

TESTIMONY
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JEFFERIES & COMPANY, INC.
UNITED STATES SENATE
SUBCOMMITTEE ON SECURITIES, INSURANCE, AND INVESTMENT
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“EMERGENCE OF SWAP EXECUTION FACILITIES: A PROGRESS REPORT”

Good morning. My name is Chris Bury and I am the Co-Head of Rates Sales and Trading for Jefferies & Company, Inc. Chairman Reed and Ranking Member Crapo, thank you for inviting me to testify this morning regarding the emergence of swap execution facilities or, as they have come to be known, SEFs.

Jefferies is a full-service global securities and investment-banking firm that, for almost 50 years, has been serving issuers and investors. We provide investment banking, and research sales-and-trading services and products to a diverse range of corporate clients, government entities, institutional investors and high net worth individuals. The last few years have been a pivotal time for Jefferies as we gained market share and built significant momentum by capitalizing on strategic opportunities to expand and diversify on multiple levels and across all business lines. Over the last five years, our firm's annual revenue, equity market capitalization and global headcount have increased significantly, with now almost \$3 billion in annualized net revenue, over \$4 billion in equity market value, and soon-to-be 3,600 employees.

It bears noting that during that same period – that is, during the financial crisis – at no time did Jefferies seek or receive taxpayer assistance. As a publicly traded company on the New York Stock Exchange, our capital comes solely from the markets, and Jefferies' ability to persevere and emerge from the financial crisis positioned for growth and diversification can best be attributed to the firm's focus on a strong capital position, ample liquidity, and sound risk management.

There are a few key points that Jefferies would like to convey to the Subcommittee:

- **First**, we are ready to go. From our perspective, the architecture, infrastructure and technology necessary to bring the over-the-counter derivatives markets into an era of transparency, dispersed counterparty risk and open access are in place. Just as we are a leading provider of liquidity and execution in stock and bonds, we believe we can become a leading provider to buyers and sellers of derivatives. The market awaits the adoption of final rules – it is a fallacy to suggest that rules should be delayed to allow more time for this market structure to develop.
- **Second**, we believe that those sections of Title VII of Dodd-Frank pertaining to SEF trading of derivatives are necessary to remedy the artificial barriers to entry in the OTC derivatives market. It is with the intention of enhancing market participation and fostering competition that we support prompt implementation of these requirements.
- **Third**, implementation timelines should be the top priority at this juncture. The proposed rules are generally clear and understandable. The market needs the certainty of when the rules will become applicable far more than it needs any more suggestions about how bilateral agreements offer an alternative to central clearing.

- **Fourth**, it is vitally important to guard against the development of market structures that enable opaque bilateral contract relationships to continue to exist. Current standardized-execution-agreement proposals for centrally cleared swaps do nothing but preserve the closed and anti-competitive elements of these markets as they existed prior to the financial crisis.
- **Fifth**, the adoption of the rules and a clear timeline for implementation of Title VII will bring to the markets the same clear benefits gained from similar developments in equities and futures markets: increased access, expanded competition, improved price transparency, and decentralized risk. SEF trading will lead to lower transaction costs, greater liquidity, strengthened market structures and reduced implicit risks to market participants and the American taxpayer.

For years, firms such as Jefferies were effectively locked out of being a dealer in the OTC markets by virtue of a series of artificial barriers and requirements that perpetuated a closed system. Market participants were reliant upon bilateral contract arrangements with a self-selected group of large interconnected banks, dealers and insurers. The weaknesses and lack of true competition of that closed system exacerbated the credit crisis of 2008 to the great expense of our economy. We support the implementation of SEF trading as quickly and responsibly as possible. We believe that these provisions will increase transparency, reduce systemic risk, increase competition, and broaden access to centralized clearing within the derivatives market place.

From our perspective, the development of the SEF market and access to SEFs are fairly straightforward. In addition, the rules as jointly proposed by the Commodity Futures Trading Commission and Securities and Exchange Commission with regard to mandatory exchange or SEF trading are clear.

Jefferies' main concern, therefore, is not centered around a lack of understanding of the rules, nor around the notion that the rules are being implemented before the SEF market has developed. Quite to the contrary: Jefferies is concerned that a rule delay is one of the biggest risks facing this emerging SEF marketplace today. We believe the market will successfully transition to SEF trading once a timeline is established in terms of what types of swaps will be required to transact on a SEF.

Another risk to the development of the cleared derivatives market is the potential for the handful of too-big-to-fail banks that were bailed out by taxpayers to undermine and delay implementation of derivatives reform. We believe that recent suggestions from those banks regarding alternative documentation and workflow issues are nothing more than an effort to stifle competition and maintain the status quo.

We believe that the concern over these workflow issues and "what-if" scenarios will rapidly fade once the scale and scope of the technological investment in SEFs and a centrally cleared derivatives marketplace is better understood. Significant technological, financial and intellectual resources have been committed by a wide variety of market participants to get SEFs up and running as quickly as possible. Those investments have paid off, as the Financial Times noted last month in its special report on derivatives:

“[T]he main participants, banks, interdealer brokers and ‘big end users’ are ready to go when it comes to electronic trading and clearing.” (*Financial Times Special Report, May 31, 2011, as quoted in SDMA Letter to CFTC and SEC dated June 1, 2011.*)

The article went on to note that SEF-compliant trades between swap dealers and major swap participants have been reported on Javelin, TradeWeb, MarketAxess, and Bloomberg in both interest rate swap and credit default swap products.

Our industry is, indeed, approaching full readiness for standardized OTC derivatives contracts to begin trading on SEFs. If the proposed rules are implemented by the end of 2011, Jefferies would anticipate that trading volumes will begin increasing by the fourth quarter of this year and then increase significantly into 2012 as we approach final implementation of mandatory SEF trading of standardized derivatives. A firm timeline for mandatory SEF trading of the most standardized swaps will be instrumental for the market to achieve its full potential.

More importantly, delaying the implementation process will provide opportunities for entrenched interests to promote agreements that will degrade and deter free market forces from operating in the derivatives arena. The recently released Futures Industry Association (FIA) Cleared Swap Agreement is one such example. Although it is marketed as an industry-wide document developed by a variety of market participants, we are concerned that the published version, were it broadly adopted by market participants, would embed chokepoints into the system. Customer agreements that provide for either fallback provisions to bilateral relationships or workflows that require complicated credit limit checking arrangements, as the current FIA offering proposes, will not foster a fully transparent, open, and competitive market. Congress and the regulators should encourage market participants to adopt agreements and

market frameworks that provide for immediate certainty of clearing in order to advance the open access provisions and central clearing mandate of Dodd-Frank.

CONCLUSION

Jefferies believes that implementation of Title VII reforms will unleash free market forces held in check by entrenched business models, and we are ready and eager to compete in the derivative marketplace. Thank you for inviting me to testify today, and I look forward to any questions the Subcommittee may have.