April 4, 2011

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

Re: Registration and Regulation of Security-Based Swap Execution Facilities; Release No. 34–63825; File No. S7–07–11

Dear Ms. Murphy:

The Asset Management Group (the "**AMG**") of the Securities Industry and Financial Markets Association ("**SIFMA**") appreciates the opportunity to provide the Securities and Exchange Commission's ("**SEC**") with comments on its proposed rule on registration and regulation of security-based swap execution facilities (the "**SEC Proposal**"), published on February 28, 2011.[1] The AMG previously provided the SEC and the Commodity Futures Trading Commission (the "**CFTC**" and, together with the SEC, the "**Commissions**") with its views on swap execution facility ("**SEF**") and security-based swap execution facility ("**SB SEF**") requirements in a pre-rulemaking comment letter dated November 24, 2010,[2] and on block trading definitions and reporting issues in a comment letter dated February 7, 2011 (the "**Block Trading Comment Letter**").[3]

The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, state and local government pension funds, endowments, ERISA funds, 401(k) and similar types of retirement funds, and private funds such as hedge funds and private equity funds. In their role as asset managers, AMG member firms, on behalf of their clients, engage in transactions, including transactions for hedging and risk management purposes, that are classified as

[1] Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10,948 (Feb. 28, 2011) (adding 17 CFR Pts. 240, 242 and 249).

[2] November 24, 2010 AMG Comment Letter, *available at* http://www.sec.gov/comments/df-title-vii/mandatory-facilities/mandatoryfacilities-23.pdf.

[3] February 7, 2011 AMG Comment Letter, *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27614&SearchText.

"swaps" or "security-based swaps" ("**SB swaps**" and, together with CFTC-regulated "swaps," "**Swaps**") under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**").

The AMG supports the flexible approach to the definition of SB SEF proposed by the SEC. In particular, the AMG supports the SEC's proposed interpretation of the definition of an SB SEF to include a trading platform that provides multiple participants with the *ability* to accept bids or offers made by multiple participants but would *permit* a participant to send an RFQ to any number of liquidity providers, including just a single liquidity provider. We believe that this strikes the appropriate balance among promoting transparency, preserving liquidity and ensuring appropriate pricing in SB swap transactions, thereby encouraging market participants to transact on SB SEFs. As we indicated in our March 8, 2011 letter to the CFTC regarding its proposed rule on core principles and other requirements for SEFs,[4] the AMG is concerned that requiring market participants to send RFQs to any minimum number of liquidity providers greater than one will have an adverse effect on buy-side users of Swaps. The AMG also agrees with the SEC's decision not to require a delay following the entry of certain customer orders comparable to the 15-second pause that the CFTC has proposed for certain swap transactions submitted to SEFs.[5] As we discussed in greater detail in our March 8, 2011 letter to the CFTC, because such a requirement would create market uncertainty, impose unnecessary costs on end users and discourage trading on SEFs contrary to Congressional intent, no delay requirement should be included in final rulemaking for SEFs or SB SEFs.

In this letter, we highlight several aspects of the SEC Proposal that we believe should be modified. First, the AMG believes that responses to a request for quote ("**RFQ**") should not be included in an SB SEF's composite indicative quote stream. Second, we believe that block trades should be given a broad exemption from minimum pre-trade price transparency and interaction requirements. The thresholds for block trades should also be flexible and vary by asset class. Third, we support requiring specific objective criteria to be used by swap review committees to determine which and when SB swaps have been made available to trade. Fourth, the AMG believes that an SB SEF's authority to collect information regarding participants should be limited. Fifth, we believe that SB SEFs should not be permitted to exclude non-registered eligible contract participants from becoming participants in a discriminatory manner or impose heightened capital requirements for participants in excess of those imposed on such participants by the SEC. Sixth, we believe that SB SEF rules should not be self-certified, but instead should be subject to public comment. Seventh, we believe the SEC should exempt certain packaged SB swap transactions from mandatory execution. Finally, the AMG believes that the Commissions should harmonize their final rulemakings with respect to SEFs and SB SEFs.

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[4] March 8, 2011 AMG Comment Letter, *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=31341&SearchText=.

[5] Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1,214,§ 37.9(b)(3) (Jan. 7, 2011) (the "**CFTC Proposal**").

Responses to RFQs should not be included in an SB SEF's composite indicative quote stream.

RFQs generally. The SEC Proposal requires SB SEFs that operate RFQ platforms to include any response to an RFQ in a composite indicative quote, which would show an average quote for each SB swap available and be accessible to all participants of the SB SEF on a quote screen. An RFQ system is a valuable execution model for SB swaps, especially those that are illiquid, precisely because it permits a seeker of liquidity to obtain pricing information from one or more liquidity providers without signaling to the market its trading strategy. The requirement that RFQ responses be included as part of a composite indicative quote, however, would detract from the benefits that an RFQ system provides participants. If information about SB swap quotes executed on an RFQ system must be streamed to other participants that are external to the transaction, such other participants may act opportunistically ahead of the execution of the RFQ transaction on the basis of information from the composite indicative quote to the detriment of the quoting liquidity provider. As a result, liquidity providers will have less of an incentive to transact through RFQs on SB SEFs and consequently liquidity in SB swaps may be negatively impacted. Buy-side participants, including AMG members on behalf of their clients, may therefore find it more difficult or more costly to enter into SB swap transactions.

RFQs for blocks. The detrimental effects are especially pronounced in the context of block trades. As we mentioned in our November 24, 2011 letter to the Commissions,[6] block trades allow participants to execute a large order at a single negotiated price without signaling to the entire market information about the participant's position or trading strategy. If this information becomes publicly available before sufficient time has passed for parties to hedge their exposure and reduce their risk for the large-size trade, other participants may engage in "front-running" and bid/ask spreads may increase, ultimately resulting in increased costs for end users that use SB swaps for risk-management purposes. The requirement that pre-trade price information must be reported as part of a composite indicative quote could give rise to these harmful effects because participants would perceive the occurrence of a block trade based upon a spike or trough in the composite indicative quote.

Additionally, the inclusion of pricing information obtained in responses to RFQs for block trades in a composite indicative quote could distort SB swap prices. As we discussed in the Block Trade Comment Letter, prices for block trades do not accurately reflect and are not relative to market prices for smaller, social size transactions and therefore, including them in an SB SEF's composite indicative quote could skew market prices. At a minimum, to ensure the SB SEF's composite indicative quote stream is not misleading, as well as the appropriate pricing of block trades, and to preserve liquidity, the SEC should exclude information received in response to RFQs for block trades from dissemination on the composite indicative quote stream.

[6] November 24, 2010 AMG Comment Letter, *available at* http://www.sec.gov/comments/df-title-vii/mandatory-facilities/mandatoryfacilities-23.pdf.

Block trades should be given a broad exemption from transparency and interaction requirements, and the SEC should provide flexible and tailored standards for what constitutes a block trade.

Although the SEC Proposal provides that SB SEFs generally may establish different trading rules for block trades than for other SB swap transactions,[9] the discussion in the release indicates that the SEC would require that block trades executed on an SB SEF be subject to the same minimum pre-trade reporting requirements as other SB swaps and interact with existing interest on the SB SEF. The AMG believes that imposing these requirements with respect to block trades is not required by Dodd-Frank and would severely undermine the utility of block trades.

The SEC Proposal would require block trade orders to interact with resting bids and offers available through its other systems. For example, the SEC Proposal states that an SB SEF that operates both an RFQ system and a central limit order book would need to have functionality to allow an RFQ for a block trade to interact with resting bids and offers on a central limit order book before the RFQ is executed. In support of this approach, the SEC Proposal states that these requirements are necessary to prevent block trades from being executed off of the SB SEF and then reported to the SB SEF in such a way as to circumvent the mandatory trade execution requirement and undermine the goals of providing for more transparent and competitive trading on an SB SEF."[7]

The AMG believes that Dodd-Frank's mandatory trade execution requirement requires neither minimum transparency requirements nor interaction requirements with respect to particular block transactions. Instead, SB SEFs must adopt rules regarding appropriate trading procedures for block trades, and block transactions effected pursuant to such rules would be permissible. While transparent and competitive trading on SEFs are objectives of Dodd-Frank, such objectives must be balanced against concerns of liquidity and significant increased costs of transactions for users of Swaps. Congress clearly contemplated such balancing, in the context of trade reporting, when it directed the SEC to adopt rules to establish an "appropriate time delay for reporting large notional security-based swap transactions (block trades)."[8]

As we have indicated above and in our Block Trade Comment Letter and our March 8, 2011 letter to the CFTC, imposing certain pre-trade price transparency requirements on block trades would signal to market participants that a block trade is being contemplated, even if the notional amount of a block trade is not disseminated.

Moreover, the AMG believes that SB SEFs should indeed be permitted to allow block trades to be executed off of the SB SEF, or by any other modality of execution. This approach would grant SB SEFs discretion regarding how block trades will be

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[9] SEC Proposal § 242.811(d)(9), at 11,061.

[7] SEC Proposal, at 10,974.

[8] Securities Exchange Act of 1934 § 78m(m)(1)(E)(iii), as amended. See also Regulation SBSR—Regulation and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75,208 (Dec. 2,2010) § 242.902(b) and discussion at 75,225.

handled pursuant to Proposed Rule 811(d)(9).[9] This model would also be consistent with the way in which block trades in futures are treated. Under the rules of the CME, CBOT, NYMEX and COMEX, block trades are privately negotiated futures, options or combination transactions that are permitted to be executed apart from the public auction market so long as they are entered into at a "fair and reasonable price." The SEC should explicitly provide for such an exemption in its final rulemaking.

The SEC Proposal also allows SB SEFs to determine what constitutes a block trade until the SEC establishes criteria for such a determination.[10] Such a rule could result in the inconsistent treatment of comparable SB swap transactions, which would generate uncertainty among participants in the market who wish to transact in SB swaps. To avoid such uncertainty, the SEC should establish clear block trade thresholds before SB SEFs establish rules on how block trades will be handled. These block trade thresholds should vary by asset class and provide the flexibility necessary to address distinctions such as tenor and liquidity among SB swaps. As we mentioned in the Block Trading Comment Letter, the SEC should also periodically reexamine these factors as they change over time.

The number of participants actively trading an SB swap, frequency of trading and transaction size should be among the objective criteria that swap review committees of SB SEFs use to determine whether a swap is available to trade.

The AMG strongly supports the SEC's view that the determination of when an SB swap should be considered to have been "made available to trade" should be made pursuant to "objective measures established by the [SEC], rather than by one or a group of SB SEFs."[11] Without clear, objective criteria, SB SEFs may make inconsistent determinations regarding whether an SB swap is available to trade. Such inconsistencies would be problematic if an SB SEF were to act opportunistically and use its authority to determine whether a swap is available for trading in a manner that would draw participants to its facility to the detriment of other facilities. We also agree that there may not yet be sufficient data available to set appropriate thresholds for such a determination.

While the possible criteria suggested in the SEC Proposal[12] may all be workable, the AMG believes that, at a minimum, the SEC should specify minimum levels for the number of participants actively trading an SB swap, the frequency of trading and transaction size. These criteria measure the relative liquidity of an SB swap in a manner that swap review committees of SB SEFs could uniformly understand, track and follow. The SEC also should make clear that the same objective criteria to be used in determining

[9] SEC Proposal § 242.811(d)(9) (granting SB SEFs the authority to establish and enforce rules regarding "the manner in which block trades will be handled, if different from the handling of non-block trades").

[10] SEC Proposal, at 10,974.

[11] SEC Proposal, at 10,969.

[12] SEC Proposal, at 10,969.

that an SB swap should be made available to trade may also be used to determine that an SB swap should no longer be made available to trade.

The final rule should resolve an inconsistency in the proposed rule. On the one hand, the discussion in the release indicates that the SEC will establish the objective criteria to be used in determining whether an SB swap has been made available to trade.[13] On the other hand, the proposed rule itself provides that swap review committees are to determine the criteria upon which they shall base their review of SB swaps.[14] The AMG agrees that the SEC, and not SB SEFs, should make this determination. In any event, the SEC should establish the criteria for making the determination and should allow sufficient time for public comment on proposed criteria.

The SEC should also provide further guidance regarding the composition of swap review committees. The SEC Proposal currently provides "for the fair representation of participants of the [SB SEF] and other market participants, such that each class of participant and other market participants shall be given the right to participate… and that no single class of participant or category of market participant shall predominate."[15] Because of the significant impact that determinations that a transaction has been made available to trade will have on the SB swap market, swap review committees must require meaningful buy-side participation.

The reach of an SB SEF's information-gathering authority should be limited.

The AMG urges the SEC to limit the authority of an SB SEF to collect information from participants. The SEC Proposal charges SB SEFs with the authority to establish and enforce rules to capture information including, for example, financial information, books, accounts, records, files, memoranda, correspondence and other information relating to a trading interest entered and transactions executed on or through an SB SEF.[16] Although the SEC Proposal prohibits SB SEFs from using confidential information for non-regulatory purposes,[17] the AMG requests that the SEC clarify the scope of "non-regulatory purposes" to protect participants from the inappropriate dissemination of proprietary information. Such a limitation would encourage participants to trade SB swap transactions on SB SEFs.

Allowing SB SEFs to exclude certain eligible contract participants and to impose capital requirements that exceed those established by the SEC would result in discriminatory effects.

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[13] SEC Proposal, at 10,969.

[14] *See* SEC Proposal § 242.811(c)(3) ("The security-based swap execution facility shall establish criteria that the swap review committee shall consider in determining which security-based swaps shall trade on the security-based swap execution facility.").

[15] SEC Proposal § 242.811(c)(2).

[16] SEC Proposal § 242.814(a)(1).

[17] SEC Proposal § 242.810(c).

The AMG generally supports the SEC's approach to ensuring impartial access to, and the financial integrity of transactions on, an SB SEF in compliance with Core Principles 2 and 6. The SEC Proposal would permit an SB SEF to choose whether to permit eligible contract participants that are not registered as a security-based swap dealer, major SB swap participant or broker ("**non-registered ECPs**") to become direct participants in the SB SEF, subject to not unreasonably discriminatory standards and appropriate risk management controls and procedures. Direct access to trading platforms is essential to many AMG members that likely will be non-registered ECPs but who have long-standing trading relationships with security-based swap dealers. The AMG is concerned that denying non-registered ECPs direct access to SB SEFs could force buy-side market participants to execute transactions through other entities, which could be costly, or may prevent them from executing such transactions at all. Therefore, the AMG believes that all non-registered ECPs should be permitted to become participants on an SB SEF, provided that they meet objective eligibility criteria established by the SEC.

The SEC Proposal also requires SB SEFs to establish their own recordkeeping and reporting requirements.[18] If such requirements vary among SB SEFs, compliance would become unnecessarily burdensome and costly for non-registered ECPs who execute transactions on multiple SB SEFs. Therefore, the AMG believes that the SEC should establish uniform recordkeeping and reporting requirements to be applied across all SB SEFs.

In seeking to balance the objectives of impartial access and financial integrity, the SEC has requested comment on whether SB SEFs should be permitted to impose higher capital requirements on participants than those that may be imposed on such participants by the SEC.[19] The AMG believes that granting such authority to SB SEFs would endorse discriminatory behavior by SB SEFs. If certain SB swaps are only available to trade on a small number of SB SEFs, and those SB SEFs impose heightened capital requirements, buy-side entities that do not meet the heightened capital requirements would be denied direct access to such SB swap transactions. Prohibiting direct access to such transactions would be contrary to Dodd-Frank's goal of ensuring equal access to swap transactions in the marketplace. The related limitations on access could simultaneously drive down the price of an SB swap, benefiting only those entities that meet the SB SEF-established capital requirements.

Self-certification by SB SEFs of their rules and amendments thereto should be replaced with broad requirements for public comment.

The SEC has proposed self-certification rules for SB SEFs similar to those proposed by the CFTC for SEFs.[20] Unlike the CFTC's proposal, however, which

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[18] SEC Proposal § 242.809(c)(2)(ii).

[19] SEC Proposal, at 10,979.

[20] *Compare* CEA § 5c(c) *and* Provisions Common to Registered Entities, 75 Fed. Reg. 67,282 (proposed November 2, 2011) (amending 17 CFR Pt. 40) (implementing the amended procedures for self-certification of rules mandated by § 745 of Dodd-Frank, which amended § 5c(c) of the CEA, by codifying amended self-certification procedures in Proposed Rule 40.6) *with* SEC Proposal §§ 242.806, 242.807.

implements the self-certification and approval procedures explicitly required by Section 745 of Dodd-Frank, the SEC's proposed rule is not required by statute.

Under the SEC proposal, a new rule or rule amendment of an SB SEF that is certified by the SB SEF will become effective within ten business days after the SEC receives the self-certified rule or amendment.[21] The SEC may stay the certification under certain limited circumstances,[22] which would trigger a review period of up to 90 days from the date of the notification of the stay, including a 30-day public comment period.[23]

As stated in our March 8, 2011 comment letter to the CFTC, the AMG is concerned that the rules and amendments relating to the operations of SB SEFs will have an extremely important impact on participants in the SB swap markets. This is particularly true in light of the SEC's proposal which permits a good deal of flexibility in the scope and design of SB SEFs. The AMG firmly believes that public input is critical to informing the nature of the swap markets. Thus, the AMG requests that the SEC include opportunities for public comment with respect to SB SEF rules and amendments.

If the SEC determines that it must provide SB SEFs with the ability to self-certify their rules and amendments, then, <u>at a minimum</u>, the SEC should impose the three requirements proposed in our CFTC SEF letter. First, SB SEFs should be required to notify the public a reasonable amount of time in advance of any intent to self-certify a rule or amendment and include in its self-certification submission any and all objections voiced by market participants. In addition, the SEC should reserve the right to stay any such rule or amendment on the basis of any material market participant objections provided in the self-certification submission.

Second, as a means of establishing compliance with SB SEF Core Principle 12 – Financial Resources, each SB SEF should be required to submit to the SEC and make available for public comment evidence demonstrating that the SB SEF will have in place sufficient legal, business and technological resources (including appropriate systems, policies and procedures and adequate personnel) to process user applications and accommodate the transactional flow of the number of market participants that it reasonably estimates will become users of the SB SEF over time.

Finally, the SEC should require SB SEFs to submit for public comment prior to self-certification the forms of user agreements, all terms to be incorporated into such user agreements and all business and technological requirements for market participants.

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[21] *Id.*

[22] *Id.* (SEC Proposal § 242.806(c)(1) would stay the certification of a rule if the SEC determines that the new rule or amendment raised one of three issues, including: if the rule or rule amendment "present[s] novel or complex issues that require additional time to analyze, the new rule or rule amendment is accompanied by an inadequate explanation, or the new rule or rule amendment is potentially inconsistent with the Act or Commission rules or regulations thereunder.").

[23] *Id.* at § 242.806(c)(1)-(2).

The SEC final rules should contain exceptions from mandatory execution on an SB SEF for certain packaged SB swap transactions.

As stated in our March 8, 2011 comment letter to the CFTC, some AMG members engage in "packaged" or "combination" SB swap transactions which combine into a single transaction two or more component transactions. These components can consist of other SB swaps, futures, cash market transactions or other financial instruments. Because the pricing and economic rationale of the packaged SB Swap transaction depends on the pricing of its components, such packaged SB swap transactions have unique pricing, trading and credit characteristics.

Requiring an SB swap component of such a transaction to be executed on an SB SEF because that component, when traded independently, is available for trading on an SB SEF would impair the viability of the packaged SB swap transaction. Decoupling the packaged SB swap transaction and requiring it to be executed on an SB SEF may not reflect the true price of the packaged instrument and does not promote accurate pricing information to market participants trading such instruments. Similarly, the AMG believes that the entire combination instrument should be excluded from the SB SEF execution requirement. When asset managers execute packaged SB swap transactions on behalf of their clients, they seek the best price on the overall transaction, and are not just looking at its component parts. Similarly, the SB SEF rules should look at these packaged products on the basis of the overall transaction, and not its individual component parts. Thus, the AMG believes that the final SEC rules should explicitly exempt packaged SB swap transactions from the SB SEF trade execution requirements.

The SEC and the CFTC should coordinate their final rulemakings for SB SEFs and SEFs.

As the SEC states in the SEC Proposal, the approach that the SEC and CFTC may take to the regulation of SB SEFs and SEFs, respectively, may differ in various respects. The SEC attributes this to the "differences between the markets and products that the [SEC] and the CFTC currently regulate."[24] The AMG is concerned, however, that many market participants will engage in both swaps and SB swaps and thereby will be subject to both regulatory regimes. Requiring such market participants to execute similar types of transactions in dissimilar ways on separate trading platforms will add significant administrative and compliance costs and risks, generating unnecessary confusion. The AMG does not believe it is necessary or appropriate for the SEC and the CFTC to have different rules on SEFs and SB SEFs, despite their oversight of different swap products.

In a recent letter to Chairpersons Mary Schapiro and Gary Gensler, Congressman Barney Frank stressed the need for harmonization and coordination between the Commissions for Dodd-Frank rulemaking.[25] Congressman Frank expressed a concern regarding unnecessary differences between the Commissions' rules, which would "drive

[24] SEC Proposal, at 10,950.

[25] Letter from Barney Frank, Ranking Member, H.R. Comm. on Fin. Servs., to Hon. Mary L. Schapiro, Chariman, Sec. Exch. Comm'n, and Hon. Gary Gensler, Chairman, Comm. Fut. Trading Comm'n (Feb. 18, 2011).

up the cost of implementation, without improving the regulatory structure," and cited discrepancies between the approaches the SEC and CFTC have taken regarding their proposed rules on SB SEFs and SEFs, specifically with respect to RFQ systems and block trades.[26] Congressman Frank surmised that the differences between the existing equity and futures markets do not justify differing treatment of SB swaps and swaps. He also pointed out that Swaps are "very different products from those currently traded in the highly evolved equities and futures markets" and that, therefore, the rules for the trading of Swaps should not be based on those existing markets or differences between those markets.[27] Congressman Frank's concerns are consistent with President Barack Obama's recent Executive Order, in which he requested that federal agencies undertake greater coordination to avoid redundant, inconsistent or overlapping regulations.[28]

[26] *Id.*

[27] *Id.*

[28] *See* Executive Order, "Improving Regulation and Regulatory Review" (Jan. 18, 2011) (recognizing that, generally speaking for all regulatory agencies, "[s]ome sectors and industries face a significant number of regulatory requirements, some of which may be redundant, inconsistent, or overlapping" and "[g]reater coordination across agencies could reduce these requirements, thus reducing costs and simplifying and harmonizing rules"). These principles seem highly relevant to the Commissions' coordination on Swaps rulemaking.

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The AMG thanks the SEC for the opportunity to comment on proposed rulemaking concerning the registration and regulation of security-based swap execution facilities under Title VII. The AMG would welcome the opportunity to further discuss our comments with you. Should you have any questions, please do not hesitate to call the undersigned at 212-313-1389.

Respectfully submitted,

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Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

cc: Chairman Mary L. Schapiro, SEC
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