on CLOB SEFs. These problems seem likely to cause dealers to pull back from trading on CLOB SEFs and perhaps the market overall.²⁰

Third, the fact that a PTNGU ban would likely decrease dealer trading on CLOB SEFs, and that most of such trading involves taking not providing liquidity, would make it essential that mandating fully anonymous trading would encourage more participants to provide liquidity on CLOBs. But, although it might be the case that certain buy-side participants do not wish to trade on CLOBs with PTNGU, it does not necessarily follow that they would provide liquidity on fully anonymous CLOBs either. If they wanted to provide liquidity on fully anonymous CLOBs today, then those venues are already available and so they can do so. Instead they choose to trade via RFQ, for all of the reasons described in Part II. Banning PTNGU is unlikely to change this preference for RFQ venues.

Finally, it is not clear that banning PTNGU would attract alternative liquidity providers to CLOBs. To the extent these liquidity providers act as market makers, they should not have directional trading strategies and so should be indifferent to trading anonymously or with PTNGU. Accordingly, if they indeed exist, they would be trading on CLOBs already.

²⁰ Fully anonymous trading may also present other problems that discourage trading on CLOB SEFs. *See, e.g.,* Osborn (noting that liquidity could suffer if trading migrates to anonymous CLOB trading).

B. Other Markets Cited Where CLOB Trading Has Been Adopted Are Incomparable and Offer Mixed Conclusions

Although those in favor of banning PTNGU might point to experience with anonymous trading in the equities and futures markets, those markets are not comparable to the swap markets. As noted above, swap markets have many fewer participants, of which institutional participants constitute a far larger proportion, much lower trading frequency, far greater variation in tradeable products, and much larger typical trade sizes. In addition, futures market trading is fully concentrated in a single venue, the designated contract market, which has a monopoly on trading in the futures contracts it lists. And in the U.S. equities market, SEC Regulation NMS forces order flow to be socialized across exchanges and alternative trading systems. No similar mechanisms exist in the swap markets to homogenize and aggregate liquidity formation across venues. Instead, information from mechanisms such as PTNGU is necessary to evaluate diverse sources of liquidity. Further, healthy liquidity in the swaps market requires significant principal-based (as opposed to agency-based) trading, which explains the importance of managing balance sheet capacity in the swaps market in particular.²¹

Additionally, these other markets, which are not subject to impartial access requirements, have embraced mechanisms that provide a similar effect to PTNGU. In the equities market, Alternative Trading Systems (“ATs”) offer anonymous order books with controlled access.²² The Treasuries market has also embraced such ATs. The SEC has also invited innovative competition by granting exchange licenses to the Investors Exchange and the Long-Term Stock Exchange, each of which offer order types, trading functionality, and rule sets that are attractive to a segment of market participants while being quite objectionable to another.

Even if alternative liquidity providers did expand participation on CLOBs, it is not clear that market quality would benefit. As the Treasuries market has expanded anonymous CLOB trading, the impacts on market quality have been mixed. Principal trading firms and HFT firms now dominate the volume and market depth in the Treasuries market’s interdealer CLOBs, at times constituting 80% of market depth and 50% of trading volume.²³ This has resulted in the Treasuries market becoming much more reactive to volatility events, with liquidity disappearing far more quickly as volatility rises as was experienced as recently as this summer, “hint[ing] at their role in measurably amplifying volatility shocks in rates markets.”²⁴

²¹ See, e.g., Osborn (quoting one London-based e-commerce adviser, who notes, “rates and credit default swaps have traditionally been very dependent on the risk capacity of the banks.”).

²² Securities and Exchange Commission (“SEC”) Rule 301(b)(5) subjects some (but not all) ATs to a fair access requirement, but the SEC interprets this requirement to permit an ATs to establish objective limitations on access. See *Regulation of Exchanges and [ATs]*, 63 Fed. Reg. 70844, 70874 (Dec. 22, 1998). A 2014 paper estimates that ATs trading volume comprised 11.31% of dollar trading volume in U.S. listed equities and trading over-the-counter (“OTC”) outside of ATs (e.g., by OTC market makers) comprised 16.99% in dollar trading volume. See Tuttle, Laura, *OTC Trading: Description of Non-ATS OTC Trading in National Market System Stocks*, <https://www.sec.gov/files/otc-trading-white-paper-03-2014.pdf>.

²³ Salem, M., et al., *Where Have All the Cowboys Gone?* (Aug. 14, 2019).

²⁴ *Id.*

V. Banning PTNGU Is Not Mandated by Nor Consistent with the CEA

The Proposed Rule advances three statutory arguments for banning PTNGU: (a) promoting swaps trading on SEFs and fair competition among market participants; (b) preserving swap data repository (“SDR”) information privacy requirements; and (c) preserving impartial access to SEFs. None of these arguments stands up to careful scrutiny. Indeed, banning PTNGU would be plainly inconsistent with the flexible execution methods that Congress envisioned for SEFs.

A. Banning PTNGU Will Not Promote Swaps Trading on SEFs or Fair Competition Among Market Participants

Citing to Section 5h(e) of the CEA, regarding the promotion of trading on SEFs, and Section 3(b) of the CEA, regarding the promotion of fair competition, the Proposed Rule asserts that banning PTNGU will “promot[e] swaps trading on SEFs and promot[e] fair competition among market participants.”²⁵ This is not the case.

Banning PTNGU will, at best, shift SEF trading on CLOBs from CLOB SEFs with PTNGU to CLOB SEFs offering fully anonymous protocols. A shift in trading volume from one type of SEF trading protocol to another will not necessarily promote greater trading on SEFs overall. Moreover, for the reasons described earlier in this letter, we think the more likely outcome of banning PTNGU will be to reduce overall trading on SEFs, as dealers pull back from trading via RFQ because they can no longer hedge efficiently in CLOBs.

It also does not stand to reason that a PTNGU ban will drive competition and new activity to appear on CLOB SEFs from non-dealers, given that they have not chosen to trade today on available and operational CLOB SEFs offering fully anonymous protocols. Further, even if dealers on the CLOB SEFs were replaced by alternative liquidity providers, as discussed in Part III.A, the business model of those liquidity providers is not consistent with providing liquidity in larger sizes nor in times of market stress because they carry less capital and so cannot profitably carry risk on their balance sheets beyond the trading day on a consistent basis.

In addition, PTNGU does not limit fair competition, as it is merely part of one of several trading protocols available today, and no one is forced to trade subject to PTNGU nor prevented from trading fully anonymously. In this way, the existing market structure promotes competition and attracts SEF trading by providing market participants multiple protocols from which to choose depending on their business models and preferences as well as the liquidity characteristics of the swaps themselves. Indeed, banning PTNGU would itself impair competition and pose an unreasonable restraint on trade by forcing dealers to trade fully anonymously in order to access a CLOB, even though dealers prefer PTNGU for all the reasons described above.

One commenter has argued that PTNGU creates information asymmetries by providing only dealers with full access to all of the SEFs in the market.²⁶ However, nothing is preventing non-

²⁵ Proposed Rule, 84 Fed. Reg. at 72265.

²⁶ MFA Letter at 4.

dealers from accessing the CLOB SEFs offering PTNGU, and any market participant can join such SEFs and observe trade flows even if they choose not to trade.

Finally, we emphasize that the fair competition requirement in CEA Section 3(b) cited by the Commission reads, in full, that the Commission is required “to promote responsible innovation and fair competition among boards of trade, other markets and market participants.” By limiting the methods through which SEFs can operate and compete with each other, banning PTNGU would clearly reduce innovation and reduce competition “among . . . markets,” thus in fact contravening Section 3(b)’s mandate.

B. PTNGU Does Not Undercut the Congressional Objectives Unpinning SDR Information Privacy Requirements

The Proposed Rule argues that PTNGU undermines the intention behind the requirement that an SDR maintain the privacy of any and all swap transaction information that it receives from a swap dealer, counterparty, or any other registered entity.²⁷ We do not believe that the Congressional intent behind the SDR information privacy requirements requires a prohibition on PTNGU. On the one hand, an SDR has to keep data anonymous that counterparties are required to report under CFTC regulations, while on the other hand, PTNGU discloses counterparties’ information who choose not to trade on a fully anonymous platform. Parties are not required to trade on a platform that engages in PTNGU, but they may choose to and by choosing to do so, they are implicitly waiving the privacy of their identities by providing their own identifying information. Just because some market participants do not prefer to disclose their identities in this manner does not mean it is illegitimate for others to voluntarily choose to do so.

Further, arguably the privacy requirement codified in Commission Regulations § 49.17(f)(2) should not extend to swaps executed with PTNGU, no more than it extends to swaps executed via RFQ, where the parties likewise choose to reveal their identities. Whether the parties choose to do so on a pre- or post-trade basis should not affect the SDR’s privacy obligations because in either case the SEF, not the SDR, is responsible for disclosing the parties’ information. CEA Section 21(c)(6) only imposes the privacy requirement on SDRs. If Congress wanted to extend the privacy requirement to SEFs, it certainly would have done so and because it did not, we do not see why the CFTC would view Congress’s intentions as extending beyond the SDRs.

C. PTNGU Does Not Undermine the Policy Goals of Impartial Access

The Proposed Rule acknowledges that PTNGU does not violate impartial access requirements and is not discriminatory in isolation, but goes on to argue that it has resulted in a “discriminatory effect” against certain market participants.²⁸ But just because one group of market participants prefers not to trade via a protocol that involves PTNGU does not mean that the venue employing that protocol is engaged in discrimination. Under this logic, banning PTNGU would itself be a discriminatory act because it would deter trading on CLOB SEFs by traditional dealers who are concerned about the costs and risks of trading via fully anonymous

²⁷ Proposed Rule, 84 Fed. Reg. at 72266.

²⁸ *Id.* at 72267.

protocols. Similarly, if the Commission were to apply this logic (*i.e.*, that something has a “discriminatory effect” just because it deters certain market participants) to RFQ, would that mean that because certain market participants prefer not to trade using RFQ, the Commission should prohibit RFQ? The Commission has not articulated any cognizable limiting principle to this amorphous and strained reading of impartial access requirements.

Further, the Proposed Rule cites allowing additional liquidity providers to participate on SEFs as a goal of impartial access.²⁹ As noted in Parts III and IV above, while eliminating PTNGU might draw certain market participants to trade on CLOB SEFs that are fully anonymous, it may drive others (*e.g.*, dealers) away. Therefore, it is not clear that prohibiting PTNGU would further the goal of impartial access to allow additional liquidity providers to participate on SEFs.

D. Neither Dodd-Frank Nor the CEA Require or Support the Proposed PTNGU Ban

The proposed PTNGU ban is neither required nor supported by the CEA or Dodd-Frank. More specifically, even though PTNGU existed at the time that Dodd-Frank was enacted, Dodd-Frank did not direct the elimination of PTNGU. Dodd-Frank amended the CEA to provide that a SEF may conduct its activities “through any means of interstate commerce”³⁰; it did not direct the Commission to specify the means by which a SEF may conduct its activities. The CEA and Dodd-Frank also do not require the Commission to drive the swaps market toward all-to-all anonymous trading. Even though the Proposed Rule specifically states that encouraging all-to-all trading is not the Commission’s objective,³¹ the PTNGU ban would practically do so. Further, such a ban would be prejudicial to the interests of one segment of market participants (dealers) as described above.

In addition, as we have noted above, PTNGU is an execution protocol, not an “ancillary post-trade protocol” as the Proposed Rule suggests.³² The Commission has never dictated, and arguably was not authorized and directed by Congress to dictate, execution protocols for swaps that are not MAT.³³ Therefore, at the very least, the PTNGU ban should not be applicable beyond MAT swaps. And even for MAT swaps, the Commission’s justification for restricting execution methods has been to satisfy the multiple-to-multiple requirement in the statutory SEF definition and goals of promoting pre-trade price transparency and trading of swaps on SEFs.³⁴ But here, banning PTNGU would not help satisfy the SEF definition by changing the number of SEF participants from whom a party can accept bids and offers (unlike mandating CLOB and

²⁹ *Id.*

³⁰ Dodd-Frank, Section 721(a)(50).

³¹ Proposed Rule, 84 Fed. Reg. at 72265.

³² Proposed Rule, 84 Fed. Reg. at 72265.

³³ Dodd-Frank, Section 733.

³⁴ See *Core Principles and Other Requirements for [SEFs]*, 78 Fed. Reg. 33476, 33497 (Jun. 4, 2013) (“Core Principles for SEFs”).

RFQ methods), affecting what prices are transparent pre-trade or, as noted in Part IV.A. above, increasing trading on SEFs. Therefore, we have serious doubts that a ban of PTNGU would be consistent with Congress's intent.

VI. The Proposed Rule's Cost-Benefit Analysis Is Not Sufficiently Robust and Further Study Is Required

There is not sufficient evidence to support an intervention by the Commission to ban PTNGU. Any decision to ban PTNGU should be made after a complete and holistic review of the important costs and benefits at play for all market participants. Instead of relying on various academic studies that are inapposite and inconclusive at best, the Commission should conduct its own study to evaluate market structure and price and liquidity formation in the MAT swaps market as well as the potential effects of a PTNGU ban on market quality in the MAT swaps market with a focus beyond simply price and inclusive of the multiple dimensions of liquidity and market resiliency.

We observe that the only relevant study cited by the Proposed Rule that actually refers to the swaps market reinforces our belief that liquidity would overall decrease because the study finds that a PTNGU ban would “decrease total volume[] and widen average spread[s].”³⁵ The other studies cited by the Proposed Rule largely address markets that are not analogous to the swaps market, such as the cash equities market. Given the unique nature of the swaps markets, as discussed in Part IV.B, those studies cannot be relied upon heavily and certainly not without attempting to study the swaps market itself. The Commission itself acknowledged this in the Proposed Rule, noting that “the markets that are the subjects of these studies are not the same as U.S. swaps markets and are mostly not dealer-oriented markets. Some of the markets studied are also deeper and more liquid than the U.S. swaps market.”³⁶

Further, these other studies do not provide much support for a PTNGU ban. For example, one of the studies cited by the Proposed Rule to support the idea that anonymous post-trade reporting improves quoted spreads, price impact, and limit order book depth only observed and studied the change from multilateral to bilateral transparency (*i.e.*, from all members of an exchange being able to see counterparty broker codes associated with a particular trade to only the counterparties to a particular trade being able to observe the broker codes).³⁷ Therefore, this particular study does not directly support the idea that prohibiting PTNGU would be beneficial.

The studies cited by the Proposed Rule also seem to point to mixed results and therefore do not confirm the potential benefits of prohibiting PTNGU. A change in the status quo of a market that is currently functioning well should be supported by convincing data that clearly demonstrates the potential benefits of a regulatory mandate and that those benefits are reasonably expected to meaningfully exceed the potential costs.

³⁵ Lee, T. and Wang, C., *Why Trade Over-the-Counter? When Investors Want Price Discrimination* (2019 working paper) at 26-27. Although this study finds that these changes might increase welfare, that finding is based on increased welfare for speculators, at the expense of dealers and hedgers.

³⁶ Proposed Rule, 84 Fed. Reg. at 72269.

³⁷ Dennis, P.J., and Sandas, P., *Does Trading Anonymously Enhance Liquidity?* (2019 working paper) at 5.

In reviewing these studies, the Commission also focuses unduly on price without taking into account other important market characteristics. For example, the Commission notes that it believes that “negative pricing effects on SEFs would be unlikely to result” from the prohibition on PTNGU.³⁸ As also noted in Parts III and IV, however, there are other costs beyond the “pricing effects on SEFs” that need to be taken into account that go to market quality and resiliency, such as the potential for increased volatility and decreased stability as well as a decrease in available liquidity providers and market depth, particularly during times of stress, as witnessed in other markets with fully anonymous trading.

VII. The Commission Should Consider Less Drastic Alternatives

Given the risks summarized above, the Commission should be wary of imposing an outright ban on PTNGU. Finalizing a rule with the intent of gathering data unobservable today is risky. If it turns out after the fact that a ban on PTNGU does not prove to be a positive measure for the swaps market, it would be difficult to reverse any final rule banning PTNGU. Market participants expend considerable resources to comply with regulations, and any changes made to staffing or systems in reaction to a PTNGU ban will not be easily reversed. Therefore, any rulemaking banning PTNGU should be made once a positive outcome is more certain.

Accordingly, the Commission should take the necessary time to gather relevant and applicable data before mandating a change in the swaps market that could potentially destroy a viable market venue (*i.e.*, CLOB SEFs offering PTNGU) in the hopes of making another market venue viable that is currently not (*i.e.*, CLOB SEFs offering fully anonymous protocols). It would be helpful to better understand why market participants are not trading on CLOB SEFs offering fully anonymous protocols today. Perhaps the CFTC would find that there is a better suited and more tailored fix to the lack of participation on fully anonymous CLOB SEFs. As demonstrated by the Treasuries market—where fully anonymous trading evolved without regulatory fiat—if the market wants to evolve to fully anonymous trading, it will do so organically. It could therefore also be helpful for the Commission to study what led the Treasuries market to develop fully anonymous trading, how market liquidity and quality were helped or harmed in the process, and whether analogies can be appropriately drawn to the swaps market.

Another approach would be to provide for a pilot period during which PTNGU is banned for some but not all MAT swaps, in order to assess whether the purported liquidity benefits come to fruition. This alternative would allow the Commission to better assess the costs and benefits associated with any prohibition on PTNGU by gathering data regarding the effects of a PTNGU ban.³⁹ If, after collecting such data, the CFTC sees positive results from the temporary PTNGU

³⁸ Proposed Rule, 84 Fed. Reg. at 72269. The Commission supports this belief based on the theory that “competition from new market participants and incumbent liquidity providers that continue to provide liquidity should offset this possibility.” *Id.* However, the Commission does not cite any evidence to support this theory and, as discussed in Part III, prohibiting PTNGU may lead dealers to provide less liquidity and widen the spreads offered on those SEFs where nearly all non-dealer activity takes place today.

³⁹ One example of such a pilot period is the SEC’s Tick Size Pilot, which was a two-year pilot program that widened the minimum quoting and trading increments for stocks of certain smaller companies in an effort to improve their liquidity. After seeing the results of the pilot program unfold over the course of two years, the SEC decided to allow the program to expire at the end of the two-year period as the hoped for results did not materialize. By testing the approach as a pilot, the SEC spared the market from a market-wide change that would not have addressed the core

ban, it could pass a final rule. If, on the other hand, the swaps market reacts negatively to the ban, the pilot program could be terminated or would come to a natural end without requiring a lengthy rulemaking process during which any negative impacts would continue. Further, a pilot program, given its temporary nature, would not send a signal to dealers to immediately change their commitment to the market or market behavior.

If, after conducting further analysis, the Commission is nonetheless still convinced that a ban on PTNGU makes sense, we believe that the Commission should consider certain intermediate measures instead of adopting an absolute ban. The Commission has a history of striking a balance of competing interests, such as in the context of requiring an RFQ to no less than three participants as opposed to five participants after balancing the desire for pre-trade transparency and competition with concerns from market participants regarding excessive information leakage.⁴⁰ Similarly, instead of adopting a ban on PTNGU, the Commission should at least consider scaling back the extent of any ban. For example, the Commission could allow SEF participants to opt-in on a trade-by-trade basis to fully anonymous trading (or opt-out of PTNGU), or the Commission could require that any CLOB SEF that offers PTNGU must also offer a fully anonymous protocol.

concern. *Statement on the Expiration of the Tick Size Pilot*, SEC (Sept. 10, 2018), <https://www.sec.gov/news/public-statement/tm-dera-expiration-tick-size-pilot>.

⁴⁰ Core Principles for SEFs, 78 Fed. Reg. at 33495-97.

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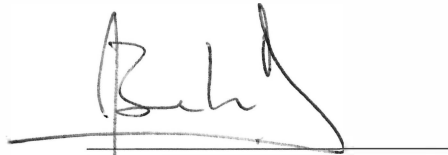
As the foregoing illustrates, we have serious concerns that prohibiting PTNGU will have negative effects on the swaps market, which we hope the Commission will consider before it finalizes the Proposed Rule.

If you have any questions concerning our comments, please feel free to contact the undersigned. J.P. Morgan welcomes the opportunity to discuss these issues further with the Commission and its staff. For the Commission's reference, we also have provided our responses to the Proposed Rule's specific requests for comment in the attached Appendix.

Respectfully submitted,



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Head of Global Markets
J.P. Morgan



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Appendix: Responses to Requests for Comment

(1) Does post-trade name give-up undermine the Commission's stated goals of impartial access to (i) ensure market participants can compete on a level playing field, and (ii) allow additional liquidity providers to participate on SEFs? Please explain why or why not, and include any supporting data.

Response: Please see Part V.C above.

(2) Should the Commission narrow the scope of the proposed prohibition on post-trade name give-up to apply only to swaps that are required to be cleared under section 2(h)(1) of the Act, or alternatively, only to swaps that are subject to the trade execution requirement under section 2(h)(8) of the Act? Why or why not?

Response: As our letter states, we do not believe that a ban of PTNGU is necessary or appropriate to achieve the CFTC's stated goals; however, if pursued, for the reasons stated in Part V.D, any PTNGU ban discussion should only be focused on MAT swaps.

(3) How, if at all, would a prohibition on post-trade name give-up affect pre-trade price transparency on a SEF operating an anonymous central limit order book?

Response: Due to dynamics described in Parts I and III above and experience with other markets described in Part IV.B above, we think that traditional dealers would reduce their participation on CLOB SEFs, thus reducing transparency.

(4) How would the proposed prohibition on post-trade name give-up affect existing liquidity on SEFs? How would the proposed prohibition affect liquidity on central limit order books? Would the proposed prohibition indirectly affect liquidity on name-disclosed request for quote systems? If so, how? In particular, please provide substantiating data, statistics, and any other quantifiable information related to any such comments.

Response: Please see Parts III and IV.

(5) Please explain the nature of any potential new liquidity on SEFs that may result from the proposed prohibition. For example, would liquidity increase due to a greater number of market participants trading and/or would liquidity increase due to additional market makers competing on affected SEFs?

Response: The proposed prohibition would likely reduce overall trading activity and the number of participants on CLOB SEFs in addition to negatively affecting liquidity and market quality on RFQ SEFs, given the importance of PTNGU to dealers' hedging. Please see Parts III and IV.A above for more details.

(6) How, if at all, would the proposed prohibition on post-trade name give-up affect trading protocols such as auctions, portfolio compression, and/or workup sessions?

Response: Please see Part III.B above.

(7) Is trading on a SEF platform with post-trade name give-up for anonymously executed, intended-to-be-cleared swaps preferable to a fully-disclosed platform for a swap dealer's capital allocation purposes? If so, why?

Response: The question implies that dealers allocate capital based on their counterparties on CLOB SEFs. In fact, a dealer allocates capital in the form of balance sheet capacity to customers via RFQ and hedges the resulting risk on CLOB SEFs. See Parts I and III above.

(8) Please describe how post-trade name give-up currently helps swap dealers make markets in swaps, if at all.

Response: Please see Parts I and III above.

(9) If the Commission were to prohibit post-trade name give-up as proposed in this notice, then how might that affect the prices that swap dealers quote to buy-side participants on SEFs operating name-disclosed, request for quote platforms?

Response: We expect that a PTNGU ban will negatively affect not only the prices quoted by dealers to buy-side participants on RFQ SEFs, but also the liquidity and resiliency of RFQ SEFs. More broadly, the ban would potentially have second order impacts on related markets, including non-MAT swaps. Please see Parts I and III.A above for more details.

(10) How does the price for a given swap listed on a SEF operating an anonymous central limit order book compare to the price for an equivalent swap listed on a SEF operating a name-disclosed request for quote system? How does the practice of post-trade name give-up relate to any such difference in price?

Response: Prices available via RFQ are typically better than prices available on CLOB SEFs, including CLOB SEFs offering PTNGU.

(11) Are there certain cleared swap classes for which post-trade name give-up serves a particularly important role for swap dealers for market-making or hedging purposes that would be adversely affected by a prohibition?

Response: As a rule of thumb, the more illiquid a particular swap is, the more necessary it becomes to have market participants that are willing to take on balance sheet risk and manage such risk over time. Dealers provide this critical function in the swaps market (and in other markets). Because, as we have discussed in Part III.A, PTNGU facilitates dealer hedging, PTNGU becomes particularly important for market liquidity for swaps that are less liquid.

(12) How many and what types of additional liquidity providers (e.g., funds, proprietary trading firms, high-frequency traders) might join affected SEFs if post-trade name give-up were prohibited? Would these new participants be particularly interested in trading certain kinds of swap transactions (e.g., spread trades)? Would these new participants be floor traders, swap dealers, or another type of entity?

Response: Please see Part III.A and Part IV.A above for the reasons why we believe that additional liquidity providers may not join affected SEFs post-PTNGU ban, including the fact that trading on CLOB SEFs with fully anonymous protocols is currently very thin.

(13) What other effects would a prohibition on post-trade name give-up have on the swap market?

Response: Please see Parts I, III, and IV above.

(14) Should the Commission provide an exception to the prohibition on post-trade name give-up for swaps that are components of package transactions involving an uncleared swap? To what extent are such package transactions anonymously traded, given the involvement of an uncleared swap at the outset?

Response: As discussed in Part III.C, the argument that is most often provided in support of a ban on PTGNU, that counterparty identities are not relevant for swaps that are intended to be cleared given the absence of bilateral credit risk, does not apply to package transactions involving an uncleared swap. Therefore, the Commission should provide an exception to the PTNGU ban, if it adopts one, for swaps that are components of package transactions involving an uncleared swap.

(15) If the Commission provides an exception with respect to package transactions, should it include an exception for package transactions involving any non-swap instrument, including Treasury securities? Should such an exception apply to the swap components if such non-swap instrument components are also executed anonymously and intended to be cleared?

Response: For the reasons that we support PTNGU as it currently operates, we believe that any exception that the Commission provides with respect to package transactions should include an exception for package transactions involving any non-swap instrument, including if such non-swap components are executed anonymously and intended to be cleared. As discussed in Part III.C, in some cases, the clearing infrastructure for other types of instruments, including certain securities, can require clearing firm details to be disclosed (unless the SEF itself is or is affiliated with a clearing firm). These other instruments also are not subject to pre-trade credit check requirements or *void ab initio*. Further, limiting an exception to PTNGU to only a subset of package transactions would be operationally more difficult to implement.

(16) Excluding swaps that are components of certain package transactions, what, if any, operational, credit and settlement, legal, or similar issues exist that would still require post-trade name give-up for a swap that is intended to be cleared?

Response: Even for a swap that is intended to be cleared, there is a small chance that the swap does not clear and therefore is subject to *void ab initio*. In such an instance, parties that may want to execute the trade nonetheless would not be able to learn each other's identities if a ban on PTNGU were imposed. Such disclosure may be necessary to correct errors. Further, for the exceptional circumstance such as a "Lehman"-like scenario where a market participant might lose access to clearing organizations because of its credit, PTNGU helps a counterparty to such a market participant assess the greater risk that a clearing organization might reject the trade. In such an instance, the straight-through-processing rules would not protect against this scenario because they do not require clearing organizations to conduct a pre-trade credit check.

(17) Are there any alternatives to the proposed prohibition on name give-up that would better achieve the regulatory objectives stated above? For example, could these objectives be better accomplished through additional guidance or enforcement activity to address applications of post-trade name give-up that are inconsistent with the impartial access requirement?

Response: We do not believe that any action is necessary at this time; rather, inaction is likely to better achieve the CFTC's objective than is banning PTNGU. However, further thoughts are included in Parts VI and VII above.