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Americans for Financial Reform
1629 K St NW, 10th Floor, Washington, DC, 20006
202.466.1885

April 6th, 2011

Ms. Elizabeth M. Murphy
Secretary Securities and Exchange Commission
100 F Street NE
Washington DC 20549–1090

Re: RIN 3235–AK93; Registration and Regulation of Security-Based Swap Execution Facilities

Dear Ms. Murphy:

On behalf of Americans for Financial Reform, thank you for the opportunity to comment on the proposed rule setting out certain core principles and other requirements for security-based swap execution facilities. Americans for Financial Reform is an unprecedented coalition of over 250 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, religious and business groups as well as prominent economists.

A key objective of Title VII of the Dodd-Frank Act (DFA) is to create transparency in previously unregulated derivatives markets. Indeed, the transparency goal is apparent in the short title of the section – "The Wall Street Transparency and Accountability Act". Transparency is a critical goal across the entire Dodd-Frank Act, and is mentioned in the overall purpose statement of the legislation.

Transparency brings many benefits. Pre-trade transparency in particular lowers prices, improves competition and prevents exploitation of smaller or less sophisticated participants by large market insiders. It can also improve systemic stability by lessening the chance of liquidity crises and market panic. As two distinguished financial scholars have stated[1]:

> "Liquidity or market network effects are more likely to occur when a financial entity's balance sheet is more complex and risk and valuation models less transparent, all else equal. One reason for this became clear in the thick of the financial crisis, when institutions by-and-large tried to sell off assets rather than deleverage….Structured mortgage credit instruments, like the swaps on CDO bonds that AIGFP was writing, trade in an OTC dealer market, so "selling off" those assets is difficult. We think that this illiquidity and the contagion it engendered should have been a …factor in risk and

[1] Marsh, Terry and Paul Pfleiderer, "The 2008-2009 Financial Crisis: Risk Model Transparency and Incentives", Quantal International, November 12, 2009.

> valuation models; even in normal times that OTC market was relatively narrow, with around ten serious dealers and further specialization among them. Trading was relatively opaque, e.g. only the counter-parties to trades, one of whom was typically the dealer, knew prices."

Improving systemic stability is of course another central goal of the DFA.

Security-based swap execution facilities (SB SEFs) are central to achieving the key mandated objective of market transparency. More than any other factor, the rules for swap execution facilities will determine the level of price transparency that exists for security based swaps (SBS) market users.

Scope of SB SEF Definition

As added by Section 761 of the DFA, Section 3C(h) of the Securities and Exchange Act of 1934 requires the execution of cleared swaps on an exchange or a SB SEF. Furthermore, the statutory definition of a security-based SEF in Section 761 of the DFA makes clear that such facilities require pre-trade price transparency and competitive participation by multiple parties on both sides of the trade:

> ''(77) SECURITY-BASED SWAP EXECUTION FACILITY.—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—
>
> '(A) facilitates the execution of security-based swaps between persons; and
>
> '(B) is not a national securities exchange."

The multiple-to-multiple requirement in the law *requires* that multiple participants on each side of the trade have the opportunity to make bids or offers for each swaps transaction. AFR believes the standards laid out by the Commission in this proposed rule do not satisfy the multiple-to-multiple requirement.

Instead, the Commission appears to have taken the approach that its rules should be designed simply to permit the possibility of greater transparency and market participation, rather than to create the reality of it. In particular, the proposed rule states that "under the proposed interpretation of the definition of SB SEF, a SB SEF would be able to offer functionality to a participant (or a participant's customer) enabling that participant to choose to send a single [request for quote] to any number of specific liquidity providing participants on the SB SEF, including just a single liquidity provider."[2] This does not do enough to mandate pre-trade price

[2] Release at 10953.

transparency and certainly fails to meet the multiple-to-multiple requirement. The ability of SB SEF participants to send RFQs out to only a single counterparty would allow the continuation of the current practice of opaque bilateral dealing that the Dodd-Frank Act was meant to limit.

The Dodd-Frank Act's goal of pre-trade transparency is not satisfied by simply allowing market participants the *option* of revealing prices to the broader market, as contemplated in this proposal.[3] Instead, a SB SEF should require price transparency, ideally through an exchange-type system such as a central limit order book.

If a more limited Request For Quote (RFQ) system is used, the Commission should address the statutory intent of the Dodd-Frank Act by requiring full pre-trade and post-trade transparency within that system. Market participants using an RFQ system should be required to make quotes available to many counterparties, each of whom should have the ability to make a bid or offer on the transaction. The current Commission proposal instead allows a SB SEF platform to completely sidestep the multiple-to-multiple requirement and allows the continuation of bilateral trading with limited or no price transparency.

There are practical issues related to price transparency, including the question of how to price customized or highly illiquid swaps. However, this issue is already handled within the framework of the Dodd-Frank Act. The Act only mandates the use of SB SEFs for trading in SBS that have already been approved for a clearing requirement. Such approval indicates that the SBS is sufficiently liquid and standardized to permit a clearinghouse to accept it, and also guarantees each participant that a clearinghouse stands on the other side of the trade and not a counterparty of uncertain credit quality.[4]

Another practical issue is that large block trades may not be suitable for fully open trading, because of their possible impact on market prices. In such cases, SB SEFs should be required to put forward a clear set of rules to differentiate block trades from other transactions, and alternate, less transparent channels for swaps trading should be limited to such block trades. These block trading rules should be narrowly tailored and restricted to trades of specified sizes relative to the

[3] On 10953 of the CFR, the Commission offers the interpretation that "In the Commission's view, a system or platform that affords a quote requesting participant 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, would satisfy the statutory definition because multiple participants would have *the ability* to execute or trade SB swaps by accepting bids or offers made by multiple participants." But this is an incorrect interpretation of the use of "ability" in the DFA, which clearly refers to the requirement that multiple participants have the ability to make both bids and offers on any trade on a SEF. Using the statutory reference to "ability" to transform the multiple-to-multiple requirement into an discretionary choice violates the both the letter and spirit of the DFA.

[4] See e.g. Section 3C(B)(4)(b) of the Securities Exchange Act of 1934, requiring the Commission to examine notional exposures, trading liquidity, and sufficient price data prior to designating a swap for mandatory clearing.

market, to ensure that only those trades that may cause significant moves in market prices due to their size are defined as "block trades."[5]

In sum, the Commission's proposal does not meet the intent or mandate of the Dodd-Frank Act to require the trading of cleared SBS on SB SEFs that provide price transparency and open participation to customers. We urge the Commission to implement a requirement that SB SEFs utilize a true order book system that would realize the price transparency goals of the Act. Issues such as block trades could be handled with a limited and specific set of exceptions.

Definition of "Available to Trade"

In addition to the basic disagreement with the Commission's approach to requiring price transparency on SB SEFs, AFR has a number of other concerns with this proposed rule. One concern involves the definition of "available to trade" in Section VIII.B (10968-10969) of the proposed rule. The Act provides an exception to the mandate that SBS subject to the clearing requirement be executed on a SB SEF if no SB SEF has made the swap "available to trade".[6] The Commission proposes that the decision as to when a swap is "available to trade" would be determined pursuant to objective standards established by the Commission, as opposed to by decisions of individual SB SEFs.

Two reasons are given for reserving this decision to the Commission. The first is that a small number of dealers might gain control or undue influence over SB SEFs. Such dealers might influence SB SEFs to refuse trading availability to a security-based swap in order to preserve dealer profits in the OTC market. In this situation, the Commission might wish to mandate that a SB SEF make a SBS available to trade even if no SB SEF had approved the swap for trading. AFR certainly agrees that in such a case of undue, anti-competitive influence the Commission should step in to require trading availability for the swap. Such intervention would be justified under the core principles for SB SEFs, which set forth safeguards against anti-trust violations and conflicts of interest.[7]

However, the Commission also states that it might wish to override the decisions of SB SEFs to make the swap available for trading. The reason given is apparently that it would be inappropriate to require the removal of a swap from the OTC market and its trading on SB SEFs just because a single SEF had made the swap available for trading. The Commission states, "a determination by even one SB SEF or national securities exchange that a SB swap was available to trade on the exchange or SB SEF could have unintended consequences for the trading of such SB swap." (10969).

[5] While the Commission sets forth a procedure to allow SEFs to define block trade rules in this proposed rule, the requirements for retail trade price transparency are already so lax that there is no specification of an alternate, less transparent channel for block trading. If the retail trade price transparency requirements were strengthened then the block trading rules could be permitted to specify a less transparent or open channel for such trades.

[6] Section 3C(h)(2) of the Securities and Exchange Act of 1934, as amended by Section 763 of the DFA.

[7] Section 3D(d)(10) and (11) of the Securities and Exchange Act of 1934, as amended by Section 763 of the DFA.

AFR strongly disagrees that the Commission should overrule the decision by a SB SEF to make a swap that is subject to mandatory clearing available for trading. The "unintended consequences" referred to by the Commission – the removal of the swap from the OTC market – are in fact exactly the consequences intended by the DFA. The intent of the DFA is precisely to maximize the trading of security-based swaps on transparent exchange-type platforms, and to remove such trading from the opaque OTC market. Again, it is critical to understand that the use of SB SEFs is only mandated for swaps that have previously been made subject to mandatory clearing. The decision to subject a swap to mandatory clearing *already* requires the application of objective thresholds for trading liquidity and the availability of price data. The Dodd-Frank Act clearly did not require a separate test to be applied to swaps after they had been subjected to mandatory clearing in order to determine if they could then be "made available for trading". If such a test had been intended, it would have been outlined in the law. Instead, Congress simply stated that cleared security-based swaps would not be required to execute on a SB SEF if no SB SEF had yet made that swap available for trading. The Commission should hold to the plain meaning of this statement, and should not violate the spirit of the Act by requiring a cleared swap to remain in the OTC market even when a SB SEF has offered to make such a swap available for trading.

Impartial Access Requirements

AFR also has concerns relevant to the open access requirements for SB SEFs. Proposed Rules 809(a) and 809(b) would limit access to direct trading on SB SEFs to SB swap dealers, major SB swap participants, brokers and eligible contract participants (ECPs), while allowing SB SEFs to exclude ECPs altogether. It is reasonable to restrict trading access to entrants who have sufficient risk controls and financial capacity to satisfy the terms of the swaps they enter into. However, allowing SB SEFs to restrict access threatens the public interest in impartial and open access to swaps markets. The impartial access requirements of Dodd-Frank were intended to break the monopolistic control over swap trading platforms by the largest players in the financial markets. Those who must be permitted access under the proposed rules - SB swap dealers, major SB swap participants, and brokers - are, by and large, the same entities that currently retain oligopolistic control over these markets. Allowing these entities to deny access to ECPs altogether risks continuation of the status quo.

These concerns could be addressed by strengthening open access rules in two areas. One area is open access to information. While trading access may be restricted in order to ensure the financial capacity of parties to a trade, there is no such justification for restricting access to market data feeds. It is important that pricing data be made widely available, including to potential market participants who may be smaller and less sophisticated, so that all potential customers can understand their options in entering into swaps.

In addition, we urge the Commission to improve open access rules by improving the specificity of financial integrity standards in Proposed Rule 809(d). This rule requires SB SEFs that allow access to non-registered ECPs to implement specific rules and standards to ensure the financial

integrity of ECP participants. The Commission does not provide guidance for SB SEFs establishing such rules to ensure financial integrity requirements are not overly burdensome. We believe this is a mistake. By allowing SB SEFs to establish their own rules in this area, the SEC would allow them to get out of the impartial access requirements by setting unrealistic controls and procedures that make it impossible for ECPs to gain access. We strongly urge the Commission to establish a framework for SB SEF's financial integrity requirements that will ensure that these controls and procedures do not become an illegitimate way to avoid allowing ECPs access.

Conclusion

A common theme in these comments has been the need to open up the murky and opaque bilateral derivatives trading system we have today to true market and price competition. The Commission must not interpret the Dodd-Frank Act mandate as simply suggestive, as meant to encourage or facilitate the migration of derivatives trading to more open markets, rather than requiring such migration. If it does, then these rules may perpetuate the current derivatives trading system, in which large dealer insiders earn substantial spreads at the expense of other market participants, and the lack of clear information encourages financial instability and panics. A recent analyst report from Morgan Stanley and Oliver Wyman predicted that despite the Dodd-Frank process, large dealer influence would ensure that a two-tiered derivatives pricing system with a substantial inter-dealer market would remain intact.[8] We hope that inadequate derivatives rules will not make this prediction come true.

We appreciate the opportunity to comment on the proposed rule. If you have any questions, please contact Heather Slavkin at Hslavkin@aflcio.org or (202) 637-5318.

Sincerely,

Americans for Financial Reform

[8] Morgan Stanley And Co, Oliver Wyman Consultancy, The Future of Capital Markets Infrastructure, February 16, 2011.

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- A New Way Forward
- AARP
- AFL-CIO
- AFSCME
- Alliance For Justice
- Americans for Democratic Action, Inc
- American Income Life Insurance
- Americans for Fairness in Lending
- Americans United for Change
- Calvert Asset Management Company, Inc.
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Greenlining Institute

- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Information Press
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National People's Action
- National Training and Information Center/National People's Action
- National Council of Women's Organizations
- Next Step
- OMB Watch
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS

- U.S. Public Interest Research Group
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

Partial list of State and Local Signers

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)

- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- NOAH Community Development Fund, Inc., Boston MA

- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG