WMBA
AMERICAS
WHOLESALE MARKETS BROKERS' ASSOCIATION

July 31, 2012

Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549–1090

Re: Registration and Regulation of Security-Based Swap Execution Facilities (RIN 3235–AK93)

Dear Ms. Murphy:

The Wholesale Market Brokers' Association, Americas ("WMBAA" or "Association")[1] appreciates the opportunity to provide specific comments to the Securities and Exchange Commission ("SEC" or "Commission") related to the provision of regulatory services by a third party to ensure compliance with certain requirements in rules related to the registration and regulation of security-based swap execution facilities ("Proposed Rules")[2] under the Securities Exchange Act of 1934 ("Exchange Act").[3]

The WMBAA urges the Commission to permit third-party service providers to contract with security-based ("SB") swap execution facilities ("SEFs") to ensure that core principles and other requirements are enforced, allowing SB SEFs to use the "reasonable discretion" afforded by the Exchange Act to establish the manner in which they comply with the core principles.[4] As discussed below, third-party service providers can provide their services without registering with the Commission, as the Exchange Act does not require registration and because such an arrangement is consistent with Commission precedent for other segments of securities markets.

This letter supplements prior comments provided by the WMBAA to the Commission in response to its Proposed Rules.[5] As previously indicated, the WMBAA is supportive of a regulatory regime

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[1] The WMBAA is an independent industry body representing the largest inter-dealer brokers operating in the North American wholesale markets across a broad range of financial products. The five founding members of the group are: BGC Partners; GFI Group; ICAP; Tradition; and Tullett Prebon. The WMBAA seeks to work with Congress, regulators and key public policymakers on future regulation and oversight of OTC markets and their participants. By working with regulators to make OTC markets more efficient, robust and transparent, the WMBAA sees a major opportunity to assist in the monitoring and consequent reduction of systemic risk in the country's capital markets. For more information, please see www.wmbaa.com.

[2] See Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10948 (February 28, 2011).

[3] See 15 U.S.C. § 78a et seq.

[4] See Exchange Act 3D(d)(1) ("Unless otherwise determined by the Commission, by rule or regulation, a security-based swap execution facility described in subparagraph (A) shall have reasonable discretion in establishing the manner in which it complies with the core principles described in this subsection.").

[5] See, e.g., letter from J. Christopher Giancarlo, Chairman, WMBAA, to Commission and CFTC, dated July 29, 2010; see also letter from Julian Harding, Chairman, WMBAA, to Commission and CFTC, dated November 19, 2010; letter from Julian Harding, Chairman, WMBAA, to Commission and CFTC, dated November 30, 2010; letter from Julian Harding, Chairman, WMBAA, to Commission, dated January 18, 2011; letter from Stephen Merkel, Chairman, WMBAA, to Commission, dated April 4, 2011; letter from Stephen Merkel, Chairman, WMBAA, to Mr. Robert Cook, dated May 31, 2011; and letter from Stephen Merkel, Chairman, WMBAA, to Commission and CFTC, dated June 3, 2011.

for over-the-counter ("OTC") SB swaps markets that improves regulatory transparency, promotes competition, and fosters market participant access to a vibrant, affordable source of liquidity. The WMBAA supports transparency in OTC SB swaps markets for all market participants. WMBAA members' trade execution platforms provide their participants with the most current market information for the express purpose of price discovery and the matching of buyers and sellers, using knowledgeable brokers and sophisticated electronic trading and matching systems to create greater trading liquidity.

SEC Precedent Permits Reliance on Third Parties

The Commission has previously recognized the value of contracting with third parties to fulfill certain obligations. We believe this precedent is a valuable indicator that the Commission should permit SB SEFs to contract with third-party service providers.

Most recently, in January 2011, the Commission's Division of Trading and Markets ("Division") issued a no-action letter, responding to a request by the Securities Industry and Financial Markets Association ("SIFMA") for assurances that it would not recommend enforcement action if a broker-dealer were to rely on a third-party to perform its obligations under the Exchange Act.[6] In particular, SIFMA requested that the Division take a no-action position similar to its prior no-action positions from 2004, 2005, 2006, 2008, and 2010,[7] and not recommend enforcement action under Exchange Act Rule 17a-8 if a broker-dealer were to rely on a registered investment adviser to perform some or all of its customer identification program ("CIP") obligations.

The Division extended the 2004 no-action position, which recognized the unique position of advisers and unnecessary compliance costs to broker-dealers,[8] for an additional two years, and stated that, if certain criteria are met, it would not recommend enforcement action under Exchange Act Rule 17a-8 against a broker-dealer who reasonably relies on a registered investment adviser to perform the broker-dealer's CIP obligations.

As the Commission has previously allowed reliance on third parties to perform obligations under the Exchange Act, the WMBAA respectfully submits that reliance on third-party service providers for SB SEFs to implement and facilitate compliance with the Commission's regulations aligns with its precedent. Just as a broker-dealer may reasonably rely on a registered investment adviser to perform its CIP obligations,[9] an SB SEF is afforded "reasonable discretion" by the Exchange Act to comply

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[6] See SIFMA, SEC No-Action Letter (Jan. 11, 2011).

[7] See Letter from Annette L. Nazareth, Director, Division, Commission, to Alan Sorcher, Securities Industry Association ("SIA"), dated February 12,2004; Letter from Annette L. Nazareth, Director, Division, Commission, to Alan Sorcher, SIA, dated February 10,2005; Letter from Robert L.D. Colby, Acting Director, Division, Commission, to Alan Sorcher, SIA, dated July 11, 2006; Letter from Erik Sirri, Director, Division, Commission to Alan Sorcher, SIFMA, dated January 12,2008; Letter from Daniel M. Gallagher, Jr., Deputy Director, Division, Commission, to Ryan Foster., SIFMA, dated January 11, 2010.

[8] Letter from Annette L. Nazareth, Director, Division, Commission, to Alan Sorcher, SIA, dated February 12, 2004.

[9] See SIFMA, SEC No-Action Letter (Jan. 11, 2011) (noting that the broker-dealer's reliance on the investment advisor must be reasonable).

with its requirements and, thus, should be permitted to contract with a third-party service provider in order to comply with the core principles.[10] This approach is consistent with the Exchange Act, as amended by the Dodd-Frank Act, which provides reasonable discretion for SB SEFs to implement and comply with the rules. Contracting with a third-party service provider is not prohibited under the Exchange Act.

Finally, the WMBAA believes that by contracting as a third-party service provider, the Commission can permit regulatory services to be provided by the National Futures Association ("NFA") without subjecting the NFA to Commission registration or oversight. The contractual relationship between registered SB SEFs and the NFA would be distinct from and different than the relationship between the Financial Industry Regulatory Authority ("FINRA"), acting as a self-regulatory organization ("SRO"), and the entities that it oversees. The contractual arrangement would benefit SB SEFs for the reasons previously stated without impeding FINRA's current regulatory duties or preventing Commission enforcement of the Exchange Act and its promulgating rules, including core principles for SB SEFs.

Reliance on Third-Party Service Provider for Regulatory Oversight Services

Many likely SB SEFs are not currently regulated as exchanges, but rather as futures commission merchants ("FCMs"), broker-dealers or, where applicable, alternative trading systems ("ATSs"). These entities have familiarity with the rules of one or more SROs, such as FINRA or the NFA, which together with the Commission and the Commodity Futures Trading Commission ("CFTC"), will perform many of the regulatory functions assigned by the Dodd-Frank Act to SB SEFs and SEFs.

While FINRA and the NFA are SROs, the WMBAA is not advocating that they act as the SRO for SB SEFs and SEFs. Instead, the WMBAA believes that these organizations are best suited to provide, on a contractual basis, regulatory services to ensure SB SEF and SEF compliance with core principles and other obligations.

The WMBAA believes that reliance on a third-party service provider would best ensure the integrity of the swaps market and protect market participants from abusive trading practices. The WMBAA and its members are not the only market participants who have this position. In fact, numerous letters to the Commission identify the benefits of and urge the reliance on a third-party service provider.[11]

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[10] See Exchange Act 3D(d)(1) ("Unless otherwise determined by the Commission, by rule or regulation, a security-based swap execution facility described in subparagraph (A) shall have reasonable discretion in establishing the manner in which it complies with the core principles described in this subsection.").

[11] See letter to Commission from MarketAxess dated April 4, 2011 ("SB SEFs should be allowed to delegate to any qualified RSP . . . MarketAxess supports the SEC's approach, which would not limit the universe of RSPs and thus would encourage innovation and competition."); see also letter to Commission from Phoenix Partners Group LP dated April 4, 2011 ("As the SB SEF is not a counterparty to any transaction that takes place over its platform, this responsibility is misplaced and should be undertaken by a regulatory body such as the Commission or a self regulatory organization ("SRO") such as FINRA or a new SRO formed to oversee SB SEFs. We strongly feel that a SB SEF can only reasonably establish, maintain, and enforce rules which are properly designed to govern conduct on its own platform. Such rules must be tested, verified and, when necessary, amended. This is the framework used successfully

For example, some of the real-time monitoring and automated alerts contemplated by the Proposed Rules could be delegated to and carried out by a third party with particular technology or experience in those areas. A similar arrangement could be established for detecting fraudulent or manipulative acts. The reliance on a third-party service provider would also ensure that trade monitoring is done consistently among SB SEFs and prevent a situation in which participants can select a SB SEF based on the weakness of its monitoring and enforcement capabilities.

This arrangement is consistent with current practices for other service providers in the securities industry, such as compliance technology companies that provide technology platforms for fraud and anti-money laundering monitoring. These technology companies do not register with the Commission in order to provide regulatory compliance services, as the recipient of the service (*i.e.*, broker-dealer) retains regulatory liability for any violations. Just as specialty service providers do not register with the Commission prior to assisting with regulatory compliance, third-party service providers, such as the NFA, need not register with the Commission prior to contracting with SB SEFs.

Efficiencies of Third-Party Service Providers for SEFs and SB SEFs

Based upon public statements and conversations with industry participants, including many likely SB SEF applicants, there is a strong preference for SB SEFs to have the ability to enter into a regulatory services agreement with a third-party service provider to detect, investigate, and enforce rules for SEFs and SB SEFs with respect to swap and SB swap markets, respectively.[12] The WMBA and

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under NASD Conduct Rules 3010 and 3012 for FINRA member firms and we feel that it is the appropriate framework to be used in the SB SEF context as well."); see also letter to Commission from Thomson Reuters dated April 4, 2011 ("the SEC should permit third-parties to provide regulatory compliance solutions regarding the detection of rules violations, surveillance, and audit trail and disciplinary rules. Targeted applications can provide efficient compliance while preserving a firm's security and data integrity."); see also letter to Commission from Bloomberg dated April 4, 2011 ("[W]e would like to affirm with the Commission the ability of a SB SEF to use a third-party regulatory service provider to assist in complying with Dodd-Frank Title VII Core Principles and related rules. The Commission has recognized the appropriateness of regulatory outsourcing arrangements in other contexts. . . We believe that the SB SEF self-regulatory functions that may be appropriate for outsourcing may include, but would not be limited to, the following: trade practice surveillance; market surveillance; real-time market monitoring; investigations of possible rule violations; and disciplinary actions . . . The ability of SB SEFs to broadly avail themselves of a third-party regulatory service provider would allow SB SEFs to meet aggressive effective dates as well as allow SB SEFs to more efficiently focus on integrating the entire gamut of new rules and policies imposed on them. The value of being able to enlist an established third-party service provider should not be underestimated in terms of the Commission's being able to facilitate the expeditious and reliable introduction of SB SEFs into the newly constituted SB swaps marketplace."); see also letter to Commission from Bloomberg dated December 9, 2011 ("We encourage the Commission to recognize the ability of a SB SEF to use a third-party regulatory service provider for certain, limited functions that would allow for greater SB SEF cost efficiencies."); see also letter to Commission from George Baker dated March 5, 2012 ("It is essential for the Commission to recognize the ability of a SB SEF to use a third-party regulatory service provider to assist in complying with SB SEF Core Principles and related rules. The ability of SB SEFs to broadly avail themselves of a third-party regulatory service provider would allow SB SEFs to cost-effectively meet compliance obligations and effective dates as well as allow them to more efficiently focus on integrating the new rules imposed on them.").

[12] These services would include (i) monitoring trading to prevent manipulation; (ii) enforcing position limitations; (iii) investigating possible violations of SB SEF, CFTC or SEC rules, or other applicable laws; and (iv) establishing a code of procedure for administering discipline for rule violations and conducting hearings when necessary to determine if a violation may have occurred.

other commenters have indicated their belief that third-party service providers should be permitted to provide regulatory services for both swaps and SB swaps markets.[13]

Among those likely to offer these services, there is a preference among WMBAA members and many other industry participants that service providers, like the NFA, be permitted by the Commission to provide regulatory services for both SEFs and SB SEFs. As an example, the NFA has publicly announced it has reached agreement to provide regulatory services with eight entities that expect to register as SEFs and SB SEFs.[14] There are, to be sure, other entities currently negotiating similar arrangements with the NFA that have not yet been published.[15] The NFA has undertaken a significant commitment, in terms of allocation of resources, technology, and human capital, to meet the demands for SEFs and SB SEFs. NFA has been working with some future registered entities for nearly a year in preparation for this new role.

SEFs and SB SEFs are working with the NFA to ensure that the platforms meet the self-regulatory requirements, including surveillance of trading activity. The NFA, relying on its experience with DCMs and other entities, has already begun testing files of trading activity for the various asset classes for validation of the required fields on a daily basis. Once the validation process is complete, the NFA will conduct a compliance review which monitors the actual contents of the files. This process, which will take substantial effort to ensure timely and accurate implementation, should not be replicated with a second third-party service provider for nearly identical market data.

The benefits to this approach are numerous. For example, relying on a third-party service provider will ensure the harmonized implementation of monitoring and enforcement of CFTC and SEC rules across various asset classes, such as the streamlined processing for the SEF/SB SEF that executed transactions in both single-name and index credit default swaps.

Reliance on Third-Party Service Provider Does not Abrogate SB SEF Liability

The WMBAA urges that the Commission allows contracting with a third-party service provider for regulated services, but, to be clear, does not intend that such contractual relationship will allow a registered SB SEF to evade its ultimate responsibility to comply with "the core principles described in the [Exchange Act]; and any requirement that the Commission may impose by rule or regulation."[16] These obligations include appropriate monitoring, investigating, and enforcement of its rules and administering discipline for violations.

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[13] See letter to Commission from MarketAxess dated April 4, 2011 ("Allowing a system or platform that operates both a SEF and a SB SEF to delegate compliance with the SEF and SB SEF Core Principles to the same RSP would greatly reduce its cost of compliance.").

[14] See National Futures Association, "News Releases," available at http://www.nfa.futures.org/NFA-market-regulation/news-releases.HTML.

[15] See Testimony of Daniel Roth before the Senate Committee on Agriculture, Nutrition and Forestry, June 15, 2011 ("NFA has been contacted by numerous potential SEFs that are interested in outsourcing certain self regulatory responsibilities to NFA.").

[16] Exchange Act Section 3D(d)(1).

This approach is consistent with the relevant provisions of the Exchange Act and a position endorsed by other anticipated SB SEFs in their comments to the Commission.[17] Similarly, such a conclusion aligns with SEC findings related to SIFMA,[18] declaring that "[n]othing in this no-action letter relieves a broker-dealer of its obligation to establish policies, procedures, and controls that are reasonably designed to detect and report suspicious activity that is attempted or conducted by, at, or through the broker-dealer."[19] Just like the relief granted to broker-dealers, SEFs and SB SEFs that contract with a third-party service provider should not be relieved from their obligations under the Exchange Act.

Conclusion

The WMBAA thanks the Commission for the opportunity to comment on the Proposed Rules. Please feel free to contact the undersigned with any questions you may have on our comments.

Sincerely,

Christopher Ferreri
Chairman, WMBAA
ICAP

[17] See letter to Commission from Tradeweb dated April 4, 2011 ("Tradeweb urges the Commission to clarify that while a SEF would remain responsible for applicable self-regulatory functions, it would have flexibility in contracting with third party service providers, so long as the SEF uses reasonable diligence and acts in a manner consistent with market practice."); see also letter to Commission from Bloomberg dated April 4, 2011 ("Under such an arrangement the SB SEF would retain responsibility for complying with the Core Principles and related rules but would use a third-party to perform certain functions.").

[18] See SIFMA, SEC No-Action Letter (Jan. 11, 2011).

[19] See SIFMA, SEC No-Action Letter (Jan. 11, 2011), fn. 3.