



March 24, 2010

Darrell Duffee, Ada Li, Theo Lubke
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

Re: Policy Perspectives on OTC Derivatives Market Infrastructure

Dear Mr. Duffee, Ms. Li and Mr. Lubke,

The Wholesale Markets Broker's Association, Americas ("WMBAA" or the "Association"), appreciates the opportunity to comment on the Federal Reserve Bank of New York's (the "Fed") Staff Report on "Policy Perspectives on OTC Derivatives Market infrastructure" (the "Report").

The WMBAA is an independent industry body representing the largest wholesale and Interdealer Brokers ("IDBs") operating in the North American wholesale markets across a broad range of financial products. IDBs serve as intermediaries for banks and other financial institutions that facilitate access to a full range of OTC and exchange-traded products and their associated derivatives. IDBs are registered broker/dealers for securities activities and are regulated by numerous agencies, including the SEC, the Federal Reserve and, for relevant markets, the CFTC.

Each day, IDBs collectively handle on average two million OTC trades globally corresponding to about \$5 trillion in notional amount, across the range of FX, securities, interest rate, credit, equity and commodity asset classes in both cash and derivative forms.

While the debate may continue regarding appropriate legislative actions to further strengthen the OTC Derivatives market, we welcome the opportunity to participate in the activities underway within the industry to achieve these goals. Acting as a single voice among competitors in the IDB space, the Association strives to provide insights into the core of the interdealer markets.

We have, in our comments, made the assumption that the term electronic trade platform ("ETP") is synonymous with electronic platforms run by IDBs.

Summary of WMBAA's Views

- The Fed has made outstanding progress in its efforts to bring greater transparency to the derivatives markets. We support your efforts to reduce risk in derivatives products without diminishing the value of a robust market that provides liquidity and stability.
- Fair and open and non discriminatory access to Clearing Houses and Central Counterparties (“CCPs”) are critical to ensure competition and innovation that is in the best interest of the economy.
- Increased anonymous central counterparty clearing will broaden the institutions participating on ETPs and will attract additional market makers
- Certain OTC derivative trades should remain bilateral, to maintain the availability of customized products that companies need to best manage their risk.
- Exchanges do not necessarily provide the transparency and effective competition that regulators are seeking
- The flexibility provided by a wide array of brokerage (ranging from voice, to hybrid to electronic) has proven effective as a critical component to generating adequate liquidity for a wide range of products.
- Pre- and post trade transparency to market participants can be achieved equally through exchange traded transactions reported to a CCP and OTC traded transactions reported to a CCP.
- The flexibility in modes of execution offered by the IDBs best suits the trading needs of the market participants in the OTC derivative markets and has proven effective as a critical component to aggregating liquidity as products become more standardized.
- The aggregate price and volume information regulators and investors need is currently available through many mediums.
- A TRACE-like post-trade price transparency system could provide non market participants the same post trade price transparency which is currently available in the corporate and municipal bond market today.
- Pre-trade price transparency and/or real time trade reporting may have a chilling effect on a firm's willingness to take on risk as it may affect its ability to hedge its risk.

Discussion of WMBAA's Views

- **Central Counterparty Clearing**

The Association strongly supports the Fed's position that there be fair, open and non-discriminatory access to CCPs. We agree with the Fed's interest in the use of CCPs for any product that is deemed by the regulators to be sufficiently liquid and standardized. The Association believes the Fed's recognition of the need for many instruments, especially those

March 24, 2010

Page 3

which are highly customized or in their early stages of development in the OTC markets, to remain bilateral is appropriate.

- **Exchanges and Electronic Trading Platforms**

The Association strongly agrees with the Fed in its assessment that not all OTC derivative trading should be forced on exchanges, as this would disrupt well established marketplaces and do nothing to reduce systemic risk, promote transparency or provide for greater regulatory oversight. The US Treasury wholesale market is a perfect example to illustrate the principle that CCP cleared markets need not be on an exchange at all. The existing inter-dealer networks and execution platforms are ideal, innovative and competitive existing pools of liquidity (which arranges trillions of dollars of security and non-security based swaps), which currently, and in the future, can meet regulatory requirements.

However, the Association disagrees with the statement that exchanges necessarily provide effective competition. In fact the idea of futures exchanges offering “effective competition” has been seriously questioned by the Departments of Treasury and the Justice Department. The Justice Department observed in a 2008 comment letter to the Treasury Department that where a central counterparty clearing facility is affiliated with an execution exchange (such as in the case of US 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 in the comment letter’s summary, “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.

In the IDB-brokered markets, the market participants enjoy full transparency both pre-trade and post-trade through voice brokerage, ETPs or hybrid trading (a combination of voice and ETP). The Association believes that this flexibility in the means of execution responds best to the variety of trading needs of the market participants in these markets as they evolve and that electronic-only trading is not suitable for all products, trading strategies or markets conditions. Trading of illiquid and more customized products generally occurs through interaction involving brokers, which are capable post-trade of deploying electronically trade capture, trade reporting, and straight through processing.

March 24, 2010

Page 4

To exemplify again, large swathes of both equity derivative and energy derivative markets exhibit many of the characteristics of an efficient IDB market. Single-name equity options and natural gas basis swaps, for instance, are both traded OTC, novated by CCPs within minutes of execution, and clearing corporations monitor risk with margin payments and act as counterparties to trades. This arrangement provides participants with multiple competitive execution platforms and varying levels of electronic, voice or hybrid execution options.

Many of the regulatory goals sought to be achieved are already within the capabilities of IDBs. Association member firms possess advanced technological and record-keeping and reporting capabilities and can provide the CFTC, the SEC and banking regulators with real-time trading information, affording identification of: (i) suspicious trading activities, (ii) inappropriate levels of credit and market risk in given marketplaces and (iii) critical information on overall financial conditions and market dynamics.

Market Participants on ETPs

The Report further states that “ETPs typically serve only a narrow range of major market participants, including dealers.” Being marketplaces of dealers, ETPs are constrained in the number of participants using them by prevailing, and asset-class specific, conventions of what constitutes a “dealer.” The range is not of our doing. In many instances, the regulators determine what regulatory standard must be met in order for an entity/person to participate in a market. Examples would be the CFTC’s requirements for market participants to be eligible contract participants (“ECPs”). These regulatory standards are adhered to strictly as many of these markets are not suitable for unsophisticated investors. Only those entities meeting the regulatory standards should be given access. However, a shifting of those conventions, broadening which institutions can be regarded as “dealers” and thereby admitting them into the interdealer markets via ETPs, might mitigate concerns of over-concentration in certain products voiced by legislators and regulators alike. Importantly, such a shift would more seamlessly occur in an environment where anonymous central counterparty clearing is the norm. An ideal example of ETP participation is the OTC Spot Foreign Exchange market which serves a broad and diverse range of market participants. These markets reflect the benefits of operating OTC marketplaces that are focused on establishing and maintaining optimal levels of liquidity, not on limiting participants.

Pricing Transparency Exchange vs. ETP

The Association disagrees with the Report’s view that “prices offered through ETPs are generally indicative quotes.” This is not accurate. IDBs can through their ETPs offer various forms of intermediation, often on the same platform, including pure dealer automation, broker input/electronic execution and broker execution/electronic confirmation. Prices may be firm or

indicative and would be noted as such. For example, there are numerous examples of platforms developed and supported by Association member firms that broadcast live, executable prices in US Treasuries, Agencies, Mortgages, Repo, CDS, Energy, Emerging Markets and others. The report additionally states that exchanges provide real price transparency, however this depends on how transparency is defined. Generally it is defined as the bid or offer at where a small transaction may be executed. The Association believes ETPs provide the same level of price transparency for market participants. ETPs also have similar volume limitations, inherent in individually negotiated transactions, to an exchange's published screen quotes, whether through a broker or single dealer platforms. There is a different price to execute a 100 share stock order than the price to execute a 1,000,000 share order. The difference in the size of the trade effectively makes them different transactions. This is no different from what occurs on exchanges today.

Liquidity Standards for Exchange Trading

There are several references in the Report which state that there may be sufficient liquidity for exchange trading. However there are no objective standards to determine when this is appropriate. In addition, the Report does not differentiate between the trading modality and its relationship to central counterparty clearing. We are concerned with the uncertainty of who will make this decision and the criteria upon which such a decision will be based. In practically every example where IDB-led OTC markets compete pari passu with an exchange for a particular product, volumes transacted on the former far outweigh those on the latter.

- **Increase Market Transparency with Publicly Available Aggregate Price and Volume Information**

With respect to the availability of pricing for collateral purposes, IDBs and market data providers, such as Bloomberg and Thomson Reuters provide OTC market transparency through publication of unbiased and independent market data and pricing data before, during and after trades are executed. The information collected, maintained and generated by IDBs also provides transparency by facilitating enhanced audit trails, which can be used by market regulators in monitoring for fraud and manipulation in the markets.

The report references the need for greater protection of "unsophisticated or uninformed market participants." It is the Association's belief that unsophisticated and uninformed parties should not be market participants in (many of) the OTC derivative markets.

- **Improve level of Price Reporting**

Much of what is contemplated for Swap Execution Facilities is already well within the advanced technological and record-keeping capabilities of our member firms. Our technology-based reporting systems can provide the CFTC, the SEC and banking regulators with real-time trading information, affording identification of: (i) suspicious trading activities, (ii) inappropriate levels of credit and market risk in given marketplaces and (iii) critical information on overall financial conditions and market dynamics. We also provide transparency into the over-the-counter markets through the publication of market and pricing data, facilitating enhanced audit trails, to monitor against market fraud and manipulation.

In the interdealer-brokered markets, participants enjoy full transparency both pre-trade and post-trade through voice brokerage, ETPs or hybrid trading (a combination of voice and ETP). A TRACE-like post-trade price transparency system could provide non-market participants the same post trade price transparency which is currently available in the corporate and municipal bond market today.

Although Association members do demonstrate the highest levels of conformity to TRACE reporting requirements today, we would caution on how quickly this information should be reported. There have been conflicting analyses of data as to the effects of TRACE reporting on market efficiency (liquidity) in covered markets.

The transaction size in the potentially affected OTC markets is significantly larger than in those instruments currently subject to TRACE reporting. The immediate publication of these transactions may unfairly disadvantage those participants needing to effect large trades without disrupting existing market liquidity and pricing. This will lead to wider bid/ask spreads given the lack of a window to hedge exposures and would encourage purely speculative behavior by others who would otherwise not be involved in the transactions, eventually draining liquidity and destroying the credibility of the market/instrument.

The Association is concerned that intraday aggregated data disclosure could also be misleading (i.e., a large transaction is posted which reflects the offset of either a prior transaction or a transaction in a related market). It may also unfairly disadvantage certain participants by alerting the market before the party has had a reasonable opportunity to hedge their risk exposure. If market participants come to expect the publication of these “private” activities, it will quickly widen spreads and transaction costs, to the benefit of only those actors who act in a predatory manner with the information. For similar reasons, the Association strongly questions the validity of pre-trade transparency in light of the need to allow some measure of freedom to hedge to “dealers” to whom risk has been transferred.

March 24, 2010

Page 7

If you have questions or comments about our letter, please contact me. The Association hopes that it can continue this valuable dialogue with you and your colleagues.

We thank you for the chance to share our views with you regarding your Staff Report and look forward to discussing these comments in the near future.

Sincerely,

Christopher Giancarlo/pp. du
Christopher Giancarlo
Chairman