



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

February 27, 2013

The Honorable Gary Gensler
Chairman
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

The Honorable Scott O'Malia
Commissioner
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

The Honorable Bart Chilton
Commissioner
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st St, NW
Washington, DC 20581

The Honorable Jill Sommers
Commissioner
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

The Honorable Mark Wetjen
Commissioner
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st St, NW
Washington, DC 20581

Dear Members of the Commodity Futures Trading Commission:

On behalf of Americans for Financial Reform, we are writing to support robust price competition and transparency requirements for Swaps Execution Facilities (SEFs).¹ At a minimum, AFR believes that it is necessary to maintain the system laid out in the Commission's original proposal for implementing price competition on SEFs, which required that participants engage five counterparties using a Request for Quote (RFQ) system. Weakening of this initial proposal – which already represented a compromise on the price transparency goals of the Dodd-Frank Act – to require fewer RFQs would be unacceptable. Reducing SEF requirements so that they could be fulfilled by an essentially bilateral transaction, which could involve just one or two RFQ counterparties, would nullify most of the intended benefits of the Dodd-Frank Act provisions on derivatives market execution.

¹ [Americans for Financial Reform](http://www.ourfinancialsecurity.org) is an unprecedented coalition of more than 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, faith based and business groups.

As you know, the Dodd-Frank Act requires that derivatives with sufficient liquidity be traded through open exchanges called “Swaps Execution Facilities”, or SEFs. These facilities are meant to allow for fair price competition and ensure that derivatives customers can see competitive, executable prices for swaps before making a trade. This ‘pre-trade price transparency’ allows customers to identify the best price for the swaps they wish to purchase, and allows new sellers of swaps who are willing to charge lower prices to enter the market and compete with established dealers.

Pre-trade price transparency and fair price competition are key elements of properly functioning markets, and the Dodd-Frank Act is very clear that this is a central goal for derivatives markets. Indeed, Section 733 of the Act, which establishes SEFs, states clearly that “the goal of this section is to...promote pre-trade price transparency on the swaps market”. The definition of SEFs in Section 722 of the Act also requires ‘many-to-many’ transparency in transactions that take place on SEFs, explicitly stating that each transaction must grant users the ability to accept bids and offers made by “multiple participants”.

Properly designed SEFs will create significant benefits for the stability of the financial system. First, competitive and transparent pricing should increase the number and diversity of liquidity providers in the swaps markets, as new entrants will be able to compete with the small oligopoly of large bank dealers who currently dominate the markets. The excessive dependence of the markets on a few ‘too big to fail’ banks that dominated the derivatives markets and were also deeply involved in credit intermediation was an important contributor to the systemic fragility that led to the financial crisis of 2008. Second, the pricing information from SEFs will be an important input to risk management by both derivatives clearinghouses and individual financial institutions.

By breaking up the small ‘club’ of derivatives dealers who are currently able to charge above-market prices, fair price competition will also create major economic benefits for swaps end users. A Deloitte Financial Services study states that “exchange trading of OTC derivatives will lead to significantly narrower bid-ask spreads” – in other words, prices for derivatives customers should be significantly reduced as a result of the move to SEFs.² More recently, research by the Brookings Institution and the International Monetary Fund has come to similar conclusions, stating that³:

“Exchange trading is much more transparent than the current dominant mechanism of bilateral transactions where a client contacts at most a few dealers and compares their prices before transacting with one dealer. Clients will have a clearer idea about market conditions before they commit to a trade and there will be much more information

² Deloitte Financial Services, “Central Clearing For OTC Derivatives Impact on OTC Revenues – What Can You Expect Besides Compression?”, Perspectives on Financial Reform Issue 4, Deloitte Financial Services, 2011.

³ Santos, Andre Oliveira and Douglas Elliot, “[Estimating the Costs of Financial Regulation](#)”, IMF Staff Discussion Note, September 11, 2012.

available afterwards to market participants about what trades have taken place...Customized derivatives, which have been a product with high profit margins, will be replaced to a large extent by standardized derivatives, which will tend to have lower profit margins as a result of the greater competition and transparency.”

These benefits will be lost if the Commission does not require SEFs to provide genuine price competition and full pre-trade transparency. Poor design choices by the Commission could undermine the Dodd-Frank Act’s transparency mandate and sacrifice the public benefits that should be created by SEFs.

Americans for Financial Reform was critical of the Commission’s initial proposed rule defining the pre-trade price transparency requirements that must be followed by SEFs, because it did not require that users of the SEF expose their bids and offers to the entire market, so that all participants could benefit from full price competition.⁴ Instead of creating price transparency for the entire market, the Commission proposed to require that market participants query five counterparties in a Request for Quote (RFQ) system. True pre-trade transparency would be limited to these counterparties, and full interaction with the broader market or with a central order book was not required. While we felt this truncated system did not fully realize the goals of the Dodd Frank Act, the mandate to query a significant number of counterparties did enhance price competition significantly when compared to the pre-reform status quo in these markets, and could make it possible for new entrants to compete with incumbent liquidity providers.

The proposed five RFQ system already represented a compromise between the statutory goals of price transparency and the concerns of incumbent dealers. Further weakening this initial compromise through additional reductions of the required RFQs to an even smaller number of counterparties would sacrifice the public interest for the interest of large incumbent dealers. Arguments made by current incumbents that making prices available to multiple counterparties will threaten their ability to transact on these markets are simply not credible. It is important to realize that the transactions affected by the transparency requirements are limited to those that are:

- A) Sufficiently liquid to be removed from over-the-counter (OTC) markets and subjected to the exchange trading requirements, and
- B) Small enough in size that they do not qualify for the block trading exemption to transparency requirements, since they do not move market prices.

It is deeply misguided to argue that even these transactions, specifically selected as those which are conducted in liquid markets and are small enough that they do not significantly move prices, cannot be subjected to execution requirements that require genuine pre-trade price transparency.

⁴ Americans for Financial Reform, “[Comment on RIN Number 3038-AD18: Core Principles and Other Requirements for Swap Execution Facilities](#)”, March 8, 2011

The *option* to expose prices to a wider market, without a *requirement* to do so, is not sufficient to satisfy the price transparency mandate of the Dodd-Frank statute. If it were sufficient, the statute would not have required derivatives to be executed on SEFs, but would simply have left the option to market participants. Nor is the mere existence of an order book sufficient to rescue price transparency if SEFs are required to expose market prices to just a small number of counterparties. An order book which can be circumvented at will by parties transacting in the dark is not a feasible instrument for real price transparency. Finally, arguments that requirements for pre-trade price transparency would improperly restrict the ‘means of interstate commerce’ through which transactions can be conducted are fallacious. The Commission’s initial proposal permitted transactions to be executed through any means of interstate commerce, so long as requirements for transparency and price competition were satisfied.

In sum, AFR believes that the five RFQ system laid out in the initial Commission proposal, while far from ideal, does provide some transparency to market participants in a manner that would be difficult to manipulate. However, further reductions in the number of required RFQs would unacceptably compromise the goals of the Dodd-Frank Act in mandating price transparency for sufficiently liquid derivatives. A return to the days of essentially bilateral transactions, as would occur if, for example, just one or two RFQs were required, would be a major step backward in derivatives regulation.

Thank you for the opportunity to comment on these issues. Should you have additional questions, please contact Marcus Stanley, AFR’s Policy Director, at (202) 466-3672 or marcus@ourfinancialsecurity.org.

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
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- 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
- Home Defender's League
- 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
- NAACP
- 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 Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OMB Watch
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- 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
- UNITE HERE
- 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

List of State and Local Affiliates

- 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
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- 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
- New Yorkers for Responsible Lending
- 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

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET

