

April 4, 2011

Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Registration and Regulation of Security-Based Swap Execution Facilities (RIN 3235-AK93)

Dear Ms. Murphy:

The Wholesale Market Brokers' Association, Americas ("WMBAA" or "Association")¹ appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or "Commission") on the proposed rules related to the registration and regulation of security-based swap execution facilities ("Proposed Rules")² under the Securities Exchange Act of 1934 ("Exchange Act").³ The WMBAA appreciates the thoughtful approach of the Commissioners and the SEC staff in implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").⁴ The WMBAA believes that the Commission has worked hard to fashion rules that generally balance the compelling interests of fostering growth in competitive over-the-counter ("OTC") markets while ensuring that regulatory oversight will be in place to monitor for risks to these vital markets.

The WMBAA is supportive of a regulatory regime for OTC security-based ("SB") swaps markets that improves regulatory transparency, promotes competition, and fosters market participant access to a vibrant, affordable source of liquidity. The WMBAA supports transparency in OTC SB swaps markets for all market participants. WMBAA members' trade execution platforms provide their participants with the most current market information for the express purpose of price discovery and the matching of buyers and sellers, using knowledgeable brokers and sophisticated electronic trading and matching systems to create greater trading liquidity.

The principle reforms at the heart of Title VII of the Dodd-Frank Act, mandatory clearing and trade execution of certain SB swaps and the reporting of all SB swaps to SB swap data repositories ("SDRs"), will bring much needed transparency and stability to OTC swap markets. In light of these goals, the WMBAA encourages the Commission to consider the following comments as it considers rules designed to protect the integrity and efficiency of OTC SB swaps markets.

¹ The WMBAA is an independent industry body representing the largest inter-dealer brokers ("IDB") operating in the North American wholesale markets across a broad range of financial products. The WMBAA and its member firms have developed a set of *Principles for Enhancing the Safety and Soundness of the Wholesale, Over-The-Counter Markets*. Using these *Principles* as a guide, the WMBAA seeks to work with Congress, regulators and key public policymakers on future regulation and oversight of OTC markets and their participants. By working with regulators to make OTC markets more efficient, robust and transparent, the WMBAA sees a major opportunity to assist in the monitoring and consequent reduction of systemic risk in the country's capital markets.

² See Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10948 (February 28, 2011).

³ See 15 U.S.C. § 78a et seq.

⁴ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

This letter addresses several specific issues, including (i) the definition of a SB swap execution facility (“SEF”) and the related registration requirements; (ii) the proposed conditional exemption from the registration of brokers registered as SB SEFs; (iii) the Proposed Rule’s provisions related to conflicts of interests; (iv) the potential role for a common regulatory organization (“CRO”)⁵ to implement and facilitate certain aspects of SB SEF operations for compliance with rules and core principles; (v) the importance of harmonization between U.S. regulatory agencies with each other and with foreign jurisdictions; and (vi) comments on several of the provisions of the Proposed Rules related to trading on and access to a SB SEF and compliance with core principles.

These comments reflect the joint position of the Association’s five member firms⁶ and are supported by each of the WMBAA’s individual members. The WMBAA hopes that this will not be the Association’s last opportunity to provide thoughtful and constructive commentary about the functioning of effective markets for SB swap products that are vital to U.S. financial markets and economic recovery. Because of the complicated interplay of the numerous rules proposed by both the Commodity Futures Trading Commission (“CFTC”) and the SEC with regard to implementation of Title VII of the Dodd-Frank Act in such a short time frame, the WMBAA looks forward to ongoing constructive dialogues with the Commission and its staff with regard to the details of rule implementation. The WMBAA strongly believes that the final rules will be more effective and efficient if the Commission continues to have a flexible approach to implementation that takes advantage of the increased availability of data and other market developments in the derivatives markets.

I. Executive Summary

The WMBAA members have long acted as intermediaries in connection with the execution of SB swaps in the OTC market and are responsible for the execution of more than 90% of inter-dealer intermediated swaps and SB swaps transactions in the world. Although a SB SEF might be a new concept originating in the Dodd-Frank Act, the effective role of intermediaries in the OTC markets, including the SB swaps marketplace is not. The WMBAA members are already subject to oversight by financial regulators across the globe for services offered in a range of other products and markets. The WMBAA members are regulated by the SEC, the CFTC, the Financial Industry Regulatory Authority (“FINRA”), and the National Futures Association (“NFA”) in the U.S., by the Financial Services Authority in the UK, and other regulatory agencies around the world. The WMBAA members have acted as OTC SB swap execution platforms for decades and, as a result of this practical experience, understand what is necessary to support and promote a regulated, competitive, and liquid SB swaps market.

The following points briefly summarize the WMBAA’s comments on the Proposed Rules:

- The WMBAA supports the Commission’s flexible approach to evaluating applicant SB SEFs. A broad application of the SB SEF definition and rules is consistent with Congressional intent to establish a competitive market of innovative trading systems or facilities and will promote the

⁵ Distinguished from a self-regulatory organization (“SRO”) to avoid confusion with the legal and regulatory implications of an SRO.

⁶ BGC Partners, Inc., GFI Group Inc., ICAP, Tradition, Tullett Prebon.

development of efficient, regulated SB swap markets. The WMBAA supports a regulatory framework that allows any SB SEF applicant that meets the statutory requirements set forth in the Exchange Act to be permitted to operate under the Commission's rules in accordance with the Exchange Act.

- The WMBAA strongly supports the Commission's interpretation of the SB SEF definition as it applies to trade execution through any means of interstate commerce, including request for quote ("RFQ") systems, order books, auction platforms, or voice brokerage trading, because such an approach is consistent with letter and spirit of the Dodd-Frank Act and ensures flexibility in the permitted modes of execution of SB SEF. The WMBAA believes that this approach should be applied consistently to all trading systems or platforms and will encourage the growth of a competitive marketplace of trade execution facilities.
- Wholesale broker platforms are vital to the existence of liquidity in OTC markets, particularly for swaps markets that feature a wide array of less frequently traded products, often in large notional amounts. It is critical that the final rules take into consideration the unique characteristics of OTC markets, particularly wholesale markets, and provide a regulatory framework that permits the many modes of swaps trade execution currently deployed by wholesale brokers. This flexibility is consistent with the definition of a SB SEF, which permitted SB SEF trading to occur "by any means of interstate commerce."
- The WMBAA believes that the initial SB SEF application deadline of July 13, 2014 appropriately reflects the Commission's recognition that the newly mandated requirements for existing trade execution platforms are significant and will result in considerable changes to operations and complex infrastructure. The WMBAA members are willing to undertake the necessary changes to meet the registration requirements for SB SEFs. However, temporary registration relief must be in place for registered trading systems or platforms at the time that SB swaps are deemed "clearable" by the Commission to allow such platforms to execute transactions at the time that trades begin to be cleared under the Exchange Act. At the same time, a temporary registration regime should ensure that trade execution on SB SEFs and national securities exchanges is in place without benefitting one execution platform over another. Temporary registration for existing trade execution platforms should be fashioned into final rules in order to avoid disrupting market activity and provide a framework for compliance with the new rules over a period ending on July 13, 2014.
- The WMBAA supports the formation of a CRO for SB SEFs to implement and facilitate compliance with the Commission's rules. The CRO would ensure that a single, consistent standard is applied across multiple SB SEFs and SEFs and prevent a "race to the bottom" for rule compliance and enforcement programs. The CRO would also prevent market participants from selectively choosing which SB SEF to use based upon the leniency of its rules regime. The WMBAA believes that an industry-wide standards body would best ensure the integrity of the swaps market and protect market participants from abusive trading practices.
- Many of the requirements set forth in the Proposed Rules, particularly those implementing certain core principles, impose significant burdens. This is particularly true because SB SEFs, as established by the Dodd-Frank Act, are not monopolistic entities like exchanges, but are part of

a highly competitive industry. The goals of the core principles can be achieved through more efficient mechanisms. Further, the imposition of requirements related to post-execution duties (or any duties unrelated to trade execution) will often be impossible for the SB SEF to perform due to its narrow market function.

- As noted in previous remarks submitted to the Commission,⁷ it is critical that the block trade threshold levels and the reporting regimes related to those transactions are established in a manner that does not impede liquidity formation. A failure to effectively implement block trading thresholds will frustrate companies' ability to hedge commercial risk. Participants rely on swaps to appropriately plan for the future, and any significant changes to market structure might ultimately inhibit economic growth and competitiveness. The rules governing the core principles and other requirements for SEFs, in conjunction with the real-time public reporting of swap transaction data, must work collectively to ensure these markets retain their vibrancy in the future.

II. Definition of a SB SEF

Role of Wholesale Brokers

Wholesale brokers facilitate the execution of hundreds of thousands of OTC trades daily, corresponding to an average of approximately \$3 trillion in daily total notional across the range of foreign exchange, interest rate, Treasury, credit, equity, and commodity asset classes in both cash and derivative instruments. The WMBAA member firms account for over 90% of intermediated swaps transactions taking place around the world today.

Wholesale brokers, acting as intermediaries in the operation of liquid markets, provide for trade execution for their market participants, and do not operate as "exchanges." Instead, as competing execution venues, wholesale brokers vie with each other to win their customers' business through better price, provision of superior market information and analysis, deeper liquidity, innovative trading technology, and better service. This industry does not serve household or retail customers, but rather operates at the center of the global institutional financial markets by aggregating and disseminating prices and fostering trading liquidity for financial institutions around the world. Customers include large national and money center banks, major industrial firms, integrated energy and major oil companies, utilities, and governmental and sovereign entities.

In the preamble to the Proposed Rules, the Commission asks whether "bilateral" negotiation by wholesale brokers is consistent with the definition of a SB SEF. The WMBAA believes that it clearly is. First, negotiation by two parties through a wholesale broker registered as a SB SEF meets the requirements of the Exchange Act, which allows SB SEFs to intermediate transactions through "any means of interstate commerce."⁸ As a matter of construction, that negotiation by two parties through a wholesale broker is an intermediation function that renders a transaction no longer strictly

⁷ See, e.g., letter from J. Christopher Giancarlo, Chairman, WMBAA, to Commission and CFTC, dated July 29, 2010; see also letter from Julian Harding, Chairman, WMBAA, to Commission and CFTC, dated November 19, 2010; letter from Julian Harding, Chairman, WMBAA, to Commission and CFTC, dated November 30, 2010; letter from Julian Harding, Chairman, WMBAA, to Commission, dated January 18, 2011.

⁸ See Exchange Act Section 3(a)(77).

bilateral. Such activity is, in fact, not a bilateral negotiation but, rather, an intermediated transaction, which is exactly what the Dodd-Frank Act seeks to regulate, and not prevent. Such negotiations are a legal means of “interstate commerce” and are sanctioned under the Exchange Act. Treating such negotiations as outside the scope of SB SEF activity will be harmful to liquidity in many sectors of the swaps marketplace. It would have the effect of pushing swaps trades requiring such negotiations outside the regulatory framework rather than bringing them within it.

It is the case that in “multiple to multiple” SB swaps trading, facilities operated by wholesale brokers experience instances where brokers need to step in and engage in direct negotiations to enable parties to complete transactions. For example, on a SB SEF’s electronic trading platform, two parties may have entered two corresponding bids and offers for the same size transaction executable by all participants on the SB SEF. The orders, however, are separated by a few price points preventing them from executing a transaction. A broker at a SB SEF seeing these corresponding bids and offers may contact each of the counterparties and, through negotiation and with anonymity, encourage the counterparties to increase the size of the transaction for a price that is in the middle of the earlier price spread allowing the transaction to go forward on the electronic platform. During the course of these negotiations, the broker or his colleagues may also contact additional or all market participants to “work up” the order and generate more transactions to take place. Such direct negotiations are important sources of liquidity in many swaps markets where liquidity is often disparate.

Anonymous trade negotiations with counterparties are a method used by wholesale brokers within multiple-to-multiple trading platforms to encourage greater trading activity to take place within the SB SEF. These direct negotiations are means by which wholesale brokers provide anonymous counterparties with a greater degree of pre-trade price transparency. The SEC should apply the same degree of flexibility to direct negotiations by wholesale brokers that take place within multiple-to-multiple execution environments as the SEC proposes to extend to (one to many) RFQ trading platforms (i.e., permitting SB SEFs to have one-to-one requests if a participant had (but declined) the “ability” to send the request to many participants).

Regulatory Application of SB SEF Definition

As defined in the Exchange Act, the term “security-based swap execution facility” means a trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that (i) facilitates the execution of security-based swaps between persons; and (ii) is not a national securities exchange.⁹

The WMBAA supports the Commission’s flexible approach to evaluating applicant SB SEFs, granting registration “if the Commission finds that the requirements of the [Exchange] Act and the rules and regulations thereunder with respect to the applicant are satisfied.”¹⁰ This method of registration is consistent with the broad definition of a SB SEF adopted by Congress that allows a wide array of trading systems or platforms to satisfy the criteria.

⁹ See *id.*

¹⁰ Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 11054.

This regulatory framework will meet the Commission's goal to "facilitate competition and innovations in the SB swap market that could be used to promote more efficient trading in organized, transparent and regulated trading venues."¹¹ The Proposed Rule will foster growth in these markets, with multiple trading systems or platforms competing to offer superior technological capabilities and more immediate dissemination of market information to a broad spectrum of market participants, thereby improving the efficient functioning of the market. Congress recognized that restricting methods of execution of SB swaps instruments could do substantial harm to the orderly operation of U.S. SB swaps markets overall, particularly for those trades that do not enjoy natural continuous liquidity, to the detriment of all market participants requiring access to the market to manage risk.

The WMBAA supports the Commission's approach in providing "baseline principles interpreting the definition of SB SEF, consistent with the requirements of the Exchange Act, as amended by the Dodd-Frank Act, which any entity would need to be able to meet to register as a SB SEF."¹² So long as an applicant SB SEF has the bona fide ability to allow multiple market participants to execute or trade SB swaps by accepting bids and offers made by multiple participants through any means of interstate commerce, the WMBAA believes that the trading system or platform should be permitted to operate under the Commission's rules in accordance with the Exchange Act.

The WMBAA believes it is important that all trading systems and platforms, regardless of their operational characteristics, be evaluated by the same criteria. Further, it is imperative that each entity seeking designation as a SB SEF be able to satisfy the "multiple to multiple" requirement of the definition and, at the same time, be permitted to execute transactions "through any means of interstate commerce." As a baseline, the WMBAA believes that if a SB SEF meets the statutory requirements set forth in the Exchange Act, the SB SEF's application should be approved for registration.

The Proposed Rules indicate that, in the case of an RFQ system, the statutory definition of a SB SEF would be met if the system or platform not only provided the quote requesting participant with the ability to send a single RFQ to all liquidity providing participants, but also if the system or platform provided the quote requesting participant with the ability to choose to send an RFQ to fewer than all liquidity providing participants, as that capability affords the *ability* to send an RFQ to all participants, but also permits the quote requesting participant to choose to send an RFQ to fewer participants, satisfying the statutory definition for multiple participants.¹³

The WMBAA strongly supports the Commission's interpretation of the SB SEF definition as it applies to trade execution through any means of interstate commerce, including RFQs,¹⁴ order books, auction platforms, or brokerage trading, because such an approach is consistent with letter

¹¹ *Id.* at 10952.

¹² *Id.*

¹³ *See id.* at 10953.

¹⁴ *See* letter from the WMBAA to the CFTC, dated March 8, 2011, *available at* <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=31296>, page 6.

and spirit of the Dodd-Frank Act, namely ensuring flexibility the permitted modes of execution of SB SEF. The WMBA urges the Commission to ensure that the rules and their implementation consistently apply this approach to each of the trading models. With consistent application, the Commission's analysis will conclude that the SB SEF definition and rules also permit trade execution services offered by voice brokerage platforms that meet the "multiple to multiple" requirement.

In that case, a wholesale market or interdealer customer should be able to request pricing information from fewer than all potential counterparties, so long as the platform has the *ability* to seek pricing information from all market participants. Such a result would allow market participants to choose how widely or narrowly their trading interests are disseminated within the market. In particular, end-users have noted that they "may choose not to broadcast their transaction details to multiple participants," noting that "overly prescriptive SEF rules would restrict this discretion and may unnecessarily prevent end-users' from having access to efficient and cost effective hedging."¹⁵

The same application of the Proposed Rules for RFQ and voice systems with the ability to include multiple participants would extend to "hybrid brokerage" platforms that integrate voice with electronic brokerage systems. As the SEC noted in the preamble to the Proposed Rules, a wholesale broker executing on a hybrid system is likely to be acting as an intermediary between various potential participants to a SB swap transaction and utilizing electronic systems to display trading interest with which various participants could interact to transact in SB swaps. The combination of traditional "voice" brokers with sophisticated electronic trading and matching systems is necessary to provide liquidity in markets for less commoditized products where liquidity is not continuous. Failure to unambiguously include such systems is not only inconsistent with the statute but will severely limit liquidity production for a wide array of transactions.

The Exchange Act requires that SB swaps subject to the clearing requirement be executed on an exchange or a SB SEF.¹⁶ The distinction between the two entities is important, as Congress intentionally chose to create the new SB SEF framework and, at the time, rejected an approach that would have required that all standardized derivatives be traded through an exchange. The establishment of new categories of SEFs, different from the characteristics and obligations of exchanges, demonstrates that Congress recognized the need for a flexible, yet transparent and regulated means of intermediated execution. The WMBAA is supportive of the SEC's flexible approach to the regulation of SB SEFs that recognizes the need to balance liquidity concerns in the SB swap market with the goal of "bring[ing] trading of SB swaps onto regulated markets, as reflected in the statutory requirement that, subject to certain exceptions, any SB swap subject to mandatory clearing must be traded on a SB SEF or an exchange, unless no SB SEF or exchange makes such SB swap available for trading."¹⁷

¹⁵ See letter from the Coalition for Derivatives End-Users to the CFTC, dated March 8, 2011, *available at* <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=31328&SearchText>.

¹⁶ See Exchange Act Section 3C(h).

¹⁷ See Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. at 10949.

III. Conditional Exemption from the Regulation of Brokers Registered as Security-based Swap Execution Facilities – § 240.15a-12

The Proposed Rules permit a SB SEF to register as a broker under sections 15(a)(1) and (b) of the Exchange Act by registering as a SB SEF, if such SB SEF does not engage in any activity other than facilitating the trading of SB swaps on or through the SB SEF in a manner consistent with the Proposed Rules. In practice, this would allow a broker that does not engage in any activity other than facilitating the trading of SB swaps on or through the SB SEF to be exempt from, with certain exceptions,¹⁸ the requirements of the Exchange Act and the rules and regulations thereunder that, by their terms, require, prohibit, restrict, limit, condition, or affect activities of a broker, unless those requirements of the Exchange Act or any rule, regulation, or order thereunder specifies that it applies to a SB SEF.¹⁹

The WMBAA supports the SEC's decision to preclude SB SEFs from duplicative and unnecessary additional regulation governing brokers, as the SB SEF rules and other provisions in Title VII of the Dodd-Frank Act provide a comprehensive framework for the regulation of derivatives markets and participants. The Commission's approach demonstrates a thoughtful consideration of potential duplicative or inconsistent rules and suggests a simple solution. However, the WMBAA is concerned that the conditional nature of the exemption requires additional direction to ensure compliance.

For purposes of clarity, the WMBAA suggests that this provision make clear that an individual is acting as part of a SB SEF when (i) performing a function as an employee of the SB SEF; and (ii) the intent of that function is to facilitate the execution of a trade on the SB SEF. This approach would make clear that the conditional exemption does not include, for example, an individual facilitating the execution of a trade off of a SB SEF (where permitted) or engaging in an introducing broker function to a SB SEF from a different legal entity. Further, the WMBAA requests additional guidance on what constitutes "facilitating the trading" "in a manner consistent with Regulation SB SEF" and asks that such action be distinguished from what would be considered a more traditional brokering of a transaction. Should the Commission determine that a transaction involves a broker and not a SB SEF, it is possible that the product traded between counterparties could be an unregistered security, which may require licensing by the broker, different reporting requirements than for a SB swap, and other regulatory requirements.

The distinction between investment discretion and the exercise of time and price discretion provides an example of conflicting and duplicative regulation. Specifically, Exchange Act Section 11(a) generally provides that a member of a national securities exchange may not effect a transaction on such exchange for an account with respect to which it exercises "investment discretion" unless an exemption from this restriction is available. Exchange Act Section 3(a)(35) generally provides that a person will be deemed to exercise "investment discretion" over an account if it is authorized to

¹⁸ See Exchange Act Section 15(b)(4), *see also* Exchange Act Section 15(b)(6), Exchange Act Section 17(b).

¹⁹ See Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. at 11052. The exemption would also relate to the Securities Investor Protection Act.

determine what securities or other property are purchased or sold by or for the account. These provisions make it clear that a person merely exercising time and price discretion over a customer order is not subject to the restrictions set forth in Section 11(a).

The rules of various self-regulatory organizations also make this distinction. For example, NASD Rule 2510 and NYSE Rule 408 generally preclude a member of these organizations from exercising discretionary authority over a customer's account without the customer's prior written approval. These rules require members to approve each discretionary order in writing and to review all discretionary accounts at frequent intervals in order to detect and prevent transactions which are excessive in size or frequency in view of the financial resources and character of the account. However, these rules do not apply to brokers who exercise time and price discretion over orders received from institutional customers on a "not-held" basis.

As is evident from this example, guidance or an interpretation of the exemption's scope would be beneficial to ensure that a SB SEF does not unknowingly violate the exemption, thus finding itself subject to duplicative regulations under the Exchange Act. Providing additional certainty will allow SB SEFs to operate trading systems or platforms with an understanding of how to execute transactions under the appropriate regulations, and counterparties to SB swaps will enjoy the legal certainty of knowing that their transactions are executed by a duly registered SB SEF and not a broker under different (or perhaps conflicting) rules and regulations.

IV. Potential Role for a Common Regulatory Organization

The WMBAA previously shared its thoughts with the Commission regarding the potential value of a third party service provider, such as a CRO, to assist in ensuring SB SEF compliance with the new rules and core principles.²⁰ The reliance on a CRO would be within the SB SEF's authority under the Exchange Act, which allows SB SEFs "reasonable discretion" in establishing the manner in which they comply with the core principles.²¹

Given the scope of the new requirements, it is clear that the Proposed Rules will create a host of new obligations for both SB SEFs and regulatory agencies. These include requirements that are typical for exchanges and self-regulatory organizations, such as requirements to (i) establish, investigate, and enforce rules; and (ii) monitor trading and obtain information necessary to prevent manipulation.

Many likely SB SEFs are not currently regulated as exchanges, but rather as futures commission merchants ("FCMs"), broker-dealers or, where applicable, as alternative trading systems ("ATS"). As a result, these entities have familiarity with the rules of one or more self-regulatory organizations, such as FINRA or the NFA, which together with the Commission and the CFTC, will perform many of the regulatory functions assigned by the Dodd-Frank Act to SB SEFs and SEFs.

²⁰ See letter from Julian Harding, WMBAA, to Commission, dated November, 30 2010, available at <http://www.sec.gov/comments/df-title-vii/mandatory-facilities/mandatoryfacilities-21.pdf>.

²¹ See Exchange Act 3D(d)(1) ("Unless otherwise determined by the Commission, by rule or regulation, a security-based swap execution facility described in subparagraph (A) shall have reasonable discretion in establishing the manner in which it complies with the core principles described in this subsection.).

The WMBAA proposes the establishment of a CRO that will facilitate its members' compliance with the core principles, as well as any other SB SEF that agrees to follow its rules. The CRO itself would not have any direct regulatory responsibilities, but would, by way of contractual obligations, assist members in addressing compliance issues that are common to all SEFs, including: (i) establishing and maintaining model provisions for each SEF's rule book that would be adopted by each of its SB SEF members with regard to core principles on investigations, enforcement authority, trade monitoring and obtaining information; (ii) on behalf of its members, entering into one or more regulatory services agreements with existing SROs pursuant to which the CRO will have the capacity to detect, investigate, and enforce those rules for its members;²² (iii) on behalf of its members, establish and enforce rules that will allow the facility to obtain any necessary information from other SEFs, other market participants, and other markets to perform any of the functions required by the core principles; and (iv) reviewing associated persons of each SB SEF to ensure that that are not statutorily disqualified from being associated with a SB SEF.

Membership in the CRO would be voluntary and open to any entity intending to register as a SB SEF, though member SB SEFs would be contractually bound to abide by the rules. Further, as a voluntary organization, the CRO would not necessarily need legislative or rulemaking authority to proceed. The creation of a CRO would establish a platform to ensure that certain key rules for SB SEFs are written fairly and establish a uniform standard of conduct. This, in turn, would make it easier and more efficient for the SEC and CFTC to review potential SEF applications in accordance with the above mentioned core principles, as any SEF that was a member of the CRO would agree to implement the model provisions for their rule books and would agree to utilize the services offered by the CRO to aid in satisfying many of their obligations under the core principles. Moreover, by acting as an intermediary for compliance by its members, the CRO would simplify the CFTC's and SEC's oversight responsibilities for SEFs.

V. Importance of Harmonization between Commissions in the U.S. and with Foreign Jurisdictions

The WMBAA encourages the SEC and CFTC to work together to harmonize their regulatory regimes to the greatest extent possible. Inconsistent rules will only make the implementation for SEFs and SB SEFs overly burdensome, in terms of both time and resources. Although both Commissions rely on substantially similar legislative authority, the SEC's Proposed Rules offer a very different approach to permissibility of trade execution. With respect to determining whether a trading system or platform should be recognized as a SEF or a SB SEF, the WMBAA believes the SEC's proposal more accurately reflects the mechanics of competitive, intermediated OTC derivatives markets.

As proposed, the SEC and CFTC's regulatory frameworks lack harmonization and will lead to regulatory arbitrage and unreasonably burden market participants with inconsistent compliance requirements. While the WMBAA is generally supportive of the objectives of the CFTC's proposed

²² These services would include (i) monitoring trading to prevent manipulation; (ii) enforcing position limitations; (iii) investigating possible violations of SB SEF, CFTC or SEC rules, or other applicable laws; and (iv) establishing a code of procedure for administering discipline for rule violations and conducting hearings when necessary to determine if a violation may have occurred.

rules,²³ there are certain approaches set forth in the SEC's Proposed Rules that better reflect the characteristics of OTC derivatives markets and, as such, would be more appropriate for SB SEFs, which are by definition OTC trade execution facilities. These provisions include the approach taken with respect to permitted execution methods, impartial access that must be provided by SEFs, and compliance with core principles in a flexible manner that best recognizes the unique characteristics of competitive OTC swaps markets.

There are also certain parts of the CFTC's proposal that are more in line with competitive OTC swaps markets. As discussed in this letter, the WMBAA suggests that the SEC consider the CFTC's approach with respect to SB SEF technology requirements, the role of third party service providers, and governance requirements.

The WMBAA also notes that "mixed swaps" will exist under the new regulatory regime. Without a clear understanding of the definition of these products (because definitions have not yet been released) and the extent to which the SEC and CFTC will have overlapping jurisdiction, inconsistent rules could exacerbate the difficulty of regulating these particular products. The WMBAA believes that harmonization of the joint regulation of mixed swaps is extremely important to ensure that liquidity remains present for these particular products.

Further, U.S. regulations should be harmonized with regulations of foreign jurisdictions to avoid driving trading liquidity away from U.S. markets toward markets offering greater flexibility in modes of trade execution. In particular, European regulators have not yet agreed upon their preferred approach to trade execution methodology. However, they seem to recognize the value and necessity of a flexible regulatory approach toward trade execution. As a recent report issued by the International Organization of Securities Commission ("IOSCO") concluded, "it is appropriate to trade standardised derivatives contracts with a suitable degree of liquidity on "exchanges or electronic trading platforms," provided that a flexible approach encompassing a range of platforms that would qualify as "exchanges or electronic trading platforms" for derivatives trading is taken."²⁴

In a world of competing regulatory regimes, business naturally flows to the market place that has the most optimal regulations – not necessarily the most lenient, but certainly the ones that have the optimal balance of liquidity, execution flexibility, and participant protections. In a swaps market that excludes retail participants, the WMBAA questions what useful protections are afforded to swaps dealers and major swaps participants under regulations limiting the methods by which orders may be executed.

²³ See Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1214 (January 7, 2011).

²⁴ Report of Trading of OTC Derivatives, Technical Committee of the International Organization of Securities Commissions, February 2011, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD345.pdf>.

VI. Discussion of Proposed Rules

General Principles for Consideration

As wholesale brokers involved in the formation and execution of OTC derivatives transactions, ensuring that OTC derivatives markets continue to provide liquidity to and be a source of risk mitigation for end-users is vital to the WMBAA. The variety of transactions in the derivatives markets demands the breadth and flexibility of an OTC market to ensure competitive price discovery and liquidity. The Dodd-Frank Act does not eliminate the OTC derivatives market. Rather, the Dodd-Frank Act preserves an OTC derivatives market and, importantly, provides trade reporting of all transactions and regulates a significant subset of that market by mandating clearing and trade execution on regulated markets (exchanges or SB SEFs) in order to provide market participants a more competitive pricing environment and regulators greater information for oversight and systemic risk management.

The Proposed Rules are the first attempt to establish rules and impose market structure for a long-established market entity (*i.e.*, SB swaps intermediaries). This important effort must take into consideration the unique characteristics of OTC markets in order to achieve the legislation's goals while preserving proper market function. Although the relationship between exchange-traded and OTC markets has been complimentary generally, as each market typically provides unique services to different trading constituencies for products with distinctive characteristics and liquidity needs, the nature of trading liquidity in the exchange-traded and OTC markets is often materially different. The Commission recognizes that OTC derivatives markets are different than other markets that have significant retail participation and possess characteristics more appropriate for exchange trading.²⁵ Many SB swaps markets feature a broader array of less-commoditized products and larger-sized orders that are traded by fewer counterparties, all of which are institutional. Trading in these markets is characterized by variable or non-continuous liquidity. Such liquidity can be episodic, with liquidity peaks and troughs that can be seasonal (*e.g.*, certain energy products) or more volatile and tied to external market and economic conditions (*e.g.*, many credit and interest rate products). From the perspective of wholesale brokers predominantly involved in the execution of large sized transactions between institutional counterparties, the WMBAA believes that the CFTC and SEC need to carefully structure a clearing, execution, and reporting regime for block trades that is not a "one size fits all" approach, but rather takes into account the unique challenges of fostering liquidity in the broad range of swaps markets. Such a regime must permit the execution of larger transactions without imposing unnecessary regulatory burdens or materially reducing market liquidity.

Timing: Implementation of Final Rules

The Proposed Rules provide that, for applications filed on or before July 31, 2014, the Commission must grant registration or institute proceedings related to registration within 360 days of filing for applications for registration as a SB SEF. The application review process must be concluded within 450 days after the date of application. For applications filed after July 31, 2014, the Commission must grant registration or institute proceedings related to registration within 180 days of filing for

²⁵ See Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. at 10975 ("In addition, there is not at this time any direct retail participation in the SB swap market.").

applications for registration as a SB SEF. The application review process must conclude within 270 days after the date of application.²⁶

The WMBAA believes that an application deadline of July 13, 2014 appropriately reflects the significant undertakings associated with and the time requirements necessary to comply with the Proposed Rules. Providing a three-year window to submit an application for registration reflects the Commission's recognition that the changes for existing trade execution platforms are significant and will result in considerable modifications to operations and complex infrastructure.

The vast number of changes required to be made to existing trading systems or platforms to register as a SB SEF will impose a substantial burden in the short term. Upon implementation of the Dodd-Frank Act and final rules, wholesale brokers that register as SB SEFs will be required to undertake activities that include, but are not limited to (i) developing extensive rulebooks; (ii) meeting new substantive and reporting-related financial requirements; (iii) implementing sophisticated trading, surveillance, monitoring, and recordkeeping processes, and technology; (iv) creating extensive self-regulatory capabilities and entering into arrangements with their customers setting forth the terms of this new arrangement; (v) potentially restructuring the governance structure of their companies, including identifying and recruiting independent board members and establishing required governance committees; (vi) potentially altering the mix of their existing customer base and adding new customers; (vii) implementing appropriate contractual and technological arrangements with clearing houses and swap data repositories; (viii) hiring staff and creating a compliance program structured to meet the Commission's specifications; and (ix) educating staff on the requirements relating to trade execution, clearable vs. non-clearable trades, blocks vs. non-blocks, bespoke and illiquid trades, end-users vs. non-end-users, and margin requirements.

In addition to significant investments for new operations and compliance requirements, the Proposed Rules will require SB SEFs to invest substantial resources into information technology requirements. SB SEFs are required to, among other things, capture information related to rule violations,²⁷ prevent participants from entering orders, requests for quotes, quotations or other indications of interest that are clearly erroneous with respect to the terms of the trade,²⁸ halt trading in SB swaps pursuant to regulatory authority,²⁹ electronically monitor to detect fraudulent or manipulative practices,³⁰ and, in the case of an RFQ, create and disseminate a composite indicative quote.³¹ Each of these new regulatory requirements will necessitate significant investments in technologies that allow a SB SEF to meet these new obligations.

For this reason, the WMBAA appreciates the Commission's recognition that implementation "may take a period of time, as well as require the expenditure of resources, for an SB SEF to implement a

²⁶ *See id.* at 11054.

²⁷ *See id.* at 11060.

²⁸ *See id.* at 11061.

²⁹ *See id.*

³⁰ *See id.* at 11060.

³¹ *See id.* at 11060-61.

number of the requirements.”³² The WMBAA members are committed to devoting the necessary time and resources to comply with the Commission’s final rules, but encourage the Commission to consider the potential unintended consequences to market participants, market activity, and liquidity formation if the final rules are put into place with too short of a period to make the necessary changes.

The WMBAA recognizes that the timeframe for application and compliance is consistent with the implementation timeline for regulatory regimes that imposed lesser burdens than the Dodd-Frank Act, such as the introductions of TRACE reporting for corporate bonds and Regulations SHO and NMS in the equity markets. The imposition of these new regimes required less drastic changes to the markets and required participants to expend fewer resources, yet provided market participants with sufficient time to comply without disrupting market activity. The WMBAA believes that the SEC’s approach in this instance is sufficiently measured to achieve a similar result.

Sequenced Implementation of Final Rules

The mandatory trade execution requirement will become effective at the time that SB swaps are deemed “clearable” by the Commission. As such, it is necessary that SB SEFs be registered with the SEC, even if on a temporary basis, and available to execute transactions at the time that trades begin to be cleared under the Exchange Act. As previously noted, the WMBAA estimates that its members currently account for over 90% of inter-dealer intermediated swaps and SB swaps transactions taking place around the world today. If the SB SEF registration process is not effectively handled by the time various SB swaps are deemed clearable, there could be serious disruptions in the U.S. SB swaps markets with adverse consequences for broader financial markets.

It is imperative that the implementation timeline for final rules does not disrupt swaps markets or disadvantage SEF applicants. As the mandatory trade execution requirement cannot be enforced until there are identified “clearable” SB swaps and SB swaps are “made available for trading,” the Commission should ensure that a functioning and competitive marketplace of registered SB SEFs exists at the time the first trade is cleared and made available for trading. Congress distinguished between exchanges and SB SEFs, intending for competitive trade execution to be made available on both platforms. The phasing in of final rules for both exchanges and SB SEFs should be done concurrently to ensure that this competitive landscape remains in place under the new regulatory regime.

Finally, Congress was clearly sensitive to the potential advantage that exchanges with affiliated clearing agencies could have over SB SEFs that must depend on access to clearinghouses to complete clearable transactions. The Exchange Act provides the clear and unambiguous requirement that clearing agencies must provide SB SEFs “nondiscriminatory” access to clearing. Consistent with this concern, the sequencing of implementation of the rules should also not provide exchanges, particularly those affiliated with clearing agencies, an advantage over SB SEFs.

³² See *id.* at 11015.

VII. Discussion of Specific Provisions

242.800 Definitions

The Proposed Rules define a “block trade” using the same definition as Proposed Regulation SBSR,³³ to which the WMBAA previously offered comments.³⁴ The WMBAA believes that the impact of the policy governing large block trading on market liquidity is dependent on the details set forth in final rules. If the policy governing block trades does not properly define such a trade, the rules related to the calculation of a block trade threshold and trade reporting could negatively impact market liquidity, disturbing businesses’ ability to hedge commercial risk. The WMBAA believes the appropriate threshold amount will differ by asset class and instrument. The block trade thresholds should be individually based upon an instrument’s unique liquidity requirements so that the process of completing a block trade is appropriately defined and trading may continue without adversely impacting market participants’ ability to place, exit, or hedge their trades.

In its previous comments, the WMBAA proposed the formation of a Security-Based Swaps Standards Board (“Board”) made up of recognized experts and representatives of registered SDRs and SB SEFs to make recommendations to the Commission for appropriate block trade thresholds for SB swaps. The Board would work with the Commission to establish and maintain written policies and procedures for calculating and publicizing block trade thresholds for all SB swaps reported to the registered SDR in accordance with the criteria and formula for determining block size specified by the Commission.

The reporting obligations of the SB SEF should reflect the information it possessed at the time of the transaction and the SB SEF should not have the primary reporting obligations. If a SB SEF were required to report the transaction details as the proposed regulation requires, it would likely take at least 30 minutes to gather and confirm the accuracy of that information. Disseminating the specific notional amount of a block could jeopardize the anonymity of the counterparties to such trades, making counterparties less willing to engage in transactions of size. Similarly, the effect of having no delay, or only a short dissemination delay, for a block trade report that includes the full notional size will discourage market makers from committing capital and providing liquidity to the broader market.

242.801 Application for Registration as a Security-based Swap Execution Facility

As discussed above, the Proposed Rules set forth the requirements for registration, including the filing of an electronic application to demonstrate compliance with the Exchange Act and rules and regulations thereunder. The WMBAA encourages the SEC and the CFTC to adopt one common application form for the registration process. While regulatory review of the application by the two agencies is appropriate, reducing the regulatory burden on applicant SEFs and SB SEFs to one common form would allow for a smoother, timelier transition to the new regulatory regime. Because the two forms are consistent in many respects, the WMBAA believes the differences

³³ See *id.* at 11052.

³⁴ See letter from Julian Harding, Chairman, WMBAA, to Commission, dated January 18, 2011, available at <http://www.sec.gov/comments/s7-34-10/s73410-23.pdf>.

between the two proposed applications could be easily reconciled to increase regulatory harmonization and efficiency.

The Proposed Rules also permit the Commission to grant temporary registration to SB SEFs upon submission of an application. In considering whether to grant a request for temporary registration, the Commission will review and consider the information and materials provided in the registration application to determine, among other things, whether the applicant's trading system satisfies the definition of a "security-based swap execution facility" in Section 3(a)(77) of the Exchange Act and any Commission rules, interpretations, or guidelines regarding such definition. Additionally, the Commission will consider any access requirements or limitations imposed by the SB SEF, the ownership and voting structure of the SB SEF, and any certifications made by the SB SEF, including with respect to its capacity to function as a SB SEF and its compliance with the Exchange Act and the rules and regulations thereunder.³⁵

The WMBAA is concerned that it will be incredibly difficult, if not impossible, to satisfy the requirements of Section 242.801 at the time temporary grandfather relief is sought, thereby making the temporary relief provided by this section illusory. While the temporary grandfather relief allows the Commission to grant interim authority for a SB SEF to operate, the relief is less significant for the applicant SB SEF that must be in compliance with the final rules at the time of application. For that reason, the WMBAA suggests that the temporary grandfather relief will provide a more efficient transition if given at the time of application provided the trading system or platform is functioning prior to implementation of the final rules and the applicant certifies it is actively taking steps to meet the final rules' requirements within a finite period of time. Final registration should remain dependent upon a SB SEF illustrating its ability to comply with the final rules.

Otherwise, the imposition of final rules on potential SB SEFs as a prerequisite for temporary grandfather relief will have a potentially adverse impact on existing trade execution platforms, given that some time will be needed for these entities to meet the Proposed Rules' requirements. It is, therefore, critical that a competitive registered SB SEF marketplace exist prior to the clearing of the first SB swap under the new regulations. As noted, if the SB SEF registration process is not effectively implemented for WMBAA member firms (who are responsible for over 90% of inter-dealer intermediated SB swaps transactions) by the time various swaps are deemed clearable, there could be serious negative impact to the U.S. swaps markets. Moreover, during any such disruption, certain SB swap exchanges may seek to exploit an unfair competitive advantage (simply because they control the clearing function) that will enable them to capture a significant amount of the initial volume in SB swaps to the detriment of other entrants to the market. Any implementation of registration requirements should protect the inherently competitive nature of these markets.

The failure of the Commission to provide registration, even on a temporary basis, for existing trading systems or platforms, may alter the SB swaps markets and unfairly induce market participants to trade on already-registered and operating national securities exchanges, albeit ones that have limited experience in OTC swaps execution (*i.e.*, SB swap exchanges). The WMBAA strongly encourages the Commission to provide prompt provisional registration to existing trade execution intermediaries that intend to register as a SB SEF and express intent to meet the regulatory requirements within a predetermined time period. To require clearing of swaps through

³⁵ See Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. at 11054.

derivatives clearing organizations without the existence of the corresponding competitive trade execution venues risks inconsistent implementation of the Dodd-Frank Act and could have a disruptive impact on market activity and liquidity formation, to the detriment of market participants.

As previously discussed, such an approach is consistent with Congressional sensitivity to the natural advantage that exchanges with affiliated clearing agencies would have over SB SEFs that rely on nondiscriminatory access to clearing to complete the trade. The language in the Exchange Act demonstrates that Congress sought a regulatory regime that ensured competition and equal opportunity for exchanges and SB SEFs.

242.809 Access to Security-based Swap Execution Facilities

Proposed Rule Section 242.809 requires a SB SEF to permit a registered security-based swap dealer, major security-based swap participant, broker, or eligible contract participant to become a participant in the SB SEF and provide them with impartial access to the trading system or platform. The SB SEF may not permit access to eligible contract participants that are not registered with the Commission as a security-based swap dealer, major security-based swap participant, or broker.

The WMBAA is generally supportive of these provisions, as the Proposed Rule codifies objective standards for the application of the requirements set forth in Core Principle 2 of the Exchange Act. The WMBAA believes that the access requirements should apply consistently to registered security-based swap dealers, major security-based swap participants, brokers, or eligible contract participants, but that competing SB SEFs and national exchanges should be treated differently than market participants. Congress clearly intended for the trade execution landscape after the implementation of the Dodd-Frank Act to include multiple competing trade execution venues, and ensuring that competitors cannot access a SB SEF's trading system or platform furthers competition, to the benefit of the market and all market participants.

The CFTC's corresponding proposed rule contemplates that a SEF must provide impartial access to eligible contract participants and independent software vendors. In comparing the two proposals and the plain language in the Commodity Exchange Act and the Exchange Act, respectively, the WMBAA believes that the SEC's approach more accurately implements rules within the legislative authority provided by the Dodd-Frank Act. The WMBAA prefers the SEC's proposed impartial access rules and believes they provide a more appropriate foundation for the operation of competitive trade execution platforms that seek to provide counterparties with the best possible pricing.

242.810 Compliance with Core Principles

Proposed Rule Section 242.810 discusses the requirements for registering and maintaining registration as a SB SEF. SB SEFs must comply with the Core Principles and rulemakings imposed by the Commission, not use confidential information for non-regulatory purposes, and establish nondiscriminatory, equitable rules and systems. The SB SEF's rules must provide for the equitable allocation of reasonable dues, fees, and other charges among its participants and any other users of its system and cannot permit unfair discrimination among its participants. The SB SEF's rules must also provide, in general, a fair procedure for disciplining participants for violations of the rules of the SB SEF.

With respect to these provisions, the WMBAA is concerned that, under the Proposed Rules, SB SEFs are not provided with the reasonable discretion afforded them in the Exchange Act. The legislative authority establishing this Core Principle clearly defers to the SB SEF to implement these requirements in a manner the SB SEF deems most appropriate.³⁶

The WMBAA believes that the CFTC's proposed rule incorporating Core Principle 1 is more appropriate given the legislative authority granted to each Commission. To that end, there is no specific direction in the Exchange Act providing that the SEC can mandate how dues, fees and other charges are allocated among participants.

With respect to the procedures used for disciplining participants for a SB SEF's rules violations, the WMBAA would suggest that this responsibility be permitted to be contracted out to a third party service provider (*e.g.* FINRA, NFA or another entity that can provide regulatory and market surveillance services). As previously discussed, a CRO might be best positioned to facilitate compliance with the core principles by each of its members, as well as for any other SB SEF that agrees to follow its rules.³⁷

Section 272.810(c) prohibits a SB SEF from using any confidential information it collects or receives from or on behalf of any person, in connection with the SB SEF's regulatory obligations for non-regulatory purposes. The Exchange Act, as amended by the Dodd-Frank Act, does not impose this requirement. Any information provided to a SB SEF by a market participant is done in the course of providing commercial services, generally with the intent of a participant to either hedge risk or enter into a speculative position. The SB SEF's obligation in providing trade execution services, as opposed to post-trade obligations, is to disseminate pricing and economic information to market participants as quickly as possible to locate a counterparty for consummation of the trade. It is unclear what information the Commission considers confidential in markets exclusively consisting of eligible contract participants. The WMBAA would request that the Commission clarify in its final rules what constitutes "confidential information" in order to ensure that SB SEFs have clarity on what information is covered by this provision. This information should, at a minimum, be limited to the type of information obtained by the SB SEF other than in the ordinary course of its trade execution services and related to the performance of market surveillance activities.

242.811 Compliance with Rules

Proposed Rule Section 242.811 outlines various rules that must be established and enforced by SB SEFs, including rules regarding (i) compliance with established rules; (ii) trading, trade processing, and participant rules; and (iii) operational rules. SB SEFs must establish rules governing the operation of the SB SEF, such as the trading procedures to be used in entering and executing orders

³⁶ See Exchange Act Section 3D(d)(1)(B) ("Unless otherwise determined by the Commission, by rule or regulation, a security-based swap execution facility described in subparagraph (A) shall have reasonable discretion in establishing the manner in which it complies with the core principles described in this subsection." (emphasis added)).

³⁷ As an example, the NFA recently provided the CFTC with comments about possible ways in which it could act as a utility with respect to swap transactions, including assisting SEFs in complying with certain core principles, including requirements to perform basic self-regulatory functions regarding its trading platform. See Possible Role for NFA as a Utility for Swap Transactions, *available at* http://www.cftc.gov/ucm/groups/public/@swaps/documents/dsubmission/dsubmission13_083110-nfa.pdf.

traded or posted on the SB SEF, including block trades. Section 242.811 describes the records the SB SEF must keep and reporting requirements on Form SB SEF. Further, the Proposed Rule requires the SB SEF to establish a swap review committee, which must provide representation by the SB SEF's participants and other market participants and meet periodically to review and determine which SB swaps will trade on the SB SEF.

The WMBAA does not believe that the swap review committee framework is one contemplated by the Exchange Act. It is concerned that the composition requirement of the proposed swap review committee is too prescriptive, and finds the composition requirement to be potentially problematic. First, it is unclear why non-SB SEF participants should be provided representation before a SB SEF, and who would constitute an appropriate representative of that constituency. Further, the presence of customers of participants might negatively impact a SB SEF's participant's ability to provide candid guidance to the SB SEF. In addition, the requirement that "no single class of participant predominate" the swap review board is an ambiguous standard to implement, and might be difficult in practices for certain SB SEFs, particularly an interdealer platform that might consist primarily of one class of participant. Finally, the Proposed Rule's requirement that the SB apply "not unreasonably discriminatory standards" or ensure that its policies "not unreasonably prohibit" certain entities are unclear and might be inconsistently interpreted by competing SB SEFs, resulting in potential arbitrage among SB SEFs by market participants.

The Proposed Rules require that, as a condition of becoming a SB SEF participant, each participant submit to the oversight (including disciplinary procedures) of the SB SEF in connection with the participant's trading on the facility. With respect to whether a SB SEF can assert jurisdiction over any person or entity executing swaps on the SB SEF (either for its own account or on behalf of another) the Commission must recognize that SB SEFs are competing, rather than monopolizing, trading venues. The only jurisdiction a SB SEF will have over a market participant is with respect to the particular SB SEF's rules. The SB SEF's ultimate sanction would be to ban a market participant from the trading system or platform, which has little utility if the market participant can continue to execute swaps on other SB SEFs.

The Proposed Rules also contemplate that a SB SEF will establish and enforce compliance with rules concerning the terms and conditions of the SB swaps traded on the SB SEF. The WMBAA believes that this requirement is not authorized by the Exchange Act and would impose an impractical duty on registered SB SEFs. As intermediaries that match buyers and sellers, SEFs will not act as a party to transactions, do not maintain positions, hold collateral, or handle counterparties' assets. As neutral service parties, SB SEFs lack the privity of contract needed to enforce the terms of an agreement between two parties.

A SB SEF that operates an RFQ platform must create and disseminate a composite indicative quote for SB swaps traded on or through such system, which shall be made available to all participants. The composite indicative quote shall include both composite indicative bids and composite indicative offers.

242.812 Security-based Swaps Not Readily Susceptible to Manipulation

Proposed Rule Section 242.812 limits a SB SEF to only permit trading in SB swaps that are not readily susceptible to manipulation. Proposed Rule Section 242.812 also requires a SB SEF's swap

review committee to review and determine that the SB swap is not readily susceptible to manipulation. Further, the rules of the SB SEF must require the swap review committee to periodically review the trading in the SB swap to ensure that it is not readily susceptible to manipulation.

The WMBAA is supportive of this approach to determining the susceptibility of a particular SB swap to manipulation. As competitive trading systems and platforms, IDBs work to effect transactions in a wide array of products traded by market participants on these systems. Permitting the SB SEF, through its swap review committee, to determine whether a SB swap is readily susceptible to manipulation allows for prompt determinations and expedient trading in new products as they are conceived in the market. In comparison to the CFTC's approach, which requires the SEF to demonstrate compliance to the CFTC, the WMBAA supports the SEC's proposed regulation, as it relies upon the SB SEF to make the appropriate determination, eliminating the burden placed on the regulatory agency.

242.813 Monitoring of Trading and Trade Processing

Proposed Rule Section 242.813 requires a SB SEF to establish and enforce rules on trading procedures and procedures for trade processing, as well as monitor trading activity in SB swaps for manipulation, price distortion, and market disruptions. Each SB SEF must have the ability to electronically monitor trades in SB swaps on its market through automated surveillance systems designed to detect and deter fraudulent or manipulative behavior or market distortions or disruptions. The system must also conduct real-time monitoring and collect data to allow the SB SEF to respond promptly. SB SEFs must establish and enforce rules that require participants on the facility to maintain and provide access to books and records on the activity. Finally, SB SEFs must establish and maintain procedures to investigate possible rule violations, to prepare reports concerning the findings and recommendations of any such investigations, and to take corrective action, as necessary.

The WMBAA is supportive of efforts to monitor trading and trade practices for manipulative behavior or potential market distortions or disruptions. However, several of these requirements, as noted previously, would be more effectively carried out by a neutral third party service provider. For example, some of the real-time monitoring and automated alerts contemplated by the Proposed Rules could be delegated to and carried out by a third party with particular technology or experience in those areas. A similar arrangement could be established for detecting fraudulent or manipulative acts. Further, a CRO would be an appropriate body to investigate possible rule violations, prepare reports, and take corrective action, as necessary. The reliance on a third party service provider would also ensure that trade monitoring is done consistently among SB SEFs and prevent a situation where participants can select a SB SEF based on the weakness of its monitoring and enforcement capabilities.

242.814 Ability to Obtain Information

Proposed Rule Section 242.814 outlines the rules that SB SEFs must establish regarding requirements for participants, including furnishing information necessary to permit the SB SEF to perform its duties, cooperate with the SB SEF to examine its books and records, and cooperate with Commission representatives. It also specifies that SB SEFs must cooperate with Commission

representatives upon requests to examine books and records or to verify other information, promptly furnish copies of documents to the Commission upon request, have the capacity to carry out international information-sharing agreements as may be required by the Commission, and certify to this capacity on Form SB SEF.

The WMBAA is concerned about any requirement that a SB SEF's participants must provide their records to the Commission. It is unclear whether such authority is granted in the Exchange Act. Further, the WMBAA would point out that the CFTC was given substantially similar authority under the Commodity Exchange Act ("CEA")³⁸ and arrived at a less burdensome arrangement to satisfy the core principle. The WMBAA respectfully suggests that the Commission consider implementing the CFTC's approach in its final rules.

242.818 Recordkeeping and Reporting

Proposed Rule Section 242.818 requires that a SB SEF keep and preserve at least one copy of all documents, as made or received by it in the conduct of its business. This recordkeeping requirement extends for a period of not less than five years, with the most recent two years' records readily available. The Proposed Rule also imposes a requirement to retain accurate, time-sequenced records, including the key terms of all orders, requests for quotations, responses, quotations, other trading interest, and transactions that are received by, originated on, or executed on the SB SEF. This data must be verified pursuant to a SB SEF's written policies and procedures, and the information, including representative copies, must be reported to the Commission when determined to be necessary.

The WMBAA fully supports the Commission's proposal to capture a complete audit trail for executed transactions on a SB SEF. To that end, WMBAA members currently have the ability to capture and retain all audit trail information on all firm bids and offers and all executable customer orders, including the terms of each order. In promulgating final rules related to audit trail requirements, the WMBAA recommends that the Commission set forth a common data format for audit trail information to ensure consistency between multiple SB SEFs for ease of use by the Commission in investigating customer and market abuses.

As stated above, the Proposed Rule's record retention requirements extend beyond executed transactions. The WMBAA supports the retention of audit trail information for all firm bids and offers under the Proposed Rules. However, the WMBAA believes that to impose this data retention requirement on SB SEFs for requests for quotes, responses, quotations and other trading interests would extend beyond the legislative authority³⁹ granted the Commission and would be more expansive than the audit trail requirements currently in place in other financial markets regulated by various financial regulators. Specifically, the requirement that records be retained for activity performed "in the conduct of its business"⁴⁰ is overly broad and will likely prove to be an onerous

³⁸ 7 U.S.C. 1a et seq.

³⁹ See Exchange Act Section 3D(d)(9)(i) (A security-based swap execution facility shall maintain records of all activities relating to the business of the facility, including a complete audit trail, in a form and manner acceptable to the Commission for a period of 5 years.)

⁴⁰ Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. at 11063.

task. The WMBAA would suggest the scope of the record retention requirement be reduced to certain records for specific activity. Otherwise, the record retention requirements would result in an unnecessary burden and significant data storage costs.

Finally, given that trade execution can take place “through any means of interstate commerce,” it is important that the audit trail permits the retention of relevant information through various modes, as determined by the mode of communication, so long as the audit trail is accurate and complete. This is particularly important to SB SEFs that operate electronic and voice platforms, along with hybrid platforms that incorporate aspects of the two. A flexible audit trail regime will ensure that regulators have all of the necessary information to recreate transactions.

242.820 Conflicts of Interest

Proposed Rule Section 242.820 requires a SB SEF to have no less than 20 percent of the total number of directors of the SB SEF be selected by its participants, excluding certain interested participants.⁴¹ Further, the Proposed Rule requires that at least one director on the Board represent investors who are not SB swap dealers or major security-based swap participants, and such director must not be a person associated with a participant. Finally, the SB SEF’s rules must establish a fair process for participants to nominate an alternative candidate or candidates to the Board by petition, and the rules must specify the percentage, which cannot be unreasonable, of the participants necessary to put forth the alternative candidate or candidates.

The WMBAA believes that many of the stated objectives of Section 242.820 will be achieved through the implementation of impartial access requirements, as required by the Exchange Act and contemplated by the Proposed Rule. The WMBAA is also concerned that the requirements in this section of the Proposed Rule exceed the legislative authority granted by the Exchange Act, as amended by the Dodd-Frank Act, and create a burden for SB SEFs not intended by the core principle. The Commission previously proposed specific rules for the mitigation of certain conflicts of interest under Section 765 of the Dodd-Frank Act.⁴² Those rules, among other things, propose “numerical limits on the control of, or the voting rights with respect to, any security-based swap clearing agency, or on the control of any SB SEF or SB swap exchange, by specified entities.” While the stated purpose of that rule was to reduce the influence of certain large bank holding companies, certain nonbank financial companies and their affiliates, security-based swap dealers, or major security-based swap participants, there does not appear to be legislative authority, particularly under Section 3C(h) of the Exchange Act, to limit ownership of a SB SEF by its participants or require an investor who is not a SB swap dealer or major SB swap participant to serve on the Board.

It is worth noting that the WMBAA member firms are either public companies or privately held institutions. The WMBAA member firms are not owned by market participants or any consortium

⁴¹ *See id.* at 11064 (“Any participant, or any group or class of participants, either alone or together with its related persons, that beneficially owns, directly or indirectly, an interest in the SB SEF from dominating or exercising disproportionate influence in the selection of such directors if the participant may thereby dominate or exercise disproportionate influence in the selection or appointment of the entire Board.”).

⁴² *See* 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, 75 Fed. Reg. 65882 (October 26, 2010).

of market participants. These institutions, which execute more than 90% of inter-dealer intermediated swaps and SB swaps transactions in the world, do not face the same or similar potential conflicts of interest as other market entities which are owned or governed by their users.

Further, the Exchange Act's enumeration of this core principle is general in scope and does not indicate such prescriptive rules are appropriate.⁴³ In comparison, the CFTC, which was provided with substantially similar legislative authority, proposed much more flexible rules related to the conflicts of interest principle.⁴⁴ The WMBAA respectfully suggests that the SEC consider the CFTC's approach for two reasons. First, as discussed previously, the legislation does not contemplate such prescriptive rules. Second, the SEC has already proposed Regulation MC to address many of the concerns related to conflicts of interest.

Finally, the WMBAA asks that the Commission refine this proposal to include more precise terminology or interpretive guidance for SB SEFs. For example, it is unclear what acts will be construed to "dominate or exercise disproportionate influence" or what nominating framework will constitute a "fair process." Similarly, it is unclear what percentage of participants must support an alternative candidate or candidates to satisfy the "percentage shall not be unreasonable" requirement.

242.821 Financial Resources

Proposed Rule Section 242.821 requires a SB SEF to have adequate financial, operational, and managerial resources to meet its responsibilities. A SB SEF's financial resources are adequate if the SB SEF can meet its financial obligations notwithstanding a default by the participant creating the largest financial exposure for the SB SEF in extreme but plausible market conditions and the resources exceed the total amount necessary to cover the operating costs for the SB SEF for a one-year period, as calculated on a rolling basis.

The WMBAA believes that the financial resources are most appropriately calculated based on the fixed costs associated with the operation of the trade execution facility. The calculation should not include any variable costs related to a firm in wind-down because at that time, those variable costs can either be eliminated or shifted to other operations within the institution, and would no longer apply to the facility being dissolved.

242.822 System Safeguards

Proposed Rule Section 242.822 outlines requirements for SB SEF support systems that are integrally related to the performance of its activities, including adequate capacity, resiliency, and security policies and procedures. At a minimum, these policies and procedures must require the SB SEF to establish reasonable current and future capacity estimates, conduct periodic capacity stress tests of

⁴³ See Exchange Act 13D(d)(13) ("The security-based swap execution facility shall (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.").

⁴⁴ See Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1249 ("The swap execution facility shall (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.").


critical systems, develop and implement reasonable review procedures, review the vulnerability of the systems, and establish adequate contingency and disaster recovery plans. It also requires SB SEFs to annually submit an objective review to the Commission, promptly notify the Commission in writing of material systems outages and any remedial measures that have been implemented or are completed, and notify the Commission in writing 30 days prior to implementing planned material systems changes.

The Commission should recognize that hybrid platforms incorporating electronic and voice elements of trade execution are best positioned to protect against a crisis caused by electronic trading platforms. The human element involved in brokering trades can prevent a “run” on trading triggered by electronic trading platforms, and only a knowledgeable broker will be able to identify and correct irregularities before a state of crisis.

VIII. Conclusion

The WMBAA thanks the Commission for the opportunity to comment on the Proposed Rule. Please feel free to contact the undersigned with any questions you may have on our comments.

Sincerely,



Stephen Merkel
Chairman, WMBAA
BGC Partners, Inc.



Shawn Bernardo
Vice Chairman, WMBAA
Tullett Prebon



Christopher Ferreri
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