SWAPS & DERIVATIVES MARKET ASSOCIATION

April 21, 2012

Elizabeth M. Murphy
Secretary
Security and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: Request For Quote, Order Interaction & Viable Alternative Comments for the Notice of Proposed Rules Regarding the Registration and Regulation of Security-Based Swap Execution Facilities 17 CFR Parts 240, 242, and 249 [Release Number 34-63825; File No. S7-06-11, RIN 3235-AK93]

Dear Secretary Murphy,

The Swaps & Derivatives Market Association ("SDMA") appreciates the opportunity to provide further comments to the Securities and Exchange Commission (the "Commission") on its Notice of Proposed Rulemaking regarding Parts 240, 242 and 249 of Title 17 of the Code of Federal Regulation entitled "Registration and Regulation of Security-Based Swap Execution Facilities; Proposed Rules" ("Proposed Rules"). For the avoidance of any doubt, the SDMA is sending this letter as a follow up to its letter dated February 18, 2012 to clarify that the SDMA recommends that order interaction be part of any request for quote ("RFQ") execution methodology used for a Security-Based Swap Execution Facility ("SEF").

The SDMA is a non-profit financial trade group formed in January 2010 to support the goals of the Dodd Frank Act. The SDMA believes that the systemic risk of Over-The-Counter ("OTC") derivatives can be mitigated through proper regulation, the creation of central clearing, and by ensuring open and transparent access to promote greater competition, lower transaction costs and increased liquidity. The SDMA is comprised of many US and internationally based broker-dealers, investment banks, futures commission merchants and asset managers participating in all segments of the exchange-traded and OTC derivatives and securities markets.

RFQ with Order Interaction with Regard to Security Based Swaps ("CDS")

The SDMA supports Request For Quote ("RFQ") execution methodologies In the CDS Market with strict order interaction, such as RFQ that includes at least one liquidity provider ("RFQ to 1") or RFQ that includes at least three liquidity providers ("RFQ to 3"). The SDMA believes that such RFQ methodologies must be combined with order interaction and indicative quote bulletin boards for CDS. Only with order interaction will RFQ execution methodologies promote market integrity, provide open access to the market, and encourage new market entrants to compete. Greater liquidity and lower transaction costs will result by combining such order interaction with RFQ.

<u>Pre-Trade Price Transparency and the Unique Nature of CDS</u>

Pre-trade price transparency is important to the growth and systemic stability of the CDS market. Pre-trade price transparency creates a level playing field where all market participants are treated equally and where one participant is not advantaged at the expense of others. Discussed in earlier comment letters, such a level playing field in the marketplace will encourage new dealers and buyside participants to enter the market which will drive liquidity higher and transaction costs lower as competition for end user business increases. A recent study by Deloitte estimates that these transaction costs, currently at $55 Billion annually, will decline by 35% and increase volumes 175% if transparency is permitted to take hold.[1]

Pre-trade price transparency is a function of market participants having equal *knowledge* and *access* to orders as they enter the market and before they become trades. RFQ without order interaction has limited, if any, pre-trade price transparency. Only the requestor who initiated the RFQ and the dealer that responded to the RFQ *have knowledge of and access to* the prices shown. Allowing a single dealer to be the sole determinant of a price and be the only party with access to the information creates a clear disadvantage to the market as a whole.

To be sure, RFQ to 1 is also subject to abuse where two parties may ”paint the screen” or claim trading at fictitious prices without testing such prices with a third party or broader market place.

The SDMA also recognizes that the CDS market is unlike more liquid, generic swaps markets such as Credit Indices and Interest Rate Swaps (“IRS”). Unlike those markets, there exist fewer liquidity providers and many more credits to trade. There are at least 450 single credit curves that trade, as opposed to one single curve for dollar based IRS. Thus, because these markets are significantly different, the optimal solution with regard to execution methodology is also predictably different.

<u>Optimal Execution Methodologies for CDS</u>

An appropriate solution to promote pre-trade transparency is to mandate that RFQ execution systems interact with any existing firm prices--resting bids and offers--at the same or better price on a central limit order book (“CLOB”). Once the RFQ interacts with the CLOB, all market participants on the CLOB will have *knowledge of and access* to those prices. Importantly, the customer who initiates the RFQ will be assured optimal execution, knowing the best bids and offers are ”swept” from the order book before the dealer completes the RFQ with its own price.

For the CDS markets, the SDMA strongly agrees with the Commission’s proposed rule 811(e) that requires that if a SEF operates a RFQ platform it must create a Composite Indicative Quote (“CIQ”) screen, disclosing the average quote for each CDS traded on the SEF, and make it available to all market participants. The CIQ screen increases pre-trade price transparency by providing market participants with price information they would not otherwise have.

To be clear, RFQ to 1 <u>with</u> order interaction is optimal for the CDS market where as RFQ <u>without</u> order interaction is not. RFQ to 1 with order interaction promotes pre-trade price transparency and best execution in the unique Single Name CDS markets.

---

[1] <u>See</u> *Central Clearing for OTC Derivatives Impact on OTC Revenues* (Deloitte, 2011).

After careful consideration, the SDMA also believes that, because of the unique characteristics of the CDS market, RFQ to 1 with order interaction is better in promoting competition than RFQ to 3 without order interaction. In all likelihood little would be gained by non incumbent liquidity providers in the RFQ to 3 selection process by the customer. Most customers already query three dealers routinely and that selection process would likely not open up to smaller or new dealers automatically.[2]

Since it is uncertain that new market entrants would be included in the RFQ to 3, RFQ to 1 with order interaction provides greater pre-trade price transparency and enables new entrants to compete in the market.

Competition will promote best execution of trades and enable market participants to execute trades at the most advantageous price possible for their customers. As a result, customers will enjoy lower transaction costs. Increased competition and best execution will increase market liquidity. The level playing field that results from the combination of pre-trade price transparency, increased competition, lower transaction costs, and increased liquidity will enhance the integrity and growth of the CDS market.

Conclusion
The SDMA strongly believes that RFQ to 1 with order interaction is vastly better than RFQ to 1 without order interaction, because of the unique nature of the CDS markets. RFQ to 1 with order interaction will promote market integrity, provide open access to the market, and enable new entrants to compete in the market, all of which will result in increased liquidity and lower transaction costs.

Best Regards,

Michael Hisler
The Swaps & Derivatives Market Association
(646) 588-2011

[2] It has been well documented that 97% of the CDS market is controlled by five dealers. See Regulation MC: SEC Proposed Rules to Mitigate Conflicts of interest involving CDS: http://www.sec.gov/news/press/2010/2010-190.htm.