THE FINANCIAL SERVICES ROUNDTABLE

Financing America's Economy

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By Electronic Mail (http://comments.sec.gov)

April 4, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F St., NE.
Washington, DC 20549–1090.

Regarding: SEC Release No. 34–63825; File No. S7–06–11

Registration and Regulation of Security-Based Swap Execution Facilities

RIN Number 3235–AK93

Dear Ms. Murphy:

The Financial Services Roundtable[1] respectfully submits these comments in response to the request for comments by the Securities and Exchange Commission (the "Commission") with respect to its proposed rulemaking, SEC Release No. 34–63825; File No. S7–06–11, Registration and Regulation of Security-Based Swap Execution Facilities, RIN Number 3235-AK93 (the "Proposing Release"),[2] to implement certain requirements of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[3] The Proposing Release is part of a significant rulemaking endeavor by the Commission to implement the provisions of Title VII of the Dodd-Frank Act and subject security-based swap transactions to comprehensive regulation and regulatory oversight. The Proposing Release in particular relates to Section 763 of the Dodd-Frank Act and related provisions establishing a new category of registered entity, the "security-based swap execution facility" ("SB SEF"); articulating the key characteristics of and core principles governing a SB SEF; and clarifying important aspects of the SB SEF's role within the larger regulated environment for security-based swaps established by the Dodd-Frank Act.

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[1] The Financial Services Roundtable (the "Roundtable") represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.1 trillion in revenue, and 2.3 million jobs.

[2] 76 Fed. Reg. 10948 (February 28, 2011).

[3] Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376, 1897 (July 21, 2010).

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1. <u>We support: a) the inclusion of an RFQ platform as one of the possible means of trading on a SB SEF and b) the Commission's proposal that the RFQ platform allow the requesting party to submit the request to a single counterparty selected by the requesting party</u>.

As the Commission notes, compared to other types of financial positions traded on exchanges, swaps and security-based swaps are extremely illiquid.[4] Although the Dodd-Frank Act seeks to encourage transparency and exchange trading for these instruments, the lack of liquidity poses a challenge to the effort to establish centralized trading. The Commission has acknowledged this challenge, in part by proposing that a request-for-quotations ("RFQ") platform be permitted as well as a central limit order book for SB SEFs. In an illiquid market, transparency can undermine rather than facilitate true price discovery by allowing market participants to exploit information about other parties' trading strategies or hedging needs. For this reason, the RFQ platform is a better option than a central limit order book for illiquid positions, because it does not require a party to telegraph intent to the entire market.[5]

Similarly, an extremely important characteristic of the OTC markets has been the fact that participants know their counterparties and can evaluate counterparty risk. Within the security-based swaps market, reputational risk is a strong incentive in ensuring the completion of obligations. Relationship-based trading can also be a significant factor in preserving liquidity in a market that is under stress. Anonymous, exchange-traded markets may have more legal uncertainty and may face liquidity challenges in times of financial crisis that would not be present in the OTC markets. These concerns, as well, support the establishment of RFQ platforms that will increase transparency by making consolidated quotations available, while preserving important well-functioning aspects of the current markets.

Our members believe that an RFQ system will work best if it has the following features:

(1) Participants have control over the liquidity providers to which their queries are conveyed;
(2) Participants have the ability to select a quote in their discretion, even where the quote may not reflect the best price among the quotes received if there are relevant factors that make it more desirable;

[4] Proposing Release at 10952 n. 35.
[5] This is equally true in the context of block trades. We note that, although the Commission has included provisions in its proposed rules that are intended to prevent market manipulation, such rules are unlikely to prevent other parties from using widely disseminated information to their advantage. Such use would be harmful to the market participant initiating the trade, and is unlikely to provide offsetting benefits to the markets as a whole, such as increased liquidity or transparency.

(3) Liquidity providers receiving the request for quote have relevant information about the identity of the party making the query; and
(4) The request for quotation is not published by the SB SEF until after the trade has been completed, and then only as part of aggregated disclosures.

Because of the liquidity challenges in the security-based swap markets, we believe that an RFQ platform is an essential part of a SB SEF. Our members do not believe that a central limit order book, on a stand-alone basis (*i.e.*, not paired with an RFQ platform), generally would be sufficient for trading the security-based swaps that currently comprise the OTC markets.

Finally, we support the Commission's proposal to allow participants to query a single other participant. Our members feel this policy may be effective in preventing inappropriate manipulation, while requiring broader queries may make participants more vulnerable to such manipulation. We support the Commission's proposed interpretation of the definition of a SB SEF in Section 761—which defines a SB SEF as "a trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility or system"[6]—to focus on the meaning of the word "ability," so that the relevant requirement is only that the market participant requesting the quote have the *option* to query multiple parties—not that it be required to do so.[7]

2. <u>We urge the Commission to strike an appropriate balance in its proposals between requiring open access to SB SEFs and allowing counterparties to conduct their own diligence with respect to uncleared trades.</u>

Many of our members expect to be ECPs that will not be required to register as swap dealers or major swap participants, and we support broad access for such ECPs to SB SEFs. At the same time, we believe that counterparty credit risk assessment will be an essential aspect of uncleared trades on a SB SEF, even if the SB SEF has robust financial requirements as a condition of access. We therefore support the Commission's proposed approach under Section 815(b) to allow SB SEFs to establish rules that will permit their participants to consider counterparty credit risk in connection with uncleared trades.

For this reason, we believe that a trading platform such as a central limit order book that supports anonymous trades would only be appropriate for transactions that will be submitted for clearing. Indeed, we believe central clearing is fundamental to the proper functioning of a central limit order book system, especially on a facility that provides open access. We request that the Commission clarify that anonymous trading can only occur on a platform with comprehensive central clearing.

[6] Dodd-Frank Act, Section 761.
[7] Proposing Release at 10953.

3. The Commission should provide significant flexibility to SB SEFs to determine: a) how bids on a central limit order book platform will interact with those on an RFQ platform, and b) which platforms are appropriate for particular products.

The Commission has made several proposals that would limit the broad discretion it otherwise affords to SB SEFs to determine appropriate trading platforms. In particular, the Commission has proposed to require that the swap review committee periodically re-examine the choice of platform for a product and sets out specific criteria the committee must consider. We believe that a SB SEF should have greater operational discretion in this regard, especially if it believes that making a change in platform would disrupt the market or its position within the market. In addition, the Commission has indicated that block trades done on an RFQ platform would have to sweep up bids made on a central limit order book platform. Here, too, we believe the SB SEF, and participants trading on it, should have discretion over the interaction between its platforms. If a customer concludes that transacting a block trade as a single block will have significant operational or pricing advantages, it should be able to do so without having to pick up small bids along the way. Moreover, if the resting bids are transparent, as we assume they would be, the customer presumably will have considered them in making its determination to pursue a block trade. Finally, creating the ability for the two systems to interact as proposed may be difficult or expensive from a technology perspective and may not be justified if such functionality would seldom be used in the market.

4. The Commission should clarify: a) what it means to "execute" a trade, and b) establish clear guidelines for acceptable preliminary communications between market participants.

For participants in the security-based swap market, executing transactions on a SB SEF or national securities exchange will represent a significant change from the current practice in which most security-based swap transactions are created through direct communication between the parties. We believe the exchange-trading requirements of Title VII allow direct communication, including by telephone, so long as no binding commitment to enter into a transaction is made during such communication. In other words, we believe customers should continue to be permitted to have off-exchange discussions with dealers regarding the terms of a swap, with both parties then bringing the swap onto a SB SEF, or exchange platform, to make a binding commitment in accordance with the rules of the facility. Certain aspects of the proposed rules seem to contemplate that significant precursors to a trading arrangements may have occurred prior to consummation of the trade on the facility. Our members have nonetheless emphasized a need for clear guidance on permitted versus impermissible conduct and contacts. We therefore request that the Commission clarify where these lines will be drawn in order to ensure compliance with the requirement that the trade be executed on a SB SEF or exchange.

5. We support the Commission's proposed approach to determining when a security-based swap is "available to trade" and agree that the determination should be made by the Commission based on objective standards, rather than being left in the hands of market participants.

The term "available to trade" has a significant new meaning in the context of a SB SEF, as it is a critical aspect of the determination that a security-based swap must be traded on a SB SEF or national securities exchange. It is not the same as a security-based swap being "listed," or the SB SEF permitting transactions to occur on its trading platforms.

We support the Commission's proposal to adopt an objective standard for determining when a security-based swap is available to trade rather than leaving this determination in the hands of one, or a handful, of SB SEFs. We realize that the Commission has not yet proposed the parameters of the objective standard, and we may have comments when that is proposed. Given the nascent stage of development of SB SEFs and the rules under which they would operate, however, we believe that the Commission's decision to defer proposing a standard until more information is available is an appropriate one. We feel very strongly that the infrastructure for SB SEF and exchange trading of security-based swaps should be established and tested, and that the repercussions of such trading on the liquidity of such swaps should be understood, before such trading is made compulsory

We similarly believe the Commission should require a test period of some weeks or months between the time a security-based swap is listed on a SB SEF and the time it may be deemed "available to trade." Instituting this timeframe will allow the SB SEF, the Commission, and other market participants the opportunity to confirm that such a designation is appropriate. Once a security-based swap is available to trade on a SB SEF, it must trade on a SB SEF or national securities exchange if it is subject to the mandatory clearing requirement and no exception is available. If the determination is made that a security-based swap is "available to trade" when the system is not yet adequately able to support such trading, it will unnecessarily disrupt the ability of all market participants to enter into such swaps.[8]

6. We *strongly* believe that Chief Compliance Officers should not be required to sign certifications that will effectively make them strictly liable for aspects of their compliance programs and should not be given responsibility for periodic filings of financial reports.

Section 3D(d)(14) of the Securities Exchange Act, as added by Section 763 of the Dodd-Frank Act, requires that a SB SEF have a chief compliance officer ("CCO"), and sets out the responsibilities and obligations of the CCO. One of the obligations of the

[8] On this basis, we believe that deferral of the development of the objective standard until after the first SB SEFs begin operation would also be a reasonable approach.

CCO is to provide an annual compliance certificate that describes the compliance of the SB SEF with the Securities Exchange Act and "the policies and procedures, including the code of ethics and conflict of interest policies," of the SB SEF. The CCO is also required to "include in the report a certification that, under penalty of law, the report is accurate and complete."[9]

We recognize that the statute requires the compliance report to be submitted concurrently with a financial report. However, we do not read to the statute to require, as the Commission has proposed,[10] that the CCO prepare and submit to the Commission a full set of audited financial statements prepared in accordance with GAAP and other financial information. Preparation of such a report should be handled by the Chief Accounting Officer or Chief Financial Officer. CCOs will have a significant work load with respect to their compliance obligations; the Commission should not also try to place responsibility for financial reporting on these persons.

We are also concerned about the lack of knowledge or materiality qualifiers in the proposed CCO certification.[11] The CCO will have to rely on materials prepared by other persons in making the certification. For example, clause (vi), which requires reports of the results of the surveillance program, requires the CCO to rely on reports generated by the firm's computer systems. A CCO should not have strict liability for reporting in this circumstance. Instead, a CCO certification that reflects a good faith effort to evaluate, assess, and otherwise report fully with respect to the state of the SB SEF's compliance program should not subject the CCO to liability for errors that are immaterial or of which the CCO was not aware. We are greatly concerned about the willingness of qualified persons to take on the CCO roles at this type of entity, and we advise against a certification standard that may require them to guarantee the results of their compliance systems, rather than to report them to the best of their knowledge and ability.

7. <u>The Commission should work closely with the Commodity Futures Trading Commission ("CFTC") to ensure that the rules for SEFs and SB SEFs are consistent and support dual registration.</u>

We appreciate that the Commission and the CFTC are not required to promulgate identical rules for swap execution facilities ("SEFs") and SB SEFs, and that there may be aspects of both types of products that lead to regulatory differences in some circumstances. We appreciate, for example, that the Commission may not share the CFTC's concerns about the availability of physical commodities, which will not be a relevant consideration for security-based swaps, and that the CFTC may not share the Commission's concerns about insider trading. Both the Commission and the CFTC, however, have stated that they are consulting with each other in connection with various rules, and the Commission in particular has noted that it expects that many entities will

[9] Securities Exchange Act Section 3D(d)(14).
[10] Proposed Section 242.843(e), Proposing Release at 11065.
[11] In this regard, we note that the CFTC felt comfortable including a knowledge qualifier when interpreting comparable language.

request dual registration as SEFs and SB SEFs.[12] Despite this consultation, it appears that many of the current differences in proposals are not particularly correlated to differences in the products. In addressing virtually identical language, the Commission and the CFTC have proposed rules that are organized differently, use different language and impose different requirements. An example of this is Core Principle 4, Monitoring of Trading of Trade Processing, for which Congress used virtually the same language in the provisions for SEFs and SB SEFs. Also, a comparison of Subpart E of the CFTC's proposed rules in Part 37 to Section 813 of the Commission's proposed rules in Part 242 shows that they differ in scope, detail, and substance in ways that do not appear tied to product differences.

Another example of differences between the Commission and the CFTC's SEF rulemaking deals with the handling of confidential information. The Commission's version of the proposed rule, which we support, states that "[a] security-based swap execution facility shall not use for non-regulatory purposes any confidential information it collects or receives, from or on behalf of any person, in connection with the security-based swap execution facility's regulatory obligations."[13] The CFTC's comparable provision, which is much narrower and allows for too broad a use of confidential information, states that "[a] swap execution facility may not use for business or marketing purposes any proprietary data or personal information it collects or receives, from or on behalf of any person, for the purpose of fulfilling its regulatory obligations."[14] We see no reason that provisions such as these should not be conformed. Otherwise, entities attempting to register as both SEFs and SB SEFs will find themselves dealing with the challenge of structuring their compliance programs to conform to two different sets of rules that supposedly should address the same subject and implement the same core principle.

We recognize that timing constraints and differing regulatory priorities have made coordinated rulemaking even more challenging than it would otherwise be. Nonetheless, we are concerned that the complications of differing and potentially conflicting sets of rules may limit the ability of these new trading platforms to develop or expose them to unnecessary compliance costs. We urge the Commission and the CFTC to work together now—before final rules are adopted—to enhance the consistency of these rules. Where rules need to be different we urge both Commissions to explain the reasons such differences are required. We believe such explanation will promote understanding among market participants and ultimately enhance implementation and compliance.

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[12] See SEC Release No. 34–63107; File No. S7–27–10, 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, at footnote 12. "The Commission preliminarily believes that an entity that registers with the Commission as either a security-based swap clearing agency or a SB SEF is likely to register also with the CFTC as a derivatives clearing organization or swap execution facility, respectively. As a result, the Commission staff and the CFTC staff have consulted and coordinated with one another regarding their respective agencies' proposed rules to mitigate conflicts of interest."

[13] Proposed Rule 242.810(c), Proposing Release at 11060.

[14] CFTC Proposed Section 37.7 in RIN Number 3038-AD18, Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1214, 1240 (January 7, 2011).

Conclusion

We appreciate the opportunity to express our views on these extremely complex issues. We are confident that the Commission will adequately address the areas of specific concern that the Roundtable has addressed above. If you have any questions about this letter, or any of the issues raised by our comments, please do not hesitate to call me or Brad Ipema, the Roundtable's Senior Regulatory Counsel, at (202) 589-2424.

Sincerely,

Richard M. Whiting
Executive Director and General Counsel
Financial Services Roundtable