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

Re: Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC; RIN 3235-AK74. 75 FR 65882 (October 26, 2010)

Dear Ms. Murphy:

Bloomberg L.P. ("Bloomberg") appreciates the opportunity to provide our further comments[1] to the Securities and Exchange Commission ("Commission") with respect to the proposed rules in the above-referenced release ("Regulation MC"). Proposed Regulation MC is designed to create ownership and governance requirements for various regulated entities, including security-based swap execution facilities ("SB SEFs"), under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank").[2] For the reasons stated below, we respectfully advise the Commission that certain of its proposed SB SEF rules exceed its statutory powers under Dodd-Frank and for that reason would be legally infirm.[3] Specifically, we suggest that the Commission should revise the proposed board composition rule requiring an SB SEF to have an independent majority of its board of directors to explicitly exclude SB SEFs that are not owned by one or more Specified Entities, as discussed below.

Bloomberg or an affiliate of Bloomberg is considering whether to conduct business and register as an SB SEF in order to continue to facilitate trading in the security-based swap markets under the new regulatory regime. Neither Bloomberg nor any of its affiliates is a Specified Entity. Bloomberg or its affiliate will be the only owner of Bloomberg SB SEF. It would be difficult for any Non-Specified Entity to justify the investment of capital and time that is

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1 *See also* letters to the Commission from Bloomberg L.P. dated November 24, 2010 and April 4, 2011.

2 Act of July 21, 2010, Pub. L. No. 111-203, 124 Stat. 1376.

3 *See* Section 25(b) of the Securities Exchange Act of 1934 (the "Exchange Act").

necessary to run a successful SB SEF if it would not have a majority on the SB SEF's board of directors.

I. SEC Statutory Rulemaking Authority for SB SEFs

The Commission's statutory authority for its proposed Regulation MC is Section 765 of Dodd-Frank and Section 3D of the Exchange Act. The Dodd-Frank statutory language[4] and legislative history[5] indicate that the Commission was granted rulemaking authority for SB SEFs to address the conflicts of interest that may arise when Specified Entities are also owners and directors of trading venues. It was not intended to give the Commission broad authority to achieve other ends or to require SB SEFs to comply with the regulatory requirements applicable to national securities exchanges.[6] Certain provisions of proposed Regulation MC, as currently drafted, would exceed the Commission's statutory rulemaking authority by imposing governance requirements, purportedly to mitigate conflicts of interest, even when a conflict of interest arising from control of an SB SEF by Specified Entities does not exist. Those provisions are legally insupportable because they are "in excess of [the Commission's] statutory jurisdiction, authority or limitations," and are "short of [the Commission's] statutory right."[7] As noted by the United States Court of Appeals for the District of Columbia Circuit, "[A] regulation perfectly reasonable and appropriate in the face of a given problem may be highly capricious if that problem does not exist."[8]

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[4] Section 765 specifically empowers the SEC to adopt rules to mitigate conflicts of interest arising from control of an SB SEF by a bank holding company, a nonbank financial company, an affiliate of a bank holding company or a nonbank financial company, an SB swap dealer, a major security-based swap participant or a person associated with an SB swap dealer or a major SB swap participant ("Specified Entities"). The proposed Regulation MC release itself describes the rulemaking authorization under Section 765 as limited to mitigating conflicts of interest with respect to Specified Entities. *See* 75 FR 65882, 65883.

[5] Representative Stephen F. Lynch (D-MA) articulated the purpose of Section 765 less than one month prior to Dodd-Frank's enactment: "Mr. Chairman, I want to call your attention to sections 726 and 765 of the bill. These two provisions require the CFTC and the SEC to conduct rulemakings to eliminate the conflicts of interest arising from the control of clearing and trading facilities by entities such as swap dealers and major swap participants." *Congressional Record*, daily edition, vol. 156, June 30, 2010, p. H5217.

[6] The definition of SB SEF in Section 761 of Dodd Frank specifically differentiates SB SEFs from entities that are registered as national securities exchanges.

[7] *See* Exchange Act Section 25(b)(4).

[8] *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 36 (D.C. Cir. 1977) (internal quotation marks omitted) (quoting *City of Chicago v. FPC*, 458 F.2d 731, 742 (D.C. Cir. 1971)).

II. Majority of Independent Directors Requirement

Proposed Rule 242.702 in Regulation MC would require an SB SEF to have a majority of independent directors on its board even if the SB SEF were not owned in whole or in part by Specified Entities. Section 765 of Dodd-Frank, however, is concerned with domination of swap markets by Specified Entities and reflects a Congressional intent to prevent Specified Entities from dominating SB SEFs. The Commission's rulemaking authority under Dodd-Frank does not include any broader power to impose governance requirements on SB SEFs beyond those necessary to address the potential conflicts of interest Congress perceived.

Section 765 of Dodd-Frank. The Commission does not have broad authority to mandate governance standards except under Section 765 of Dodd-Frank as it relates to conflicts of interest. Moreover, the proposed majority of independent directors requirement in fact would likely frustrate Congress's intent to encourage entry of less conflicted parties into the swap markets because it would deter entities not affiliated with Specified Entities from forming and operating SB SEFs. Facilitating formation of SB SEFs that are not affiliated with Specified Entities promotes the statutory objective of addressing conflicts of interest without unnecessarily consuming limited regulatory resources. The Commission's attempted rulemaking would thus not be lawful and, we respectfully suggest, would likely be vacated by a U.S. Court of Appeals if challenged on appeal.[9] For that reason, the Commission should revise the proposed board

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[9] In December 2004 the Commission adopted a rule that sought to override a provision of the Investment Advisers Act of 1940 (the "Advisers Act"), as it then stood, by redefining the word "client" so as to treat every investor in a hedge fund as a separate client for purposes of determining whether an exemption from Advisers Act registration would be available to advisers who had fewer than 15 clients in any twelve-month period,. The Commission had argued that changes in the advisory business, particularly including the growth of hedge funds, in the more than 60 years since the Advisers Act had been enacted justified making the statutory exemption unavailable to hedge fund managers, a regulatory approach not envisioned by Congress in the Advisers Act.

The United States Court of Appeals, in *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006), vacated the Commission's rule as arbitrary and contrary to law. In so doing, it criticized the Commission's rationale for departing so markedly from the statute it was called upon to administer:

> The Commission reasons that because hedge funds are now national in scope, treating the entity as a single client for the purpose of the exemption would frustrate Congress's policy. If Congress did intend the exemption to prevent regulation only of small-scale operations—a policy goal that is clear from neither the statute's text nor its legislative history—the Commission's rule bears no rational relationship to achieving that goal. The number of investors in a hedge fund—the "clients" according to the Commission's rule—reveals nothing about the scale or scope of the fund's activities. It is the volume of assets under management or the extent of indebtedness of a hedge fund or other such financial metrics that determines a fund's importance to national markets. One might say that if Congress meant to exclude regulation of small operations, it chose a very odd way of accomplishing its objective—by excluding investment companies with one hundred or fewer investors and investment advisers having fewer than fifteen clients. But the Hedge Fund Rule only exacerbates whatever problems one might perceive in Congress's method for determining who to regulate. The Commission's rule creates a situation in which funds with one hundred or fewer investors are exempt from the more demanding Investment Company Act,

composition rule to explicitly exclude SB SEFs that are not owned by one or more Specified Entities.

Section 3D of the Exchange Act. In addition to Section 765, the Commission refers to Section 3D of the Exchange Act as amended by Dodd-Frank as a basis for the proposed Regulation MC. Conflicts of interest are addressed in Section 3D(d)(11) of the Exchange Act, which requires an SB SEF to (A) establish and enforce rules to minimize conflicts of interest in its decision-making process, and (B) establish a process for resolving the conflicts of interest. Section 3D(f) gives the Commission power to prescribe rules governing the regulation of SB SEFs under Section 3D. This power, however, is limited by Section 3(f) of the Exchange Act, the Administrative Procedure Act and the case law with respect to interpretation and implementation of statutes by administrative agencies.

In appropriate cases, the courts will accord judicial deference to "those with great expertise and charged with responsibility for administering the provision."[10] Regulators, however, must remain careful not to overstep the bounds of a legislative mandate, as rules and orders that are against the plain meaning of statutory language, or exceed the authority granted by Congress, are accorded no deference and are invalid.[11]

Courts have the authority to review agency decision-making and invalidate "agency action, findings, and conclusions found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law . . . in excess of statutory jurisdiction, authority, or limitations, or short of statutory right."[12] *Chevron* deference should not be taken as a grant to legislate outside the original empowering statute.[13]

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but those with fifteen or more investors trigger registration under the Advisers Act. This is an arbitrary rule. *Goldstein*, 451 F.3d at 883-884.

In an earlier case, the United States Court of Appeals for the District of Columbia Circuit struck down an ambitious effort by the Commission to overrule, by adopting its own Rule 3b-9, a statutory exemption for banks from broker-dealer registration under the Exchange Act. American Bankers Ass'n v. SEC, 804 F.2d 739 (D.C. Cir. 1986). The court stated: "Because Rule 3b-9 contravenes the intent of Congress, unambiguously expressed in the language of the 1934 Act, and confirmed in the Act's legislative history, we reverse the decision of the District Court and order it to declare Rule 3b-9 unlawful and to enjoin the Rule's operation against the member banks." Id. at 740.

[10] *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

[11] "[I]f the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Id.* at 842. Where Congress is silent or ambiguous as to the specific issue, "the question for the court is whether the agency's answer is based on a permissible construction of the statute." *Id.* at 843.

[12] Administrative Procedure Act, 5 U.S.C. § 706(2)(A) and (C). Where an agency rule-making runs afoul of Section 706(2), it is not entitled to deference even if strong policy reasons exist for the rule-making; the D.C. Circuit frequently invalidates "agency regulations challenged as facially inconsistent with governing statutes despite the presence of easily imaginable valid applications," *National Mining Association v. Army Corps of Engineers*, 145

In Section 765 of Dodd-Frank, the Commission is authorized to develop rules that mitigate risk or prevent conflicts of interest by an SB SEF with respect to the Specified Entities only. In its proposed Rule 242.702, the Commission, in contravention of Congressional intent, requires that "[t]he Board of *any* security-based swap execution facility . . . must be composed of a majority of independent directors" [emphasis added]. Section 765 indicates that Congress was concerned with conflicts of interest for SB SEF operators who were also Specified Entities. Specifically, the Commission mentioned in Part XI of the proposing release for the Regulation MC that security-based swaps are currently executed and traded in the OTC market, with five large commercial banks representing 97% of the total U.S. banking industry notional amounts outstanding of derivatives.[14] Since no such issue exists for SB SEFs not owned or operated by Specified Entities, the same argument cannot be sustained. It is a "cardinal rule that a statute is to be read as a whole,"[15] and to allow the Commission to expand the directorship requirement notwithstanding the limited purpose established by Section 765 exceeds the Commission's mandate.

Section 3(f) of the Exchange Act. We also point out that the Commission, in adopting Exchange Act rules, must assess their effect on efficiency, competition, and capital formation, as required by Section 3(f) of the Exchange Act. While the Commission considered the impact of the proposed Rule 242.702 on SB SEFs operated by dealers, which are on the list of Specified Entities, it failed to consider the rule's impact on SB SEFs operated by an entity that is not a Specified Entity. We respectfully suggest that the impact of the Commission's proposed majority of independent directors requirement of Rule 242.702 would have substantial and unjustifiable effects on efficiency, competition and capital formation. Specifically, it will discourage operation of SB SEFs by a single non-Specified Entity. It would be difficult for such entity to justify the time and capital commitment necessary to set up a successful SB SEF knowing that it will lose control over its SB SEF board of directors. We respectfully suggest that the Commission could not sustain those rules in light of the required Section 3(f) analysis.[16]

F.3d 1399, 1407 (D.C. Cir. 1998). There may still be contravention of Congressional intent even where ambiguity exists: "[t]he ambiguity must be such as to make it appear that Congress either explicitly or implicitly delegated authority to cure that ambiguity." *Michigan v. EPA,* 268 F.3d 1075, 1082 (D.C. Cir. 2001).

[13] *Goldstein, supra. See also Committee for Effective Cellular Rules v. Federal Communications Commission,* 53 F.3d 1309 (D.C. Cir. 1995).

[14] 75 FR 65882, 65925, Part XI. Consideration of Burden on Competition, and Promotion of Efficiency, Competition, and Capital Formation.

[15] *King v. St. Vincent's Hospital,* 502 U.S. 215, 221 (1991).

[16] *See Business Roundtable and Chamber of Commerce of the United States of America v. Securities & Exch. Comm'n,* No. 10-1305 (D.C. Cir. July 22, 2011). The court vacated Rule 14a-11 under the Exchange Act, which would have allowed shareholder access to the proxy materials of publicly traded companies. The court held that the

We appreciate the opportunity to provide our comments on proposed Regulation MC, and would be pleased to discuss any questions that the Commission or the staff may have with respect to this letter.

Respectfully submitted,

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Global Head Fixed Income
Bloomberg L.P.

cc: The Hon. Mary L. Schapiro, Chairman
The Hon. Elisse B. Walter, Commissioner
The Hon. Luis A. Aguilar, Commissioner
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SEC acted arbitrarily and capriciously by failing to adequately consider the effect of Rule 14a-11 on efficiency, competition, and capital formation, as required by law.