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April 4, 2011

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

**Re: S7-06-11 – Registration and Regulation of Security-Based Swap Execution Facilities**

Dear Ms. Murphy:

The Securities and Exchange Commission ("SEC") has requested public comment on proposed rules implementing Registration and Regulation of Security-Based Swap Execution Facilities ("SB SEFs") under the Securities Exchange Act of 1934 as amended by Dodd-Frank. See Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10,948 (Feb. 28, 2011) (the "Proposed Rules"). The SEC faces a difficult challenge formulating appropriate and workable SB SEF rules that will promote SB swap trading on organized, regulated platforms, one of the key reform objectives of Dodd-Frank.

MarketAxess Corporation ("MarketAxess") is regulated as a broker-dealer and as an alternative trading system ("ATS") operator by the SEC and the Financial Industry Regulatory Authority ("FINRA").<sup>1</sup> We operate a leading electronic trading platform for investment industry professionals that promotes transparency, price discovery, and liquidity in the corporate bond and other markets, including both index and single name credit default swaps ("CDS").

MarketAxess' current operations are consistent with the SEC's SB SEF proposals for trading protocols, price transparency, audit trails, independence<sup>2</sup> and financial resources. We are ideally suited to achieve Dodd-Frank's objectives for SB SEFs and intend to begin operations as a SB SEF as soon as possible. We therefore have an acute interest in, and appreciate the opportunity to submit detailed public comment on, the SEC's SB SEF proposals.

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<sup>1</sup> MarketAxess Corporation is the principal operating subsidiary of MarketAxess Holdings Inc., a public company. Our principal offices are located in New York City, and we currently employ approximately 227 persons.

<sup>2</sup> Although initially a dealer-owned entity, MarketAxess Holdings Inc. is now a public company, with no dealer(s) owning, individually or in the aggregate, more than 20% of MarketAxess' common stock. In addition, MarketAxess' 12-person Board of Directors includes nine individuals who meet the requirements for independence under the rules of the Nasdaq Stock Market.



The SEC's proposals underscore the importance of SB SEFs to accomplishing Dodd-Frank's goals of promoting trading on and competition among SB SEFs, resulting in greater pre-trade transparency. While some SB swaps may eventually be traded on traditional exchange platforms, SB SEFs are the new venues where most SB swap trading is expected to migrate from today's voice broker-dominated market structure. Congress understood that most SB swaps are used for legitimate risk transfer by commercial and financial enterprises. Enhanced SB SEF swap trading should therefore decrease the cost of capital and stimulate economic growth. A thriving SB SEF business model in the United States would contribute materially to achieving the national economic policy objectives embedded in Dodd-Frank.

Against that backdrop, MarketAxess agrees with and supports many aspects of the SEC's proposals. We also will suggest some areas for improvement based on our experience operating a successful electronic trading platform. Our primary concern is that some aspects of the SEC's proposals may inadvertently undercut the viability of the SB SEF business model.

Today, organized, regulated trading platforms range from electronic Request for Quotation ("RFQ") platforms operated by registered broker-dealers such as MarketAxess to Central Limit Order Books operated by national securities exchanges and designated contract markets ("DCMs"). The SEC's proposals place SB SEFs near the exchange markets on the spectrum of regulated trading platforms. By imposing on SB SEFs rigid, exchange-like self-regulatory obligations for infrastructure and discipline, among other requirements, the SEC would erect unwarranted and formidable barriers to entry for SB SEFs.

These barriers to entry for SB SEFs are quite real, particularly given the fact that, in comparison to other markets, including the securities markets, trading activity in OTC derivatives -- at least in its early phases -- is likely to be modest at best. For example, current CDS trading is relatively miniscule when compared to the several millions of transactions executed daily in U.S. equity options markets. Recent Depository Trust and Clearing Corporation data indicate that only approximately 6,000 CDS transactions are executed daily across all regions, market segments (dealer-to-dealer and client-to-dealer), and products (indexes, tranches, single names). Given this comparatively meager trading, if SB SEF regulatory costs are too high, very few SB SEFs will be successful, or even created, and the market will suffer from a lack of innovation and competition, exactly the opposite of what Congress intended in Dodd-Frank.

We therefore strongly urge the SEC to consider, consistent with the SB SEF Core Principles, whether its proposals can be streamlined to adopt more of an ATS-type regulatory model, which the SEC has used for many years to enhance competition among trading platforms in many securities markets. (We have also urged the CFTC similarly to reconsider the thrust of its swap execution facility ("SEF") proposals.) Regulation ATS has provided a flexible and cost-effective framework. We believe strongly that a similar model that would permit a Regulatory Service Provider ("RSP") to perform a SB SEF's self-regulatory duties is appropriate for SB SEFs, which are expected to experience, at least initially, episodic trading and limited execution fees similar to an ATS. This would be consistent with the fact that the "E" in SB SEF stands for *execution*, not trading; execution facility can mean many things and take many forms.



The SEC's proposing release refers often in different contexts to the salutary goal of promoting "competition." It is unclear in some instances what competition the SEC is intending to promote. We understand and ask the SEC to clarify in its release accompanying the final rules that when the SEC refers favorably to promoting "competition" in the context of SB SEFs, it means allowing SB SEFs to compete fairly with other execution platforms and allowing all qualified market participants to enjoy impartial access to the SB SEF. The SEC does not mean, as its rule permitting RFQs to be sent to only one other market participant shows, that all SB SEF market participants must receive every request for quote. If SB SEFs evolve to provide the particular kind of access to order flow that characterizes central limit order books, it should be because market participants want that type of trading platform, not because the SEC or the CFTC mandates it.

MarketAxess appreciates that the SEC is attempting to strike the right regulatory balance while promoting the congressional goal of robust SB SEF trading. International competition should also be an important element of the SEC's formula for successful SB SEFs. The majority of SB swap transactions are conducted by global dealers, banks, hedge funds, and investment managers. These global institutions may, with relative ease, shift trading capital to non-U.S. trading platforms that offer a more hospitable regulatory environment for trade execution. That result would thwart the purpose of Dodd-Frank and should be avoided if at all possible.

Following our executive summary, our comments begin with a statement of our background and experience as well as a synopsis of the statutory framework for SB SEFs and the SEC's proposal. We then address five basic areas:

1. Broad and Effective Delegation of SB SEF Self-Regulatory Functions (pages 16-17);
2. Effective Temporary SB SEF Registration (pages 18-22);
3. Passport SB SEF Registration among SEC SB SEFs and CFTC SEFs (pages 22-24);
4. Specific Refinements to the SEC's Proposal to Promote SB SEF Trading (pages 24-39); and
5. Clarifications and Technical Comments on the SEC's Proposal, as drafted (pages 39-42).

## **EXECUTIVE SUMMARY**

Customer service is MarketAxess' cornerstone. We take the service part of that phrase very seriously. We are not in business to give investment advice, to take the other side of our customers' trades, to protect retail investors (we have none) or to remove counter-party credit risk. Instead, our business is to provide more than 800 market participants – from commercial banks and pension plans to hedge and investment funds – a fair, open, and reliable electronic



trading network for non-continuous, episodic negotiations and executions in generally less liquid OTC securities and derivatives. Our customers use MarketAxess as a means to facilitate efficient and transparent trade communication among mostly otherwise regulated market participants.

MarketAxess offers our customers different types of trading protocols to match their needs. This flexibility has served our customers well and allows our trading platform to flourish. We are neither an exchange for retail investors nor any other form of self-regulatory body. We offer a professional trading network. Regulating our SB swap market as if it were an exchange would be unwarranted and unwise.

Congress agrees. Dodd-Frank's execution mandate does not require cleared SB swaps and swaps to be traded only on national securities exchanges and DCMs. Instead, Congress envisioned SB SEFs and SEFs as new competitive alternatives to national securities exchanges and DCMs that would be able to operate in a lesser-regulated environment where professional and sophisticated market participants could transact in SB swaps and swaps when advisable or mandated by the SEC or the CFTC. Congress did not intend SB SEFs to be self-regulatory organizations ("SROs").

Consistent with that intent, Congress sought to provide a flexible framework for SB SEF oversight. Otherwise, new market entrants would never become SB SEFs, leaving the SB swap execution field to exchanges or entities that could bear heightened regulatory costs, either because they already had built, or had the capital to build, that degree of functionality and regulatory infrastructure. Recognizing that regulatory costs would be important to any new enterprise, Congress eschewed one-size-fits-all, command and control requirements and instead adopted flexible Core Principles.

This congressional decision was critical. It provides the SEC and the CFTC discretion to adopt identical, or at least consistent, regulatory approaches for SB SEFs and SEFs, relying on the SEC's experience with the ATS and RFQ market structures and the CFTC's experience with Core Principles.

For these reasons, flexibility should be central to SB SEF regulation and the SEC's administration of the SB SEF Core Principles. With respect to trade execution, for example, we support the SEC's flexible interpretation of the SB SEF definition that would allow an RFQ to be submitted to one other market participant. Our customers believe there is real value in the flexible "one to one" RFQ format, and their needs should be paramount. Each customer should be allowed to choose, through the RFQ selection of one or more potential counterparties, how much "pre-trade price transparency" the customer wants. The approach proposed by the SEC would accomplish that.<sup>3</sup>

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<sup>3</sup> This approach is consistent with the alternative language proposed by CFTC Commissioner Jill Sommers in the CFTC's proposal, but not with the language that the CFTC proposed. See Proposed CFTC Rule 37.9 and Commissioner Sommers' alternative language thereto.



The SEC proposals also provide for flexible third-party delegations by SB SEFs to meet virtually all of the Core Principles. We commend the SEC for formulating this approach. If each SB SEF were required to build out a complete self-regulatory apparatus, including, among other things, the requirement to administer a disciplinary program and monitor the financial condition of participants, the SB SEF ranks would dwindle considerably and market participants might decide to restrict the number of SB SEFs they use. In order to adequately reduce a significant barrier to entry and thereby promote SB SEF trading, the SEC must allow for effective delegations by ensuring that SB SEFs may realistically have a broad array of parties to which they could delegate performance of Core Principle functions, while retaining legal responsibility for that performance.

MarketAxess further supports the SEC's policy allowing temporary SB SEF registration. We believe, however, that when a SB SEF files a materially complete registration application and demonstrates how it will in the future have the capacity to comply with the applicable standards, the SB SEF applicant should be granted Temporary Registration until final action by the SEC on the application. More specifically, the SB SEF should be able to obtain Temporary Registration if it certifies that it already meets most of the SB SEF Core Principles – impartial access, trading protocols, conflict of interest (including the SEC's ownership and governance standards when finalized), audit trails, only offering SB swaps that are not readily susceptible to manipulation, financial resources, revocation of access to those violating its trading rules, and clearing connectivity to applicable clearing agencies.

This is especially critical for MarketAxess. The SEC's proposal conditions obtaining a Temporary Registration on the applicant's certification that it complies with the 14 SB SEF Core Principles. But compliance with some of those Core Principles necessarily will need to await the build-out of functionality by a RSP that will perform the required services. In these circumstances, many SB SEF applicants will not be able to certify actual compliance for some time in the future and surely not at the time of filing a SB SEF registration application.

In the interim, MarketAxess should be able to offer a regulated trading platform in SB swaps, especially in light of our use of many of the same electronic trading protocols that we have used for many years for securities transactions subject to SEC oversight, as well as our ability to meet the bulk of the SEC's SB SEF standards. Otherwise, our competitive position will be severely compromised as only entities, such as existing exchanges, which have self-regulatory functionality already in place, or deep-pocketed entities that can afford to create the infrastructure from scratch, will be first to market.

Our recommendation is perfectly compatible with the congressional goal to promote trading on, and competition among, SB SEFs. Requiring a SB SEF to spend considerable resources to develop capabilities that a SB SEF plans to delegate as soon as a RSP is prepared to take over those functions would be both a wasteful use of valuable resources and a potentially fatal barrier to entry for many SB SEFs.

MarketAxess also commends the SEC for proposing that the agency itself will make the all-important determination as to what SB swaps must be cleared and thus traded on a SB SEF.



We are confident that the SEC will set these mandates based upon the available data and evidence of trading activities.

Although we appreciate the SEC's intended flexibility in proposing to allow SB SEFs to set block sizes until the SEC adopts criteria and a formula for determining minimum block sizes, we believe very strongly that the SEC, not individual SB SEFs, should set the minimum size for SB swap blocks for both interim and final rules (with that latter based on actual trading experience on SB SEFs). Allowing SB SEFs to set block sizes in the interim could encourage SB SEFs to set the minimum block size at a lower threshold than their competitors to attract more business by permitting participants to avoid Dodd-Frank's real-time reporting requirements.

In setting the minimum block sizes for interim purposes, we believe the SEC should consider, based on the information available, the liquidity of a particular SB swap, the relative size of a trade compared to the average size of a trade for that particular SB swap, and the breadth of market participants that already provide liquidity for that class of SB swap. However, the SEC should ensure that the rules are not so complex as to create market confusion or costly operational overhead. The SEC also should expand the proposed permissible reporting delay for block trades as many of our customers have suggested; the SEC's proposed time period for delayed block reporting is too short.

MarketAxess requests that the SEC consider some form of "passport" or notice SB SEF registration for those entities that register with the CFTC as SEFs. Congressman Barney Frank's letter of February 18, 2011 expresses well the rationale for this policy. As the SEC and the CFTC are implementing identical SB SEF and SEF registration standards, each agency should recognize the validity of the other agency's registration determination. As MarketAxess intends to operate a SB SEF for single-issuer CDS and a SEF for broad-based index CDS, we urge the SEC and CFTC generally to adopt SB SEF and SEF registration and regulatory standards that are identical or as close to identical as possible. That policy is consistent with the public interest and the efficient use of government and private sector resources.

Lastly, MarketAxess offers numerous substantive and technical suggestions in this letter. We have tried to provide thoughtful and constructive suggestions to the SEC on how its proposal could be improved to serve better the congressional goal of promoting SB SEF trading with its resulting increase in pre-trade transparency. Included among our technical comments are:

1. Firm bids and offers for uncleared swaps should only be made available to participants with the appropriate trading relationship and credit documentation in place.
2. A composite indicative quote should not include responses to RFQs, should only be required for SB swaps on which dealers have provided multiple indicative bids and offers, and should not be required for uncleared SB swaps.
3. SB SEF management, not a special committee, should decide what SB swaps will be traded on a SB SEF.



4. SB SEFs should be able to list new SB swaps not only on an individual basis, but as a class of transactions.
5. The SEC should determine which SB swaps are made "available to trade" using objective criteria based on actual data once sufficient data becomes available and this determination should apply to all similar SB swaps in the same class of transactions.
6. Once a SB SEF has commenced operations, absent a showing of abuse, the SEC should refrain from banning certain execution methods.
7. A SB SEF should have a duty to monitor only activity on its market, not those operated by its competitors.
8. A SB SEF should only be required to administer a summary disciplinary program and should be able to delegate disciplinary functions.

Our overall objective is to make sure that SB SEF regulation does not mimic exchange regulation but instead allows SB SEFs to offer flexible, efficient and reliable electronic trading networks that meet the needs of all qualified professional market participants. We believe that, as detailed below, our approach is perfectly compatible with, and in many respects even compelled by, congressional intent: As in the past, we would be happy to discuss these observations at any time that may be convenient for the SEC and its staff.

## **BACKGROUND**

### **MarketAxess Story**

MarketAxess operates a leading electronic trading platform that promotes transparency, price discovery, and liquidity in the corporate bond and other fixed income markets and allows investment industry professionals to trade efficiently corporate bonds, other types of fixed-income instruments and derivatives, including CDS. Today, more than 800 active institutional investor clients, including investment advisers, mutual funds, insurance companies, public and private pension funds, bank portfolios, broker-dealers and hedge funds, use the MarketAxess platform to trade with 78 broker-dealer market-maker liquidity providers, including substantially all of the leading broker-dealers in global fixed-income trading.<sup>4</sup> We also provide fixed-income market data, analytics and compliance tools that help our clients make trading decisions, and our automated post-trade messaging facilitates the communication of trade acknowledgment and allocation information between our institutional investor and broker-dealer clients.

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<sup>4</sup> Our broker-dealer clients accounted for approximately 97% of the underwriting of newly-issued U.S. high-grade corporate bonds and approximately 68% of the underwriting of newly-issued European high-grade corporate bonds in 2010. We believe these broker-dealers also represent the principal source of secondary market liquidity in the markets in which we operate.



MarketAxess was formed in April 2000 in response to investors' need for a single electronic trading platform with easy access to multi-dealer competitive pricing in a wide range of debt securities. From the time of the commercial launch of our electronic trading platform in January 2001, our annual trading volume has increased from \$11.7 billion to more than \$400 billion, and we have consistently added new clients, having commenced business with approximately 60 institutional investor clients and eight broker-dealer clients. Our volume in U.S. high-grade corporate bonds represented approximately 8.4% of the total U.S. high-grade corporate bond volume,<sup>5</sup> excluding convertible bonds, for 2010 as reported on FINRA's Trade Reporting and Compliance Engine ("TRACE"), which includes inter-dealer and retail trading as well as trading between institutional investors and broker-dealers.<sup>6</sup>

MarketAxess permits qualified dealers ("Dealers") and institutional investor firms ("Users") to access its system and relies on existing SEC classifications and oversight to help determine whether to grant access. Dealers, which must be registered with the SEC as a broker-dealer and a member of a SRO (typically FINRA), must execute a MarketAxess Dealer Agreement to gain access to the MarketAxess platform. Dealers must agree to comply with Federal and State laws as well as applicable SEC rules and regulations. Dealers must comply with recordkeeping requirements under SEC regulations and the rules of the SRO where the Dealer is a member.

MarketAxess and its participating Dealers agree to cooperate with one another, and provide access to information as necessary, in the event of a regulatory audit or examination. The Dealer Agreement allows MarketAxess to suspend a Dealer's access at any time and for any reason. Dealers must maintain specified system security requirements. The agreement also requires Dealers to honor settlement obligations and settle through customary industry means. MarketAxess reserves discretion on whether to admit qualified new Dealers.

In order to access MarketAxess' platform, a User must execute a User Agreement and identify Dealers with whom it has a trading relationship and documentation in place. Once a Dealer identified by the User confirms to MarketAxess that the requisite documentation exists, the User will be able to access information from, and transact with, that Dealer on the MarketAxess trading platform.

MarketAxess also requires each User to be a Qualified Institutional Buyer ("QIB"), as defined by SEC regulations, and to provide its QIB certification. Users are not permitted to share information from MarketAxess' system with any third parties. Users must provide

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<sup>5</sup> Although we believe that we account for substantially all of the total U.S. high-grade corporate bond volume that is traded electronically, "traditional" means of trading (*i.e.*, telephone and email) remain the manner in which the majority of bonds are traded between institutional investors and broker-dealers.

<sup>6</sup> TRACE is a FINRA-developed service that disseminates real-time price information for over-the-counter corporate bond transactions (99 percent of U.S. corporate bond transactions occur in the OTC market). The system was introduced in 2002 in order to bring price transparency to the corporate bond market. Under SEC rules, all broker-dealers who are FINRA members must report transactions in corporate bonds to TRACE, which disseminates price information about these transactions immediately. TRACE does not disseminate information about the identity of the counterparties to a trade.



information about themselves or their clients to MarketAxess, upon request, when necessary for MarketAxess or a Dealer to comply with regulatory reporting requirements. Users must meet system and security requirements specified in the User Agreement. Users are also responsible for complying with any recordkeeping requirements under any applicable laws as well as rules and regulations of the SEC and any SRO with which the User is a member. The User Agreement also permits MarketAxess to suspend or revoke a User's access at any time and for any reason.

MarketAxess is not responsible for transactions entered into between Users and Dealers. Rather, we serve as an intermediary between our institutional investor clients and our broker-dealer clients, enabling them to meet, agree on a price, and then transact with each other.

Traditionally, bond trading has been a manual process, with product and price discovery conducted over the telephone between two or more parties. This traditional process has a number of shortcomings resulting primarily from the lack of a central trading facility for these securities, which creates difficulty matching buyers and sellers for particular issues. Many corporate bond trading participants use e-mail and other electronic means of communication for trading corporate bonds. While this has addressed some of the shortcomings associated with traditional corporate bond trading, the process is still hindered by limited liquidity, limited price transparency, significant transaction costs, compliance and regulatory challenges, and difficulty in executing numerous trades at one time. Efforts to develop exchange-sponsored central limit order book platforms for corporate bonds also have not been successful due to limited liquidity.

In contrast to traditional bond trading methods, our multi-dealer trading platform allows our institutional investor clients to simultaneously request competing, executable bids or offers from our broker-dealer clients and execute trades with the broker-dealer of their choice from among those that choose to respond. We enable our broker-dealer clients to efficiently reach our institutional investor clients for the distribution and trading of bonds. In addition to U.S. high-grade corporate bonds, European high-grade corporate bonds, and emerging markets bonds, including both investment-grade and non-investment grade debt, we offer our clients the ability to trade crossover and high-yield bonds, agency bonds, asset-backed and preferred securities and CDS.

Through our disclosed multi-dealer RFQ trading functionality, our institutional investor clients can determine prices available for a security, as well as trade securities directly with our broker-dealer clients. The price discovery process includes the ability to view indicative prices from the broker-dealer clients' inventory available on our platform, access to real-time pricing information and analytical tools (including spread-to-Treasury data, search capabilities and independent third-party credit research) and the ability to request executable bids and offers simultaneously from up to 64 of our broker-dealer clients during the trade process.

Our services relating to trade execution include single and multiple-dealer inquiries; list trading, *i.e.*, the ability to request bids and offers on multiple bonds at the same time; and swap trading, which is the ability to request an offer to purchase one bond and a bid to sell another bond, in a manner such that the two trades will be executed simultaneously, with payment based on the price differential of the bonds. Once a trade is completed on our platform, the broker-dealer client and institutional investor client may settle the trade with the assistance of our



automated post-trade messaging, which facilitates the communication of trade acknowledgment and allocation information between our institutional investor and broker-dealer clients.

It is important to note that as a result of our electronic connectivity to the trade processing operations of our participating dealers, the vast majority of the trades done on the MarketAxess trading platform are reported to TRACE within one to two minutes following execution, further enhancing transparency and price discovery in the markets we serve.

We provide numerous benefits to our institutional investor and broker-dealer clients over traditional fixed-income trading methods, including:

*Competitive Prices.* By enabling institutional investors to simultaneously request bids or offers from our broker-dealer clients, our electronic trading platform creates an environment that motivates our broker-dealer clients to provide competitive prices and gives institutional investors confidence that they are obtaining a competitive price.<sup>7</sup>

*Transparent Pricing on a Range of Securities.* The commingled multi-dealer inventory of bonds posted by our broker-dealer clients on our platform consists of a daily average of more than \$70 billion in indicative bids and offers. Subject to applicable regulatory requirements, institutional investors can search bonds in inventory based on any combination of issuer, issue, rating, maturity, spread-to-Treasury, size and dealer providing the listing, in a fraction of the time it takes to do so manually. Institutional investor clients can also request executable bids and offers on our electronic trading platform on any debt security in a database of U.S. and European corporate bonds. Our platform transmits bid and offer requests in real-time to broker-dealer clients, who may respond with executable prices within a time period specified by the institutional investor. Institutional investors may also elect to display live requests for bids or offers anonymously to all other users of our electronic trading platform, in order to create broader visibility of their inquiry among market participants and increase the likelihood that the request results in a trade.

*Improved Cost Efficiency.* We provide improved efficiency by reducing the time and labor required to conduct broad product and price discovery. Single-security and multi-security inquiries (bid or offer lists) can be efficiently conducted with multiple broker-dealers. In addition, our Corporate BondTicker<sup>TM</sup> service eliminates the need for manually-intensive phone calls or e-mail communication to gather, sort and analyze information concerning historical transaction prices.

*Greater Trading Accuracy.* Our electronic trading platform includes verification mechanisms at various stages of the execution process that result in greater accuracy in the processing, confirming and clearing of trades between institutional investor and broker-dealer

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<sup>7</sup> For typical MarketAxess multi-dealer corporate bond inquiries, the range of competitive spread-to-Treasury responses is, on average, approximately 10 basis points (a basis point is 1/100 of 1% in yield). As an example of the potential cost savings to institutional investors, a one basis point savings on a \$1 million face amount trade of a bond with 10 years to maturity translates to aggregate savings of approximately \$775.00.



clients. These verification mechanisms are designed to ensure that our broker-dealer and institutional investor clients are sending accurate trade messages by providing multiple opportunities to verify they are trading the correct bond, at the agreed-upon price and size. Our platform assists our institutional investor clients in automating the transmittal of order tickets from the portfolio manager to the trader, and from the trader to back-office personnel. This automation provides more timely execution and a reduction in the likelihood of errors that can result from manual entry of information into different systems.

*Efficient Risk Monitoring and Compliance.* Institutional investors and their regulators are increasingly focused on ensuring that best execution is achieved for fixed-income trades. Our electronic trading platform offers both institutional investors and broker-dealers an automated audit trail for each stage in the trading cycle. This enables compliance personnel to review information relating to trades more easily and with greater reliability. Trade information including time, price and spread-to-Treasury is stored securely and automatically on our electronic trading platform. This data represents a valuable source of information for our clients' compliance personnel. Importantly, we believe the automated audit trail, together with the competitive pricing that is a feature of our electronic trading platform, gives fiduciaries the ability to demonstrate that they have achieved best execution on behalf of their clients.

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### **MarketAxess' Ability to Facilitate CDS Trading**

MarketAxess recently demonstrated the capabilities of its RFQ platform by facilitating CDS trades between JPMorgan and six mutual customers of MarketAxess and JPMorgan. Some of these CDS fall within Dodd-Frank's definition of SB swaps. MarketAxess believes that the execution of these transactions was broadly consistent with the proposed SB SEF and SEF rules. All of the trades were reported electronically to ICE-Link, an affirmation service, and the SB swaps that are standardized were cleared at ICE Trust.<sup>8</sup>

### **Regulation ATS**

Regulation ATS provides a good example of a flexible trading system that has helped foster competition and innovation in securities markets, while maintaining regulatory oversight. Recognizing the importance of new, emerging markets, the SEC specifically designed Regulation ATS to provide "a regulatory framework that addresses [the SEC's] concerns about alternative trading systems without jeopardizing the commercial viability of these markets." Regulation of Exchanges and Alternative Trading Systems, 63 Fed. Reg. 70844, 70846 (Dec. 22, 1998).

Among other things, Regulation ATS permits a trading platform, which would otherwise be regulated as a securities exchange, to rely on FINRA to perform market oversight and surveillance. This allows a trading platform that experiences episodic trading to avoid building a costly internal SRO apparatus required for registered securities exchanges. An extensive internal

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<sup>8</sup> "JP Morgan Trades CDS With 6 Firms In Spirit Of New Swap Rules," Katy Burnes, Dow Jones Newswires (Mar. 9, 2011). [http://online.wsj.com/article/BT-CO-20110310-708826.html?mod=wsj\\_qt\\_latest\\_wsj](http://online.wsj.com/article/BT-CO-20110310-708826.html?mod=wsj_qt_latest_wsj).



SRO structure can only be supported by high transaction volume that generates correspondingly high transaction fees. Regulation ATS provides a flexible and cost-effective framework. A similar model that would permit an RSP to perform self-regulatory duties is appropriate for SB SEFs, which are expected to experience similar episodic trading and limited execution fees.

### **Statutory SB SEF Framework**

SB SEFs are critical components of the Dodd-Frank reforms. Over time, Congress intended that SB swap executions would migrate to SB SEF trading platforms to serve the goal of more competitive and transparent trading. We understand the SEC's proposals to be intended to attempt to achieve these goals.

### **SB SEFs and SEFs are Alternatives to National Securities Exchanges and DCMs.**

Even before drafting the bill that became the Dodd-Frank Act, the Obama Administration had identified the goal of moving swap trading to organized markets. The Administration contemplated two kinds of regulated markets where SB swaps and swaps could trade – traditional regulated exchanges and alternative "regulated transparent electronic trade execution systems" – in order to increase the number of traded SB swaps and swaps, which would help SB swap and swap market participants by adding competition and price transparency. Treasury White Paper, p. 48-49 (June 17, 2009).<sup>9</sup>

In Dodd-Frank itself, Congress was very specific about the statutory goal for SEFs. Congress stated:

*"The goal of this section is to promote the trading of swaps on [SEFs] and to promote pre-trade transparency in the swaps market." Dodd-Frank § 733, adding new CEA § 5h(e).*

Although there is no corresponding SB SEF provision, a colloquy involving Senator Blanche Lincoln, Chairwoman of the Senate Agriculture Committee and a key author of the Act, shows that the trading of certain SB swaps and swaps on a SB SEF, a SEF, a national securities exchange, or a DCM "is at the heart of swaps market reform." Congressional Record-Senate, July 15, 2010, S5921. The use of the word "goal" conveys that Congress intended policies would be adopted that would allow SB SEF and SEF execution systems to evolve, leading to more competition for executions and more pre-trade price transparency among market participants as the SB swap and swap markets mature.

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<sup>9</sup> The Administration's first draft of the bill called for all standardized SB swaps to be executed on a national securities exchange or an "Alternative Swap Execution Facility" (called a SB SEF in Dodd-Frank) and provided that any SB swap could be traded on an ASEF. Treasury Proposal of Title VII, § 753(a), proposing new Exchange Act § 3A(a)(7) and § 753(b), proposing new Exchange Act § 3B(b) (Aug. 2009).



## **SB SEFs were Intended to Be Less Regulated than National Securities Exchanges and DCMs to Promote SB Swap Trading.**

Dodd-Frank includes four basic SB SEF provisions: a definition; a registration requirement; a series of flexible Core Principles; and the execution mandate for certain SB swaps. Congress defines the term 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, through any means of interstate commerce, including any trading facility, that—(A) facilitates the execution of security-based swaps between persons; and (B) is not a national securities exchange."* Dodd-Frank § 761(a)(6), adding new Exchange Act § 3(a)(77).

This definition states explicitly that a trading facility operated by a national securities exchange is not a SEF. National securities exchanges may still operate SB SEFs, but the two are different regulatory categories and SB SEF trading was intended to be different from national securities exchange trading. Any person that operates a facility for the trading of SB swaps must be registered either as a SB SEF or a national securities exchange. Dodd-Frank § 763(c), adding new Exchange Act § 3D(a)(1).<sup>10</sup> The key difference is that market participants that are not Eligible Contract Participants ("ECP") may only trade SB swaps on national securities exchanges. Retail customers may not participate on SB SEFs; they are purely professional markets. Dodd-Frank § 763(e), adding new Exchange Act § 6(1).

Unlike national securities exchanges, SB SEFs are not defined by statute as SROs and are not subject to Exchange Act §§ 6 and 19.<sup>11</sup> Instead, Congress requires that registered SB SEFs (and SEFs), like DCMs, comply with flexible, statutory Core Principles. SB SEFs need to satisfy 14 Core Principles; by contrast, DCMs must meet 23 Core Principles (and SEFs must meet 15 Core Principles). Congress grants both SB SEFs (and SEFs) and DCMs reasonable discretion in establishing compliance with these Core Principles (unless otherwise determined by the SEC or CFTC). Dodd-Frank § 763(c), adding new Exchange Act § 3D(d)(1)(B); Dodd-Frank § 733, adding new CEA §§ 5h(f)(1)(B) and 5(d)(1)(B). However, the set of flexible Core Principles applicable to SB SEFs (which is substantially similar to the set applicable to SEFs) exhibits substantive regulatory differences from the set of Core Principles applicable to DCMs.

While DCMs must satisfy a centralized price discovery standard in some circumstances (DCM Core Principle 9), SB SEFs (and SEFs) need not do so. The absence of a Core Principle 9 analogue demonstrates the clear congressional intent that SB SEF (and SEF) trading and execution systems should have greater flexibility. Unlike DCMs, SB SEFs (and SEFs) also do not need to satisfy a Core Principle to provide fair and equitable trading. Dodd-Frank § 735(b),

<sup>10</sup> There is a corresponding swaps provision. Dodd-Frank § 733, adding new CEA § 5h(a)(1).

<sup>11</sup> Exchange Act § 3(a)(26) defines the term 'self-regulatory organization' to mean "any national securities exchange, registered securities association, or registered clearing agency, or (solely for purposes of sections 19(b), 19(c), and 23(b) of this title) the Municipal Securities Rulemaking Board established by section 15B of this title."



adding new CEA § 5(d)(12)(B). Also, SB SEF (and SEF) disciplinary procedures are allowed to be less extensive than DCM disciplinary procedures. *Compare* new CEA § 5(d)(13) with new Exchange Act § 3D(d)(4)(B) *and* new CEA § 5h(f)(4)(B).

Lastly, Dodd-Frank mandates that many SB swaps subject to the clearing mandate must be executed on a SB SEF or a national securities exchange so long as a SB SEF or a national securities exchange "makes the security-based swap available to trade." Dodd-Frank § 763(a), adding new Exchange Act § 3C(h). Although commercial end users are exempt from this requirement, the trade execution mandate was designed to encourage robust trading of SB swaps on SB SEFs and is the statutory backdrop to the SEC's proposal.

## **OVERVIEW OF THE SEC'S SB SEF PROPOSAL**

The SEC has proposed a package of rules and interpretations to implement the SB SEF provisions. Dodd-Frank § 763(c), adding new Exchange Act § 3D(f). To implement the SB SEF definition, the SEC provides an interpretation that would allow SB SEFs to use various execution systems, including limit order book and RFQ systems, for SB swaps. Under this interpretation, RFQ platforms must not impose a limit on the number of dealers from which a participant may request a quote on the SB SEF, but could allow the participant to choose to send a RFQ to only one other participant. Proposed Rules at 10,972. RFQ platforms also would need to provide market participants with the ability to make and to display executable bids or offers accessible to all of the SB SEF's market participants. Proposed Rules at 10,955. All responses to an RFQ would be required to be included within the composite indicative quote that the SB SEF would make available to all of its market participants. Proposed Rules at 10,972.

To implement the registration requirement, the SEC proposes an extensive array of information to be submitted in the registration application. The SEC concedes that the proposed SB SEF registration process is similar to the existing registration framework for national securities exchanges. Proposed Rules at 10,997. The SEC proposes numerous rules to implement the 14 SB SEF Core Principles in Proposed Rules 242.810-242.823. The SEC states that it will determine which SB swaps will be "made available for trading," and therefore subject to the execution mandate, using objective standards that the SEC will propose based on actual data once sufficient data becomes available. Proposed Rules at 10,969.

### **Consideration of a SB SEF's Compliance Costs Under the Proposed Rules**

In developing the appropriate regulatory structure for SB SEFs, it is essential that the SEC "identify and use the best, most innovative, and least burdensome tools for achieving regulatory ends," and take into account quantitatively and qualitatively, benefits and costs.<sup>12</sup> *See*

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<sup>12</sup> Section 1(b) of Executive Order 13563 provides in relevant part that "[a]s stated in that Executive Order and to the extent permitted by law, each agency must, among other things: (1) propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs (recognizing that some benefits and costs are difficult to quantify); (2) tailor its regulations to impose the least burden on society, consistent with obtaining regulatory objectives, taking into account, among other things, and to the extent practicable, the costs of cumulative regulations; (3) select, in choosing among alternative regulatory approaches, those approaches that maximize

*(cont'd)*



Improving Regulation and Regulatory Review, Executive Order 13563, 76 Fed. Reg. 3821, Section 1(a) (Jan. 21, 2011). If SB SEF regulations impose costs that are too great, fewer SB SEFs will be created, which is contrary to the public interest the statute endorses in promoting SB SEF trading. Exchange Act § 23(a)(2) (prohibiting the SEC from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act).

The SEC estimates that the initial costs for an entity that has existing operations that could be modified to become an SB SEF will be approximately \$5 million. The SEC also notes that "industry sources" generically estimate the cost of forming a SB SEF will be between \$15 million and \$20 million, depending upon the extent of a SB SEF's operations prior to implementation of the Proposed Rules. Proposed Rules at 11,041. We propose less burdensome alternatives to the SEC's proposal that we believe would reduce the initial costs of becoming a SB SEF, lowering barriers to entry and thus presumably increasing competition.

MarketAxess appreciates the time and attention that the SEC and SEC staff have devoted to generating the detailed estimates. In our judgment, the SEC's preliminary cost estimates are generally realistic and accurate estimates of the true expected costs of establishing and operating a SB SEF. We also found that the hourly rates relied upon for these estimates are broadly consistent with industry standards. Accordingly, our comments will focus only on a few specific areas where we have questions or comments.

With regard to general estimates, the SEC estimates software and product development costs for the first year of operation (for entities that currently own and/or operate OTC trading platforms) to be \$50,000 to \$3 million. We understand these software costs to be principally focused upon product development, as the SEC also provides more specific costs for automated surveillance that are quite significant. If, however, the SEC intended to include surveillance costs in this estimate, then we believe that it is on the low side.

With regard to ongoing annual SB SEF compliance staff costs, the SEC estimated that this cost would be approximately \$1 million per year, which would include the salary of a Chief Compliance Officer ("CCO") and at least two junior compliance personnel, expected to be attorneys. We believe that this estimate is in the ballpark, but we anticipate a somewhat higher number of \$1.2 million per year to be more likely.

As to the preparation of financial statements for the SB SEF registration, the SEC's estimate includes a cost of \$99,000 to complete the financial statements and a cost of \$500,000 for independent public accounting services. While the full scope of work needs to be confirmed,

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net benefits."

Section 4 of Executive Order 13563 provides that, "[w]here relevant, feasible, and consistent with regulatory objectives, and to the extent permitted by law, each agency shall identify and consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public."



both of these estimates strike us as being on the high side, particularly with respect to the independent public accounting services.

With regard to the SEC's estimate of programming costs for the development of composite indicative and executable bids and offers to be a one-time cost of \$21,120 per SB SEF, we understand this estimate to involve programming time relating only to the display of the quotes. Based upon that understanding, we believe that this estimate is accurate.

Finally, the SEC's estimates concerning the initial costs of establishing an automated surveillance system (in compliance with proposed SEC Rules 811 and 813) are not clear. Specifically, the SEC estimates the total initial cost to be \$3,256,800 per SB SEF. However, the total estimate includes an initial cost per SB SEF of \$1,756,800 in initial programming as well as a one-time capital expenditure of \$1.5 million in information technology costs. As we understand the estimate, the first of these costs would generally involve programming to be undertaken internally, while we presume, based on the amount, that the second estimate largely entails some form of software purchase or licensing from an outside vendor. It is not clear what the SEC assumes concerning the costs associated with work to be done internally as compared to the costs for software to be provided by an outside source.

## **SUBSTANTIVE COMMENTS**

MarketAxess has reviewed the SEC's comprehensive SB SEF proposal. We share the SEC's strong interest in promoting the trading of SB swaps on SB SEFs, which will enhance pre-trade price transparency, reduce SB swap transaction costs and encourage more competition among liquidity providers. Our comments are designed to "promote efficiency, competition, and capital formation" pursuant to Exchange Act § 3(f) by strengthening the viability of the SB SEF business model under appropriate SEC oversight.

### **1. Broad and Effective Delegation of SB SEF Self-Regulatory Functions.**

The SEC has correctly recognized that many SB SEFs will likely comply with the applicable statutory Core Principles and SEC rules by delegating the actual performance of self-regulatory duties to an RSP. MarketAxess looks forward to working with the SEC to make this delegation and third party service provider system work on a timely and constructive basis.

#### **A. SB SEFs Should be Allowed to Delegate Broadly Core Principle Self-Regulatory Duties.**

The SB SEF application contemplates that a SB SEF may arrange for an RSP to provide services to assist the SB SEF in complying with the SB SEF Core Principles.<sup>13</sup> Specifically, Exhibit G of Form SB SEF would require a SB SEF applicant to provide "any agreements or

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<sup>13</sup> The CFTC contemplates SEFs delegating compliance with SEF Core Principles. See Proposed CFTC Rule 37.204(a).



contracts entered into or to be entered into by the applicant . . . , including . . . *third-party regulatory service*, or other *agreements* relating to the operation of an electronic trading system to be used to effect transactions on the [SB SEF] *that enable or empower the applicant to comply with Section 3D of the Exchange Act.*" We recognize that, as noted by the CFTC in the SEF proposal, SB SEFs that delegate will still be responsible legally for compliance with the Core Principles. We agree with the SEC that a SB SEF should be allowed to delegate broadly many of the SB SEF's duties to comply with the SB SEF Core Principles.<sup>14</sup>

The cost of developing the infrastructure and operational abilities needed to satisfy the proposed compliance, surveillance and disciplinary duties would be prohibitively expensive for an entity interested in becoming a SB SEF that is not already an exchange. Requiring a SB SEF to bear these costs would limit drastically new SB SEF market entrants. A SB SEF's ability to delegate these duties broadly and effectively to an RSP that already has or could more easily develop the needed infrastructure and operational abilities will provide a more cost-effective means of compliance and allow new market entrants to become SB SEFs. This will further Congress' intent of promoting competition and trading of SB swaps on SB SEFs.

Nothing in Dodd-Frank limits in any way the authority of the SEC (or CFTC) to permit broad delegations by SB SEFs (or SEFs) of their compliance and rule enforcement functions. We support the SEC's recognition of the need for flexible delegation of these duties by SB SEFs in order to make the SB SEF structure work.

#### **B. SB SEFs Should be Allowed to Delegate to Any Qualified RSP.**

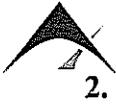
The SEC contemplates that SB SEFs generally may contract with "third-party regulatory service" providers to satisfy compliance with the SB SEF Core Principles. Proposed Form SB SEF, Exhibit G. MarketAxess supports the SEC's approach, which would not limit the universe of RSPs and thus would encourage innovation and competition.

MarketAxess has recommended that the CFTC reconsider Proposed CFTC Rule 37.204(a) (which would limit possible RSPs that could serve as a SEF delegate to CFTC-approved registered entities) and instead adopt an approach like the SEC's that would permit any qualified RSP to perform the SEF functions.<sup>15</sup> 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.

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<sup>14</sup> Some of the Core Principles involve functions that we would not expect a SB SEF to be able to delegate—for example, ensuring the trading platform meets the SEC's base-line specifications, maintaining the required financial resources, and complying with the governance and conflicts of interest standards. But we would urge the SEC to be very flexible in considering what functions may be delegable by SB SEFs, either partially or completely. As a new regulatory category, it is uncertain how the SB SEF apparatus will evolve and the role RSPs will play in helping SB SEFs meet their regulatory duties.

<sup>15</sup> MarketAxess Letter to CFTC on SEF Proposal, p. 15.



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## **Effective Temporary SEF Registration.**

The SEC has proposed correctly a system for Temporary Registration of SB SEFs in order to allow the benefits of SB SEF trading to be applied to the SB swap market when SB SEF registration applications are filed (and before the SEC has analyzed and approved any SB SEF (permanent) registration applications). A delay in the process of registering SB SEFs could adversely affect SB SEF applicants, undermine the efficient implementation of the Dodd-Frank Act, create legal uncertainty for market participants, and harm the SB swaps market. *See* 76 Fed. Reg. 1,214, 1,216.

To allow a platform or system to facilitate the trading of SB swaps while its application is being reviewed, the SEC has proposed Rule 242.801(c). Other than filing a "complete" SB SEF application by July 31, 2014, Proposed Rule 242.801(c) does not provide criteria by which the SEC would consider a SB SEF applicant's request for Temporary Registration. The SEC states that, in considering whether to grant a Temporary Registration request, it would review and consider the information and materials in the applicant's SB SEF application that the SEC "believes to be relevant," including, but not limited to:

1. whether the applicant's trading system satisfies the SB SEF definition in § 3(a)(77) of the Exchange Act and any SEC rules, interpretations, or guidelines regarding this definition;
2. any access requirements or limitations imposed by the SB SEF;
3. the ownership and voting structure of the SB SEF; and
4. any certifications made by the SB SEF (including the requisite certifications to file a SB SEF application that the applicant has the capacity to assure the prompt, accurate and reliable performance of its functions as a SB SEF and is in compliance with the Exchange Act and SEC rules thereunder). Proposed Rules at 10,999.

The SEC states that a temporarily registered SB SEF would need to demonstrate on an ongoing basis as its business evolves that it has the capacity and resources to comply with the SB SEF regulatory obligations. Proposed Rules at 10,999.

MarketAxess strongly supports the Temporary Registration proposal. To allow all qualified SB SEF applicants to operate under Temporary Registration, however, we offer some suggestions and critical improvements below for the SEC's consideration.

### **A. The SEC Should Clarify What Existing SB Swap Trading Platforms Would Qualify for Temporary SB SEF Registration.**

Proposed Form SB SEF (which must be submitted in order to apply for Temporary Registration) requires an applicant to certify "that the applicant is currently in compliance with, and is currently operating its business in a manner consistent with the Exchange Act and all rules and regulations thereunder." We request that the SEC confirm in its final rules that a SB SEF



would be considered to operate its business if it operates a trading or execution system that offers for trading swaps or SB swaps, even if material trading volume has not yet occurred on the applicant's system.

**B. What showing should be required for Temporary SB SEF Registration?**

Proposed Rule 242.801(c) has an inadvertent "Catch-22" quality to it. To apply for Temporary Registration, an applicant must submit a "complete" SB SEF application using Proposed Form SB SEF. Proposed Rules 242.801(a) and (c). For the application to be considered complete, the Form SB SEF must allow the SEC to "determine whether the applicant is *able* to comply with the [Exchange] Act and rules and regulations thereunder." Proposed Rule 242.801(a). (emphasis added.) At the time of filing a SB SEF application, an applicant would need to certify "that the applicant has the capacity, to assure the prompt, accurate, and reliable performance of its functions as a SB SEF." Proposed Form SB SEF, Execution page. To make this certification, those SB SEF applicants that will be delegating their self-regulatory functions to an RSP must have confidence that a number of issues will be resolved properly consistent with their obligations as SB SEFs.

Right now, it is hard to see how these issues can be resolved by the time the SB SEF registration applications must be filed (and the certification of compliance simultaneously must be provided). Each phase of this process will take time. Until an RSP is available to accept a SB SEF's delegation, no SB SEF that will delegate these duties could demonstrate that it is *able* to meet all of the proposed obligations when the SB SEF files its registration application. Yet that demonstration appears to be a prerequisite to begin operations as a permanently registered SB SEF and as a temporarily registered SB SEF under Proposed Rules 242.801(a) and 242.801(c), respectively. To make the certification, a SB SEF will need to:

- know what Core Principle functions could be delegated (which the SEC final rules should clarify);
- know what Core Principle functions it must perform itself, if any, not through an RSP (which the SEC final rules should clarify);
- know what functions RSPs could provide or would develop the capacity to provide;
- arrange for an appropriate delegation with an RSP;
- make certain the RSP has the resources to develop the necessary self-regulatory systems;
- develop with the RSP methods for connecting SB SEF market data to the RSP's systems; and
- monitor the RSP's development of appropriate systems.



As this list suggests, and as the SEC recognized in the preamble (*see* Proposed Rules at 10,998-99), registering new SB SEFs in a new registration category will be an art, not a science, and could involve considerable give and take with the SEC staff as issues arise and are resolved.<sup>16</sup> This is a natural part of the process, and could even affect those SB SEFs that are existing exchanges and would not need to delegate functions to an RSP (or might be RSPs themselves). It may be difficult for a SB SEF applicant in these circumstances to be confident that it has filed a complete application or to make the required certification of immediate compliance that is needed for Temporary Registration.

These difficulties should not, in our view, foreclose SB SEFs from filing their registration applications and qualifying for Temporary Registration. The SEC requests comment whether there should be a separate application for Temporary Registration, whether a temporarily registered SB SEF should be required to comply with all SB SEF rules and regulations, and if not, which requirements should apply. Proposed Rules at 11,000. We are concerned that a separate application for Temporary Registration would not utilize the SEC's or the SB SEF applicant's resources most efficiently. Instead, we request that the SEC develop an alternative approach for SB SEFs seeking Temporary Registration whereby a SB SEF's application would be deemed to be "materially complete" and its certification acceptable for Temporary Registration purposes if the applicant certifies that:

1. the applicant's trading system satisfies the definition of a security-based swap execution facility in § 3(a)(77) of the Exchange Act;
2. the applicant will establish and apply fair and impartial (*i.e.*, objective) access requirements to its trading platform for any qualifying ECPs (including buy-side participants as well as liquidity-providing SB swap dealers ("SBSDs"));
3. the applicant will revoke access of any market participant that violates the SB SEF's rules;
4. the applicant has adequate financial resources to satisfy Proposed Rule 242.821;
5. the applicant satisfies governance, ownership and conflict of interest requirements in Proposed Rules 242.702 and 242.820;<sup>17</sup>
6. the applicant would only make SB swaps available that are not readily susceptible to manipulation as required by Proposed Rule 242.812;<sup>18</sup>

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<sup>16</sup> We request that the SEC confirm in its final rule that the filing of an amendment to a SB SEF application would not disqualify an entity from Temporary Registration or terminate that entity's Temporary Registration.

<sup>17</sup> We assume that, for Temporary Registration purposes, Proposed Rule 242.702(e)(1) would not incorporate all of Regulation SB SEF.

<sup>18</sup> This determination would be made by management, not a swap review committee.



7. the applicant will produce and retain an audit trail of all SB swaps entered into on, or pursuant to the rules of, its platform;
8. the applicant is connected, and has the ability to send a SB swap for clearing, to at least one clearing agency; and
9. the applicant's SB SEF application demonstrates a good faith effort to comply with all applicable SB SEF regulations in the future.

MarketAxess believes that an applicant that can demonstrate compliance with these core requirements of the SB SEF Core Principles should be qualified to begin operations as a temporarily registered SB SEF. In so doing, the SEC would serve the goals of promoting SB swap trading on SB SEFs and thus also promoting competition, while leveling the SB SEF playing field among those that will be compelled to delegate their self-regulatory functions to third parties and those that will not.

**C. Once the SEC Adopts Final Rules, SB SEFs Should Have 180 Days to File Registration Applications.**

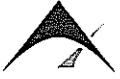
In order to fully certify compliance with the applicable Core Principles, MarketAxess anticipates that it will need to make a number of changes and enhancements to our SB SEF operations, including our trading systems. Changes and enhancements to our trading system typically require a 90-120 day development cycle. Once required functionality is finalized, business analysts write detailed specifications. Developers then use the written specifications to write code for the software changes. Following the development cycle, there is a thorough quality assurance testing period before the changes are introduced into the live trading system. Given these practical considerations, we recommend that the SEC set the filing date for SB SEF applications and Temporary Registration certifications for 180 days after the final rules are adopted by the SEC to allow applicants to adapt to the final rules.

**D. Entities Acting Under Temporary Registration Need the Ability to List SB Swaps.**

Proposed Rules 242.807 and 242.808 would permit SB SEFs generally to list SB swaps in one of two ways, by voluntarily submitting the SB swap for SEC approval or by self-certifying the SB swap. Temporarily registered SB SEFs should not be treated differently than permanently registered SB SEFs and need the ability to list SB swaps by voluntarily submitting the SB swap for SEC approval as well as by self-certifying the SB swap.<sup>19</sup> We ask that the SEC

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<sup>19</sup> We assume that a temporarily registered SB SEF would be considered to be a "registered" SB SEF for purposes of Proposed Rules 242.807 and 242.808 and that the demonstration required of a temporarily registered SB SEF under Proposed Rules 242.807(b) and 242.808(b) would be consistent with the showing required for temporary, rather than permanent, SB SEF registration.



confirm in its final rules that a Temporarily Registered SB SEF may list SB swaps in either of these ways.<sup>20</sup>

### **E. Temporary SB SEF Registration Should Not End in a Year**

We strongly support the SEC's approach in Proposed Rule 242.801(c) that Temporary Registration would not expire until the date that the SEC grants or denies registration (unless the SEC rescinds the SB SEF's temporary relief). We find this approach preferable to the CFTC's approach, which places a one-year expiration date on Temporary Registration. Proposed CFTC Rule 37.3(b)(3).<sup>21</sup>

### **3. Passport SEF Registration Should Be Allowed For Registered SB SEFs and SEFs**

The SEC should accept as a registered SB SEF any entity that is registered with the CFTC as a SEF and vice versa. Congress clearly envisioned passport registration for SB SEFs and SEFs. Specifically, Congress authorizes the SEC to exempt a SB SEF from registration "if the [SEC] finds that the facility is subject to comparable, comprehensive supervision and regulation on a consolidated basis by the Commodity Futures Trading Commission." Dodd-Frank § 763(c), adding new Exchange Act § 3D(e).<sup>22</sup> Congress also provides that a person shall register as a SB SEF with the SEC regardless of whether that person is also registered as a SEF with the CFTC. Dodd-Frank § 763(c), adding new Exchange Act § 3D(a)(2).<sup>23</sup>

Consistent with new Exchange Act §§ 3D(e) and 3D(a)(2), respectively, a simple notice registration would exempt a CFTC-registered SEF from the SEC's full registration process, but still provide for that entity's SEC registration as a SB SEF.<sup>24</sup> *See also* Exchange Act § 36. Notice registration would also be consistent with the approach Representative Barney Frank, Ranking Member of the House Committee on Financial Services and a sponsor of Dodd-Frank,

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<sup>20</sup> We have similarly requested that the CFTC clarify that temporarily registered SEFs may list swaps by voluntarily submitting the swap for CFTC approval as well as by self-certifying the swap. MarketAxess Comment Letter on CFTC SEF Proposal, p. 19. *But see* CFTC Proposed Rule 37.4(a)(2), providing that a swap voluntarily submitted for approval by a temporarily registered SEF could not be deemed to be approved until that SEF becomes permanently registered.

<sup>21</sup> If the CFTC has not completed its review and approved a SEF's application one year after the SEF regulations become effective and that entity is operating under Temporary Registration, Proposed CFTC Rule 37.3(b)(3) would prevent that entity from continuing to operate.

<sup>22</sup> *See also* corresponding provision Dodd-Frank § 733, adding new CEA § 5h(g), which reads in relevant part: "Exemptions—The Commission may exempt, conditionally or unconditionally, a swap execution facility from registration under this section if the Commission finds that the facility is subject to comparable, comprehensive supervision and regulation on a consolidated basis by the Securities and Exchange Commission."

<sup>23</sup> *See also* corresponding provision Dodd-Frank § 733, adding new CEA § 5h(a)(2), which reads: "DUAL REGISTRATION—Any person that is registered as a swap execution facility under this section shall register with the Commission regardless of whether the person also is registered with the Securities and Exchange Commission as a [*sic*] swap execution facility."

<sup>24</sup> The CFTC's adoption of this approach would be consistent with new CEA §§ 5h(g) and 5h(a)(2).



recently urged the SEC and CFTC to take when adopting SEF rules to implement Dodd-Frank. As noted in Representative Frank's February 18 letter to Chairmen Mary Schapiro and Gary Gensler:

[I]t is very important for both the SEC and the CFTC to coordinate and harmonize their respective rules as closely as possible. Differences in the rules that are not required by differences between various financial products will only serve to drive up the cost of implementation, without improving the regulatory structure. . . [S]waps (and securities-based swaps)[ ] are very different products than those currently traded in the highly-evolved equities and futures markets, and they serve a variety of different purposes. Harmonizing SEC's and CFTC's respective regulations within the swaps markets, to the maximum extent possible, will maintain liquidity and stability in these new markets and reduce costs.

Notice registration would avoid significant expenditures of both agencies' resources in reviewing registration applications for the same system or platform. This would also conserve a SB SEF's resources by permitting it to prepare one comprehensive application rather than two.<sup>25</sup>

Notice registration would require the SEC's and CFTC's rules to be comparable. We agree with Representative Frank that this harmonization is essential to the efficient and effective regulation of SB SEFs and SEFs. Differences in SB swaps and swaps simply do not necessitate or provide support for the significant differences between the current versions of the SEC's SB SEF proposals and the CFTC's SEF proposals. Neither do differences between the markets and products that the SEC and CFTC regulate currently. *But see* Proposed Rules at 10,950 (pointing to differences between the markets and products that the SEC and CFTC regulate currently as a possible basis for divergent SB SEF and SEF regulations proposed by the agencies).

MarketAxess currently intends to apply to become both a SB SEF and a SEF, using the same trading protocols and systems for, at least, single name CDS and index CDS. We see no basis for materially different SEC SB SEF rules and CFTC SEF rules for these products and instead find a number of grounds to support consistency of regulatory treatment.

First, essentially the same general grouping of market participants trade these products. Second, to an overwhelming extent, market participants will be trading both kinds of products. If a market participant is trading in single name CDS, it will also be trading index CDS. We are not aware of any participants who might only be trading the single name CDS products. Thus, index and single name CDS should be viewed as products that in fact are being traded in a combined market.

Third, it is worth noting that there is a considerable degree of fungibility between the two types of products, and these products can be substitutes for each other. For example, the CDX Emerging Market Index currently is comprised of 15 single names. But it would be possible for

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<sup>25</sup> See Section 1(b) of Executive Order 13563, cited above in note 12.



a market participant to send out an inquiry to dealers for a basket of single names that replicates the entities included in the CDX EM index and thus essentially constitutes a synthetic substitute of that index. While dealers may find it easier to work with the one index, from a mathematical perspective, the values of the single names in this synthetic basket should be the same as the index.

Fourth, as noted above, both kinds of products operate under the same operational requirements and trading procedures; there are no significant differences in trading practices that would warrant differences in regulatory treatment.

Finally, it is possible, although not necessarily probable, that index CDS products could become more liquid at a faster rate than might be the case for single name CDS. However, we do not believe that mere differences in liquidity levels between two essentially fungible products should somehow warrant being subject to an entirely different regulatory regime.

The common Core Principles that Congress adopted for SB SEFs and SEFs further support adopting identical regulations that would apply to SB SEFs and SEFs.<sup>26</sup> We hope the SEC and the CFTC will continue to work together to develop identical regulations, wherever possible, and harmonized regulations, in other cases, to allow these markets to develop efficiently and without fragmentation.

#### **4. Specific Refinements to the SEC Proposal to Help Promote SB SEF Trading**

MarketAxess respectfully proposes certain refinements to the SEC's proposed rules in order to reduce significant barriers to entry, increase the pro-competitive elements of the proposal, and thereby help promote SB swap trading on SB SEFs. By streamlining some of the regulatory burdens associated with being a SB SEF, the SEC will ensure that non-exchange entities like MarketAxess that already provide competitive, efficient marketplaces for securities (including SB swaps) and swaps will be able to continue to provide this customer service, consistent with the goals of Dodd-Frank.

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<sup>26</sup> All of the substantive requirements adopted in the Core Principles applicable to SB SEFs will also apply to SEFs, with one exception. Compare Dodd-Frank § 763(c), adding new Exchange Act § 3D(d) with Dodd-Frank § 733, adding new CEA § 5h(f). A SB SEF will need to have the capacity to disseminate trade information with respect to transactions executed on or through the SB SEF. New Exchange Act § 3D(d)(8)(B).

The SEF Core Principles place three additional requirements on SEFs that are not required by the SB SEF Core Principles:

- 1) a SEF's rules must provide that when a Swap Dealer ("SD") or Major Swap Participant ("MSP") enters into or facilitates a swap that is subject to the clearing mandate, the SD or MSP is responsible for complying with the execution mandate (new CEA § 5h(f)(2)(D));
- 2) a SEF will need to adopt position limitations or position accountability for speculators, if necessary and appropriate (new CEA § 5h(f)(6)); and
- 3) records related to cross-currency rate swaps that are required by SEF Core Principle 10 must be kept open to inspection and examination by the SEC (new CEA § 5h(f)(10)(a)(iii)).



**A. The SEC Should Make Certain Clarifications Regarding "Impartial Access" to the SB SEF and to Other Participants on the SB SEF.**

Core Principle 2 will require a SB SEF to provide market participants with impartial access to its platforms. Dodd-Frank § 763(c), adding new Exchange Act § 3D(d)(2). The SEC has proposed Rules 242.809 and 242.811(b) to implement this requirement.

*1. Several of the SEC's Proposed Rules for Impartial Access Should be Adopted as Proposed.*

Proposed Rule 242.811(b) would require a SB SEF to establish fair, objective, and not unreasonably discriminatory standards for granting impartial access to trading on the SB SEF. A SB SEF could not apply these standards in a manner that would unreasonably prohibit or limit any person's access to services offered by the SB SEF. The SEC states that the impartial access requirement in SB SEF Core Principle 2 does not require a SB SEF to "allow unfettered access to any and all persons. Rather, the requirements of Core Principle 6 that SB SEFs ensure the financial integrity of transactions on their markets . . . permit SB SEFs to have minimum standards for access to their markets, though such access must be provided on an impartial basis." Proposed Rules at 10,961.

Proposed Rules 242.809(a) and (b) would require a SB SEF to provide access to all registered SBSBs, major security-based swap participants ("MSSPs"), and brokers that satisfy the SB SEF's access criteria. A SB SEF could choose to provide access to ECPs not registered as SBSBs, MSSPs, or brokers ("non-registered ECPs") that satisfy the SB SEF's access criteria. A SB SEF's access rules would need to require, among other things, all participants to be, or to have a relationship with, a clearing member of a registered clearing agency and to require all registered SBSBs, MSSPs, and brokers to meet the SEC's minimum financial responsibility and recordkeeping and reporting requirements. Proposed Rule 242.809(c).

MarketAxess supports these rules, which codify the need for a SB SEF to provide access to qualified participants who satisfy the SB SEF's fair and objective standards, consistent with the IOSCO Principles.<sup>27</sup>

*2. The SEC Should Clarify Compliance with Risk Management Requirements.*

Proposed Rule 242.809(d) would require a SB SEF that provides any non-registered ECP with access to its platform to "establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity." The SEC states that the purpose of this rule is to reduce the risks that non-registered ECPs "enter into trades that exceed appropriate credit or capital limits for their risk capacity. The [SEC] preliminarily believes that the SB SEF is best positioned to implement the proposed controls and procedures." Proposed Rules at 10,963. The SEC notes that this proposed rule is similar to, but does not include the specific requirements

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<sup>27</sup> IOSCO Report on Trading of OTC Derivatives, p. 14, n. 28 (Feb. 2011) <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD345.pdf> ("IOSCO Report").



provided in, recently adopted Rule 15c3-5 that applies to ATSS. The SEC requests comment whether Proposed Rule 242.809(d) should include specific requirements. Proposed Rules at 10,964.

Although MarketAxess believes that SB SEFs are not necessarily best positioned to monitor credit or capital limits, we nonetheless support Proposed Rule 242.809(d) and believe that this proposed rule, if applied flexibly, would be consistent with congressional intent. *See* Dodd-Frank 763(c), adding Exchange Act 3D(d)(1)(B). Instead of incorporating specific requirements (such as capital requirements), MarketAxess requests that the SEC clarify in its final rules that a SB SEF may satisfy this rule for a cleared SB swap by requiring that the non-registered ECP identify each clearing member with which it has a relationship and that the non-registered ECP identify which clearing member will clear a particular SB swap before entering into that SB swap. The SB SEF also could have systems in place to confirm with each clearing member of a non-registered ECP that the non-registered ECP has not exhausted its credit limit with that clearing member.

For an uncleared SB swap, a SB SEF should be able to rely on a representation received, for example, from both the non-registered ECP and its SBSD or MSSP counterparty that appropriate credit arrangements (including credit filters) exist and both participants have the ability to exchange collateral before these two participants enter into a SB swap that will not be cleared. *See* Proposed Rules at 10,979 (requesting comment whether SB SEFs should be required to have rules in place that transacting members have these arrangements and abilities in place).

The SEC should also confirm that a SB SEF may rely on written or electronically signed representations by a participant regarding its status as an ECP. SB SEFs may then adopt rules to require that the participant notify the SEF immediately of any change to its status after the participant makes this representation.

3. *SB SEFs Should Not Be Required to Allow Participants to Make Executable Bids or Offers Accessible to All Other Participants.*

In describing the scope of the definition of a SB SEF, the SEC states that "no matter what other functionality a SB SEF puts in place . . . it also would be required to provide 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 market participant chooses to do so." Proposed Rules at 10,955. Although this interpretation is not embodied in the text of any Proposed Rule, the SEC asks whether this proposed requirement would be beneficial or useful to participants. Proposed Rules at 10,966. The SEC also suggests that "if a SB SEF displays firm, executable trading interest, it must display such interest to all participants." Proposed Rules at 10,972.

This interpretation goes beyond what Dodd-Frank requires and may limit competition by excluding applicants that wish to offer RFQ services without this functionality. Today, MarketAxess provides market makers with the ability to make and display executable quotes. A dealer who streams an executable bid or offer on MarketAxess decides which customers and dealers can see the bid or offer, including the price of this bid or offer. Requiring dealers to



show to competing dealers the prices at which they make executable bids or offers would discourage dealers from posting executable bids and offers on SB SEFs. The SEC should not adopt a rule that would require dealers that stream an executable bid or offer to show the price to competing dealers.

Further, with respect to a SB swap that will not be cleared, a SB SEF could not allow every participant on the SB SEF the ability to make or display executable bids or offers to all of the SB SEF's participants while ensuring compliance with SB SEF Core Principle 6 or Proposed Rule 242.815. As the SEC recognizes in Proposed Rule 242.815(b), any participant entering into an uncleared SB swap needs to consider counterparty credit risk.

Only parties with trading relationships and credit documentation in place with one another could enter into SB swaps that will not be cleared. Non-registered ECPs will not, and MSSPs will not likely, have these relationships and documentation in place with other non-registered ECPs or with MSSPs. Similarly, neither non-registered ECPs, MSSPs nor dealers will likely have trading relationships and credit documentation in place with every other dealer with access to the SB SEF.

Requiring each participant to have such relationships and documentation in place with every other participant or even every dealer on that SB SEF would effectively preclude non-registered ECPs, and would likely preclude MSSPs, from accessing any SB SEFs. This would directly conflict with Proposed Rule 242.809, which allows SB SEFs to permit non-registered ECPs access and requires SB SEFs to permit qualified MSSPs access.

The SEC separately proposes Rule 242.811(d)(5), which would require each SB SEF to establish and enforce rules that address how trading interest—including orders, RFQs, responses, *quotations*, and transaction data—will be disseminated. The SEC states that this rule was "drafted to allow maximum flexibility by a SB SEF to determine the best manner to disseminate trading interest by such SB SEF." Proposed Rules at 10,972. MarketAxess supports Proposed Rule 242.811(d)(5), which would grant a SB SEF the flexibility to provide for the dissemination of executable bids and offers in the manner that SB SEF believes is best.

4. *Equitable Allocation of Dues and Fees Should Permit Volume Discounts and Other Pricing Arrangements.*

Proposed Rule 242.810(b)(1) would require a SB SEF to provide equitable allocation of reasonable dues, fees and all other charges among participants. The SEC should make clear that the Proposed Rule would permit SB SEFs to provide their participants with volume discounts and other business-related pricing arrangements so long as such discounts and arrangements are based upon objective criteria that are applied uniformly.

**B. The SEC Should Make Certain Clarifications Regarding Composite Indicative Quotes.**

1. *Composite Indicative Quotes Should Not Include Responses to RFQs.*

Proposed Rule 242.811(e) would require SB SEFs operating an RFQ platform to "create and disseminate through the [SB SEF] a composite indicative quote for [SB] swaps traded on or



through such system, which shall be made available to all participants." The composite indicative quote must include "both composite indicative bids and composite indicative offers." *Id.*

The SEC states that "if the SB SEF operates a RFQ mechanism, the rules of the SB SEF should specify that any response to an RFQ that is provided to the participant submitting the RFQ should be included in the composite indicative quote of the SB SEF." Proposed Rules at 10,972. The SEC then asks whether responses to RFQs should be included in the composite indicative quotes. *Id.*

Responses to RFQs should not be included in the SB SEF's composite indicative quote. Responses to RFQs that are *not* accepted may differ substantially from the current market price (perhaps because the responder offered a price that was substantially off-market). Therefore, inclusion of such responses to RFQs may harm, rather than improve, pre-trade transparency by skewing the composite indicative quote. Further, it would be difficult for a SB SEF to manage these responses to RFQs as a practical matter (*e.g.*, at what point would stale RFQ responses be overridden by an updated indicative price or a response to a newer RFQ).

Responses to RFQs that *are* accepted would be included within the data that will be disseminated publicly pursuant to the SEC's real-time public reporting rules. In lieu of including responses to RFQs in the composite indicative quote, the SB SEF should provide its participants with a trade tape of real-time executed prices, which together with the composite of indicative bids and offers, would provide participants with the desired price transparency.

2. *A SB SEF Cannot Include Composite Indicative Quotes for a Particular SB Swap if Dealers Have Not Elected To Post Indicative Bids and Offers on that SB Swap.*

For each kind of SB swap listed on a SB SEF, each dealer with access to the SB SEF may choose, but cannot be required, to provide indicative bids and offers. Especially for contracts that trade infrequently, there may not be any indicative bids and offers on a particular SB swap contract. The SEC should clarify when adopting its final rules that a SB SEF is not required to create or disseminate a composite indicative quote for any SB swap for which dealers have not provided multiple indicative bids and offers.

3. *Composite Indicative Quotes Should Only Be Provided for Clearable SB Swaps.*

The SEC states that posting a composite indicative quote "would provide valuable pricing information to the participants of a SB SEF, while at the same time not disclosing specific trading interest of individual participants when that interest is not firm." Proposed Rules at 10,973. The SEC may have intended that composite indicative quotes would only be required for cleared SB swaps. But the text of Proposed Rule 242.811(e) is not clear on this point.<sup>28</sup>

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<sup>28</sup> Proposed Rule 242.811(e) would require SB SEFs operating an RFQ platform to "create and disseminate through the [SB SEF] a composite indicative quote for [SB] swaps traded on or through such system, which

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Instead, as written, this rule could be read as requiring composite indicative quotes for both cleared and uncleared SB swaps.

A major factor that affects pricing of uncleared SB swaps is credit risk. But indicative bids and offers will not incorporate how the creditworthiness of a dealer's potential swap counterparty affects the price at which the dealer is willing to enter into an uncleared SB swap with that counterparty; neither would composite indicative quotes. Without accounting for the impact of creditworthiness on pricing for uncleared SB swaps, composite indicative quotes could provide misleading, rather than valuable, pricing information. SB SEFs should not be required to create or disseminate composite indicative quotes for uncleared SB swaps.

**C. Several of the Proposed Swap Review Committee Requirements Should Be Modified.**

*1. A SB SEF's Management and Board Must Have the Power to Decide What SB Swaps Will Trade on the SB SEF.*

Proposed Rule 242.811(c) would require a SB SEF to create a Swap Review Committee. This Committee would determine which SB swaps shall be traded on the SB SEF (pursuant to criteria established by the SB SEF) and how those swaps would be traded (*i.e.*, whether certain SB swaps should be subject to greater price transparency than others). To ensure that a SB SEF's participants and other market participants have a voice in these decisions, this Committee would need to meet certain representation requirements. The Swap Review Committee would be required to report its decisions promptly to the SB SEF's CCO and annually to the SB SEF's Regulatory Oversight Committee ("ROC").

Proposed Rule 242.811(c)(3) would require the SB SEF to establish criteria that the Swap Review Committee would consider in determining which SB swaps would be traded on the SB SEF. The SEC states that "this would allow the most flexibility by permitting a SB SEF to choose whatever criteria it believes are important in determining which SB swaps to trade, thereby encouraging as much trading of SB swaps on SB SEFs as possible." Proposed Rules at 10,968.

MarketAxess disagrees. It is not clear how a SB SEF could even develop criteria that would encourage the trading of SB swaps on its platform while protecting its platform's financial integrity and ensuring that no SB swaps are readily susceptible to manipulation. SB swaps have never before been traded on regulated markets. The trading characteristics of SB swaps, and even the types of SB swaps that might be traded, are all unknown factors.

Decisions regarding which SB swaps shall be listed for trading and how those SB swaps are to be traded are *the* fundamental strategic decisions that SB SEFs must make. As drafted, the Proposed Rule appears to make market participants, through their representation on the Swap

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shall be made available to all participants." The composite indicative quote must include "both composite indicative bids and composite indicative offers."



Review Committee, the primary decision-makers for this fundamental SB SEF decision. The decision to trade or not to trade certain SB swaps is primarily a business, and not a regulatory, decision.<sup>29</sup> This decision may well determine whether a SB SEF is successful, and must be left to the Board and management of a SB SEF. MarketAxess also notes that, as part of our routine business development procedures, we continually reach out to our participants for feedback on the possible listing of new products. The best way to ensure that participants' views are taken into consideration is to ensure sure that the SB SEF regulatory structure facilitates competition among SB SEFs by limiting barriers to entry.

This approach would be consistent with the CFTC's approach, which proposes that a SEF's management would decide whether to allow trading of a particular swap. See CFTC Proposed Rule 37.4 Procedures for Listing Products and Implementing Rules (requiring a SEF to submit certain information before listing a new swap, but not creating representation or decision-making requirements).<sup>30</sup> While we favor many aspects of the SEC's proposal, this is one area where we believe that harmonization of approaches between the two agencies should move toward the CFTC's approach.

If the final rules require SB SEFs to have Swap Review Committees, the SEC should make clear that the Swap Review Committee would make recommendations to a SB SEF's management and/or Board, but would not be the ultimate decision-maker.<sup>31</sup> It is inappropriate and unnecessary for the Swap Review Committee to report to the ROC and CCO.

2. *Any Representation Requirements for the Swap Review Committee Should Mirror the Board Independence Requirements.*

Proposed Rule 242.811(c)(2) would require that "the composition of the swap review committee shall provide for the fair representation of participants of the security-based swap execution facility and other market participants, such that each class of participant and other market participants shall be given the right to participate in such swap review committee and that no single class of participant or category of market participant shall predominate." The SEC

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<sup>29</sup> Under the SEC's proposal, the Swap Review Committee could decide a particular SB swap should not be traded on the SB SEF simply because the existing participants are not interested in the type of SB swap, even if the trading of this SB swap on the SB SEF would be appropriate and allow the SB SEF to expand its operations and increase profitability.

<sup>30</sup> Pursuant to SEF Core Principles, a SEF's management must determine that a swap is not readily susceptible to manipulation and comply with self-certification procedures or submit the swap to the CFTC for approval. Although the CFTC's proposed procedures for determining whether a swap is readily susceptible to manipulation go too far, we agree with the CFTC that the decision whether to list a swap for trading must be left to the SEF's management.

<sup>31</sup> Interestingly, the discussion of the annual compliance report in the preamble suggests that the Swap Review Committee only makes recommendations to management and the Board. In discussing the disclosures that must be included in the annual compliance report, the SEC asks: "For example, should disclosures about instances when the SB SEF or the Board has not accepted the recommendations of the swap review committee be required to be included in the annual compliance report?" 76 Fed. Reg. 10,995.



may have intended that SB SEF management would participate in and/or run this committee.<sup>32</sup> But the text of the rule is not clear on this point. Instead, as written, this rule could be read as requiring the committee to be comprised solely of SB SEF participants.

The SEC states that the proposed swap review committee requirement is intended to protect the interests of participants by "mitigat[ing] the inappropriate exercise of market power by any given market participant or group of market participants." Proposed Rules at 11,038. While the structure of some SB SEFs may warrant these protections, a SB SEF that is publicly-owned should not trigger the SEC's concern. If the SEC adopts the proposed swap review committee requirements, the SEC should exempt from those requirements any publicly-owned SB SEF (and any SB SEF that is a subsidiary of a publicly-owned company that is not a market participant).

Alternatively, if the SEC's intent is to impose independence requirements on this committee, in lieu of Proposed Rule 242.811(c)(2) the SEC should adopt a rule that mirrors the governance and conflicts of interest requirements applicable to the Board. Those rules require the Board to consist of 20 percent independent directors and permit SB SEF participants to select at least 20 percent of the committee's participants. *See* Proposed Rules 242.702 and 242.820. These requirements should ensure the decision-making process is fair and takes participant views into account (Proposed Rules at 10968), while preserving the ability of the SB SEF's Board and management to run the company.<sup>33</sup>

**D. SEC Approval and SB SEF Self-Certification Procedures To List SB Swaps Should Be Extended to Cover All Substantially Similar SB Swaps on a SB SEF.**

Proposed Rules 242.807 and 242.808 would provide procedures for listing SB swaps on a SB SEF. The Proposed Rules set forth detailed approval and self-certification procedures. The Proposed Rules appear to contemplate that all SB swaps must be either self-certified or submitted for approval individually, even if multiple SB swaps are substantially similar.

The SEC's approval of a specific SB swap that is voluntarily submitted for approval should be extended to substantially similar SB swaps in the same group, category, type or class. To the degree that the terms and conditions of multiple SB swaps are substantially similar, the SEC's approval of one of those SB swaps should be treated as an approval of the other similar

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<sup>32</sup> The suggestion that Board members may serve on the Swap Review Committee does not ensure that members of management can serve on the Swap Review Committee. 76 Fed. Reg. 10,968, n. 142. This is because only a few members of management will also be Board members. *See* Proposed Rules 242.702(d) (requiring a majority of the Board to be independent directors) and 242.820(a) (requiring at least 20 percent of the Board to be selected by participants).

<sup>33</sup> The SEC stated that it does not intend the Swap Review Committee to decide whether a SB swap has been "made available to trade" such that the SB swap would be subject to the execution mandate under new Exchange Act § 3C(h). 76 Fed. Reg. 10,968, n. 149. MarketAxess understands that the SEC intends to make that decision itself based upon objective criteria that may include transaction volume, among other things. 76 Fed. Reg. 10,968-69.



SB swaps in that category. Similarly, a SB SEF should be able to self-certify through one certification a set of SB swaps that are substantially similar. For example, a SB SEF's self-certification or SEC approval of a SB swap on Company A's credit with a maturity of five years should cover other SB swaps based on Company A's credit with different maturities. This would ensure efficient use of SB SEF and SEC resources and would be consistent with the proposed clearing agency rules regarding approval of new SB swaps for clearing. Proposed Rule 240.19b-4(o)(4) (requiring clearing agencies to submit SB swaps for review by group, category, type, or class of SB swaps when reasonable and practicable).

**E. The SEC Should Determine Which Swaps Are "Made Available to Trade."**

Dodd-Frank will generally require that SB swaps subject to the clearing mandate be executed on an exchange or a SB SEF so long as an exchange or SB SEF "makes the security-based swap available to trade." See Dodd-Frank § 763(a); adding new Exchange Act § 3C(h). MarketAxess strongly supports the SEC's proposal that the SEC establish objective criteria to determine whether a SB swap is made "available to trade." 76 Fed. Reg. 10,968-69. We also agree that the SEC should base this determination on actual market data, which is not yet available. Proposed Rules at 10,969.

The SEC asks for numerous comments regarding the "available to trade" determination, including what types of objective criteria it should use to make such determinations. Proposed Rules at 10,970. The SEC also asks, when considering the volume of trading in a SB swap, whether it should consider liquidity both on SB SEFs and in the OTC markets. Proposed Rules at 10,970-71 (asking if it would "be possible for firms to avoid having SB swaps designated as made available to trade, for example, by suppressing SB SEF trading volume by posting inferior quotes on SB SEFs while continuing to offer identical products in the OTC market at a better price").

MarketAxess believes the SEC should develop objective criteria relating to liquidity, based upon data for SB swap trading. The SEC should consider liquidity for a SB swap on exchanges, SB SEFs, and in the OTC market. If the SEC does not take into account liquidity in the OTC market, as suggested in the SEC's request for comment, participants will have an incentive to limit volume on SB SEFs even where there is a robust market for the SB swap.

If the SEC determines a particular SB swap is "available to trade," it should also treat all SB swaps in the same group, category, type or class that are substantially similar to that particular SB swap as "available to trade." Otherwise, participants could avoid the execution mandate associated with a SB swap by trading instead in an economically similar SB swap. This approach would provide for consistent determinations of similar SB swaps and would be consistent with the SEC's approach in Proposed Rule 240.19b-4(o)(4), which requires that "[a] clearing agency shall submit security-based swaps to the Commission for review by group, category, type or class of security-based swaps, to the extent reasonable and practicable to do so." This approach would also use more efficiently the SEC's valuable and limited resources.



**F. The SEC Should Not Consider Requiring Specific Trading Methods for Certain SB Swaps.**

Proposed Rule 242.811(c)(4) requires the Swap Review Committee to review the liquidity of each SB swap to determine whether each SB swap would be "more suited for trading on a different kind of platform." In connection with this Proposed Rule, the SEC asks whether it should "establish a trading activity threshold that, if exceeded, would require a SB SEF to move the trading of SB swaps to a limit order book platform." Proposed Rules at 10,971. The CFTC similarly requested comment on whether swaps that achieve a certain threshold be limited to trading on order books. 76 Fed. Reg. 1,221.

MarketAxess believes very strongly that nothing in Dodd-Frank or the Exchange Act supports a requirement that certain SB swaps be limited to trading on SB SEFs through limit order books. Paramount to the success of SB SEFs is the flexibility to provide a variety of execution methods to satisfy customer needs. If customers believe certain SB swaps should be traded through a limit order book, SB SEFs will satisfy that demand. The SEC should not speculate on how the markets will evolve and should not consider any such requirements at this time. Such a requirement would create uncertainty about how SB SEF markets could be structured. SB SEFs need stability, certainty, and clarity, as would any newly-regulated enterprise.<sup>34</sup> Once a SB SEF has started operations, absent a showing of abuse the SEC thereafter should refrain from banning certain execution methods.

**G. The SB SEF Participant Monitoring Requirements Should be Made More Efficient.**

1. *SB SEFs Should Not Be Required to Perform Broad Oversight Similar to Oversight Required of National Securities Exchanges.*

Proposed Rule 242.810(b)(3) would require a SB SEF to establish "[r]ules that promote just and equitable principles of trade." The SEC notes in the preamble that:

"This proposed requirement is comparable to a similar requirement for national securities exchanges contained in Section 6(b)(5) of the Exchange Act. The purpose of proposed Rule 810(b)(3) is to require SB SEFs to design their rules in a manner that advances the goals of the Exchange Act of promoting fair and competitive markets for SB swaps. SB SEFs, by establishing rules for trading and monitoring trading among buyers and sellers of SB swaps on their systems, could play a significant role in the development of regulated markets for SB swaps, which in turn would help

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<sup>34</sup> The IOSCO Report notes that more structured platforms *can* be appropriate for trading more liquid products. See p. 48. However, the report emphasizes the need for flexibility and does *not* suggest that a particular type of platform be *required* for more liquid swaps. Until the SEC has experience regulating SB swap markets, it is not possible to know what types of SB swaps listed on SB SEFs, if any, will have sufficient liquidity to be traded on a more structured market or what type of additional structure might be appropriate (perhaps something less than a limit order book).



reduce incidents of systemic risk." Proposed Rules at 10,966 (footnote omitted).

The SEC also asks whether the proposed rule is appropriate. *Id.*

Congress requires the rules of a national securities exchange to be designed "to promote just and equitable principles of trade."<sup>35</sup> Exchange Act § 6(b)(5). Congress does *not* require the rules of a SB SEF to be designed to promote just and equitable principles of trade. *See* Dodd-Frank § 763(c), adding new Exchange Act § 3D(d). This omission should be respected by the SEC; the SEC should not adopt a rule that would require a SB SEF's rules to be designed to promote just and equitable principles of trade.

2. *SB SEFs Should Not Be Required to Monitor Trading Outside the SB SEF.*

Proposed Rule 242.813(a)(2) would require a SB SEF to: "[m]onitor trading in security-based swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions." The SEC may have intended that subparagraph (a)(2) of this Proposed Rule, like the rest of Proposed Rule 242.813, would be limited to a SB SEF's oversight of participant activity on that SB SEF.<sup>36</sup> But the text of the draft rule is not clear on this point. Instead, as written, the rule could require a SB SEF to monitor SB swap trading on other SB SEFs or exchanges.

Consistent with SB SEF Core Principle 4 and the remainder of Proposed Rule 242.813, a SB SEF's oversight should be limited to trading and trade processing "on or through [its] facilities." New Exchange Act § 3D(d)(4)(A). Although new Exchange Act § 3D(d)(4)(B), which will require a SB SEF to "[m]onitor trading in security-based swaps...", is not explicitly limited to activity conducted through that SB SEF, the SEC need not extend a SB SEF's duties to include monitoring all SB swap market activity generally. It is not clear how a SB SEF could even "prevent manipulation, price distortion, [or] disruptions of the delivery or cash settlement procedures" when this activity is not connected to its platform. Proposed Rule 242.813(a)(2) must limit a SB SEF's oversight obligations to activity conducted pursuant to its rules and not create duties that would require a SB SEF to stretch its oversight to cover activity that occurs on the SB SEF's competitors or in the private bilateral market.<sup>37</sup>

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<sup>35</sup> Congress similarly requires the rules of registered securities associations and certain brokers and dealers transacting in government and municipal securities to be designed to promote just and equitable principles of trade. Exchange Act §§ 15A(b)(6), 15B(b)(2)(C), and 15C(b)(3)(A). Congress also similarly requires a DCM to establish and enforce rules to promote fair and equitable trading on the contract market. Dodd Frank § 735(b), adding new CEA § 5(d)(12)(B).

<sup>36</sup> We assume that, based on the context of rule violations, the SEC intended that a SB SEF's responsibility under Proposed Rule 242.813(d) would be limited to violations of that SB SEF's rules.

<sup>37</sup> MarketAxess agrees with the SEC that SB SEFs should not be required to audit their participants. We disagree with the CFTC's approach in Proposed CFTC Rule 37.205(c) that would require SEFs to audit annually their participants' compliance with audit trail requirements.



The SEC asks whether SB SEFs should be required to exchange information regarding trading by mutual participants to facilitate surveillance and investigations of manipulative activity. Proposed Rules at 10,977-78. This question appears to suggest that SB SEFs could be required to monitor trading beyond what occurs on their facilities. SB SEFs should only be required to monitor activity on their own systems.

The SEC also asks whether SB SEFs should be required to be members of the Intermarket Surveillance Group or to form a similar group. Proposed Rules at 10,978. MarketAxess believes that this alternative approach of requiring membership in an industry-wide group would provide for broad monitoring of the SB swap markets without requiring a SB SEF to monitor activity that occurs beyond its facilities.

3. *A SB SEF Should Not Be Required to Have Access to Its Participants' Books and Records and Financial Information Not Connected to Trading on that SB SEF.*

Proposed Rule 242.814(a) would require a SB SEF to establish rules requiring its participants to furnish information necessary for the SB SEF to perform its responsibilities. "[S]uch information may include, without limitation, financial information, books, accounts, records, files, memoranda, correspondence, and any other information pertaining to orders, request for quotations, responses, quotations, or other trading interest entered and transactions executed on or through the [SB SEF]." As drafted, it is unclear whether or not Proposed Rule 242.814(a) is limited to information (particularly financial information and books and records) relating to transactions executed on or through the SB SEF.

The SEC asks whether the proposed requirement is too burdensome. Proposed Rules at 10,979. To the extent the proposed requirement would require participants to furnish books and records that are unrelated to transactions entered into on or through the SB SEF, the requirement is overly broad. Any such requirement should be limited to require a SB SEF to have access only to participants' books and records that are related to trading on the SB SEF's facilities.

Participants should not be required to provide financial information to a SB SEF at all. Instead, participants should be allowed to represent to a SB SEF that they have sufficient financial resources to engage in the contemplated transactions. Participants that are regulated by the SEC and/or an SRO will need to satisfy financial requirements set by the SEC and/or SRO and to be open to audit by the regulator. It is unnecessary also for a SB SEF to have access to that information. For participants that are ECPs not regulated by the SEC or an SRO, a SB SEF should be permitted to rely on a representation as to the financial status of those entities. Any other requirement would effectively require a SB SEF to continually examine the financial condition of those ECPs, which may include some of the largest companies in the world. For a large portion of those ECPs, SB swap trading on a particular SB SEF likely will account for only a tiny fraction of the ECP's financial information. Requiring a SB SEF to have access to all financial information of an ECP will be unduly burdensome and will discourage trading on SB SEFs.

The primary function of a SB SEF is to facilitate SB swaps execution, not to monitor the financial condition or credit risk of market participants. Clearing organizations monitor



counterparty credit risk for cleared SB swaps. For uncleared SB swaps, the parties to the transaction are best suited to monitor credit risk, which will be reflected in the pricing of individual transactions. SB SEFs can satisfy Core Principle 6, requiring SB SEFs to ensure the financial integrity of transactions, by setting appropriate financial criteria as a precondition to granting access to the SB SEF and by requiring participants to make representations regarding their financial resources. This is precisely what is contemplated in Proposed Rule 242.815(b), which permits *participants* to take into account counterparty credit risk for uncleared SB swaps.

#### **H. Disciplinary Procedures Should Be Streamlined to Feature a Summary Fine Structure.**

Proposed Rule 242.811(g) would require SB SEFs to establish disciplinary procedures, including fair and non-arbitrary procedures for any disciplinary process and appeal thereof. Proposed Rule 242.811(g)(1) would require a SB SEF to authorize its staff to recommend and take disciplinary action for violations of the SB SEF's rules.<sup>38</sup> The Proposed Rule would require sanctions commensurate with violations committed. The SEC suggests that SB SEFs look to the disciplinary rules of existing exchanges such as CBOE and NYSE as instructive. Proposed Rules at 10,975, n. 170.

But the proposed requirements extend well beyond the SB SEF Core Principles and the intent of Congress. Under Dodd-Frank, the only mention of discipline in all of the SB SEF Core Principles simply would require a SB SEF to monitor trading through disciplinary practices and procedures. Dodd-Frank § 763(c); adding new Exchange Act § 3D(d)(4)(B).<sup>39</sup> In lieu of Proposed Rule 242.811(g), MarketAxess requests that the SEC adopt a rule permitting a summary fine program.<sup>40</sup>

#### **I. The Proposed Rules Setting Forth the Duties of a CCO Should Be Modified.**

##### *1. A SB SEF's Management Should Be Responsible for Supervising the CCO.*

The SEC must carefully balance regulatory compliance requirements with operational and management responsibilities to ensure that SB SEFs are properly regulated entities, without diminishing their commercial viability. Striking this balance is critical to promoting SB SEF trading.

Proposed Rule 242.823(a) would require a majority of a SB SEF's Board to approve compensation and removal of the CCO. This requirement extends well beyond SB SEF Core

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<sup>38</sup> The inclusion of a SB SEF's "staff" could be read as precluding the SB SEF from delegating disciplinary procedures to an RSP. We ask that the final rule clarify that a SB SEF could delegate any disciplinary procedures to an RSP.

<sup>39</sup> In contrast, DCM Core Principle 13 requires a DCM to have and enforce disciplinary procedures that authorize the Board to discipline, suspend or expel members or market participants that violate the DCM's rules.

<sup>40</sup> This would be consistent with an alternative approach noted by the CFTC. 76 Fed. Reg. 1,227. MarketAxess believes a summary program is more appropriate and compatible with the SEF business model than a comprehensive disciplinary program.



Principle 14 and the intent of Congress. Although we appreciate the SEC's intent to ensure that the CCO can make independent decisions, the SEC's approach could impede effective management and operation of a SB SEF. The proposal assumes that regulatory compliance and sound business management are conflicting priorities. *See* Proposed Rules at 10993. We believe this is fundamentally incorrect.

Proposed Rule 242.823(a) should be revised to permit senior management involvement in determining the CCO's compensation and, when necessary, in dismissing the CCO. Alternatively, if the final rules require Board involvement to set compensation of or remove a CCO, the final rules should also permit these responsibilities to be fulfilled by the senior officer.<sup>41</sup> SB SEF Core Principle 14(B)(i) will require that the CCO report directly to the SB SEF's Board or senior officer.

The SEC requests comment on whether the CCO should be required to report to the Board and not the senior officer in certain situations. Proposed Rules at 10,993. We do not believe Congress intended limitations on this statutorily provided choice. MarketAxess agrees with the SEC that "[t]he Board of a SB SEF should consider the appropriate reporting structure for the CCO" and believes this determination should be left to the discretion of the Board. *Id.* MarketAxess agrees with the SEC that a SB SEF Board could delegate its oversight of the CCO to its ROC and believes that the Board should have the discretion to make this decision. It would not be inconsistent with SB SEF Core Principle 14(B)(iii) for the SEC to require that the CCO informally confer with the ROC annually. This would be in addition to, but could occur in connection with, the CCO's submission of the annual compliance report to the Board that would be required by Proposed Rule 242.823(d).

2. *The CCO's Certification of the Accuracy of the Annual Compliance Report is too Broad.*

Proposed Rule 242.823(c)(1) would require the CCO to certify that the annual compliance report is complete and accurate. This requirement could be read to impose strict liability on the CCO where an annual compliance report contains even a minor and insignificant inaccuracy or contains an error of which the CCO was not aware. The SEC should clarify this Proposed Rule by requiring the CCO to certify that the annual compliance report is "materially" accurate and complete,<sup>42</sup> and by requiring the CCO to make this certification "to the best of his or her knowledge and belief."<sup>43</sup>

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<sup>41</sup> The statute permits the senior officer to exercise the responsibilities otherwise given to the Board. Exchange Act § 3D(d)(14)(B)(i), (iii).

<sup>42</sup> MarketAxess has requested that the CFTC make the same revision to its Proposed Rule 37.1501(e)(7).

<sup>43</sup> This would be consistent with CFTC Proposed Rule 37.1501(e)(7).



3. *The Annual Compliance Report Should Not Include Financial Statements and the CCO Should Not Be Required to Prepare, Submit and Certify Financial Reports.*

Proposed Rule 242.823(e)(1) would require the CCO "to prepare and submit to the Commission a financial report of the [SB SEF]" that includes a complete set of audited, GAAP compliant financial statements.<sup>44</sup> When read in conjunction with Proposed Rule 242.823(c)(1), which requires the CCO to certify the accuracy and completeness of the entire compliance report, the rule would effectively require the CCO to certify the accuracy and completeness of the SB SEF's financial statements. Requiring the CCO to prepare, submit, and certify a financial report is duplicative, burdensome, and inappropriate.

The SEC would appear to agree with this approach in a different section of the Proposed Rules. Proposed Rule 242.802(f) would require each SB SEF to amend its Form SB SEF, including financial statements, within 60 days of the end of the SB SEF's fiscal year. See Form SB SEF Exhibits F and H. In Proposed Rule 242.823(e)(4), the SEC would permit financial statements submitted with Form SB SEF in accordance with Proposed Rule 802(f) to satisfy the requirement that the CCO prepare and submit a separate financial report if the annual compliance report is submitted at the same time as the annual update to Form SB SEF. The SEC should withdraw Proposed Rule 242.823(e).

4. *The SEC Should Not Propose Rules Specifying Procedures for CCOs to Follow For Remediation of Noncompliance Issues.*

The SEC asks whether it should "provide guidance in its proposed rules about the CCO's procedures for the remediation of noncompliance issues." 76 Fed. Reg. 10,994. The SEC should not propose such guidance. The flexible approach embodied in Core Principles 1(B) and 14 and the Proposed Rule that gives each SB SEF the discretion to determine its own procedures is consistent with congressional intent and is the most effective and efficient approach.

A one-size-fits-all process for CCOs to handle noncompliance issues would be inefficient and burdensome. First, the question presumes that "noncompliance issues" do not vary in degree (or at least that different levels of severity can be cleanly delineated) and can all be addressed in a similar manner. MarketAxess believes that this premise is false. Such procedures would likely result in minor issues receiving too much attention and/or major issues receiving too little attention.

Second, subject to some minimum requirements, SB SEFs will have different corporate and governance structures and will operate differently. For example, a CCO for a smaller SB SEF may be personally involved in remediating many noncompliance issues. Larger SB SEFs, on the other hand, may have a more robust management structure where noncompliance issues are reported through command channels and remediated by managers responsible for the business area where the issue arose. In the more robust structure, it may be appropriate for the

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<sup>44</sup> This financial report would need to be "filed with [the annual] compliance report." *But see* Proposed Rule 242.823(e)(4), which suggests that the financial report is "part of the annual compliance report."



CCO (or someone who works for the CCO) only to supervise or confirm that the issue has been remediated. The flexible approach that gives a SB SEF discretion to establish its own procedures is the better approach.

**5. Requests for Clarification, Technical Changes, and Requests for Comment**

**A. The Proposed Rule Regarding Permissible Uses of Data Should be Clarified.**

Proposed Rule 242.819(c) would prohibit a SB SEF from using, for non-regulatory purposes, any confidential information it receives or collects for the purposes of its regulatory obligations. The SEC states that the underlying policy is to prevent a SB SEF from taking advantage of confidential information it receives in connection with its regulatory responsibilities. Proposed Rules at 10,966.

MarketAxess considers its customers' privacy to be paramount and asks that the SEC clarify that a SB SEF could use, for commercial purposes, any data and information it receives, so long as doing so does not disclose the identity of any participants of the SB SEF. Disclosure of the identity of a user also should be permitted with the written consent of the market participants or members.

The SEC states that this Proposed Rule is intended to prevent a SB SEF from "taking commercial advantage of any confidential information that it receives in connection with its regulatory responsibilities." Proposed Rules at 10966. A SB SEF may not be able to distinguish whether data or information received was for the purpose of complying with its regulatory obligations or for some other purpose. Also, if the SEC intends to preclude a SB SEF from using data it receives for internal use to identify ways to better serve its customers, we ask that the SEC reconsider.

**B. Proposed Rules Relating to the Clearing Mandate Should be Clarified.**

Proposed Rule 242.811(f) would require SB SEFs to adopt and to enforce rules concerning the reporting of trades executed on a SB SEF to a clearing agency, if the SB swap will be cleared, and the procedures for processing SB swap transactions executed on or through the SB SEF. MarketAxess supports Proposed Rule 242.811(f) and requests that the SEC clarify in its final rules certain logistical components of this rule.

*1. The Choice of Which Clearing Agency Will Clear a SB Swap Should Be Made Prior to Execution of the SB Swap.*

New Exchange Act § 3C(g)(5)(A) provides that when a clearable SB swap (whether required to be cleared or not) is entered into by a SBSB or MSSP with a counterparty that is not a SBSB, MSSP, SD or MSP, the end user has the right to select the clearing agency that will clear the SB swap. For SB swaps subject to the clearing and execution requirements, a SB SEF's rules should require the party that is eligible to choose the clearing agency, to make that choice on the SB SEF's trading system before a trade is executed. Any Proposed Rule should be flexible and should permit the SB SEF to determine the best way for the parties to notify the SB



SEF, such as making identification of the clearing agency and the clearing member fields that a customer must complete when entering an RFQ.<sup>45</sup>

2. *A SB SEF Should Be Able to Send a Trade to a Clearing Agency Via an Affirmation Hub.*

The SEC should confirm that a SB SEF's rules adopted in accordance with Proposed Rule 242.811(f) may provide that a SB SEF can send a trade to the clearing agency via an affirmation hub. This will facilitate efficient use of SB SEF resources and ensure that third party services providers that already provide similar services in financial markets are permitted to compete in the SB swaps marketplace. In particular, in the event that the SEC determined to mandate by regulation a particular trade flow model that did not allow for submission of trades via an affirmation hub, SB SEFs would need to undergo the added expense of building internal functionality to replicate these services, including with respect to trade allocation. Beyond the specific costs of these requirements, the SEC also should consider the time factor associated with meeting these requirements and the opportunity cost to SB SEFs of shifting their IT focus (away from other areas not already being adequately addressed by third party service providers).

Finally (and most importantly from our customer service perspective), our clients have consistently expressed a strong preference for the use of affirmation hubs. Many of our institutional investor clients, who may trade on multiple platforms, prefer to undertake their trade allocation process to their various internal funds in one location provided by an affirmation hub rather than needing to undertake this process on every platform where they conduct trading.

C. **A SB SEF Should Be Able to Delegate Disciplinary Functions.**

Proposed Rule 242.811(g)(1) would require a SB SEF to have rules authorizing its "staff to recommend and take disciplinary action for violations of the rules of the" SB SEF. The use of the term "staff" creates ambiguity as to whether this responsibility can be delegated. A SB SEF should be permitted to delegate these investigations to an RSP that is handling the SB SEF's rule enforcement program. Consistent with the other Proposed Rules, the references to "staff" in 242.811(g)(1) should be replaced with "security-based swap execution facility" to make clear that the administration of the disciplinary program can be delegated.

D. **Demonstrating That a SB Swap is Not Readily Susceptible to Manipulation Must Be a Flexible Requirement.**

Core Principle 3 will require that a SB SEF only permit trading in SB swaps not readily susceptible to manipulation. Proposed Rule 242.812 would require a SB SEF's Swap Review Committee to determine that a SB swap is not readily susceptible to manipulation and to periodically review that analysis. While favoring this determination to be made by a SB SEF's

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<sup>45</sup> The SEC requests comment whether a SB SEF should "be required to ensure that it has the capacity to route transactions to the clearing agency." Proposed Rule at 10,979. To the extent the final rules require a SB SEF to provide connectivity to clearing agencies, the SEC should make clear that SB SEFs need not provide connectivity to every clearing agency, which would entail significant initial costs as well as ongoing costs to maintain such connectivity.



senior management rather than by an outside committee, MarketAxess otherwise supports the SEC's broad and flexible approach in the Proposed Rule.

The SEC asks whether it should provide a safe harbor for satisfying Core Principle 3. Proposed Rules at 10,977. MarketAxess believes that, where a clearing agency already accepts a SB swap for clearing, there should be a presumption that Core Principle 3 is satisfied with respect to that type of SB swap. A clearing agency may only accept a SB swap for clearing after the SEC approves that clearing agency to accept that type of SB swap. Exchange Act § 3C(b). Rules proposed under Parts 240 and 249 outline the process that a clearing agency would use to obtain SEC approval for clearing a SB swap. The process would require due diligence and analysis by both the clearing agency and the SEC. A SB SEF should be permitted to rely upon the fact that a clearing agency and the SEC have already undertaken substantial diligence and analysis and the SEC has approved the clearing agency's decision to accept the SB swap for clearing.

#### **E. The Financial Resources Requirements Should Be Clarified.**

Core Principle 12 will generally require a SB SEF to have adequate financial, operational, and managerial resources to discharge each responsibility of the SB SEF. Dodd-Frank § 763(c), adding new Exchange Act § 3D(d)(12). Proposed Rule 242.821(b) would implement this requirement by requiring that the SB SEF's financial resources be valued "using reasonable estimates and assumptions and not overestimating resources or underestimating expenses, liabilities, and financial exposure." Proposed Rule 242.821(b)(2) provides that a SB SEF's financial resources shall be considered adequate if the value of the financial resources "exceeds the total amount that would enable the [SB SEF] to cover its operating costs for a one-year period, as calculated on a rolling basis." MarketAxess supports this valuation language and Proposed Rule 242.821(b)(2), which provide SB SEFs with clear, flexible guidelines.

The remainder of Proposed Rule 242.821(b)(1), however, is unclear; it restates language in Dodd-Frank that a SB SEF's financial resources shall be considered adequate if the value of the financial resources "[e]nables the [SB SEF] to meet its *financial obligations to participants, notwithstanding a default by the participant creating the largest financial exposure for the [SB SEF] in extreme but plausible market conditions.*" See Dodd-Frank § 763(c), adding new Exchange Act § 3D(d)(12)(B)(i) (emphasis added). The SEC states that this requirement is intended to "help ensure that the financial failure of one participant would not be able to destroy the financial viability of the entire SB SEF." Proposed Rules at 10,987. But a SB SEF will not be a counterparty to the SB swaps that are offered on its platform. Thus, a SB SEF has no financial obligations to its participants and a participant's default on a SB swap that is executed on a SB SEF would not cause an economic loss for that SB SEF. The only financial exposure that a SB SEF may incur as a result of a participant's default would be the participant's failure to pay fees due for accessing and using the SB SEF's system or platform. In lieu of this portion of Proposed Rule 242.821(b)(1), MarketAxess suggests that the SEC adopt the following language to clarify the corresponding portion of SB SEF Core Principle 12, such that a SB SEF's financial resources shall be considered adequate if the value of the financial resources:

"Enables the security-based swap execution facility to meet its financial obligations, *notwithstanding a failure by the SB SEF's most active participant to pay the SB SEF fees on a timely basis*; and"



## F. Confirmations

Today, with respect to its corporate bond markets, consistent with existing broker-dealer regulations, MarketAxess produces transaction reports, but does not provide trade confirmations. MarketAxess favors the SEC's approach in Proposed Rules 242.901 and 240.15Fi-1, which keeps the responsibility of generating acknowledgments and confirmations where it rests today—with brokers and dealers. This approach is also consistent with the proposed rules for reporting uncleared SB swap data to SB swap data repositories and for reporting cleared SB swaps to clearing agencies and SB swap data repositories, none of which would make a SB SEF responsible for these duties. Proposed Rules 242.901 and 240.15Fi-1(b). There is no need for the SEC to impose the duty of generating confirmations on SB SEFs.

## CONCLUSION

MarketAxess very much appreciates the diligence, insight, and hard work of the SEC and its staff as the development of SB SEF regulation unfolds. MarketAxess agrees with and supports many aspects of the Commission's proposals. Based on our own experiences in operating a successful electronic trading platform, we have also suggested a number of areas for improvement, in particular the provision of a flexible and cost-effective regulatory framework that can fully allow an RSP separate from the trading platform to perform broadly the SB SEF's self-regulatory functions. We believe strongly that this model is appropriate for SB SEFs, which are expected to experience episodic trading and limited execution fees.

We look forward to working with the SEC to achieve the Congressional objective of promoting SB swap trading on SB SEFs. If you have any comments or questions about our comment letter or the SB SEF issues generally, please contact me or our General Counsel, Chuck Hood, at (212) 813-6053.

Respectfully,

Richard M. McVey  
Chairman and Chief Executive Officer  
MarketAxess Holdings Inc.