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Memorandum

From: Ben Macdonald
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Re: Comments on Swap Execution Facility Issues

Date: September 22st, 2010

Bloomberg L.P. appreciates the opportunity to submit comments on the regulation of the over-the-counter ("OTC") derivatives marketplace as proposed in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Act"). Our comments are intended to assist the U.S. Commodity Futures Trading Commission ("CFTC") and U.S. Securities and Exchange Commission ("SEC") in the rulemaking process.

The following comments reflect Bloomberg's interest in acting as both a Swap Execution Facility ("SEF") and Security-based Swap Execution Facility ("SB SEF") under Title VII of the Act. As one of the largest independent platforms for facilitating the electronic trading and processing of OTC derivatives, Bloomberg is in a unique position to comment on the regulation of the swap and security-based swap (collectively "swaps") markets as part the CFTC's and the SEC's efforts to bring new competition, transparency and accountability to the OTC derivatives market.¹

1. SEF and SB SEF Multiple Participants and Pre-Trade Price Transparency

The definition of SEF and SB SEF includes providing a platform "in which multiple participants have the ability to execute or trade" swaps "by accepting bids and offers made by multiple participants".² One of the goals of requiring certain platforms to register as an SEF or SB SEF is to promote "pre-trade price transparency in the swaps market."³

¹ The Act provides regulatory oversight to the CFTC for swaps and to the SEC for security-based swaps. Because many of the requirements of the Act are nearly identical for both swaps and security-based swaps this letter will use the term "swaps" to refer to both types of swaps.

² Sections 721 and 761 of the Act amending the Commodity Exchange and the Securities Exchange Act of 1934, respectively, to provide SEF and SB SEF definitions.

³ Section 733 of the Act amending the Commodity Exchange Act by inserting new paragraph 5h(e).

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Bloomberg's "single-dealer" and "multi-dealer" derivatives trading tools meet the "many-to-many" requirements and the underlying "pre-trade price transparency" goal of the Act. Both swap trading tools allow multiple participants to view and trade swaps with multiple dealers. In Bloomberg's single-dealer page system, enabled participants are readily able to view different dealer pages (simultaneously if preferred) that display the price and volume at which each dealer has indicated it will trade. After reviewing the displayed prices a participant can then request to execute against a single-dealer page displayed price with the understanding that the dealer can accept, counter or reject execution. Multi-dealer pages display a "composite price" reflecting the general market based on participating dealers price submissions. After reviewing the displayed "composite price" a participant can request specific prices from multiple dealers. The participant then has a limited time to accept or reject a trade with any of the dealers. Under both models Bloomberg provides real-time trade reporting to warehouses, data repositories and clearing venues.

It is important that the CFTC and SEC recognize that there are different platforms and models that allow for "many-to-many" trading in different forms and provide for pre-trade transparency in the OTC derivatives markets. The nature of OTC derivative trading requires a broad range of models that reflect an element of customization associated with the swaps markets. OTC derivatives industry participants support continuing to allow flexibility in SEF and SB SEF swap trading models as a means of promoting creativity and competition in the markets.⁴ Ultimately the most important elements of any model, including Bloomberg's, is to provide the mechanics for open access to multiple participants and price discovery. We believe our current trading tools provide for open access and efficient and effective pre-trade price transparency consistent with the goals of the Act.

2. SEF and SB SEF Core Principles

A. Centralized Utility for Certain "SRO" Core Principles

Title VII of the Act mandates that SEFs and SB SEFs comply with certain "core principles" designed to bring greater oversight and structure to the swaps market. Bloomberg is in a position to satisfy the key SEF and SB SEF core principles. However, public policy would be better served if certain SEF and SB SEF core principles relating to self-regulatory organization ("SRO") functions could be satisfied through the use of a centralized, independent utility. Bloomberg supports extending the oversight role to the National Futures Association ("NFA") and the Financial Industry Regulatory

⁴ This widespread support was evidenced at the September 15th Joint SEC-CFTC Roundtable ("Roundtable") where many participants encouraged the SEC and CFTC to continue to allow a multiplicity of trading models.

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Authority ("FINRA") to certain SEF swap and SB SEF security-based swaps activities reflected in the relevant core principles as follows⁵:

- Compliance with Rules: Enforcement of certain SEF and SB SEF trading rules, such as block order rules, to deter trading abuses
- Monitoring of Trading and Trade Processing: Monitoring SEF and SB SEF trading to prevent manipulation and price distortions
- Ability to Obtain Information: Obtaining information from the SEF and SB SEF and their participants to provide to the CFTC or SEC upon request or for information-sharing
- Position Limits and Accountability: Monitoring participant swap positions for compliance with the limits set by the CFTC

The NFA and FINRA should have direct authority with regard to those specific core principle functions over SEF and SB SEF participants as a condition of their use of an SEF or SB SEF. We believe this structure provides the desirable level of independent regulatory oversight necessary for objective and consistent interpretation and enforcement of the Act's requirements across the SEF and SB SEF sectors.⁶

B. Remaining Core Principles

Aside from the SRO core principles supported by NFA and FINRA, Bloomberg proposes that each SEF and SB SEF retain primary responsibility for the remaining core principles: Registration; Swaps Not Readily Susceptible to Manipulation; Financial Integrity of Transactions; Emergency Authority; Timely Publication of Trading Information; Recordkeeping and Reporting; Antitrust Considerations; Conflict of Interests; Financial Resources; Systems Safeguards and Designation of Chief Compliance Officer.

Several of the core principles, however, need further clarification. Greater guidance is needed with regards to the process of identifying swaps readily susceptible to manipulation; roles and responsibilities in determining the financial integrity of transactions; and how an SEF or SB SEF would have the authority to liquidate or transfer a participant's open position.

With regards to the first two of these principles the process would benefit from the ability of an SEF and SB SEF to use swap assessments (initial and ongoing) by the CFTC, SEC, Derivative Clearing Organizations ("DCO") and clearing agencies for swaps subject to mandatory clearing.⁷ Designation of a

⁵ Section 733 of the Act amending Sections 5h(f)(2), (4), (5) and (6) of the Commodity Exchange Act, and Section 763 of the Act inserting new Section 3D of the Securities Exchange Act.

⁶ There was also broad support at the Roundtable for the use of central utilities to provide SRO oversight roles for SEFs and SB SEFs.

⁷ The Act requires, in part, that the CFTC and SEC, in reviewing swaps for mandatory clearing consider, among other things, notional exposures, trading liquidity, and pricing data; the availability of operational expertise and

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swap as requiring mandatory clearing should give rise to a presumption that the swap is not subject to manipulation and the swap meets a baseline measure of financial integrity. Moreover, SEFs and SB SEFs should be able to take comfort in participants' margin and capital requirements as ameliorating the need for an SEF or SB SEF to determine financial integrity of individual transactions. Bloomberg or its centralized utility would, of course, monitor trading in swaps to prevent market manipulation. As to the core principle regarding emergency authority, it is not clear that an SEF or SB SEF would have the authority or the mechanism to liquidate or transfer a participant swap position that it does not hold or have control over. Bloomberg will adopt rules and cooperate fully with the CFTC or SEC in an emergency situation as required but we are concerned that we may not be in a position to effectuate a key component of this core principle. As part of its rulemaking or through other means the CFTC and SEC should outline the authority, process, and mechanism by which it would expect an SEF or SB SEF meet this requirement.

C. Uniformity and Consistency in Standards

While the CFTC and SEC should be open to innovation and healthy competition of business models between and among SEFs and SB SEFs, it is critical that the CFTC and SEC review and assess SEF and SB SEF proposed rules with the goal of ensuring an appropriate degree of uniformity of minimum standards across the SEF and SB SEF sectors to insure a "fair playing field" and to avoid regulatory arbitrage inconsistent with the purposes of the Act. It is also imperative that both the CFTC and the SEC coordinate effectively to the extent possible with regard to their respective and joint oversight for different swap products to facilitate regulatory consistency across instruments and markets.

3. Other Comment Areas

A. Non-Discriminatory Access to DCOs and Clearing Agencies

The Act requires DCOs and clearing agencies to offer clearing services to unaffiliated SEFs and SB SEFs and exchanges on a non-discriminatory basis.⁸ It is critical that this requirement encompass direct electronic connectivity by an SEF or SB SEF to facilitate confirmation of trading activity. Open connectivity is an essential component to not only ensure nondiscriminatory access to DCOs or clearing agencies but also to deter unearned competitive advantages from accruing to select entities that might want to put themselves between the SEF or SB SEF and the DCO or clearing agency and to eliminate system risk associated with centralized routing through such an entity.

relevant infrastructure; the effect on the mitigation of systemic risk and on competition. See Section 723 of the Act amending the Commodity Exchange Act by inserting paragraph (h)(2), and Section 763 of the Act inserting new section 3(c) in the Securities Exchange Act. DCOs are required to develop appropriate standards for determining the eligibility of agreements, contracts or transactions submitted to the DCO for clearing.

⁸ Section 723 of the Act amending section 2 of the Commodity Exchange Act by inserting paragraph (h)(1)(B)(ii), and Section 763 of the Act inserting new section 3(c) in the Securities Exchange Act.



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B. Extraterritoriality and Non-US SEF Participants:

The provisions of the Act relating to the regulation of swaps do not relate to “activities outside the United States” unless those activities have a “direct and significant connection with activities in, or effect on, commerce of the United States” or contravene the rules and regulations designed to prevent evasion of the Act.⁹ Greater clarification is needed on the scope of extraterritorial nature of the Act relative to jurisdictional triggers pertaining to certain transaction variables, including platform and participant location, as well as the nature of the respective swaps traded. This is particularly important in light of the global nature of swaps trading and the proposed efforts by the European Union to regulate the OTC derivatives markets.

We appreciate the opportunity to provide our comments on the Act and hope that these comments assist the CFTC and the SEC in their upcoming rulemaking efforts.

⁹ Section 722 of the Act amending Section 2 of the Commodity Exchange Act by inserting subparagraph (d)(i).