



Americans for Financial Reform
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March 8th, 2011

Mr. David A. Stawick
Secretary Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington DC 20581

Re: RIN Number 3038–AD18; Core Principles and Other Requirements for Swap Execution Facilities

Dear Mr. Stawick:

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 swaps 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 Nobel Prize-winning economists.

A central and key objective of Title VII of the Dodd-Frank Act 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. For market participants, pre-trade transparency in particular lowers prices and prevents exploitation of smaller or less sophisticated participants by large market insiders. For society as a whole, it improves systemic stability, another central goal of the Dodd-Frank Act. When financial markets are opaque and the market prices of key assets are not understood, it is far more likely that investors and creditors will lose confidence in their counterparties and financial panic will spread. When prices are transparent, it is more likely that disruptions in financial markets can be resolved by participants in an orderly manner.

Swap execution facilities (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 swaps market users. The question of permissible swaps execution methods raises the issue of transparency most directly. AFR believes the clear regulatory intent of the Dodd-Frank Act is to mandate that the trading in cleared swaps be performed through an open exchange or exchanges. Swaps execution methods must follow the “multiple-to-multiple” requirement of the legislation and must be designed to maximize the pre-trade transparency of swaps prices to market participants, specifically through the use of open exchanges. This will improve market efficiency, lower derivatives prices for swaps users, and increase confidence in the market.

It is important to understand that the most customized, illiquid and thinly traded swaps are unlikely to be traded on SEFs. Use of SEFs is only mandated for trading in swaps that have already been approved for a clearing requirement. Such approval indicates that the swap 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.¹ Thus the cleared swaps required to be traded on SEFs are suitable for an open trading system. In the case of large block trades, a clear set of rules should be put forward to differentiate block trades from other transactions, and alternate, less transparent channels for swaps trading should be limited to such block trades. These rules should be narrowly tailored to ensure that only those trades that may cause significant moves in market prices due to their size are defined as “block trades.”

AFR believes the RFQ method laid out in this proposed rule does not satisfy the Dodd-Frank Act’s goals of pre-trade transparency. The multiple-to-multiple requirement in the Dodd Frank Act describes an open platform with broad pre-trade price transparency for market participants. It is not satisfied by simply allowing market participants the *option* of revealing prices to the broader market. If an RFQ system is used, the Commission should address the statutory intent of the Dodd-Frank Act by requiring as much pre-trade transparency as possible within that system, and by requiring market participants to interact with many counterparties.

In regard to other sections of the proposed rule, SEFs face substantial conflicts of interest because of the need to attract dealer volume, and it is important that governance and oversight rules address these conflicts of interest clearly. Because of this, AFR recommends that the requirements for equal access to SEF services be strengthened and that volume pricing discounts for access to SEF services or trading data be explicitly banned.

The AFR also recommends that the rules for appointment, supervision, removal, and compensation of the SEF Chief Compliance Officer (CCO) be strengthened. Specifically, the CCO should be responsible only to the Regulatory Oversight Committee, which consists of public directors. Non-public directors of the SEF, and executives appointed by such non-public

¹ See e.g. Section 2(h)(2)(D)(ii) of the Commodities Exchange Act, requiring the Commission to examine notional exposures, trading liquidity, and sufficient price data prior to designating a swap for mandatory clearing, and 75 FR 67277, CFTC proposed rule for review of swaps for mandatory clearing.

directors, will almost certainly face significant conflicts of interest related to regulatory compliance. CCO independence can only be guaranteed by vesting oversight of the position exclusively in public directors (or their equivalent for SEFs that are not structured with a board of directors).

The set of emerging proposals for SEF definition and governance threatens to perpetuate the current derivatives trading system, in which large dealer insiders earn substantial spreads at the expense of other market participants. A recent analyst report from Morgan Stanley and Oliver Wyman predicted 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.² Quoted in the press, one author of the report stated:

“The definition of SEFs is not yet ready, and we understand the banks are heavily lobbying against this,” Robert Urtheil, a partner at Oliver Wyman who co-authored a report this week with Morgan Stanley on the future of the capital markets structure, said in an interview yesterday. “The market structure will stay as it is, with an inter-dealer market and a dealer-to-client market.” That’s because billions of dollars are at stake, Urtheil said. The largest dealers make a collective \$30 billion a year by executing fixed-income swaps, such as for interest rate and credit risk, with their customers, compared with \$3 billion to \$5 billion a year from trading fixed-income futures, said the New York and Frankfurt-based consultant. Keeping their customers separated from other dealers would prevent the swaps market from becoming like the futures market and help preserve their revenue, he said.³

SEF rules that do not take a strong stand on broad pre-trade price transparency and market openness will continue to enable the anti-competitive practices that currently exist in the derivatives market.

Permitted Execution Methods – 37.9

AFR strongly agrees with the Commission’s statement that:

one-to-one voice services and single-dealer platforms do not satisfy the statutory requirement under CEA1a(50) that “multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system”

² Morgan Stanley And Co, Oliver Wyman Consultancy, [The Future of Capital Markets Infrastructure](#), February 16, 2011.

³ Leising, Matthew, “[Banks to Thwart CFTC on Swap Rule, Oliver Wyman Says](#)”, Bloomberg Businessweek, February 18, 2011.

The “multiple-to-multiple” trading requirement in the Dodd Frank Act is central to the legislative goals of increasing transparency, and is a clear statutory directive. Permitting a continuation of opaque bilateral trading of clearing swaps through single dealers is not in accordance with statutory intent.

Does the proposal appropriately implement the statutory directive that a SEF provide multiple participants with the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system? If not, how should the Commission best carry out the intent of the Congress in the registration and oversight of SEFs?

The rule of construction provided in the Dodd-Frank Act regarding SEFs (section 5h(e) of the Commodities Exchange Act) states that the goal of the legislation regarding SEFs is to “promote pre-trade price transparency in the swaps market”. In addition, the multiple-to-multiple requirement in CEA 1(a)(50) clearly refers to a system in which multiple parties on both sides of any transaction have the opportunity to trade at a publicly posted price. The combination of a mandate for pre-trade price transparency and a multiple-to-multiple requirement plainly describes an open system where bid and ask prices on every trade are available to a range of market participants, those participants can freely trade at such prices, and trades can be made between parties without a pre-existing relationship.

The Commission apparently interprets the multiple-to-multiple requirement as meaning simply that each market participant will have the *option* or *ability* to make prices transparent, should they choose to do so. AFR strongly believes that the requirement reflects the overall statutory intent to *require* truly open and transparent trading of cleared swaps.

The request for quote (RFQ) system described in this proposed regulation does not fully satisfy the statutory intent of creating pre-trade price transparency through multiple-to-multiple trading. Although the requirement to submit an RFQ to multiple counterparties is helpful in creating some transparency, this is not a multiple-to-multiple system, since only a single participant will see price offers from the counterparties. In addition, an RFQ system is at best only a limited version of the open system contemplated in the legislation.

AFR supports a strong requirement to use truly open and transparent trading for cleared swaps. Thus, SEFs should be required to use an exchange-like platform for swaps that are required to be traded.

In light of the multiple participant to multiple participant requirement, the Commission has proposed that requests for quotes be requested of at least five possible respondents. Is this the appropriate minimum number of respondents that the Commission should require...If not, what is an appropriate minimum number? Some pre-proposal commenters have suggested that market participants should transmit a request for quote to “more than one” market participant.

A truly open market makes bid and ask prices available to all participants. As fewer participants are allowed pre-trade access to prices or the ability to trade at those prices, the trading system diverges more and more from a fully open market. The choice to require five respondents falls well short of a fully open market but is still clearly superior to smaller numbers of respondents. In particular, a simple requirement that an RFQ should be transmitted to “more than one” market participant hardly diverges from simply bilateral trading. It would be relatively simple for e.g. two respondents to cooperate and coordinate their response to an RFQ so it was not truly competitive.

In general, does the proposal properly implement the CEA’s goal to promote both the trading of swaps on SEFs and pre-trade price transparency?

As discussed above, the proposal does not fully implement the goal of pre-trade price transparency. Such transparency requires that pre-trade bid and ask prices for all transactions be available to all SEF participants, or at least a broad subset. An RFQ system where price revelation to the broader market is optional does not achieve this goal.

What level of pre-trade transparency should be required to promote price discovery, competition, and the trading of swaps on SEFs? Should the Commission consider requiring a request for quote method that provides for transparency in the request for quote process in addition to the posting of any resting bids/offers on its trading system or platform? Should all orders and quotes be displayed to all participants or should alternative engagement rules apply on a pre-trade basis?

In accordance with the goals of the Dodd-Frank Act, the Commission should seek to maximize pre-trade price transparency. An RFQ process that provides for all orders and quotes to be displayed to all participants would be helpful in achieving this. In cases where large block trades had the power to move the market and full pre-trade transparency is imprudent, an alternative mechanism could be set up. Definitions of large block trades should be tightly and carefully defined based on the size of the trade relative to the relevant market and alternative mechanisms should be limited to such trades.

Should SEFs be required to make responses to requests for quotes transparent to all market participants? If so, when should this information be provided to the market? Prior to execution? At the time of execution? Subsequent to execution?

SEFs should require that responses be made transparent to market participants prior to trade execution. Not only does this serve the statutory goal of pre-trade price transparency, it would increase price competition by providing other market participants the opportunity to bid on the trade, thus lowering dealer spreads.

Would the SEF provisions in the Dodd-Frank Act support a requirement that swaps that meet a certain level of trading activity be limited to trading through order books?

As discussed above, AFR believes that the SEF provisions in the Dodd-Frank Act are intended to mandate that cleared swaps be traded on exchange-like platforms. As such, we support a requirement that cleared swaps meeting a certain level of trading activity be limited to trading through order books.

Access Requirements – Proposed 37.202

The Commission also requests public comments on proposed 37.202(a) and 37.202(c), which are intended to ensure that similarly situated persons and entities receive equal access to a SEF's trading platform and services, and that similar access and services be charged a similar fee

Section 5h.(f)(2)(B)(i) of the CEA requires that SEFs establish rules to ensure that market participants be given impartial access to the facility. In this context, it is important to avoid a situation in which larger or more powerful market participants are given preferential market access, or preferential access to trading information. Since trading volume is critical to profitability, a SEF could face substantial financial incentives to grant such preferential access.

AFR is concerned that a simple requirement that “similar” services be charged a “similar” fee, or that “similarly situated” persons receive equal access (instead of equal access for all eligible market participants) could permit volume discounts to larger actors, or else preferential access to key market data that was priced at a level that was only affordable by the largest market actors. The rule in 37.202(a)(3) should make clear that volume discounts are not permitted.

Appointment, Supervision, and Removal of Chief Compliance Officer – Proposed 37.1501(c)

AFR recommends that these rules be strengthened. SEFs are financially dependent on the trade volume that can be channeled by the largest swaps market participants. Preferential treatment of such participants could clearly influence their choices as to which SEFs to use. SEFs thus face substantial conflicts of interest that could affect compliance decisions. The Chief Compliance Officer (CCO) is the key member of organization charged with maintaining compliance with rules guaranteeing impartial access to the SEF and impartial treatment of market participants. It is thus crucial to insulate the CCO from being affected by the financial conflicts of interest that may influence the SEF.

AFR supports making the CCO responsible only to the Regulatory Oversight Committee (ROC), which consists of public directors (or their equivalent for SEFs that are not structured with a board of directors). Decisions about the appointment, removal, and compensation of the CCO should be made by the ROC and not by SEF executives or non-public members of the board of directors. Regulatory compliance is inherently a public interest role and the supervision of the CCO should reflect this.

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

Sincerely,

Americans for Financial Reform

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
- 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

