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June 13, 2012

Heather Seidel
Associate Director, Division of Trading and Markets
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: Registration and Regulation of Security-Based Swap Execution Facilities, Proposed Rules and Proposed Interpretation, **File No. S7-06-11**

Dear Ms. Seidel:

Further to our comment letter of December 12, 2011, we appreciate the opportunity to provide further detail around an element within the Commission's proposed rules governing security-based swap execution facilities ("SB SEFs").[1] In particular, the Commission has proposed to interpret the SB SEF definition to require that an SB SEF offering a request for quote ("RFQ") platform permit an individual participant "to send, at the same time, a single RFQ to all other liquidity providing participants on that system or platform and view responses from those participants"[2] We understand that the Commission has made this proposal to promote fair treatment of trading interest and pre-trade transparency.

Thomson Reuters supports the policy goals to allow a potential price taker to have the ability to contact as many price makers as appropriate within a trading platform, and that a user should not be restricted in whom they can contact to request a price. The Thomson Reuters Dealing system fulfils the policy goal of providing a level playing field for participants through the inherent system design, which ensures that all participants are treated the same within the system. No keystation or institution is defined as either price maker or price taker. Any user is able to contact any other user or group of users to request a price. Everyone is equal.

We note and welcome the Commission's determination to provide flexibility in the ways in which SB SEFs may be configured to meet the relevant policy objectives.[3] In this regard, we note that the Thomson Reuters Dealing service supports and fosters transparency both in the pre-trade

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1 Release No. 34-63825 (Feb. 2, 2011), 76 Fed. Reg. 10948 (Feb. 28, 2011) ("SB SEF Proposal").

2 SB SEF Proposal at 10953.

3 *See* SB SEF Proposal at 10953 ("[R]ather than proposing a rule that would establish a prescribed configuration for SB SEFs that would meet the statutory definition of SB SEF, the Commission proposes to provide baseline principles interpreting the definition of SB SEF, consistent with the requirements of the Exchange Act, as amended by the Dodd-Frank Act, which any entity would need to be able to meet to register as a SB SEF.").

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workflow, through the provision of a central screen where any user is able to post a buy/sell interest that is visible by all other users, and through post-trade connectivity to swap data repositories and clearing agencies as required.[4] This wider functionality is available for trades that are not likely to be mandated for clearing as well as those that are likely to fall inside the mandate.

We are concerned, however, that the current proposed interpretation of the SB SEF definition in the context of RFQ platforms assumes that any platform would be designed around the concept of a defined list of price makers with whom the price takers will interact. Within that scenario, the proposed interpretation will satisfy the policy goal. In contrast, within the design of the Thomson Reuters Dealing system, there are around 18,000 keystations in over 4,000 institutions. The current proposed interpretation could be read to require that a user be able to contact all 18,000 key stations simultaneously when requesting a quote. Given the number of participants and the geography involved (over 130 countries), it is not feasible to enable a function that a given user would be able to contact all other users.

Accordingly, we would suggest the following amendments to the proposed interpretation to maintain the underlying policy goals without the unintended impact on this existing and otherwise wholly compliant trading system:

> "Under [the Commission's] proposed interpretation, if a system or platform were **reasonably designed** to allow an individual participant (of which there must be more than one on the system, but which do not need to be acting simultaneously) to send, at the same time, a single RFQ to all other liquidity providing participants on that system or platform **in the relevant security-based swap at that time** and view responses from those participants, the Commission believes that such a model would satisfy the requirements of the statutory definition, even if the quote requesting participants are acting at different times. A key element to this model is that the SB SEF would not be able to limit the number of liquidity providing participants from whom a participant could request a quote on the SB SEF.
>
> The Commission further believes that the requirements of the statutory definition would be met if the system or platform not only **was reasonably designed to** provided the quote requesting participant with the ability to send a single RFQ to all liquidity providing participants **in the relevant security-based swap at that time**, but also provided the quote requesting participant with the ability to choose to send an RFQ to fewer than all liquidity providing participants. In the Commission's view, a system or platform that **is reasonably designed to** affords a quote requesting participant the ability to send an RFQ to all participants **providing liquidity in a security-based swap at that time**, but also permits the quote requesting participant to choose to send an

[4] *See* SB SEF Proposal at 10953 ("[T]he interpretation of the definition of SB SEF should complement other aspects of proposed SB swap regulations, including those related to post trade transparency, mandatory clearing, and the general requirement that SB swaps that are subject to mandatory clearing only be traded on an exchange or SB SEF, unless no exchange or SB SEF makes the SB swap available to trade.").

> RFQ to fewer participants, would satisfy the statutory definition because multiple participants would have the ability to execute or trade SB swaps by accepting bids or offers made by multiple participants. . . ."[5]

Thomson Reuters Dealing does not enforce a limit on the maximum number of users who can act as price makers for any given trade. However, since in theory any of the over 18,000 users could be price makers for a given trade, a requirement to provide a function for requesting quotes from all other users is impractical and has not been requested by any institution. We would suggest the text be amended as above to reflect the ability to RFQ many potential price makers without the obligation to provide a price request to all users simultaneously, but rather to other users providing liquidity in the security-based swap at that time. A Dealing keystation already allows a user to contact up to 26 other users simultaneously. By using a number of key stations a user can in theory contact a further number. Although this requirement has not been requested by any user to date, it is certainly available.

In this connection, we note the Commission's comments around a price requester not wishing to negatively impact their liquidity access and concur with the proposal not to specify a minimum number of other participants required to be contacted for a price.[6] For similar reasons, it seems unlikely that a user would want to broadcast its trading interest throughout the entire system through an RFQ to all other users.

In addition, other aspects of the Commission's proposal would meaningfully promote transparency without requiring implementation of a functionality that is unlikely to be utilized. As the Commission notes, efficient post-trade transparency ensures that all other users benefit from another user's activity on the system.[7] Moreover, we emphasize that, in the current Dealing system, users already enjoy the ability to execute across a number of other prices from multiple price makers simultaneously. Further, the system's pre-trade screen allows communication by any user to all other users of an intention to trade at a given level. This indication is executable in the sense that any user can simply RFQ the user posting an interest and execute on that price. Thomson Reuters intends to require that these pre-trade prices be "firm" – that is the posting user will have an obligation to substantiate their price with a trade in the normal market amount for that instrument. In this way, the Dealing system would satisfy the Commission's proposed requirement that a SB SEF "provide at least a basic functionality to allow any participant on the SB SEF the ability to make and display executable bids or offers accessible to all other participants on the SB SEF, if the participant chooses to do so."[8]

In this regard, we would like to reiterate strongly that the Thomson Reuters Dealing service already meets many of the Commission's policy goals relating to transparency and the development of a level playing field for all, even to the extent that the system does not

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5 SB SEF Proposal at 10953 (internal citations omitted).

6 SB SEF Proposal at 10953-54 ("Under the proposed interpretation of the definition of SB SEF, a SB SEF would be able to offer functionality to a participant (or a participant's customer) enabling that participant to choose to send a single RFQ to any number of specific liquidity providing participants on the SB SEF, including just a single liquidity provider. . . . [P]articularly for illiquid SB swaps, an investor may determine that it is in its best interest not to broadly project its trading intention, and may choose to send a RFQ to one dealer.").

7 SB SEF Proposal at 10954 ("Other investors could still benefit by the request because the response to that RFQ would become part of the composite indicative quote of that SB SEF.").

8 SB SEF Proposal at 10954.

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distinguish between price makers and takers on the system. Accordingly, we would request that the Commission consider Thomson Reuters Dealing and similar platforms on their own merits, and allow the slight amendments to the proposed rules that would allow this existing and longstanding service to continue to offer US customers an efficient and transparent trading system.

* * *

We thank you for considering these comments. Please do not hesitate to contact the undersigned if you have any questions on this matter.

Sincerely,

Jas Singh
Managing Director, Marketplaces

cc: Mary Schapiro, Chairman
Elisse Walter, Commissioner
Luis Aguilar, Commissioner
Troy Paredes, Commissioner
Daniel Gallagher, Commissioner

Robert Cook, Director
Nancy Burke-Sanow, Assistant Director
David Liu, Senior Special Counsel
Tom Eady, Senior Policy Advisor
Division of Trading and Markets

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June 13, 2012

The Honorable Troy Paredes
Commissioner
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: Registration and Regulation of Security-Based Swap Execution Facilities, Proposed Rules and Proposed Interpretation, **File No. S7-06-11**

Dear Commissioner Paredes:

This letter is to follow up on the meeting we had with you on May 9, 2012 regarding security-based swap execution facilities ("SBSEFs") and our December 12, 2011 comment letter on the same topic. We appreciate the opportunity to share our ideas around the effective regulation of SBSEFs, including the likely impact on the OTC derivatives markets if the Commission were to require a SBSEF to integrate its request for quote ("RFQ") platform with centrally displayed resting orders by providing those resting orders with price-time priority over responses to an RFQ. We are writing to provide some additional detail on this important topic.

At the outset, we emphasize that, in our experience as an operator of electronic markets for over 30 years, OTC derivative markets are inherently less liquid than equity and futures markets.[1] As a result, trading methods that work efficiently in equity and futures markets, where instruments are standardized and there is substantially greater natural trading interest at any one time, do not behave in the same way as most OTC derivatives.

In particular, mandating that displayed resting orders receive price-time priority is likely to increase costs to end users by facilitating the ability for some market participants to "game" the trading model. It would also prevent an end user from controlling its execution costs by obtaining a single "all-in" price from a price maker for the entirety of its trading interest. The relative illiquidity of the OTC derivatives markets magnifies these issues. To help illustrate this, we set out some examples below.

Scenario 1

[1] In this regard, we note the recent attached paper on non-equity markets transparency which we understand was tabled by a number of EU member states in the context of the discussions on MIFID/MIFIR.

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Participant A posts a bid on the SBSEF's centralized screen in a small amount with the aim of 'sniffing out' any block trade activity. Should a supposition of potential block trade activity result in a trade and reveal block trade activity, then the resulting trade will provide valuable information that allows Participant A to execute more significant volumes to try and profit from this information. This activity will negatively affect the ability of price takers to execute efficiently and negatively affect the ability of a price maker to hedge the block trade into the market – raising cost of execution for all concerned.

Scenario 2

Participant B puts in a two-way price at a non-*bona fide* level in an illiquid market in a small size and then sends an RFQ to other participants. Because the indicated interest is tradeable and interactive, the recipients put credence in the displayed level and respond with a price around that level. Participant B then hits all the participants and, even substantiating its own non-*bona fide* price, achieves an artificially advantageous average price for the overall amount.

Scenario 3

The displayed bids on a SBSEF's centralized screen are $3 million / $4 million. Participant C sends an RFQ to Participant D for a far larger block size and receives a bid/offer that provides a bid lower than the displayed bids. Participant C is happy to execute at the received price, with Participant D as principal. Participant C's cost of execution is controlled with a single trade to send to clearing and processing. Note that cost of processing and post-trade management can be significant. In addition, Participant D has until the end of the post-trade block reporting delay to lay off its risk without alerting the wider market, allowing it to provide a more competitive price to Participant C for the block.

If, instead, Participant C was required to hit the displayed bids before it could interact with Participant D, its cost of execution would increase significantly because it would have to process multiple executions. Similarly, if Participant D was required to hit the displayed bids before executing with Participant C, its processing costs would increase and those costs would likely be passed along to Participant C in the form of a worse price.

Moreover, the displayed liquidity would disappear while Participant D is left with the balance of the overall trade. At the same, other participants would see the disappearance of the displayed bids and recognize that a block trade was being executed. This would force the other side of the market to move away from Participant D even before post-trade reporting occurs. To address this, Participant D would need to provide a worse price to Participant C or be forced to hold onto the balance of the trade with no possibility to cover the risk in an economic fashion.

It is worth noting that in the normal market reaction to a block trade as illustrated in Scenario 3 above, any bids or offers that are already being shown in the market at the time of trade will be executed upon in the normal course of risk hedging that results from the execution of the block trade. Whilst not currently a legal requirement, the smaller players who may post a relatively smaller interest to trade into the market are already able to trade alongside the larger risk-takers on an equal basis, even if they are not interested in competing directly for the same block trade.

These differences illustrate important distinctions in market structure between more and less liquid instruments. More liquid instruments, such as futures and equities, tend to operate through an agency market structure in which end users access the market through brokers that pass most execution costs onto their end user clients, and where bid-ask spreads are tight

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because of the higher degree of standardization, natural trading interest and volumes. Less liquid instruments, including most OTC derivatives and many fixed income securities, tend to operate through a principal market structure in which dealers as intermediaries are willing to bear most of the cost of execution in return for earning a potentially greater bid-ask spread. Mandating price-time priority for displayed orders on a SBSEF would move the OTC derivatives market closer to an agency market structure under which end users bear most of the cost of execution even as there is insufficient standardization, trading interest and volume to drive down spreads.

* * *

In conclusion, we propose that the Commission should not require that displayed orders receive priority over responses to an RFQ. Any participant already has the ability to trade with any other participants who may be posting a pre-trade interest. The participant who is requesting a price within the RFQ system is entirely capable of executing against any displayed firm pricing should they so wish. This may be for a partial fill of their overall interest or to complete their interest. This is their existing ability. Enforcing an interaction between displayed orders and RFQ executions will only drive execution into a restrictive model, increasing execution costs for the end user while providing little identifiable cost benefit.

We thank you for considering these comments. Please do not hesitate to contact the undersigned if you have any questions on this matter.

Sincerely,

Jas Singh
Managing Director, Marketplaces

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