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Testimony of Stephen Merkel

Chairman Reed, Ranking Member Corker and members of the Subcommittee, thank you for providing this opportunity to participate in today's hearing.

My name is Stephen Merkel. I am the Executive Vice President, General Counsel and Secretary for BGC Partners, a leading global inter-dealer broker of over the counter financial products.[1] BGC Partners was created in August 2004, when Cantor Fitzgerald separated its interdealer brokerage business to create BGC Partners. We are a leading global intermediary to the wholesale financial markets, specializing in the brokering of a broad range of financial products including fixed income, rates, foreign exchange, equities, equity derivatives, credit derivatives, futures and structured product markets.

I am testifying today in my capacity as the Chairman of the Wholesale Markets Brokers' Association, Americas (the "WMBAA"), an independent industry body whose membership includes the largest North American inter-dealer brokers: my firm, BGC Partners, as well as GFI Group, ICAP, Tradition and Tullett-Prebon.[2]

I welcome this opportunity to discuss with you the emergence of swap execution facilities ("SEFs") under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" or "DFA"). I hope to share the perspective of the primary intermediaries of over-the-counter ("OTC") swaps operating today, both here in the United States and across the globe.

In my written testimony, I plan to cover the following points:

- **Readiness.** In terms of readiness, BGC and its fellow WMBAA member firms are currently fully functional as market intermediaries in the OTC derivatives markets and will be ready to initiate SEF operations on *day one*. Wholesale brokers are today's central

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[1] BGC Partners, Inc. (NASDAQ: BGCP) (www.bgcpartners.com) is a leading global intermediary to the wholesale financial markets, specializing in the brokering of a broad range of financial products including fixed income, rates, foreign exchange, equities, equity derivatives, credit derivatives, futures and structured product markets. BGC offers a full range of brokerage services including price discovery, trade execution, straight through processing and clearing, settlement and access to electronic trading services through its eSpeed, BGC Trader and BGC Pro brands. On April 1, 2008, BGC merged with eSpeed to form a world-class provider of voice and electronic brokerage services in the global marketplace. The combined company is BGC Partners, Inc. Since its separation from Cantor Fitzgerald in 2004, BGC has expanded to 24 offices worldwide with over 1700 brokers and approximately 2700 employees. In 2005, BGC merged with Maxcor Financial Group, integrating two leading brokerage firms. This was followed by the acquisitions of ETC Pollak and Aurel in Paris.

[2] The WMBAA is an independent industry body representing the largest interdealer brokers operating in the North American wholesale markets across a broad range of financial products. The WMBAA and its member firms have developed a set of *Principles for Enhancing the Safety and Soundness of the Wholesale, Over-The-Counter Markets*. Using these *Principles* as a guide, the WMBAA seeks to work with Congress, regulators, and key public policymakers on future regulation and oversight of institutional markets and their participants. By working with regulators to make wholesale markets more efficient, robust and transparent, the WMBAA sees a major opportunity to assist in the monitoring and consequent reduction of systemic risk in the country's capital markets. The five founding members of the WMBAA are BGC Partners; GFI Group; ICAP; Tradition and Tullett-Prebon. More about the WMBAA can be found at: www.WMBAA.org.

marketplaces in the global swaps markets and, as such, can serve as a prototype for prospective independent and competitive SEFs.

- **Voice and electronic modes of trade execution.** Wholesale brokers are experts in fostering liquidity and transparency in global swaps markets by utilizing trade execution methodologies that feature a hybrid blend of knowledgeable and qualified brokers, as well as sophisticated electronic technology. The CFTC's proposed rules are inconsistent with the statute in the way that they limit how trades are executed, most particularly in how they limit trades that occur utilizing voice or telephonic communication. Such a limitation is inconsistent with the statute's clear language that ensures that SEFs can utilize "any means of interstate commerce." The SEC's proposed rule is much more flexible and consistent with the statute.

- **Block trade size and preserving liquidity and anonymity in the market**. Liquidity in today's swaps markets is fundamentally different than liquidity in futures and equities markets, and the unique characteristics of this liquidity are what naturally determine the optimal mode of market transparency and trade execution. The CFTC's proposal could jeopardize liquidity in the markets by relying on inappropriate factors to determine a block trade. This would harm the ability of investors to manage large positions, impact the ability of counterparties to engage in anonymous price discovery and, ultimately, increase the cost of risk management to end users. The definition of block trade must be based on hard market data to minimize unintended negative consequences.

- **Competition.** It is vital that the rules be consistent with the clear and unambiguous provisions in the statute ensuring that clearinghouses provide SEFs "nondiscriminatory access" to clearing. To be consistent with the statute this must include direct and indirect actions that not only inhibit access to clearing, but also actions that would bundle the services of a clearinghouse that operates an execution facility (exchange or SEF), thereby providing favorable treatment to their own affiliates over their independent competitors. Another form of discrimination includes treating differently SEF traded contracts and those traded on exchanges in liquidation. The CFTC's proposed rule needs to be changed to ensure that in liquidation there is identical treatment of the cleared contract regardless of the venue it traded.

Essential Elements that Regulators Need to Get Right under Title VII

- The final regulations enacted by the Commodity Futures Trading Commission ("CFTC" or "Commission") and Securities and Exchange Commission ("SEC" or "Commission" and, together with the CFTC, the "Commissions") must be consistent with the plain language of Dodd-Frank and allow for multi-modes of execution as Congress intended. SEFs must not be restricted from deploying the many varied and beneficial trade execution methodologies and technologies successfully used today to execute swaps transactions.

- There must be harmonization between the CFTC and SEC, as well as consistency in international regulation.

- New regulations must be phased-in appropriately to prevent unnecessary disruption to the markets.

- Regulators must use a flexible approach to SEF registration, permitted modes of trade execution and impartial access. Regulations should support the formation of a common regulatory organization ("CRO") for SEFs to implement and facilitate compliance with the Commissions' rules. The CRO would ensure that a single, consistent standard is applied across multiple SEFs and prevent a "race to the bottom" for rule compliance and enforcement programs.

Background on Wholesale Brokers

In terms of actual operations, WMBAA members provide a marketplace for a relatively small number of sophisticated institutional buyers and sellers of OTC financial products where their trading needs can be matched with other sophisticated counterparties having reciprocal interests in a transparent, yet anonymous, environment. To persons unfamiliar with our business, I often describe interdealer brokers as a virtual trading floor where large financial institutions buy and sell financial products that are not suited to, and therefore rarely traded on, an exchange.

As we sit here today, interdealer brokers are facilitating the execution of hundreds of thousands of OTC trades corresponding to an average of $5 trillion in notional size across the range of foreign exchange, interest rate, U.S. Treasury, credit, equity and commodity asset classes in both cash and derivative instruments. WMBAA member firms account for over 90% of intermediated swaps transactions taking place around the world today.

Wholesale brokers provide highly specialized trade execution services, combining teams of traditional "voice" brokers with sophisticated electronic trading and matching systems. As in virtually every sector of the financial services industry in existence over the past 50 years, wholesale brokers and their dealer clients began connecting with their customers by telephone. As technologies advanced and markets grew larger, more efficient, more diverse and global, these systems have advanced to meet the changing needs of the market. Today, we refer to this integration of voice brokers with electronic brokerage systems as "hybrid brokerage." Wholesale brokers, while providing liquidity for markets and creating an open and transparent environment for trade execution for their market participants, do not operate as single silo and monopolistic "exchanges." Instead, we operate as competing execution venues, where wholesale brokers vie with each other to win their customers' business through better price, provision of superior market information and analysis, deeper liquidity and better service. Our customers include large national and money center banks and investment banks, major industrial firms, integrated energy and major oil companies and utilities.

Increasingly, the efficiencies of the market have inevitably led to a demand for better trading technology. To that end, we develop and deploy sophisticated trade execution and support technology that is tailored to the unique qualities of each specific market. For example, BGC's customers in certain of our more complex, less commoditized markets may choose among utilizing our electronic brokerage platforms to trade a range of fixed income derivatives, interest rate derivatives, foreign exchange options, repurchase agreements and energy derivatives entirely on screen. Alternatively, they can execute the same transaction through instant messaging devices or over the telephone with qualified BGC brokers supported by sophisticated electronic technology. It is important to note that the migration of certain products to electronic execution was not, and has never been, because of a regulatory or legal mandate but simply part of the natural evolution and development of greater market efficiencies in particular markets. Conversely, the persistence of customer preference for trade execution through telephonic communications for certain products, despite the apparent efficiencies associated with electronic trading in other similar products in the same markets, reflects those customers' preference for the unique advantages that "voice" brokers can provide in liquidity formation with respect to less-liquid or more bespoke products.

The critical point is that competition in the marketplace for transaction services has led interdealer brokers to develop highly sophisticated transaction services and technologies that are well tailored to the unique trading characteristics of the broad range of swaps and other financial instruments that trade in the OTC markets today. Unlike futures exchanges, we enjoy no execution monopoly over the products traded by our customers. Therefore, our success depends on making each of our trading methods and systems right for each particular market we serve. From decades of competing for the business of the worlds' largest financial institutions, we can confirm that there is no "one size fits all" method of executing swaps transactions.

Dodd-Frank Impact on Swaps Market Structure: Clearing and Competing Execution

Title VII of Dodd-Frank was an earnest and commendable effort by Congress to reform certain aspects of the OTC swaps market. The DFA's core provisions relating to clearing and trade execution are: (1) replacing bilateral trading where feasible with central counterparty clearing; and (2) requiring that cleared swaps transactions between swaps dealers and major swaps participants be intermediated by qualified and regulated trading facilities, including those operating under the definition of "swap execution facilities" through which "multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce...."[3]

These two operative provisions seek to limit the current market structure where swaps and the underlying counterparty risk may be traded directly between counterparties without the use of trading intermediaries or clearing and to replace it for most transactions with a market structure in which a central clearing facility acts as the single counterparty to each market participant (*i.e.*, buyer to each seller and seller to each buyer) and where those cleared transactions must be traded through SEFs and other intermediaries and not directly between the counterparties.

In enacting these structural changes, DFA wisely rejected the anticompetitive, single silo exchange model of the futures industry, in which clearing and execution are intertwined, thereby giving the exchange an effective execution monopoly over the products that it

[3] *See* Commodity Exchange Act ("CEA") Section 1a(50).

clears.[4] Rather, by requiring central clearing counterparties to provide non-discriminatory access to unaffiliated execution facilities, DFA promotes a market structure in which competing SEFs and exchanges will vigorously compete with each other to provide better services at a lower cost in order to win the execution business of sophisticated market participants. In this regard, DFA preserves the best competitive element in the existing swaps landscape: competing wholesale brokers.

BGC and the WMBAA members heartily support Dodd-Frank's twin requirements of clearing and intermediation. Their advocacy of swaps intermediation is fundamental to their business success in fostering liquidity, providing price transparency, developing and deploying sophisticated trading technology tools and systems and operating efficient marketplaces in global markets for swaps and other financial products.

Critical Elements to Get Right

There are many things to get right under DFA. Given that DFA requires all clearable trades to be transacted through an intermediary (either an exchange or a SEF), it is essential that regulators get the following aspects of this new regime right:

1. Permit multi-modes of swap execution, consistent with Congressional intent.
2. Ensure harmonization between agencies and foreign regulators.
3. Allow for the appropriate implementation of final rules.
4. Utilize a flexible approach to SEF registration, permitted modes of trade execution, and impartial access.
5. Recognize the important role a common regulatory organization can play in ensuring the integrity of the SEF industry.

1. Permitted Modes of Execution

As previously stated, DFA defines SEFs as utilizing "any means of interstate commerce" to match swaps counterparties. This is an appropriate allowance by Congress, as the optimal means of interaction in particular swaps' markets varies across the swaps landscape. Congress recognized that it was best left to the marketplace to determine the best modes of

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[4] As the Justice Department observed in a 2008 comment letter to the Treasury Department, where a central counterparty clearing facility is affiliated with an execution exchange (such as in the case of U.S. futures), vertical integration has hindered competition in execution platforms that would otherwise have been expected to: result in greater innovation in exchange systems, lower trading fees, reduced ticket size and tighter spreads, leading to increased trading volume and benefits to investors. As noted by the Justice Department, "the control exercised by futures exchanges over clearing services…has made it difficult for exchanges to enter and compete." In contrast to futures exchanges, equity and options exchanges do not control open interest, fungibility, or margin offsets in the clearing process. The absence of vertical integration has facilitated head-to-head competition between exchanges for equities and options, resulting in low execution fees, narrow spreads and high trading volume. *See* Comments of the Department of Justice before the Department of the Treasury Review of the Regulatory Structure Associated With Financial Institutions, January 31, 2008. Available at http://www.justice.gov/atr/public/comments/229911.html.

execution for various swaps and, thereby, foster technological innovation and development. Congress specifically did not choose to impose a federally mandated "one-size-fits-all" transaction methodology on the regulated swaps market.

As the swaps market has developed, it has naturally taken on different trading, liquidity and counterparty characteristics for its many separate markets. For example, in more liquid swaps markets with more institutional participants, such as certain U.S. Treasury, foreign exchange and energy products, wholesale brokers operate fully interactive electronic trading platforms, where counterparties can view prices and act directly through a trading screen and also conduct a range of pre- and post-trade activities like on-line price analysis and trade confirmation. These electronic capabilities reduce the need for actual voice-to-voice participant interaction for certain functions, such as negotiation of specific terms, and allow human brokers to focus on providing market intelligence and assistance in the execution process. And yet, even with such technical capabilities, the blend of electronic and voice assisted trading methods still varies for different contracts within the same asset class.

In markets for less commoditized products where liquidity is not continuous, BGC Partners and its competitors provide a range of liquidity fostering methodologies and technologies. These include hybrid modes of: (1) broker work-up methods of broadcasting completed trades and attracting others to "join the trade;" and (2) auction based methods, such as matching and fixing sessions. In other swaps markets, brokers conduct operations that are similar to traditional "open outcry" trading pits where qualified brokers communicate bids and offers to counterparties in real time through a combination of electronic display screens and hundreds of installed, always-open phone lines, as well as through other email and instant messaging technologies. In every case, the technology and methodology used is well calibrated to disseminate customer bids and offers to the widest extent and foster the greatest degree of liquidity for the particular market.

Permitted Use of Voice and Hybrid Trade Execution Platforms

The WMBAA feels strongly that the CFTC's proposed rules regarding SEFs do not reflect the DFA's requirement that SEF transactions can be executed "through any means of interstate commerce." Specifically, in restricting the use of voice-based systems for those clearable trades that must be executed on a SEF, the CFTC has proposed a more restrictive regime than the statute dictates. A rigid implementation of the SEF framework will devastate existing voice and "hybrid" systems that are currently relied upon for liquidity formation in global swaps markets. "Hybrid brokerage," which integrates voice with electronic brokerage systems, should be clearly recognized as an acceptable mode of trade execution for all clearable trades. The combination of traditional "voice" brokers with sophisticated electronic trading and matching systems is necessary to provide liquidity in markets for less commoditized products where liquidity is not continuous. Failure to unambiguously include such systems is not only inconsistent with Dodd-Frank but will severely limit liquidity production for a wide array of transactions. BGC and our fellow WMBAA members are concerned that such a restrictive SEF regime will lead to market disruption and, worse, liquidity constriction with adverse consequences for vital U.S. capital markets.

The WMBAA strongly supports the SEC's interpretation of the SEF definition as it applies to trade execution through any means of interstate commerce, including request for quote systems, order books, auction platforms or voice brokerage trading, because such an approach is consistent with the letter and spirit of the Dodd-Frank Act and ensures flexibility in the permitted modes of execution. The WMBAA believes that this approach should be applied consistently to all trading systems or platforms and will encourage the growth of a competitive marketplace of trade execution facilities.

What determines which blend of hybrid brokerage is adopted by the markets for any given swap product is largely the market liquidity characteristic of that product, whether or not the instrument is cleared. For example, a contract to trade Henry Hub Natural Gas delivered in Summer 2017, though cleared, will generally be insufficiently liquid to trade on a central limit order book. This is true for many cleared products with delivery dates far in the future, where market makers are unwilling to post executable bids and offers in instruments that trade infrequently. In markets where price spreads are wide or trading is infrequent, central limit order books are not conducive to liquidity, but rather may be disruptive to it.

Critically, what determines which blend of hybrid brokerage is adopted by the markets for any given swap product also has little to do with whether the size of a transaction is sufficient or not to be considered a block trade. Block trades concern the size of an order, as opposed to the degree of market liquidity or presence of tight bid-offer spreads. Depending on where block trade thresholds are set, block trades can take place in all markets – from very illiquid markets to highly liquid markets. Yet, central limit order book trade execution generally only works well in markets with deep liquidity, and such liquidity is not always available even within a usually liquid market. For less liquid markets, even non-block size trades depend on a range of trading methodologies distinct from central limit order book or request for quote systems. For these reasons, hybrid brokerage should be clearly recognized as an acceptable mode of trade execution for all swaps whether "required" or "permitted."

In addition, the regulatory framework for the swaps market must take into consideration the significant differences between the trading of futures on an existing exchange and the trading of swaps on SEF platforms. While it may be appropriate, in certain instances, to look to the futures model as instructive, overreliance on that model will not achieve Congress' goal. Congress explicitly incorporated a SEF alternative to the exchange-trading model, understanding that competitive execution platforms provide a valuable market function. Final rules governing SEFs should reflect Congressional intent and promote the growth of existing competitive, vibrant markets without impeding liquidity formation.

While certain requirements should be mandated during trade execution (*i.e.*, audit trail, trade processing and reporting), limitations on methodologies used in trade execution should be considered carefully and weighed against potential implications on liquidity formation. A rules regime that is overly prescriptive will reduce the ability for SEFs to match buyers and sellers and restrict trading liquidity, to the detriment of all market participants, including end-users.

2. Importance of Harmonization between U.S. Agencies and Foreign Regulators

While the substance of the proposed requirements for SEF registration and core principles are extremely important, it is equally, if not more, important that the final regulatory frameworks are harmonized between the CFTC and SEC. A failure to achieve harmonization will lead to regulatory arbitrage and unreasonably burden market participants with redundant compliance requirements. As the recent SEC CFTC joint proposed rule recognized, "a Title VII instrument in which the underlying reference of the instrument is a 'narrow-based security index' is considered a security-based swap subject to regulation by the SEC, whereas a Title VII instrument in which the underlying reference of the instrument is a security index that is not a narrow-based security index (*i.e.*, the index is broad-based), the instrument is considered a swap subject to regulation by the CFTC."[5]

Any discrepancy in the Commissions' regulatory regimes will give market participants incentive to leverage the slight distinctions between these products to benefit from more lenient rules. Dodd-Frank's framework was constructed to encourage the growth of a vibrant, competitive marketplace of regulated SEFs. Final rules should be crafted that encourage the transaction of OTC swaps on these trading systems or platforms, as increased SEF trading will increase liquidity and transparency for market participants and increase the speed and accuracy of trade reporting to swap data repositories ("SDRs"). Certain provisions relate to these points, such as the permitted methods of trade execution, the scope of market entities granted impartial access to SEFs, the formulation of block trade thresholds and compliance with SEF core principles in a flexible manner that best recognizes the unique characteristics of competitive OTC swaps markets.

Based upon the WMBAA's review of both the SEC and the CFTC's proposed rules, the Commissions should consider the release of further revised proposed rules incorporating comments received for additional review and comment by market participants. This exercise would ensure that the SEC and CFTC have the opportunity to review each of their proposals and integrate appropriate provisions from the proposed rules and comments in order to arrive at more comprehensive regulations. Further, the CFTC and SEC are encouraged to work together to attempt to harmonize their regulatory regimes to the greatest extent possible. While some of the rules will differ as a result of the particular products subject to each agency's jurisdiction, inconsistent rules will make the implementation for SEFs overly burdensome, both in terms of time and resources. As an example, the CFTC and the SEC should adopt one common application form for the registration process. While regulatory review of the application by the two agencies is appropriate, reducing the regulatory burden on applicant SEFs to one common form would allow for a smoother, timelier transition to the new regulatory regime. Because the two proposed registration forms are consistent in many respects, the differences between the two proposed applications could be easily reconciled to increase regulatory harmonization and increase efficiency.

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[5] Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 76 Fed. Reg. 29,818, 29, 845 (May 23, 2011).

Similarly, there needs to be a consistent approach with respect to block trades. Not only should the threshold calculations be derived from similar approaches, allowing for tailored thresholds that reflect the trading characteristics of particular products, but the methods of trade execution permitted by the Commissions should both be flexible and within the framework of the SEF definition. U.S. regulations also need to be in harmony with regulations of foreign jurisdictions to avoid driving trading liquidity away from U.S. markets toward markets offering greater flexibility in modes of trade execution. In particular, European regulators have not formally proposed swap execution rules with proscriptive limits on trade execution methodology. We are not aware of any significant regulatory efforts in Europe to mandate electronic execution of cleared swaps by institutional market participants.

In a world of competing regulatory regimes, business naturally flows to the marketplace that has the best regulations – not necessarily the most lenient, but certainly the ones that have the optimal balance of liquidity, execution flexibility and participant protections. U.S. regulations need to be in harmony with regulations from foreign jurisdictions to avoid driving trading liquidity away from U.S. markets towards markets offering greater flexibility in modes of trade execution.

3. Implementation of Final Rules

Compliance Timeline

The timeline for implementation of the final rules is as important as, if not more important than, the substance of the regulations. We recognize and support the fundamental changes to the regulation of the OTC swaps markets resulting from the passage of the Dodd-Frank Act and will commit the necessary resources to diligently meet the new compliance obligations.

However, the CFTC and SEC must recognize that these changes are significant and will result in considerable changes to the operations and complex infrastructure of existing trading systems and platforms. It is necessary that any compliance period or registration deadline provides sufficient opportunity for existing trade execution systems or platforms to modify and test systems, policies and procedures to ensure that its operations are in compliance with final rules. It is very difficult to determine the amount of time needed to ensure compliance with the rules until the final requirements are made available. However, providing market participants with an insufficient time frame for compliance could harm the efficient functioning of the markets if existing entities can no longer operate until they have built the requisite platforms to comply with every measure in final rules.

Appropriate "Phasing" of Final Rules

Based upon the plain language of Dodd-Frank, the mandatory trade execution requirement will become effective at the time that swaps are deemed "clearable" by the appropriate Commission. Accepting the premise that the mandatory trade execution requirement cannot be enforced until there are identified "clearable" swaps and swaps are "made available for trading," the Commissions need to ensure that a functioning and competitive marketplace of registered SEFs exists at the time the first trade is cleared and made available for trading. As such, it is necessary that SEFs be registered with the CFTC or SEC, as applicable, and available to execute transactions at the time that trades begin to be cleared under the new laws. As stated previously, the WMBAA estimates that its members currently account for over 90% of inter-dealer intermediated swaps transactions taking place around the world today. If the SEF registration process is not effectively finalized by the time various swaps are deemed clearable, there could be serious disruptions in the U.S. swaps markets with adverse consequences for broader financial markets.

Furthermore, requiring absolute compliance with final rules within a short time frame is particularly troublesome for likely future SEFs, as such a result may provide DCMs or national securities exchanges with an unfair advantage in attracting trading volume due to their ability to quickly meet the regulatory burdens. Congress distinguished between exchanges and SEFs, intending for competitive trade execution to be made available on both platforms. Congress also recognized the importance of SEFs as distinct from exchanges, noting that a goal of Dodd-Frank is to promote the trading of swaps on SEFs. The phasing in of final rules for both exchanges and SEFs should be done concurrently to ensure that this competitive landscape remains in place under the new regulatory regime.

Not only will implementation of the final rules impact market infrastructure, but the timing in which these rules are implemented could significantly impact U.S. financial markets. As Commissioner Jill Sommers recently remarked before the House Agriculture General Farm Commodities and Risk Management Subcommittee, "a material difference in the timing of rule implementation is likely to occur, which may shift business overseas as the cost of doing business in the U.S. increases and create other opportunities for regulatory arbitrage."[6] If the U.S. regulations are implemented before foreign regulators have established their intended regulatory framework, it could put U.S. markets at a significant disadvantage and might result in depleted liquidity due to regulatory arbitrage opportunities.

As the rulemaking process moves forward, we suggest the following progression of rules be completed:

- First, finalize product definitions. Providing the market with certainty related to the scope of what constitutes a "swap" and "security-based swap" will allow market participants to accurately gauge the impact of the other proposed rules and provide constructive feedback on those rules.

- Second, implement final rules related to real-time reporting for regulatory oversight purposes. The submission of information to SDRs is an activity that takes place in many OTC markets today and will not unduly burden those who must comply with the requirement. Ensuring that the Commissions receive current, accurate market data is a cost-effective method to mitigate systemic risk in the short-term.

- Next, establish block trade thresholds and finalize public reporting rules. The information gathered by SDRs since the implementation of the mandatory trade

[6] Statement of Jill E. Sommers before the Subcommittee on General Farm Commodities and Risk Management, House Committee on Agriculture, May 25, 2011, available at http://agriculture.house.gov/pdf/hearings/Sommers110525.pdf.

reporting requirement, along with historical data made available by trade repositories and trade execution facilities, can be used to determine the appropriate threshold levels on a product-by-product basis. At the same time, public reporting rules can be put into place, including an appropriate time delay (that is consistent with European and the other major global market rules) for block trades.

- After the reporting mechanics have been established, the clearing mandate can be implemented. During this step, the Commissions can determine what swaps are "clearable" and subject to the clearing mandate, and clearinghouses can register and begin to operate within the new framework.

- Finally, once swaps are deemed clearable, the mandatory trade execution requirement can be put into place for SEFs and DCMs for those products made available for trading. All clearable swaps will be made available for trading by SEFs, as these trade execution platforms compete to create markets and match counterparties. With the trade execution requirement's implementation, it is imperative that rules for SEFs and DCMs are effective at the same time, as implementing either entity's rules prior to the other will result in an unfair advantage for capturing market share of executable trades simply because they could more quickly meet the regulatory burdens.

Taking adequate time to get the Title VII regulations right will expedite the implementation of the worthy goals of Dodd-Frank: central counterparty clearing and effective trade execution by regulated intermediaries in order to provide end users with more competitive pricing, increased transparency and deeper trading liquidity for their risk management needs.

4. Flexible Approach to SEF Registration, Impartial Access, and Other Areas of Concern

We support a flexible approach to evaluating applicant SEFs. As noted above, Congress recognized and mandated by law trade execution "through any means of interstate commerce," establishing a broad framework that permits multiple modes of swap execution, so long as the proposed mode of execution is capable of satisfying the statutory requirements.

Moreover, any interpretation of the SEF definition must be broad, and any trading system or platform that meets the statutory requirements should be recognized and registered as a SEF. The new regulatory framework should allow any SEF applicant that meets the statutory requirements set forth in Dodd-Frank to be permitted to operate under each Commission's rules in accordance with Dodd-Frank.

BGC and the WMBAA strongly support the SEC's interpretation of the SEF definition as it applies to trade execution through any means of interstate commerce, including request for quote systems, order books, auction platforms or voice brokerage trading, because such an approach is consistent with the letter and spirit of Dodd-Frank and ensures flexibility in the permitted modes of execution. The WMBAA believes that this approach should be applied consistently to all trading systems or platforms and will encourage the growth of a competitive marketplace of trade execution facilities.

Further, we are concerned with the CFTC's interpretation of the SEF definition, as it limits the permitted modes of trade execution, specifically restricting the use of voice-based systems to block trades. The SEF definition and corresponding requirements in the CEA, as amended by the Dodd-Frank Act, do not provide any grounds for this approach and will severely impair other markets that rely on voice-based systems (or hybrid systems, which contain a voice component) to create liquidity.

Impartial Access to SEFs

The WMBAA is concerned that the CFTC's proposed mandate that SEFs provide impartial access to independent software vendors ("ISVs") is beyond the legal authority in the CEA because it expands the impartial access provision beyond "market participants" to whom access is granted under the statute. Moreover, because SEFs are competitive execution platforms, a requirement to provide impartial access to market information to ISVs who lack the intent to enter into swaps on a trading system or platform will reduce the ability for market participants to benefit from the competitive landscape that provides counterparties with the best possible pricing. Further, given the lack of a definition of what constitutes an ISV and the significant technological investments made by wholesale brokers to provide premiere customer service, the ISV impartial access requirement leaves open the possibility that SEFs could qualify as ISVs in order to seek access to competitors' trading systems or platforms. This possibility would defeat the existing structure of competitive sources of liquidity, to the detriment of market participants, including commercial end users.

The WMBAA also believes the SEC should review its proposed impartial access provisions to ensure that impartial access to the SEF is different for competitor SEFs or national exchanges than for registered security-based swap dealers, major security-based swap participants, brokers or eligible contract participants. Congress clearly intended for the trade execution landscape after the implementation of Dodd-Frank to include multiple competing trade execution venues, and ensuring that competitors cannot access a SEF's trading system or platform furthers competition, to the benefit of the market and all market participants.

Regulations Should Not Favor Execution on Particular Venues

The WMBAA believes that it is critically important that the Commissions' regulations not favor trade execution on exchanges over SEFs. An important part of the Dodd-Frank competitive landscape is that derivatives clearing organizations ("DCOs") accept trades from all execution platforms and not advantage certain trading systems or platforms over others.

WBMAA is concerned that certain proposed regulations will frustrate the development of a truly competitive landscape. For instance, one of the CFTC's proposed rules (proposed Regulation 39.13(g)(2)) would require a DCO to use a five-business day liquidation horizon for cleared swaps that are not executed on a designated contract market ("DCM"), but would permit a DCO to use a one-business day liquidation horizon for all other products that it clears, including swaps that are executed on an affiliated DCM.

The WMBAA believes that this disparity is ill-founded. In the case of two economically identical instruments - one executed on a SEF and one executed on a DCM - the liquidation horizon for each should depend upon liquidity characteristics such as average daily volume, standard deviation of average daily volume and open interest. To require a longer horizon simply because one of the two is traded on a SEF rather than on a DCM is harmful, discriminatory and based upon a flawed understanding of market dynamics. More fundamentally, the WMBAA believes that this disparity is inconsistent with the provisions of Section 2(h)(1)(B) of the Commodity Exchange Act.

The WMBAA also believes that eliminating the disparity described above is consistent with the competitive landscape that Congress intended to establish for SEFs and DCMs. Dodd-Frank is designed to encourage competition between SEFs and DCMs with respect to the trading of swaps, in part by rejecting the "vertical silo" model that has traditionally been employed in the futures markets.

Interim or Temporary SEF Registration

The implementation of any interim or temporary registration relief must be in place for registered trading systems or platforms at the time that swaps are deemed "clearable" by the Commissions to allow such platforms to execute transactions at the time that trades begin to be cleared. Interim or temporary registration relief would be necessary for trading systems or platforms if sequencing of rules first addresses reporting to SDRs and mandatory clearing prior to the mandatory trade execution requirement. The Commission is strongly encouraged to provide prompt provisional registration to existing trade execution intermediaries that intend to register as a SEF and express intent to meet the regulatory requirements within a predetermined time period. To require clearing of swaps through derivatives clearing organizations without the existence of the corresponding competitive trade execution venues risks inconsistent implementation of the Dodd- Frank Act and could have a disruptive impact on market activity and liquidity formation, to the detriment of market participants.

At the same time, a temporary registration regime should ensure that trade execution on SEFs and exchanges is in place without benefitting one execution platform over another. Temporary registration for existing trade execution platforms should be fashioned into final rules in order to avoid disrupting market activity and provide a framework for compliance with the new rules. The failure of the Commissions to provide interim or temporary relief for existing trading systems or platforms may alter the swaps markets and unfairly induce market participants to trade outside the U.S. or on already-registered and operating exchanges.

The 15 Second Rule

There does not appear to be any authority for the CFTC's proposed requirement that, for "Required Transactions," SEFs must require that traders with the ability to execute against a customer's order or execute two customers against each other be subject to a 15 second timing delay between the entry of those two orders ("15 Second Rule"). One adverse impact of the proposed 15 Second Rule is that the dealer will not know until the expiration of 15 seconds whether it will have completed both sides of the trade or whether another market participant will have taken one side. Therefore, at the time of receiving the customer order, the dealer has no way of knowing whether it will ultimately serve as its customer's principal counterparty or merely as its executing agent. The result will be greater uncertainly for the dealer in the use of its capital and, possibly, the reduction of dealer activities leading, in turn, to diminished liquidity in and competitiveness of U.S. markets with costly implications for buy-side customers and end users.

While this delay is intended by the CFTC to ensure sufficient pre-trade transparency, under the CEA, transparency must be balanced against the liquidity needs of the market. Once a trade is completed when there is agreement between the parties on price and terms, any delay exposing the parties to that trade to further market risk will have to be reflected in the pricing of the transaction, to the detriment of all market participants.

Ensuring that Block Trade Thresholds are Appropriately Established

The most important aspect to ensuring that appropriate block sizes are set, is for the Commission to integrate the new reporting requirements first, and than establish block trade thresholds based on the comprehensive and reliable market data produced from these reporting requirements. From the perspective of intermediaries who broker transactions of significant size between financial institutions, it is critical that the block trade threshold levels and the reporting regimes related to those transactions are established in a manner that does not impede liquidity formation. A failure to effectively implement block trading thresholds will frustrate companies' ability to hedge commercial risk. Participants rely on swaps to appropriately plan for the future, and any significant changes to market structure might ultimately inhibit economic growth and competitiveness.

Establishing the appropriate block trade thresholds is of particular concern for expectant SEFs because the CFTC's proposal regarding permitted modes of execution restricts the use of voice-based systems solely for block trades. While WMBAA believes that this approach is contrary to the SEF definition (as discussed above), which permits trade execution through any means of interstate commerce, this approach, if combined with block trade thresholds that are too high for the particular instrument, would have a negative impact on liquidity formation.

With respect to block trade thresholds, the liquidity of a market for a particular financial product or instrument depends on several factors, including the parameters of the particular instrument, including tenor and duration, the number of market participants and facilitators of liquidity, the degree of standardization of instrument terms and the volume of trading activity. Compared to commoditized, exchange-traded products and the more standardized OTC instruments, many swaps markets feature a broader array of less-commoditized products and larger-sized orders that are traded by fewer counterparties, almost all of which are institutional and not retail. Trading in these markets is characterized by variable or non-continuous liquidity. Such liquidity can be episodic, with liquidity peaks and troughs that can be seasonal (e.g., certain energy products) or more volatile and tied to external market and economic conditions (e.g., many credit, energy and interest rate products).

As a result of the episodic nature of liquidity in certain swaps markets combined with the presence of fewer participants, I and my fellow WMBAA members believe that the CFTC and SEC need to carefully structure a clearing, trade execution and reporting regime for block trades that is not a "one size fits all" approach, but rather takes into account the unique challenges of fostering liquidity in the broad range of swaps markets. Such a regime would provide an approach that permits the execution of transactions of significant size in a manner that retains incentives for market participants to provide liquidity and capital without creating opportunities for front-running and market distortion.

To that end, we support the creation of a Swaps Standards Advisory Committee ("Advisory Committee") for each Commission, comprised of recognized industry experts and representatives of registered SDRs and SEFs to make recommendations to the Commissions for appropriate block trade thresholds for swaps. The Advisory Committee would (1) provide the Commissions with meaningful statistics and metrics from a broad range of contract markets, SDRs and SEFs to be considered in any ongoing rulemakings in this area and (2) work with the Commissions to establish and maintain written policies and procedures for calculating and publicizing block trade thresholds for all swaps reported to the registered SDR in accordance with the criteria and formula for determining block size specified by the Commissions.

The Advisory Committee would also undertake market studies and research at its expense as is necessary to establish such standards. This arrangement would permit SEFs, as the entities most closely related to block trade execution, to provide essential input into the Commissions' block trade determinations and work with registered SDRs to distribute the resulting threshold levels to SEFs. Further, the proposed regulatory structure would reduce the burden on SDRs, remove the possibility of miscommunication between SDRs and SEFs and ensure that SEFs do not rely upon dated or incorrect block trade thresholds in their trade execution activities. In fact, WMBAA members possess historical data for their segment of the OTC swap market which could be analyzed immediately, even before final rules are implemented, to determine appropriate introductory block trade thresholds, which could be revised after an interim period, as appropriate.

5. Wholesale Brokers, CROs, and the Responsible Oversight of SEFs

The WMBAA members look forward to performing our designated roles as SEFs under DFA. The wholesale brokerage industry is working hard and collaboratively with the two Commissions to inform and comment on proposed rules to implement DFA. The WMBAA has submitted several comment letters[7] and expects to provide further written comments to the CFTC and SEC. The WMBAA has also hosted the first conference, SEFCON 1,[8] dedicated specifically to SEFs, and is currently making arrangements for a second SEFCON later this year. Further, the WMBAA has conducted numerous meetings with Commissioners and staffs. We and the wholesale brokerage industry are determined to play a constructive role in helping the SEC and the CFTC to get the new regulations under Title VII of DFA right.

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[7] *See* Comment Letter from WMBAA (November 19, 2010) ("11/19/10 WMBAA Letter"); Comment Letter from WMBAA (November 30, 2010) ("11/30/2010 WMBAA Letter"); 1/18/11 WMBAA Letter; Comment Letter from WMBAA (February 7, 2011) ("2/7/11 WMBAA Letter"); and Comment Letter from WMBAA (June 3, 2011) ("6/3/11 WMBAA Letter").

[8] SEFCON 1 was held in Washington, D.C. on October 4, 2010. The keynote address was given by CFTC Commissioner Gary Gensler.

It is clear, however, that the implementation of Dodd-Frank will create a host of new obligations for both SEFs and regulatory agencies. These include requirements that are typical for exchanges and self-regulatory organizations, such as requirements to (1) establish, investigate, and enforce rules; and (2) monitor trading and obtain information necessary to prevent manipulation.

Many likely SEFs are not currently regulated as exchanges, but rather as futures commission merchants ("FCMs"), broker-dealers or, where applicable, as alternative trading systems ("ATS"). As a result, these entities have familiarity with the rules of one or more self-regulatory organizations, such as FINRA or the NFA, which together with the Commission and the CFTC, will perform many of the regulatory functions assigned by the Dodd-Frank Act to SEFs.

In order to facilitate the development and success of SEFs, the WMBAA proposes the establishment of a CRO that will facilitate all SEFs compliance with the core principles. Membership in the CRO would be voluntary and open to any entity intending to register as SEF, though member SEFs would be contractually bound to abide by the rules. Further, as a voluntary organization, the CRO would not necessarily need legislative or rulemaking authority to proceed. The creation of a CRO would also prevent market participants from selectively choosing which SEF to use based upon the leniency of its rules regime. The WMBAA believes that an industry-wide standards body would best ensure the integrity of the swaps market and protect market participants from abusive trading practices. Moreover, by acting as an intermediary for compliance by its members, the CRO would simplify the CFTC's and SEC's oversight responsibilities for SEFs.

Conclusion

Dodd-Frank seeks to reengineer the U.S. swaps market on three key pillars: recordkeeping and reporting; central counterparty clearing; and the mandatory intermediation of clearable trades through registered intermediaries such as SEFs. Wholesale brokers are today's central marketplaces in the global swaps markets and, as such, can be the prototype of SEFs.

Liquidity in today's swaps markets is fundamentally different than liquidity in futures and equities markets and naturally determines the optimal mode of market transparency and trade execution. Wholesale brokers are experts in fostering liquidity in non-commoditized instruments by utilizing methodologies for price dissemination and trade execution that feature a hybrid blend of knowledgeable qualified voice brokers and sophisticated electronic technology. Wholesale brokers' varied execution methodologies are specifically tailored to the unique liquidity characteristics of particular swaps markets.

It is critical that regulators gain a thorough understanding of the many modes of swaps trade execution currently deployed by wholesale brokers and accommodate those methods and practices in their SEF rulemaking. Too many of the SEC's and CFTC's Title VII proposals are based off of rules governing the equities and futures markets and are ill-suited for the fundamentally different liquidity characteristics of today's swaps markets.

We appreciate the Commissions' recognition of the deliberation and thought necessary to get these rules right, and are generally supportive of the phase-in approach being pursued. Rushing the rule making process and getting things wrong will negatively impact market liquidity in the US swaps markets, disturbing businesses' ability to hedge commercial risk, to appropriately plan for the future and, ultimately, stifle economic growth and job creation. Taking adequate time to get the Title VII regulations right will expedite the implementation of the worthy goals of Dodd-Frank: central counterparty clearing and effective trade execution by regulated intermediaries in order to provide end users with more competitive pricing, increased transparency and deeper trading liquidity for their risk management needs.

With Congress' help, and the input and support of the swaps industry, regulators can continue their dedicated efforts at well-crafted rule making. If we are successful, our U.S. financial system, including the U.S. swaps markets, can once again be the well ordered marketplace where the world comes to trade.

Thank you for your consideration. I look forward to answering any questions that you may have.