ADDRESS
55 Water Street
New York, NY 10041
CONTACT
phone 212.968.4100
fax 212.968.2386
INTERNET
www.GFIgroup.com

June 6, 2012

VIA ELECTRONIC SUBMISSION
Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC; File No. S7-27-10; RIN 3235-AK74

Dear Ms. Murphy:

GFI Group Inc. ("GFI")[1] submits this letter in connection with the rules being proposed by the Securities and Exchange Commission (the "Commission") regarding the ownership and governance requirements for security-based swap execution facilities ("SB SEFs").[2] GFI met with members of the Commission's staff (the "Staff") on May 16, 2012 to discuss certain aspects of the Proposed Rules, and the Staff suggested that GFI comment on certain implications of the Proposed Rules that were discussed at that meeting. GFI is submitting this letter in response to the Staff's recommendation.[3]

---

1 GFI and its affiliates provide competitive wholesale market brokerage services in a multitude of global over-the-counter ("OTC") and exchange-listed cash and derivatives markets for credit, fixed income, equity, financial, and commodity products. GFI's parent company makes its headquarters in New York and employs more than 2,100 people, with additional offices in London, Paris, Hong Kong, Seoul, Tokyo, Singapore, Sydney, Cape Town, Dubai, Tel Aviv, Dublin, Calgary, and Sugar Land, Texas. GFI and its affiliates provide services and products to over 2,400 institutional clients, including leading banks, corporations, insurance companies, and hedge funds.

2 *See* Securities Exchange Act Release No. 34-63107 (October 14, 2010) (the "Proposed Rules").

3 GFI expects that one of its affiliates will register as an SB SEF with the Commission. Therefore, all references in this letter to GFI's registration as an SB SEF should be deemed to refer to the registration of such affiliate.

As discussed in more detail below, the broad cross-ownership restrictions set forth in the Proposed Rules would preclude a broker-dealer that is affiliated with the sponsor of an SB SEF from being a direct participant on such SB SEF (hereafter, an "Affiliated SB SEF"). We believe that this restriction would interfere with the broker-dealer's ability to satisfy its duty of best execution to its customers without providing any countervailing benefits to the marketplace. Accordingly, we are requesting that the Commission revise the Proposed Rules to permit broker-dealers who are affiliated with certain SB SEFs to participate directly in such SB SEFs in an agency capacity.

I. Background

In its SB SEF Proposal,[4] the Commission has taken the position that an entity that meets the definition of "security-based swap execution facility" under Section 3(a)(77) of the Securities Exchange Act of 1934 (the "Exchange Act") also would fall within the definition of "broker" set forth in Section 3(a)(4) of the Exchange Act. However, because the Exchange Act sets forth a comprehensive regulatory framework for SB SEFs, the Commission has proposed to adopt Rule 15a-12 under the Exchange Act to conditionally exempt any SB SEF from the Exchange Act and the rules and regulations applicable to brokers other than Sections 15(b)(4), 15(b)(6), and 17(b) thereunder. However, this conditional exemption would not be available if an SB SEF acts in a discretionary manner with respect to the execution of a security-based swap transaction.

There may be occasions on which an SB SEF exercises discretion over customer orders in order to ensure that such orders receive the most favorable execution possible under the circumstances. If the SB SEF has an affiliate that is already registered as a broker-dealer with the Commission (an "Affiliated BD"), it may avoid duplicative regulation by ensuring that the persons responsible for exercising discretion over the execution of customer orders are doing so in their capacities as employees of the Affiliated BD.

As the Commission knows, a broker-dealer has a legal duty to seek to obtain best execution of customer orders,[5] and the failure to satisfy the duty of best execution may constitute a violation of Section 15(c)(1)(A) of the Exchange Act, which makes it unlawful for any broker or dealer to "effect any transaction in . . . any security by means of any manipulative, deceptive, or other

---

4 *See* Securities Exchange Act Release No. 34-63825 (February 2, 2011) (the "SB SEF Proposal").

5 *See, e.g.,* Newton v. Merrill, Lynch, Pierce, Fenner & Smith, 135 F.3d 266, 269-70, 274 (3d Cir. 1998) (finding Merrill Lynch may have failed to maximize the economic benefit to its customers by failing to take advantage of prices better than the national best bid and offer ("NBBO")); In re Herzog, Heine, Geduld, LLC, Exchange Act Release No. 54148 (July 14, 2006); In re Certain Market Making Activities on Nasdaq, Exchange Act Release No. 40900 (Jan. 11, 1999); see also Geman v. SEC, 334 F.3d 1183, 1192-93 (10th Cir. 2003) (finding that broker-dealer violated its duty of best execution by failing to disclose that its method of executing orders deprived customers of the possibility of receiving prices better than the NBBO).

GFI Group inc.

fraudulent device or contrivance."[6] A broker-dealer's best execution obligation also is codified in FINRA Rule 5310, which generally provides that in any transaction for or with a customer, a broker-dealer and its associated persons must use reasonable diligence to ascertain the best market for a security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.[7]

II. Discussion

Section 765 of the Dodd-Frank Act[8] provides in relevant part that the Commission shall adopt rules which may include numerical limits on the control of SB SEFs. Section 765 also provides the Commission must adopt such rules only if it determines that such rules are necessary or appropriate to improve the governance of, or mitigate conflicts of interest in connection with, the conduct of business by a security-based swap dealer or major security-based swap participant on an SB SEF in which it has a material debt or equity investment. In adopting these rules, the Commission must consider any conflict of interest that may arise in connection with the amount of equity owned by a single investor in an SB SEF and the governance arrangements of an SB SEF.

In order to implement the requirements of Section 765, the Commission has proposed to adopt Rule 702(b), which would prohibit any SB SEF participant from owning more than twenty percent (20%) of any class of voting securities issued by an SB SEF or from exercising more than twenty percent (20%) of the voting power of an SB SEF. For purposes of applying these ownership and voting limitations, proposed Rule 702(b) would aggregate a participant's ownership and voting interests with those of its "related persons," which term includes any person that shares a common parent with a participant.

As the Commission noted, proposed Rule 702(b) is designed to address the conflicts of interest that may arise when an SB SEF is controlled by a small group of dealers that participate in the operation of such SB SEF.[9] However, not all SB SEFs will be operated by dealer

---

6 *See* In re Herzog, Heine, Geduld, LLC; Exchange Act Release No. 5414 (July 14, 2006); In re Knight Securities, L.P., Exchange Act Release No. 50867 (Dec. 16, 2004).

7 The factors articulated in FINRA Rule 5310 to be used when applying the "reasonable diligence" requirement are: (1) the character of the market for the security (*e.g.*, price, volatility, relative liquidity, and pressure on available communications); (2) the size and type of transaction; (3) the number of primary markets checked; (4) the accessibility of the relevant quotation; and (5) the terms and conditions of the customer's order.

8 *See* the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203).

9 As noted in the release setting forth the Proposed Rules, these proposed limitations arise, at least in part, from the Commission's concern that the market for over-the-counter derivatives is highly concentrated and dealer-

GFI Group Inc.

consortiums, and SB SEFs that are operated by wholesale brokers may utilize organizational models that seek to avoid such conflicts of interest by separating ownership and control from participation rights. Under this model (hereafter, the "Open Access Model"), a participant will merely have the right to access the platform operated by the SB SEF, but will not have an ownership interest in, or voting rights with respect to, the SB SEF.

We believe that the broad scope of proposed Rule 702(b) may inadvertently create significant disadvantages for market participants who desire to effect transactions on SB SEFs that utilize the Open Access Model without providing any corresponding benefits to the marketplace. As noted above, to the extent that an SB SEF's customers desire that an SB SEF exercise discretion over the execution of their orders, such customers would direct such orders to the Affiliated BD, rather than the SB SEF. After receiving such orders, the Affiliated BD may find the best market available for these orders is on its affiliated SB SEF, thus requiring the Affiliated BD to execute these orders on such SB SEF in order to satisfy its duty of best execution.

However, proposed Rule 702(b) interferes with the BD's ability to satisfy its best execution obligation because it precludes the BD from being a participant on an Affiliated SB SEF.[10] This restriction could have an adverse impact on customers because it may require them to establish new brokerage relationships for the sole purpose of trading on the Affiliated SB SEF. Further, customers that do not desire to take this step may be forced to incur additional costs in the form of additional brokerage fees and potential execution delays because the BD would be required to interpose another SB SEF participant in the execution process, and these costs could outweigh the benefits intended to be derived from executing their orders on the SB SEF.

Accordingly, we believe the Commission should revise the Proposed Rules to permit broker-dealers who are affiliated with SB SEFs that utilize the Open Access Model to participate directly in such SB SEFs in an agency capacity.[11] Precluding an Affiliated BD from such direct participation would not provide any benefits to the marketplace because such participation would not lead to an increase in the concentration of ownership or control over the SB SEF. Further, precluding an Affiliated BD from participating on an SB SEF could be disruptive to the BD's

---

dominated, and that such ownership and voting limits are necessary to promote the formation of competing trading venues for security-based swaps. According to the Commission, these limitations are appropriate because they limit the ability of an SB SEF participant to exert undue influence over the governance of an SB SEF while still permitting such participant to acquire a substantial equity interest in an SB SEF.

[10] Proposed Rule 702(b) would preclude the BD from being a participant in an SB SEF if the BD and the SB SEF are indirectly owned by the same parent company.

[11] This request presumes that participants in the SB SEF that are not affiliated with the SB SEF have the same access to the information generated by the SB SEF that is available to the affiliated BD, and that the personnel of the affiliated BD do not participate in the governance of the SB SEF.

existing customers because it means that they would be required to establish new brokerage relationships in order to trade on the SB SEF.

We acknowledge the argument that permitting an Affiliated BD to participate on an SB SEF may create a potential conflict of interest for the SB SEF due to the risk that it could favor the Affiliated BD over other participants. As a practical matter, however, an SB SEF has a significant commercial incentive to not give preferential treatment to the Affiliated BD but rather to maintain its reputation as a trading platform that applies its rules fairly, transparently, and impartially in order to maximize the amount of participation on the SB SEF and thus enhance the liquidity of its marketplace. Moreover, we believe that any potential conflict will be negated by a number of factors. For example, under the Proposed Rules, fifty-one percent (51%) of an SB SEF's directors must meet strict independence standards, and an SB SEF must have a regulatory oversight committee that is composed solely of independent directors. Further, although SB SEFs are not defined as self-regulatory organizations under the Exchange Act, they will be required under the SB SEF Proposal to establish fair access standards, treat all trading interests fairly and provide a fair procedure for disciplining participants for rule violations.

We note that the Commission asked in the SB SEF Proposal whether it should view wholesale brokers' SB SEF operations differently than the operations of other SB SEFs. Without attempting to address all the implications of this issue, we believe that the different incentives faced by different types of SB SEFs support our request. The Commission asserted in the Proposing Release that participants in SB SEFs that are operated by dealer consortiums might be incentivized to limit direct participation in order to limit competition. Whether or not that proves to be the case, SB SEFs that utilize the Open Access Model will generate income primarily through transaction fees, and thus will be highly incentivized to maximize the number of direct participants in, and the number of swaps traded through, their facilities.

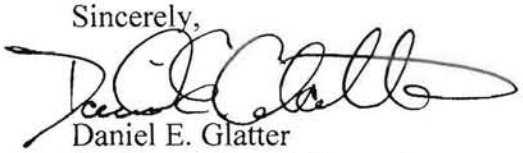
Finally, and as noted above, Section 765 of the Dodd-Frank Act generally permits, but does not require, the Commission to adopt numerical ownership limits with respect to SB SEFs if it determines that such rules are "necessary or appropriate" to mitigate conflicts of interest. We believe that, as currently drafted, the aggregation requirements set forth in proposed Rule 702(b) impose burdens on market participants and SB SEFs which utilize the Open Access Model that are neither "necessary" nor "appropriate." Therefore, we respectfully request that the Commission revise proposed Rule 702(b) to permit broker-dealers who are affiliated with SB SEFs that utilize the Open Access Model to participate directly in such SB SEFs in an agency capacity.

* * * * * * * * * * * *

GFI appreciates the opportunity to submit these comments on the proposed ownership and governance requirements for SB SEFs. If the Commission has any questions concerning the

matters discussed in this letter, please contact me at (212) 968-2982, or Scott Pintoff, General Counsel, at (212) 968-2954.

Sincerely,



Daniel E. Glatter
Assistant General Counsel

cc: Honorable Mary L. Shapiro
Honorable Elisse B. Walter
Honorable Luis A. Aguilar
Honorable Troy A. Parades
Honorable Daniel M. Gallagher
Heather Seidel – Division of Trading & Markets
Tom Eady – Division of Trading & Markets