



UBS Securities LLC
677 Washington Blvd.
Stamford, CT 06901

www.ubs.com

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

November 2, 2011

**Re: Regulation SB SEF – Registration and Regulation of Security-Based Swap Execution Facilities
(File Number S7-06-11)**

Dear Secretary Murphy:

UBS Securities LLC appreciates the opportunity to submit comments to the Securities and Exchange Commission (the "**Commission**") in response to the Commission's proposed rule on the Registration and Regulation of Security-Based Swap Execution Facilities (the "**Proposed Rule**").¹ This letter is a follow-up to the meeting held with Commission staff on July 20, 2011.

As acknowledged by the Commission in its Proposed Rule, a number of security-based swap execution facilities ("**SEFs**") may be established as the trading of security-based swaps migrates to regulated markets.² In a market environment with a significant number of SEFs, each with varying membership and connectivity requirements³, customers will rely on broker-dealers registered with the Commission to provide services enabling customers to efficiently locate liquidity and achieve best execution, as they do in other markets regulated by the Commission. However, absent further clarity from the Commission, we are concerned that a lack of legal certainty may result in SEFs or other liquidity platforms taking actions that prevent broker-dealers from performing this fundamental role on behalf of customers transacting in security-based swaps. We strongly urge the Commission to expressly provide in the final SEF rules that broker-dealers have the ability to provide customers with indirect access to the liquidity available on SEFs where the broker-dealer is a member and allow customers to view and transact against available liquidity across multiple sources in a single location. With access to the liquidity available on SEFs, broker-dealers may then, in compliance with the core principles of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"), route and execute requests for quotes and orders on behalf of customers, either on a disclosed or undisclosed basis (a broker-dealer acting in such capacity, a "**Customer Agent**"). As a result, customers will have an important cost-saving alternative to incurring the financial, technological and operational burdens associated with connecting directly to a number of SEFs in a fragmented market.

It is our view that this trading model is permitted by both the Dodd-Frank Act and the Proposed Rule⁴, and based on our July 20th meeting, we understand that the Commission also supports this view. In addition, a broker-dealer acting as Customer Agent is consistent with the core principles of impartial access and best execution, and is analogous to activities of registered broker-dealers in other markets regulated by the Commission that are relied upon by customers in order to locate liquidity and achieve best execution. However, we believe that it would be helpful to market participants for the Commission to expressly

¹ Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10948 (February 28, 2011).

² See Proposed Rule at 10952-55.

³ See, for example, our earlier comment letter on trade execution submitted to the Commission on December 15, 2010.

⁴ See, for example, the commentary to the Proposed Rule noting that "eligible contract participants that are not participants could access a SB SEF indirectly through a participant" and "participants that provide sponsored access to SB SEFs would be required to register with the Commission as a broker". Proposed Rule at 10963 and 10965.

acknowledge as part of the final SEF rules that a broker-dealer acting as Customer Agent is one of the accepted trading models for security-based swaps traded on SEFs, particularly given the fact that many customers have already expressed a strong desire for these types of services. We also urge the Commission to consider the clarifications and amendments discussed below, particularly given the importance of the Proposed Rule in the evolution of the security-based swaps market and the need to ensure that the Proposed Rule promotes efficiency, competition and capital formation while enabling customers to cost-effectively access the new risk mitigation elements of the market infrastructure for security-based swaps, such as SEFs.

Distinction Between a Broker-Dealer Acting as Customer Agent and a SEF

As a threshold matter, we urge the Commission to clarify that a broker-dealer **enabling customers to view and transact against available liquidity across multiple sources in a single location** and acting as Customer Agent does not fall within the definition of a SEF or an exchange and does not trigger a requirement to register as a SEF or an exchange. In the role of Customer Agent, the broker-dealer is aggregating and distributing information available from trading platforms registered with the Commission, information that is used by the customer to determine the best execution venue for a particular transaction. Once located, the specific transaction is executed on the relevant execution venue's platform, either by the customer directly or by the Customer Agent on behalf of the customer, **either on a disclosed or undisclosed basis**. Since the broker-dealer is not providing a facility where execution occurs, no "facility for the trading or processing of security-based swaps" within the meaning of Section 3D(a)(1) of the Securities Exchange Act of 1934 (the "**Exchange Act**") or "trading system or platform in which multiple participants have the ability to execute or trade security-based swaps" within the meaning of Section 3(a)(77) of the Exchange Act should be considered to exist.⁵ Instead, the broker-dealer is acting as an agent to a counterparty to a security-based swap transaction, activity that the Commission has identified in the commentary to the Proposed Rule as being specific to a broker.⁶

A broker-dealer acting as Customer Agent should not be required to register as a SEF or an exchange regardless of the number of SEFs for which the Customer Agent is a member or whether any price improvement options are also available to customers. Potential price improvement options offered by the Customer Agent could include locating other sources of available liquidity on the customer's behalf by internalizing customer orders or connecting fellow customers with one another. These types of services reflect broker-dealer activities in other markets regulated by the Commission and benefit customers while assisting broker-dealers in **fulfilling their legal obligations to seek to obtain best execution of customer orders**.⁷ Finally, **with respect to services provided for security-based swaps that are not subject to the mandatory execution requirement**, we applaud the Commission for clarifying in the commentary to the Proposed Rule that the registration requirement in Section 3D(a)(1) of the Exchange Act only applies to facilities that meet the definition of a SEF and does not apply to facilities that allow for the trading of security-based swaps that are not subject to the mandatory execution requirement.⁸

A Broker-Dealer Acting as Customer Agent is Entitled to Impartial Access

An important component of the Commission's principles-based approach to the regulation of SEFs is the requirement in both the Dodd-Frank Act and the Proposed Rule that SEFs must provide market participants with impartial access to the market. This principle is explicitly made applicable to brokers registered with the Commission in proposed §242.809 and we urge the Commission to clarify that the provision of impartial access by a SEF includes not discriminating among brokers on the basis of the types of trading engaged in by a broker or the services offered by a broker to its customers. As a result, SEFs should not be able to limit a broker's access to the market (including, without limitation, by requiring the execution of overly restrictive licensing and confidentiality agreements) simply due to the fact that such broker is acting as Customer Agent and aggregating prices so as to **enable customers to view and transact against available liquidity across**

⁵ We believe similar principles should apply for purposes of analyzing the definition of an "exchange".

⁶ See Proposed Rule at 10959. However, we note that some uncertainty appears to remain in the commentary to the Proposed Rule regarding the point at which brokerage activities may satisfy the proposed interpretation of the SEF definition and we urge the Commission to provide further clarity on this important topic in the final SEF rules (See Proposed Rule at 10955).

⁷ See Proposed Amendments to Rule 610 of Regulation NMS, 75 Fed. Reg. 20738, 20739 (April 20, 2010).

⁸ See Proposed Rule at 10949. Section 3D(a)(1) specifies that no person may operate a facility for the trading or processing of security-based swaps unless the facility is registered as a SEF or a national securities exchange.

multiple sources in a single location. This outcome is consistent with the goals of the Dodd-Frank Act for providing customer access, promoting competition and ensuring best execution.

Rule 610(a) of Regulation NMS, which prohibits a national securities exchange from imposing unfairly discriminatory terms that prevent or inhibit any person from obtaining efficient access through a member to displayed quotations in an NMS stock, provides a relevant example of Commission efforts to ensure that market participants are not unduly restricted from accessing available liquidity and broker-dealers are able to fulfill their legal obligations to seek to obtain best execution of customer orders.⁹ We urge the Commission to implement the impartial access requirement for SEFs in a similar manner and specifically consider, as part of its statutorily required analysis of the Proposed Rule, the economic effects on customers if SEFs are permitted to discriminate against particular trading models under proposed §§242.809¹⁰, 810(b)(2)¹¹ and 811(b)¹² and prevent a customer from accessing liquidity in a manner that may be the most advantageous and cost-effective alternative for that customer. Preventing broker-dealers from acting as a Customer Agent in the manner described above will result in significant financial, technological and operational costs for customers transacting in security-based swaps and may limit the benefits of the new risk mitigation elements of the market framework for security-based swaps.

In connection with the above, we also urge the Commission to specifically include public comment periods as part of the approval process for initial SEF registrations and subsequent changes to the rules of a SEF. While some comfort can be obtained from the detailed information required to be provided by initial registrants on Form SB SEF¹³, which the Commission has noted in the commentary to the Proposed Rule that it expects to make public on its website, and the requirement for a SEF to publish notice on its website regarding any subsequent rule change, the Commission should establish processes for SEFs that are consistent with Sections 19(a) and (b) of the Exchange Act, which require the Commission to afford interested persons the opportunity to submit comments regarding exchange applications and proposed rule changes. Given the important role of SEFs in the rapidly evolving security-based swaps market and the commercial incentives of each SEF to consolidate as much liquidity as possible on their specific platform, public comment may be a crucial resource for the Commission, particularly in key areas, such as access, membership and governance.

Application of the Existing Broker-Dealer Regime

In the context of analyzing the impact of the Proposed Rule and the application of the existing broker-dealer regime to transactions in security-based swaps, the Commission should remain cognizant of features of the security-based swaps market that differentiate it from other markets regulated by the Commission. Importantly, SEF membership will not be limited to entities that are required to register with the Commission, making it imperative that the Commission ensure that registered entities, such as broker-dealers, acting in a Customer Agent capacity are not held to a higher standard than, and therefore are not at a competitive disadvantage compared to, other SEF participants. As part of the Commission's statutorily required analysis of the Proposed Rule's potential effects on competition, we urge the Commission to consider the potential impact of the many components of the existing broker-dealer regime on the ability of broker-dealers to act as a Customer Agent, including capital requirements and any rules that the Commission decides to adopt that are analogous to Rule 15c3-5 (*Risk Management Controls for Brokers or Dealers With Market Access*) and that would impose additional controls and procedures on broker-dealers that access SEFs.

⁹ See Proposed Amendments to Rule 610 of Regulation NMS, 75 Fed. Reg. 20738, 20739 (April 20, 2010).

¹⁰ §242.809(b) provides that "[a] security-based swap execution facility shall permit all eligible persons that meet the requirements for becoming a participant in the security-based swap execution facility under paragraph (a) of this section [including brokers] and the security-based swap execution facility's rules to become participants of the security-based swap execution facility, consistent with the requirements for providing impartial access in section 3D(d)(6) of the [Exchange Act]".

¹¹ §242.810(b)(2) provides that a SEF shall establish "[r]ules and systems that are not designed to permit unfair discrimination among its participants and any other persons using its system".

¹² §242.811(b) provides that a SEF shall establish "fair, objective, and not unreasonably discriminatory standards for granting impartial access to trading on the security-based swap execution facility".

¹³ We note that this includes the criteria for the participation in or use of the SEF and all denials or limitations of access as part of Exhibit L of Form SB SEF.

In connection with the above and with the expansion of the broker-dealer regime to security-based swaps more generally, we also believe it is necessary for the Commission to take a fresh look at the existing rules applicable to broker-dealers with the aim of clarifying the specific obligations that are applicable depending on the activities engaged in by the relevant broker-dealer. In the context of acting as Customer Agent, given the lack of vertical integration between execution and clearing venues for security-based swaps, more than one broker-dealer may be involved on each side of a specific transaction before it is successfully cleared. The relevant policy concerns are different when a broker-dealer executes in a principal capacity or clears for a customer and holds customer margin versus when a broker-dealer is solely executing as a Customer Agent. As such, we believe that the post-Dodd-Frank Act broker-dealer framework should recognize that a broker-dealer may only be acting in the limited role of Customer Agent and that, therefore, only a particular subset of the current broker-dealer framework will apply.¹⁴ In addition, given certain customers' preferences regarding anonymity when routing and executing requests for quotes and orders, we believe that the Commission should permit a broker-dealer acting in the role of Customer Agent the flexibility to agree with the counterparties to the trade (a) timings around any disclosure of the customer's identity¹⁵ and (b) the allocation of responsibility for satisfying certain regulatory requirements, such as trading documentation and reporting.

RFQs

Finally, we request that the Commission clarify in the final SEF rules that, as part of the request for quote process, a broker-dealer acting in the role of Customer Agent may submit a request for quote to one or more dealers across multiple SEFs and, depending on the quotes received, a customer or its Customer Agent can achieve best execution by partially filling several of those received quotes rather than being forced to select only one.

* * *

UBS is grateful for the open manner in which the Commission has addressed issues arising in connection with the implementation of the SEF rules. We welcome the opportunity to provide additional information regarding our views on this topic, as well as any other issues related to the Dodd-Frank Act, and urge the Commission to continue working with the Commodity Futures Trading Commission to arrive at a consistent regulatory framework for SEFs.

Respectfully submitted,



David Kelly
Managing Director



Paul Hamill
Executive Director

¹⁴ We note that the regulatory regime for "OTC derivatives dealers" provides an example of the Commission applying only a subset of the entire broker-dealer framework to a specific class of broker-dealers.

¹⁵ Pre-trade disclosure of the customer's identity should not be required in order for the broker-dealer to be acting in an agency capacity as Customer Agent on behalf of the customer. Instead, the Commission should not disturb the contractual agreement reached between the parties to the transaction regarding the proper allocation of responsibility. We note a similar comment was previously provided to the Commission in the context of its proposed rule on Amendments to Financial Responsibility Rules for Broker-Dealers, a proposed rule that has not been adopted by the Commission as a final rule (72 Fed. Reg. 12862 (March 19, 2007)). See letter to Nancy M. Morris, Secretary, Commission, from Marshall J. Levinson, Chair, SIFMA Capital Committee, June 15, 2007.