
April 4, 2011

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

**Re: Registration and Regulation of Security-Based Swap Execution Facilities – Proposed Rules (File Number S7-06-11)(RIN 3235-AK93)**

Dear Ms. Shapiro:

Phoenix Partners Group LP submits this letter to the Securities and Exchange Commission ("SEC" or the "Commission") regarding its proposed rulemaking on Registration and Regulation of Security-Based Swap Execution Facilities (the "Proposed Rules") under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act").

Phoenix Partners Group LP is the corporate parent and wholly owns Phoenix Derivatives Group LLC ("Phoenix"), a FINRA regulated inter-dealer broker. As an inter-dealer broker that has, since 2005, provided a marketplace for, among other things, buyers and sellers of Credit Default Swap ("CDS") index and single name products, and intends to submit an application to register as a security-based swap execution facility ("SB SEF")[1], Phoenix submits the following comments based upon our experience as an established broker in the over-the-counter ("OTC") credit swap marketplace and based upon our understanding of and experience in how the credit derivative products governed by the Act and the Proposed Rules currently trade.

[1] We will also be registering as a swap execution facility (a "SEF") with the Commodity Futures Trading Commission (the "CFTC").


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## I. Requirements for registration (Proposed § 242.801)

In proposing § 242.801(c), the SEC will allow qualifying entities that will be required to register as a SB SEF the opportunity to receive grandfather relief, i.e., to operate while its SB SEF registration is pending. We agree with the SEC that delays in the processing of SB SEF registration applications at the outset of the implementation of the Proposed Rules could have a significant adverse effect on the OTC swaps markets and could ultimately undermine the goals of the Act. Grandfathering of established, qualified inter-dealer brokers that are incumbents in the market and have a history of fostering market liquidity through voice brokering, electronic brokering and hybrid brokering at the time of submitting their application for SB SEF registration will enable the OTC swaps markets to continue to operate in an orderly fashion once the Proposed Rules take effect, and will prevent market disruption and the detrimental effects that could have on end-users and the economy.

With respect to the granting of grandfather status, the Proposed Regulations (§242.801(c)) provide that an applicant may submit a notice requesting that the Commission grant it temporary grandfather relief pending a determination of its registration application. To avoid any market disruptions during the time that a request for temporary grandfather relief is pending, we believe that the SEC should allow applicants to operate as a SB SEF prior to the SEC making a decision on granting temporary registration if an applicant provides a certification that, if granted such relief, it will meet the requirements of Part 242 while awaiting a determination from the SEC granting or denying the grandfather relief request. In addition, we feel that grandfather status should only be granted to applicants who can provide transaction data that substantiates that the applicant has and continues to facilitate the execution or trading of security based swaps at the time the applicant submits the request. Such an approach would allow registrants, which are already fostering and providing marketplace liquidity, to continue to do so while awaiting the grandfather relief determination, and, because the registrant is certifying that it is compliant with Part 242, the risk of wholly unqualified registrants operating as SB SEFs is effectively eliminated.

## II. Compliance with rules (Proposed §242.811)

With respect to permitted execution methods, we commend the SEC in not dictating permitted trading systems or trading rules to SB SEFs. Allowing for each SB SEF to create a trading system that best fits the markets and clients it serves while meeting certain basic standards set forth by the SEC allows for flexibility and innovation as markets and products evolve.

We comment in response to the SEC's question "What are commenters' views on the proposed requirement that responses to an RFQ must be included in the SB SEF's composite indicative quote?" We believe that market participants will be more likely to transact in particular OTC swaps and foster liquidity in those products if

market participants are allowed under certain circumstances to not display bids or offers to all participants. For the same reasons that a party submitting a request for quote may wish not to notify the entire marketplace when the market participant is exercising investment discretion, that market participant may choose not to submit a RFQ and a market participant may choose not to respond to the RFQ if that response will be potentially broadcast (either by itself or as part of a composite quote) to the entire marketplace pre-trade. One way to achieve the twin goals of price transparency and increased liquidity under the Act is to only make responses to requests for quotes transparent to all market participants subsequent to execution. Our experience in the credit derivative market has shown us that most OTC swaps that will trade via RFQ on a SB SEF will be in more illiquid names and participants will be much more likely to initiate, and respond to, RFQs if the nature of the request and the response to the request are not broadcast to the entire market. Simply put, if the SEC does not allow for means via RFQ for market participants to both: (i) engage with less than the entire market and (ii) submit an RFQ without notifying the entire market that a party currently wishes to trade the particular OTC swap in question, liquidity in OTC swaps will suffer greatly, with end users ultimately bearing the cost of the lack of liquidity.

Furthermore, while the Act undoubtedly mandates certain levels of pre- and post-trade transparency, we believe that the right balance of pre- and post-trade transparency is essential to maintaining proper levels of liquidity in the OTC swaps market. In terms of pre-trade transparency, we commend the Commission for not requiring traders who have executed against customer orders to post one side of such a trade on a SB SEF for a period of time, as such rule would inhibit market liquidity. Such a rule, if put in place, would deter market participants from fostering liquidity based upon customer orders because those market participants would have no certainty that they would be able to complete the order as negotiated, resulting in greater uncertainty for the market participant in its use of capital.

However, we disagree with the stance taken by the Commission regarding requiring block trades to be subject to the same pre-trade transparency requirements as other trades. In many instruments this rule will prevent market participants from engaging in block trades. The risk of a block trade to a market participant is much greater than that of a non-block transaction and typically requires additional offsetting transactions, and thus forcing such trades into the same pre-trade framework as other smaller trades will undermine the goals of increased liquidity and greater price competition.

Regarding post-trade transparency, of utmost concern under the Proposed Rules is the requirement that all block trades are subject to the same transparency requirements as other trades. Again, in many instruments this rule will prevent market participants from engaging in block trades because the reporting of trades, in the same time period as non-block trades jeopardizes the anonymity of the trade and will prevent the market participant from being able to offset the risk of the block trade. This reporting requirement will most likely diminish liquidity in many instruments, and the

reporting time therefore should be increased, with end-of-day reporting being one means to allow the market participant engaging in a block trade to offset the risk it took on by engaging in a block trade.

Additionally, the Proposed Regulations under §242.811 require, in part, that a SB SEF shall establish and enforce compliance with any rule established by such SB SEF, including the terms and conditions of the security-based swaps traded or processed on or through the SB SEF. We are concerned that, while the Act mandates this provision, the fundamental nature of an SB SEF makes it impossible to comply with this obligation. As the SB SEF is not a counterparty to any transaction that takes place over its platform, this responsibility is misplaced and should be undertaken by a regulatory body such as the Commission or a self regulatory organization ("SRO") such as FINRA or a new SRO formed to oversee SB SEFs. We strongly feel that a SB SEF can only reasonably establish, maintain, and enforce rules which are properly designed to govern conduct on its own platform. Such rules must be tested, verified and, when necessary, amended. This is the framework used successfully under NASD Conduct Rules 3010 and 3012 for FINRA member firms and we feel that it is the appropriate framework to be used in the SB SEF context as well. While we understand that the Act requires amendment in order to correct this, we cannot overstate the importance of getting this concept right in the final rules.

## III. Monitoring of trading and trade processing (§242.813)

While we take the position that an SB SEF should take an active role in preventing manipulation, price distortion and disruptions on its own platform, our opinion is that the requirement imposed by the SEC on SB SEFs to monitor trading outside of its platform is misplaced. We feel that the Commission should provide guidance in its final rules indicating that this responsibility of the SB SEF be limited to activity taking place on the SB SEF. In addition, §242.813(b)(1) imposes the requirement on a SB SEF to establish an automated surveillance system designed to, among other things, detect insider trading on its platform which has occurred or is occurring. Such a requirement establishes a burden on the SB SEF to be able to reach beyond its own platform and obtain intimate knowledge of the internal operations of the trading desk of the participants transacting on the underlying name in any capacity (equities, debt, etc.). Additionally, as currently written, such a requirement could potentially require the SB SEF to pierce the "Chinese wall" of a participant and be responsible for monitoring their investment banking activities conducted with the underlying company. Neither obligation is reasonable or practicable. Such monitoring requirements should be limited to activities which have occurred or are occurring on the SB SEF and it should be made clear in the final rules that no obligation on the part of the SB SEF exists to conduct any diligence of its customer's activities outside of those occurring on the SB SEF for the purpose of detecting insider trading.


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## IV. Impartial Access (Proposed §242.809)

We commend the Commission on correctly determining that the impartial access goals of the Act can be met while preserving the ability to limit less qualified parties from participation on a SB SEF. Impartiality with respect to the treatment of SB SEF members and market participants, including, but not limited to, impartiality with respect to access to SB SEF's and enforcement of a SB SEF's rules, is an appropriate principle for achieving the Act's goal of expanding access to the OTC swaps market. However, the concept of requiring "equitable allocation of reasonable dues, fees, and other charges among its participants and any other users of its system." should be a flexible one, allowing SB SEF's to set access standards, both with respect to fees and volume of transactions, that reflect the costs of operating a SB SEF and are consistent with a market participant's ability to engage in the trading of OTC swaps.

## V. Conflicts of interest (§242.820)

The Proposed Rules establish requirements on board of director composition of SB SEFs by requiring at least 20 percent of the board of each SB SEF be selected by participants on the SB SEF. We feel that such types of governance requirements are overly burdensome and highlight the misconception that SB SEFs should resemble the historical "not-for-profit" exchange model. Given the projected number of entrants into the SB SEF marketplace and the inherent competition which will ensue, we feel that the market power of any individual SB SEF will be limited and SB SEFs that do not conduct their affairs in a manner acceptable to its participants will either be forced to adapt or be eliminated by market forces. In addition, the market power of the major participants in the OTC credit swap marketplace is, in our experience, immense, and forcing SB SEFs to give any measure of formal control to its participants could effectively transfer implicit control of the SB SEF to them. We agree that rules requiring at least one (1) director on each SB SEF be representative of investors who are not security-based swap dealers or major security-based swap participants as well as not being associated with a participant will provide impartiality and integrity to the board of an SB SEF, but rules requiring the presence of participants in the governance structure of a SB SEF are misplaced.

## VI. Financial resources (§242.821)

Because a SB SEF does not take positions or hold positions in any of the products traded on it, an orderly wind-down of a SB SEF, one that that would result in no disruption to the OTC swaps market, would take significantly less than one year. Therefore, we recommend that SB SEF's be required to maintain financial resources necessary to operate the SB SEF for a period of six (6) months instead of one (1) year as required by §242.821(b)(2). Six months of operating costs is more than sufficient for a SB SEF to wind down its activities, in particular because a SB SEF will not have to unwind positions, and because there will be numerous other SB SEFs in the marketplace that will be available to market participants and to ensure that liquidity is

not impacted by one SB SEF's wind-down.[2] This six month operating expense requirement would be two times the fixed overhead requirement imposed by the United Kingdom Financial Services Authority, which requires similar financial services companies to maintain three months of operating capital at all times. See FSA GENPRU 2.1.54.

Additionally, §242.821(b)(1) requires a SB SEF to maintain financial resources necessary to operate the SB SEF "notwithstanding a default by the participant creating the largest financial exposure for the security-based swap execution facility in extreme but plausible market conditions". Given the nature of the operations of a SB SEF, it is extremely unlikely that this calculation will ever be higher than that required under §242.821(b)(2) and, therefore, provides no additional protection to the marketplace or the public at large. As such, we recommend this provision be removed from the Proposed Rules prior to publication

The SEC stated that "a SB SEF must use reasonable assumptions and estimates and not overestimate resources or underestimate expenses, liabilities, and financial exposure." We agree with the stance of the SEC that a flexible standard appropriate to the SB SEF in question should be used in making this calculation. However, we believe that the SEC should make it clear by enumerating in §242.821 that the following resources (among others) should be included in this calculation: assets of a parent company that wholly owns the SB SEF and the SB SEF's accounts receivable from SB SEF members. As long as the parent company has committed to guarantee the financial resource obligations of the SB SEF, those assets would be available to the SB SEF and would therefore be an appropriate financial resource for the SEC to include. This is the stance taken by the CFTC in its proposed rules relating to SEFs and, we feel, an appropriate one. Similarly, as long as the SB SEF properly values its accounts receivable, those monies owed to a SB SEF by its customers are easily obtainable by a SB SEF and therefore are appropriate for inclusion by the SEC.

## VII. Phasing-In

The Act provides that final regulations should become effective not less than 60 days after publication in the Federal Register. Swaps trading in the United States is a complex, multi-trillion dollar market which has developed organically over a period of decades. While the Proposed Rules are currently available to the general public, requiring that the market be able to adapt to final regulations within 60 days of receiving notice of them runs the risk of adversely affecting liquidity in the swaps marketplace. The Commission has invited comment on whether "it should provide a SB SEF a certain amount of time to comply with the proposed requirements of

[2] The SEC indicated that it "the Commission preliminarily believes that approximately 10 to 20 entities could seek to register as SB SEFs and thus be subject to the collection of information requirements of these proposed rules. The Commission is using the higher estimate of 20 SB SEFs." 76 FR 11023.


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SB SEF a certain amount of time to comply with the proposed requirements of Regulation SB SEF applicable to a registered SB SEF once the SB SEF has become registered, and, if so, which provisions, why, and how much time should be provided." We feel that this concern is well placed and recommend a "phased in" approach which would allow the markets to properly adapt to the wholesale changes envisioned under the Act.

We fully support both the move to a central clearing model and many aspects of post-trade data dissemination being implemented 60 days subsequent to the publication of the final regulations in the Federal Register. The benefits to the swaps marketplace from these provisions cannot be understated. However, we believe that other portions of the final regulations should be phased in over time. For example, the requirements under §242.811 regarding permitted execution methods envision changes which will fundamentally change the OTC swaps marketplace. Such trading currently occurs electronically, via voice and using methods which both incorporate electronic and voice elements. Moving to a fully electronic marketplace without properly giving the markets time to adapt could have a disruptive effects on the OTC swaps markets in general. Additionally, while SB SEFs can build electronic systems presently to meet the requirements in the Proposed Rules, it is not possible to foresee the changes that will be made by the SEC between now and publication of the final rules. Additionally, we believe that most SB SEF applicants (including ourselves) will be applying simultaneously with the CFTC for to become a SEF under a differently regulatory framework. Given the burdens involved in this process, it is reasonable to extend the deadlines regarding technology and systems not currently required or customary in the OTC marketplace.

In addition, the ability of the SEC to continue to study the possible effects of these key changes during a phase-in period has tremendous value. Given the tight timeframe the SEC has been forced to work within to implement the Act, any "breathing room" provided for in the final rules can be utilized to help ensure that the regulatory regime is properly tailored to the products it is intended to cover.

In conclusion, allowing additional time for the markets to adapt to a portion of these changes during a phase-in would reduce the possibility of disrupting the overall marketplace during the transition, which would result in reduced liquidity and have the perverse effect of harming those parties intended to be helped under the Act.

Very truly yours,

Nicholas J. Stephan
Chief Executive Officer


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