

Testimony of James Cawley

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Swaps & Derivatives Market Association

for

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

SUBCOMMITTEE ON SECURITIES, INSURANCE, AND INVESTMENT

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Chairman Reed, Ranking Member Crapo, and Members of the Subcommittee, my name is James Cawley. I am Chief Executive Officer of Javelin Capital Markets, an electronic execution venue of OTC derivatives that will register as a SEF (or "Swaps Execution Facility,") under the Dodd Frank Act.

I am also here to represent the interests of the Swaps & Derivatives Market Association or "SDMA," which is comprised of several independent derivatives dealers and clearing brokers, some of whom are the largest in the world.

Thank you for inviting me to testify today.

Without a doubt, it is *mission critical* that central clearing, increased transparency and broader liquidity is properly achieved under the Dodd Frank Act for the OTC derivative markets. Towards that goal, it is important that SEFs be allowed to properly function and compete with each other whereby Congress and the Regulators ensure that such organizations and their various execution models be neither discriminated against, nor be penalized by trade workflow or documentation efforts that show preference for one SEF over another.

Only by access to a fair, level and open playing field, will SEFs be properly able to play their part in the lessening of systemic risk, to which the derivative marketplace contributed during the global financial crisis of 2008.

Product Eligibility and Open Access

With regard to product eligibility to clearing, clearing houses should recognize that the fair majority of interest rate and credit derivative products do qualify for clearing.

Regulators should be mindful to ensure that clearing houses do not favor acceptance of certain products that have built in trade restrictions that impede open access or customer choice.

While intellectual property rights may protect innovation in the short term, with regard to certain swap products or indices, they may restrict trade and liquidity in the long term. Market participants should be allowed to trade such products to meet their investor or hedging objectives. Intellectual property rights for such products should adapt with the post Dodd Frank market place where anonymous and transparent markets flourish.

Regulators should work with these IP holders to both ensure that their rights are properly protected, and the prudential need of the broader market is also protected.

Open Access to Clearing Houses

With regard to SEF access to clearing houses, clearing houses and their constituent clearing members should do as the act requires--accept trades on an “execution blind” basis. DCOs should not discriminate against trades simply because they or they shareholders dislike the method in which such trades occur.

Clearing houses should refrain from using their SEF sign-up documentation as a vehicle to restrict trade. As a precondition to access, clearing houses should not require that SEFs sign “non-compete” clauses, such that a clearing house’s other businesses – be it execution based or not – are inappropriately protected from outside competition.

Likewise clearing firms should not require that SEF’s contract with them to restrict the rights or privileges of end users, as a precondition to SEF-clearing house connectivity. Such requirements serve no prudential role with regard to risk mitigation and run contrary to the open access provisions of the Dodd Frank Act.

Real Time Trade Acceptance

Clearing houses should not require that a SEF purposefully engage in a trade workflow that adds latency or creates unnecessary steps in the settlement process.

Instead, clearing houses and their constituent clearing firms should draw from their own *proven* and *well tested* experience in listed derivatives. They should accept trades symmetrically and in ‘real time’.

Immediate acceptance of swaps trades into clearing is critical to accomplishing the goals of the Dodd-Frank Act to reduce systemic risk, increase trade integrity and promote market stability.

Settlement uncertainty, caused by time delays between the point of trade execution and the point of trade acceptance into clearing, can destroy investor confidence in the cleared OTC derivatives markets.

As the CFTC has correctly asserted such a time delay or “trade latency”, (which in the bilateral swaps markets can be as long as a week) directly constrains liquidity, financial certainty and increases risk.¹

Clearing houses and their clearing members should do as the regulators have required, accept trades into clearing *immediately upon execution* on a SEF.

Execution Documentation Efforts

Regulators should be wary of certain incumbent efforts that claim to bring execution certainty through documentation. Such documentation sets in place workflow that clearly favors RFQ (“Request for Quote”) execution models over exchange like *central limit order books*.

Such documentation denies the customer the right to trade anonymously with multiple counterparties, because under such a workflow, the dealer counterparty requires the identity of the customer be known before a trade occurs.

This is not the case with documentation and workflow requirements in the cleared derivatives markets of futures and options. In those markets, buyers and sellers trade in multiple trade venues where trade integrity, counterparty anonymity and optimal liquidity is assured through access to multiple counterparties.

Such restrictive workflow and documentation should be seen for what it is-- nothing more than a transparent attempt to limit customer choice, restrict trade and drain liquidity.

Conclusion

In conclusion, the role of the Swap Execution Facility with regard to lessening systemic risk should not be understated.

To fulfill the SEF’s role in fostering greater liquidity and transparency, Congress and the regulators should continue to be proactive and protect the market against Dodd Frank implementation ‘chokepoints.’ They should continue to ensure that all SEFs have fair and open access to clearing and the marketplace.

¹ Page 13101. (*Federal Register*, Volume 76, No. 47, 3/10/11).