Testimony

Before
The House Committee on Financial Services

On

Implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act

February 15, 2011

J. Christopher Giancarlo,
Executive Vice President,
GFI Group Inc.
Board Member, WMBAA

Testimony of
J. Christopher Giancarlo
February 15, 2011

Introduction.

Thank you Chairman Bachus, Ranking Member Frank and members of the Committee for providing this opportunity to participate in today's hearing. I am Chris Giancarlo, Executive Vice President of GFI Group Inc., a global wholesale broker of swaps and other financial products[1]. I am also a member of the Board and former Chairman of the Wholesale Markets Brokers Association, Americas (the "WMBAA")[2]. I welcome this opportunity to discuss with you implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" or "DFA") from the perspective of the primary intermediaries of over-the-counter swaps operating today here in the United States and across the globe.

In my testimony today, I will contend that:

- Wholesale brokers are today's central marketplaces in the global swaps markets and, as such, are the prototype of swap execution facilities or "SEFs".

- 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 brokers and sophisticated electronic technology.

- 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.

---

[1] GFI Group Inc. (NYSE: GFIG) is a leading provider of wholesale brokerage, clearing services, electronic execution and trading support products for global financial markets. GFI Group Inc. provides brokerage services, market data, trading platform and analytics software products to institutional clients in markets for a range of fixed income, financial, equity and commodity instruments. Headquartered in New York, GFI was founded in 1987 and employs more than 1,900 people with additional offices in London, Paris, Hong Kong, Seoul, Tokyo, Singapore, Sydney, Cape Town, Santiago, Dubai, Dublin, Tel Aviv, Calgary, Los Angeles, Bogota, Englewood (NJ) and Sugar Land (TX). GFI Group Inc. provides services and products to over 2,400 institutional clients, including leading investment and commercial banks, corporations, insurance companies and hedge funds. Its brands include GFI℠, GFInet®, CreditMatch®, GFI ForexMatch®, EnergyMatch®, FENICS®, Starsupply®, Amerex®, Trayport® and Kyte®.

[2] The WMBAA is an independent industry body representing the largest inter-dealer brokers ("IDBs") 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.

- Wholesale brokers' trading methodologies for price dissemination and trade execution 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 trading practices in their SEF rulemaking.

- Too many of the SEC's and CFTC's Title VII proposals are based off rules governing the equities and futures markets and are ill-suited for the fundamentally different liquidity characteristics of today's swaps markets.

- Three critical elements that regulators need to get right under Title VII are:
    - SEFs must not be restricted from deploying the many varied and beneficial trade execution methodologies and technologies successfully used today to execute swaps transactions;
    - The "goal" of pre-trade transparency must be realized through means that do not destroy market liquidity for market participants and end users; and
    - Regulators need to carefully structure a public trade reporting regime that is not "one size fits all", but rather takes into account the unique challenges of fostering liquidity in the diverse range of swaps markets.

- As the WMBAA has proposed[3], a block trade standards advisory board (the "Swaps Standards Advisory Board") should be established and made up of recognized experts and representatives of registered SDRs and SEFs to make recommendations to the SEC and CFTC for appropriate block trade thresholds for swaps and security based swaps.

- Congress can assist with technical corrections to Dodd-Frank and, crucially, by providing regulators with adequate time and resources to thoroughly understand the challenges and current solutions to garnering trading liquidity in the swaps markets.

- 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.

[3] *See* Comment Letter from WMBAA (January 18, 2011) (" 1/18/11 WMBAA Letter"). .

Background on GFI and Wholesale Brokers.

My firm, GFI Group, is a US publicly-traded company listed on the New York Stock Exchange with almost two thousand employees in four US cities and over 16 countries. We provide a marketplace for institutional buyers and sellers of OTC financial products where their trading needs can be matched with sophisticated counterparties having reciprocal interests in a transparent, yet anonymous, environment. To persons unfamiliar with our business, I often describe GFI as something as a virtual trading floor where large financial institutions buy and sell financial products that rarely trade on an exchange.

As we sit here today, GFI and its competitors are facilitating the execution of hundreds of thousands of OTC trades corresponding to an average of $5 trillion in size across the range of foreign exchange, interest rate, Treasury, credit, equity and commodity asset classes in both cash and derivative instruments. We are wholesale brokers (sometimes called "inter-dealer" brokers). WMBAA member firms account for over 90% of intermediated swaps transactions taking place around the world today. Our industry does not serve household or retail customers. Rather, we operate at the center of the global wholesale financial markets by aggregating and disseminating prices and fostering trading liquidity for financial institutions around the world. The roots of our industry go back over a century in the world's major financial centers. Our activities in many of the markets we serve today are highly regulated. GFI businesses are subject to oversight in the United States by the SEC, NASD, FINRA and CFTC, in the UK by the FSA and globally by regulatory agencies in France, Singapore, Hong Kong, Japan and Korea. In fact, our sister trade association in London was formed several decades ago by request of the Bank of England to represent the interests of the industry to regulators and in Parliament.

Wholesale brokers provide highly sophisticated 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 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 "exchanges." Instead, as competing execution venues, 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, major industrial firms, integrated energy and major oil companies, utilities and governmental and sovereign entities.

Increasingly, better service means 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, GFI's customers in certain of our more complex, less commoditized markets may choose among utilizing our CreditMatch®, GFI ForexMatch® or EnergyMatch® electronic brokerage platforms to trade a range of fixed income derivatives, foreign exchange options, energy derivatives and emission allowances entirely on screen or they can execute the same transaction through instant messaging devices or over the telephone with qualified GFI brokers supported by sophisticated electronic technology. In addition, GFI's Trayport subsidiary is a provider of electronic trading software and services to other wholesale brokers and exchanges around the world (such as the CME and Intercontinental Exchange) and to energy trading desks across a broad swath of the European energy markets.[4]

The critical point is that competition in the marketplace for transaction services has led GFI and competing firms 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 over the counter 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 our 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.

Fostering Liquidity in Swaps Markets.

The essential role of a wholesale broker is to enhance trading liquidity. In essence, liquidity is the degree to which a financial instrument is easy to buy or sell quickly with minimal price disturbance. The liquidity of a market for a particular financial product or instrument depends on several factors, including the parameters of the particular instrument such as tenor and duration of a swap, the degree of standardization of instrument terms, the number of market participants and facilitators of liquidity, and the volume of trading activity. Liquid markets are characterized by substantial price competition, efficient execution and high trading volume.

While the relationship between exchange-traded and OTC markets generally has been complimentary, each market provides unique services to different trading constituencies for products with distinctive characteristics and liquidity needs. As a result, <u>the nature of trading liquidity in the exchange-traded and OTC markets is often materially different. It is critically important that regulators recognize the difference</u>.

Highly liquid markets exist for both commoditized, exchange-traded products, and the more standardized OTC instruments, such as U.S. treasury securities, equities and

[4] Trayport supplies critical exchange trading system technology to such commodities and stock exchanges as the Barbados Stock Exchange, Bayerische Borse, the Dutch Caribbean Stock Exchange, the InternationalMaritime Exchange, the Jakarta Stock Exchange and the New Zealand Stock Exchange. GFI's Trayport technology accommodates electronic trading, information sharing, STP capabilities and clearing links in commodity and financial instruments.

certain commodity derivatives. Exchange-traded markets provide a trading venue for the most commoditized instruments that are based on standard characteristics and single key measures or parameters. Exchange-traded markets with central counterparty clearing rely on relatively active order submission by buyers and sellers and generally high transaction flow. Exchange-traded markets, however, offer no guarantee of trading liquidity as evidenced by the high percentage of new exchange-listed products that regularly fail to enjoy active trading. Nevertheless, for those products that do become liquid, exchange marketplaces allow a broad range of trading customers (including retail customers) meeting relatively modest margin requirements to transact highly standardized contracts in relatively small amounts. As a result of the high number of market participants and the relatively small number of standardized instruments traded and the credit of a central counterparty clearer, liquidity in exchange-traded markets is relatively continuous in character.

In comparison, many swaps markets and other less commoditized cash markets feature a broader array of less-standardized 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. To offer one simple example, of the over 4,500 corporate reference entities in the credit default swaps market, 80% trade less than 5 contracts per day.[5] Such thin liquidity can often to be episodic, with liquidity peaks and troughs that can be seasonal (certain energy products) or more volatile and tied to external market and economic conditions (e.g. many credit, energy and interest rate products).

General Comparison of OTC Swaps Markets to Listed Futures Markets[6]

Characteristic	**OTC Swaps**	**Listed Futures**
Trading Counterparties	10s – 100s (no retail)	100,000s (incl. retail)
Daily Trading Volume	1,000s	100,000s
Tradable Instruments	100,000s[7]	1,000s
Trade Size	Very large	Small

Drawing a simple comparison, the futures and equities exchange markets generally handle on any given day hundreds of thousands of transactions by tens of thousands of participants (many retail), trading hundreds of instruments in small sizes. In complete contrast, the swaps markets provide the opportunity to trade tens of thousands of instruments that are almost infinitely variable. Yet, on any given day, just dozens of large institutional counterparties trade only a few thousand transactions in very large notional amounts. .

[5] ISDA & SIFMA, "Block Trade Reporting for Over-the-Counter Derivatives Markets," January 18, 2011, ("ISDA/SIFMA Block Trade Study"). *Available at* http://www.isda.org/speeches/pdf/Block-Trade-Reporting.pdf.

[6] *See* ISDA/SIFMA Block Trade Study.

[7] Inclusive of all tenors, strikes and duration.

The effect of these very different trading characteristics results in fairly continuous liquidity in futures and equities compared with limited or episodic liquidity in swaps. There is richness in those differences, because taken together, this market structure has created appropriate venues for trade execution for a wide variety of financial products and a wide variety of market participants. But the difference is fundamental and a thorough understanding of it must be at the heart of any effective rule making under Title VII of DFA. The distinct nature of swaps liquidity has been the subject of several studies and comment letters presented to the CFTC and the SEC.[8]

It is because of the limited liquidity in many of the swaps markets that they have evolved into "dealer" marketplaces for institutional market participants. That is, corporate end users of swaps and other "buy side" traders recognize the risk that, at any given time, a particular swaps marketplace will not have sufficient liquidity to satisfy their need to acquire or dispose of swaps positions. As a result, these counterparties may chose to turn to well capitalized sell-side dealers that are willing to take on the "liquidity risk" for a fee. These dealers have access to secondary trading of their swaps exposure through the marketplaces operated by wholesale and inter-dealer brokers such as GFI Group. These wholesale marketplaces allow dealers to hedge the market risk of their swaps inventory by trading with other primary dealers and large, sophisticated market participants. Without access to wholesale markets, the risk inherent in holding swaps inventory would cause dealers to have to charge much higher prices to their buy side customers for taking on their liquidity risk, assuming they remain willing to do so.

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 concerning swaps are: one, replacing bilateral trading where feasible with central counterparty clearing, and two, 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 (SEFs)" 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..."[9] 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

[8] ISDA/SIFMA Block Trade Study; Comment Letter of JPMorgan(January 12, 2011) ("JP Morgan Letter"). .
[9] *See* Commodity Exchange Act ("CEA") Section 1a(50).

intertwined thereby giving the exchange an effective execution monopoly over the products that it clears.[10] 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 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.

GFI and its fellow WMBAA members heartily support Dodd-Frank's twin requirements of clearing and intermediation. Their advocacy of swaps clearing predates the legislation and, even, the recent financial crisis.[11] Their advocacy of swaps intermediation is fundamental to their business success in fostering liquidity, developing and deploying sophisticated trading technology tools and systems and operating efficient marketplaces in global markets for swaps and other financial products.

Wholesale Brokers Will Serve as Responsible SEFs.

As noted, GFI and its competitors actively deploy a range of execution services, technologies and other "means of interstate commerce" to display prices to "multiple participants" to connect them with other "multiple participants" in billions of dollars of daily swaps trades. As such, wholesale brokers are the true prototype for prospective independent and competitive SEFs under DFA.

More importantly, GFI and other members of the WMBAA 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[12] (copies attached) and expects to provide further written comments to the CFTC and SEC. The WMBAA has also hosted the first conference, SEFCON 1[13], dedicated specifically to SEFs. Further, the WMBAA has conducted numerous meetings with

---

[10] 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 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 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.htm.

[11] In 2005, GFI Group and ICAP Plc, a wholesale broker and fellow member of the WMBAA, took minority stakes in the Clearing Corp and worked together to develop a clearing facility for credit default swaps. That initiative ultimately led to greater dealer participation and the sale of the Clearing Corp to the Intercontinental Exchange and the creation of ICE Trust, a leading clearer of credit derivative products.

[12] *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").

[13] SEFCON 1 was held in Washington, D.C. on October 4, 2010. The keynote address was given by CFTC Commissioner Gary Gensler. The Closing address was given by Congressman Scott Garrett (NJ-5).

Commissioners and staffs. We and the wholesale brokerage industry are determined to play a constructive role in getting right the new regulations under Title VII of DFA.

Three 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 Swap Execution Facility), three critical elements are:

1. Permitted Modes of Swaps Execution
2. Pre-Trade Price Discovery & Transparency for Market Participants
3. Post-Trade Price Transparency & Reporting

1. Permitted Modes of Execution:

As 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 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, GFI and its competitors provide a range of liquidity fostering methodologies and technologies. These include hybrid modes of: (a) broker work up methods of broadcasting completed trades and attracting others to "join the trade" and (b) 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 texting 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.

GFI and the WMBAA have been active in seeking to educate US regulators about the multiple modes of execution utilized in the swaps markets today. We have given technology demonstrations to regulators in their offices and hosted tours of our New York brokerage operations to CFTC Commissioners O'Malia and Chilton. We are in the process of trying to schedule these educational tours for other CFTC and SEC Commissioners and staff. We understand that budget constraints currently facing these agencies may be a hindrance for additional tours and demonstrations. Yet, we believe it is critical that the CFTC and SEC familiarize themselves with the many modes of execution currently deployed in the marketplace to accommodate the varying characteristics of different swaps markets *before* finalizing the rules governing trade execution.

CFTC Commissioner Bart Chilton had this to say about a recent visit he made to GFI's New York brokerage floor, "I was surprised by what I didn't know. GFI and others like them were always in OTC land. Why would I know about what they do? Well, these are big, dynamic operations, not just a couple of guys in a back room with a phone. I don't think we have a full appreciation of the OTC markets yet."[14]

It is vitally important that SEF rules promulgated by the CFTC and SEC encompass the many varied and beneficial trading methodologies that are used today to execute swaps in these very competitive swap markets. Under Dodd-Frank, Congress wisely permitted SEFs to utilize "any means of interstate commerce" to transact swaps. Congress recognized that restricting methods of execution of swaps instruments with non-continuous liquidity could do substantial harm to the orderly operation of US swaps markets overall, to the detriment of those market participants who need to manage risk. There is no basis in Dodd-Frank for regulations designed to restrict or promote any one component or other of the hybrid means of swaps execution utilized by wholesale brokers and SEFs. Moreover, we believe it would be detrimental to liquidity in the swaps markets for the CFTC or SEC to mandate unduly restrictive or prescriptive transaction methodologies. Similarly, we believe it would be harmful to liquidity for the CFTC or SEC to mandate swaps trading methodologies taken from the highly commoditized equities or futures markets that are inappropriate and ill suited for the multiple and varied US swaps markets. We are highly concerned about seemingly artificial and arbitrary divisions between electronic and human-assisted modes of swaps execution that would be imposed under the CFTC's SEF proposals.

The WMBAA is currently drafting comment letters on the CFTC and SEC SEF proposals. We will be happy to provide this Committee copies as soon as those letters are filed. At this stage we are concerned that the rules have not provided enough flexibility or sufficient guidance to ensure that all modes of trade execution utilizing "any means of interstate commerce" will be embraced, a very clear directive of the DFA. We believed this is rooted in a lack of sufficient exposure to how trades are currently executed in the wholesale markets in a way that employs a wide array of technology to

[14] Energy Metro DESK, February 7, 2011. p.6. ("Chilton Desk Interview"). The article further states, "Chilton says his trip North to GFI changed his opinion about SEFs and OTC transparency in general. He says the hybrid broker model (voice and screens) for example, which actually is the rule and not the exception around the market, was news to him."

provide a vibrant and transparent market for "multiple participants [to] have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system"

It is worth noting that European regulators do not appear to be considering rules with similarly 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 market place 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. In a market without retail participants, we question what useful protections are afforded to large institutions (required to transact swaps on SEFs) by proposed US regulations that would limit the methods by which market participants may execute their orders. Rather, US regulations need to be in harmony with regulations from foreign jurisdictions to avoid driving trading liquidity away from US markets towards markets offering greater flexibility in modes of trade execution.

2. Pre-Trade Price Transparency.

The SEF provisions in Dodd-Frank contain a rule of construction for their operation: "to promote pre-trade price transparency in the swaps market."[15] Not surprisingly, GFI and its competitors operate in furtherance of that goal. Our business model is driven by revenues from commissions paid on transactions. Our goal is to complete more transactions with more customers. Therefore, each of our firms naturally and consistently disseminates trade bids and offers to the widest practical range of customers with the express purpose of price discovery and the matching of buyers and sellers. We employ a number of means of pre-trade transparency from software pricing analytics to electronic and voice price dissemination to electronic price work up technology. There is no reason we should be required to or would wish to curtail these transparency techniques upon qualification as SEFs. We endorse and currently promote the goal of pre-trade price transparency by providing market information by voice and electronic means to multiple market participants to create greater trading liquidity, the natural activity of intermediaries.

We are concerned, however, that this pre-trade price transparency rule of construction not be used as the basis for the imposition of artificial and, somewhat, experimental restrictions on market activity. For example, the CFTC's SEF proposals require "a minimum pause of 15 seconds between entry of two potentially matching customer-broker swap orders or two potentially matching customer-customer orders"[16] (Referred to below as the "15 Second Rule"). We are concerned that this provision could have a potentially devastating impact on liquidity in many swaps markets and we intend to address it in formal comments to the CFTC.

[15] *See* CEA Section 5h(e).
[16] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR 1,214 (January 7, 2011).

As noted earlier, buy-side customers often look to swaps dealers to undertake the liquidity risk of trading in swaps for which there is non-continuous liquidity. Under DFA, the dealer would take on that risk by placing both the customer's sale order and the dealer's buy order into a SEF for execution. One adverse impact of the proposed 15 Second Rule may be 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 detrimental results for buy-side customers and end users.

As a general matter, we note the conflict between, on the one hand, a rule of construction to promote pre-trade price transparency and, on the other hand, the express mandate under Dodd-Frank to allow delayed reporting of trade information for block trades because of the impact disclosure would have on liquidity in the market. In the first case, there are no operative provisions for pre-trade price transparency in Dodd-Frank that correspond to the non-binding rule of construction. In the second case, DFA specifically requires delayed reporting of block trades to preserve market liquidity and counterparty anonymity. We believe the specific DFA requirement for delayed block trade reporting takes precedence in implementation over the non-binding rule of construction to promote pre-trade transparency. We believe the Commissions should place great emphasis on complying with the operative requirements[17] of Dodd-Frank regarding block trading, ensuring liquidity of markets and preserving anonymity of parties to a trade as they relate to public reporting of trade information and ensuring that those requirements are not conflicted in the arbitrary pursuit of a "goal" of pre-trade transparency. We do not believe that the goal of pre-trade transparency justifies imposing on SEFS experimental trade execution mechanisms that are ill-suited for the unique characteristics of the swaps markets.

3. Post-Trade Price Reporting & Transparency:

It is certainly true that the right measure of pre and post trade transparency can benefit market liquidity. Yet, it is also true that absolute transparency can harm liquidity. The objective must be to strike the right balance. The impact on market liquidity of the CFTC and SEC's proposals on swaps trade reporting and transparency depend on finding the right balance in the final rules governing large block trading. If the rules do not properly define block trade size and thresholds in the context of the unique characteristics of various swaps markets, then the trade reporting of blocks could negatively impact market liquidity, disturbing businesses' ability to hedge commercial risk, to appropriately plan for the future and, ultimately, stifle economic growth and job creation.

Brokers have long recognized that in the less liquid swaps markets where a smaller number of primary dealers and market makers cross larger size transactions, the

[17] Section 727 of the Dodd-Frank Act; Section 763(i) of the Dodd-Frank Act.

disclosure of the intention of a major institution to buy or sell could disrupt the market and lead to poor pricing. If a provider of liquidity to the market perceives greater danger in supplying liquidity, it will step away from providing tight spreads and leave those reliant on that liquidity with poorer hedging opportunities. From a market structure standpoint, liquidity "takers" benefit from liquidity providers acting in a competitive environment. The liquidity providers compete with each other, often deriving reasonably small profits per trade from a large volume of transactions. By relying on their ability to warehouse trades and post capital to make markets and using their distribution and professional know-how to offer competitive prices to their customer base, dealers and market makers provide liquidity essential to the execution of hedging and other risk management strategies.

By imposing a regulatory regime where the market is quickly alerted whenever providers of liquidity take on risk, it becomes difficult for the risk takers to offset such risk without significant loss. The effect is greater risk, higher costs and, ultimately, less liquidity. Disseminating the precise notional amount of a particular large transaction could jeopardize the anonymity of the counterparties to such trades, making counterparties less willing to engage in transactions of size. Similarly, the effect of having no delay, or only a short dissemination delay, for a block trade report that includes the full notional size will discourage market makers from committing capital and providing liquidity to the broader market. For these reasons, having either no delay or a short dissemination delay will actually erode price discovery and the level of price efficiency in the market. We note and echo the concerns expressed by the Coalition for Derivatives End-Users that, "An across-the-board 15 minute time delay that does not account for the instrument type and market conditions is too simplistic to be effective for the derivatives market."[18]

There are historical examples of markets that have sought to achieve full post-trade transparency without adequate block trade exemptions. The results were not positive. In 1986, the London Stock Exchange ("LSE") enacted post trade reporting rules designed for total transparency with no exceptions for block sizes. What ensued was a sharp drop in trading liquidity as market makers withdrew from the market due to increased trading risk.[19] The LSE thereafter engaged in a series of amendments to make its block trade rules more flexible and detailed over time.

Achieving the right balance in block trade rules for swaps markets requires recognition that the thresholds and reporting delay must be different by asset class and instrument and need to be tailored with the greatest of precision. A "one-size-fits-all" approach will not work. The elements of trade size, delay period and disclosed information set should be individually established based upon the unique liquidity requirements of particular instruments and markets. It is vitally important that block trade thresholds and reporting periods be matched properly to the markets to which they apply; otherwise, the markets will adversely adapt to arbitrary rules leading to all manner of dislocation and misuse.

[18] Comment Letter from Coalition for Derivatives End-Users (February 7, 2011) ("2/7/11 Coalition Letter").
[19] ISDA/SIFMA Block Trade Study, p. 8.

It is worth noting that the trade reporting regime that is often cited positively as a model for swaps trade reporting is the TRACE system for US corporate bonds. That system was phased in over three years. We believe that markets as complex as the swaps markets require at least as long a phase-in period to be cautious and make sure the formulas and mechanisms work properly. Furthermore, as with TRACE, during the phase-in period there should be appropriate study of the effects on market liquidity, as required by the statute.

We also note that because of the fundamental differences in liquidity in the swaps markets from those in the futures and equities markets, those markets provide inadequate and inappropriate models for the swaps markets for block trade calculations of size, content and time delay. As a result of the unique non-continuous nature of liquidity in certain swaps markets (with fewer participants), we believe that the CFTC and SEC need to carefully structure a public trade reporting regime that is not "one size fits all", but rather takes into account the unique challenges of fostering liquidity in the diverse range of swaps markets, provides for the transacting of larger transactions without unnecessary regulatory burdens, and does not materially reduce market liquidity.

The WMBAA has proposed[20] the formation of a block trade standards advisory board (the "Swaps Standards Advisory Board") made up of recognized experts and representatives of registered SDRs and SEFs to make recommendations to the Commissions for appropriate block trade thresholds for swaps and security based swaps. (Copy attached.) The WMBAA cites the role of existing advisory committees, such as the in Agricultural Advisory Committee, Global Markets Advisory Committee, Energy and Environmental Markets Advisory Committee, and the Technology Advisory Committee, which serve to receive market participant input and recommendations related to regulatory and market issues. Recent Commission rulemakings in agricultural commodities[21] and co-location[22] have benefitted greatly from the industry input of these advisory committees. While the Commission is authorized under Dodd-Frank to establish block trade standards on its own, we believe that a Swaps Standards Advisory Board, similar to the above-referenced advisory committees, could provide the Commission 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.

A Swaps Standards Advisory Board would 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 Swaps Standards Advisory Board would also undertake the market studies and research at industry expense that is necessary to help establish such standards. This arrangement would permit SEFs, as the entities most closely related to block trade execution, to provide essential input into the Commission's block trade determinations and work with

---

[20] 1/18/11 WMBAA Letter..

[21] *See* Agriculture Commodity Definition, 75 Fed. Reg. 65,586 (October 26, 2010).

[22] *See* Co-Location/Proximity Hosting Services, 75 Fed. Reg. 33,198 (June 11, 2010).

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.

Areas where Congress Can Help.

In this testimony, I have called on the CFTC and SEC to better understand the distinct nature of the swaps markets and not align their rulemaking with familiar but inappropriate models of the futures and equities markets. I have criticized a specific rule proposal (the 15 Second Rule) and arbitrary limits on SEFs' use of "any means of interstate commerce" to transact customer orders. I have also endorsed a proposal by the WMBAA for a Swaps Standards Advisory Board.

I commend the two Commissions (SEC and CFTC) and their staffs for their evident good faith and determination. They are working very hard to get this right. I and many colleagues in the wholesale brokerage industry are optimistic that, given enough time, we can work with the regulators to fine tune rules regarding modes of intermediation, transparency and non-discrimination towards SEFs. That said, there are two areas where Congress can help.

Time Frames: In proscribing specific rule promulgation dates, DFA did not give regulators enough time to complete an orderly transformation of the multi-trillion Dollar US swaps market to a cleared and intermediated structure. The mandated time frames are just too tight get the details right. CFTC Commissioner Scott O'Malia has called them "unrealistic."[23] They are indeed unrealistic and put an unreasonable burden on the staff of the regulatory commissions to sufficiently familiarize themselves with the workings of the OTC swaps markets. Yet, such familiarity and, indeed, expertise, is absolutely necessary since heretofore neither agency had direct regulatory authority or involvement with these markets. Without the time or the resources to understand these markets, each agency will have the natural tendency to fall back on the familiarity of the markets they already regulate. The CFTC's proposals are therefore generally based off of the futures market model and the SEC's rules more prone to a securities market model. Not only is the swap market and its diverse elements unique, but it is critically important that there be consistency between the two agencies. More time and resources would surely give both agencies a better chance to first, do no harm and second, reach the right outcome.

Several days after viewing our New York brokerage operations, CFTC Commissioner Bart Chilton put it thus in a speech: "… We are also working, in the crafting of SEF rules, to ensure that we do not mess up platforms that are currently working well. This is a delicate balancing act, and we need to hear from market participants that have the expertise and interest in this area to make sure we get it right."[24]

---

[23] Keynote Address by Commissioner Scott D. O'Malia at Tabb Forum Conference(January 25, 2011).

[24] Speech of Commissioner Bart Chilton to the American Public Gas Association Winter Conference, Fort Myers, Florida, (February 1, 2011).

Commissioner Chilton is exactly correct that in crafting SEF rules, regulators must better understand platforms that are currently working well so as not to mess them up.

Commissioner Chilton had this to say in another forum[25] "GFI and others like them…are big dynamic operations, not just a couple of guys in a back room with a phone. I don't think we have a full appreciation of the OTC markets yet. I am worried we're going to pull the trigger too soon."

What is needed is for Congress to give regulators the necessary time to understand more precisely those swaps platforms that are currently working well and discourage them from pulling "the trigger too soon". Commissioners like Bart Chilton and responsible regulators must have the opportunity to better consider how existing intermediaries function, how they deploy technology, how they promote price transparency and how they use many means of execution to connect multiple to multiple market participants. From an understanding of the effectiveness of these systems for the markets they serve, regulators may gain comfort to more fully endorse working execution models rather than having to impose artificial models or those from distinct markets. Market research and further studies may be required to provide the thorough knowledge necessary to craft workable, effective and appropriate rules and regulations, and will take time.

If regulators are given sufficient time and, frankly, resources to craft SEF rules that are well tailored to the existing trading methods in the swaps markets, a benefit may be a shorter and more effective implementation period by the swaps industry. Rushing the rules will make implementation slower, harder and more costly. Taking the time to make the rules reflect the way the swaps markets actually work will speed implementation and save money. As the adage goes, "Measure twice, cut once."

Industry Efforts: Secondly, DFA failed to dot a few ‘’'s and cross a few ‘t’s. For example, Dodd-Frank sets up a framework of competing SEFs and DCMs, yet in its core principles requires that each SEF monitor and enforce counterparty position limits and manipulative trading practices[26]. The requirement presumes that each SEF has sufficient market and customer knowledge to comply. However, as competing execution facilities, SEFs will rarely handle or be aware of a counterparty's entire trading activity, which will be directed most likely to numerous SEFs depending on best execution, price and liquidity. Because SEFs are not structured as Designated Clearing Organizations or Swap Data Repositories, they will have no way of knowing the aggregate position limits or composite trading strategies of their customers and will fail to comply with the respective Core Principles.

Another practical impossibility is presented by Core Principle 4 which requires SEFs to monitor trading and trade processing.[27] This requirement provides that when a

---

[25] Chilton Desk Interview. p. 6.
[26] CEA Section 5h(f)(6); *See* Section 733 of the Dodd-Frank Act.

[27] CEA Section 5h(f)(4); *See* Section 733 of the Dodd-Frank Act.

swap is settled by reference to the price of an instrument traded in another venue the SEF must also monitor trading in the market to which the swap is referenced. In other words, a SEF that executes a trade of a credit default swap on a Ford Motor Company bond must also monitor trading in Ford Motor Company bonds. Yet, while SEFs certainly have the ability to monitor trades that they execute, they are not in a position to independently and effectively monitor positions and trading that takes place in other markets.

As the CFTC states on their website[28] regarding their trade surveillance program, only it can "consolidate data from multiple exchanges and foreign regulators to create a seamless, fully-surveilled marketplace" due to the Commission's unique space in the regulatory arena. The surveillance "requires access to multiple streams of proprietary information from competing exchanges, and as such, can only be performed by the Commission or other national regulators". The CFTC correctly states that the surveillance "can not be filled by foreign and domestic exchanges offering related competing products", and there is no reason to believe a SEF would be better situated. And yet, unless each SEF fills this sort of surveillance function, it will be in violation of SEF core principles.

A further issue is that SEFs ideally should be able to delegate relevant functions to a self-regulatory organization ("SRO"). Unfortunately DFA does not expressly contemplate such delegation as, for example, the CEA permits for other types of registered entities.[29] Further, it is not clear that even if permitted, SEFs would voluntarily delegate responsibilities to the existing SROs.

What is clear is that the proposed SEF rules create a host of new obligations for SEFs, as well as for the CFTC and the SEC. It also appears that the SEC and CFTC lack the resources necessary to implement and enforce the new rules. And if projections of 50 – 100 SEFs are correct, a new regulatory structure to facilitate compliance by SEFs with the applicable laws and regulations will need to be developed.

To address some of these issues, the WMBAA proposes the establishment of a common regulatory organization (CRO)[30] that will facilitate compliance with the core principles by each of its members as well as for any other SEF that agrees to follow its rules. The CRO would not itself have any direct regulatory responsibilities, but it would, by way of contractual obligations, assist its members by addressing compliance issues that are common to all SEFs. This solution would be industry and not taxpayer financed. However, this solution is not expressly authorized by DFA and would benefit from a Congressional mandate to confirm its utility.

Conclusion.

[28]CFTC Market Surveillance Program. *Available at* http://www.cftc.gov/IndustryOversight/MarketSurveillance/CFTCMarketSurveillanceProgram/tradepracticesurveillance.html.

[29] See 7 U.S.C. § 7a-2(b).
[30] Distinguished from an SRO to avoid confusion with the legal and regulatory implications of an SRO.

Dodd-Frank seeks to reengineer the US swaps market on two key pillars: central counterparty clearing and mandatory intermediation of clearable trades through registered intermediaries such as SEFs. Wholesale brokers like GFI are today's central marketplaces in the global swaps markets and, as such, are the prototype of swap execution facilities.

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 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.

Regulators are undoubtedly working hard to put in place appropriate rules under Title VII. They have their work cut out for them and there are at least three critical elements for success:

1. SEFs must not be restricted from deploying the many varied and beneficial trade price dissemination and trade execution methodologies and technologies successfully used today to execute swaps
2. The "goal" of pre-trade transparency must be realized through means that do not destroy market liquidity for market participants and end users.
3. Regulators need to carefully structure a public trade reporting regime that is not "one size fits all", but rather takes into account the unique challenges of fostering liquidity in the diverse range of swaps markets.

Congress can assist with technical corrections to Dodd-Frank and, crucially, by providing regulators with adequate time and resources to thoroughly understand the challenges and current solutions to garnering trading liquidity in the swaps markets. 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 US financial system, including the US swaps markets, can once again be the well ordered marketplace where the world comes to trade.

J. CHRISTOPHER GIANCARLO

GFI Group Inc.
55 Water Street, New York, New York — April 2001 to present

Executive Vice President – Corporate Development.

Fenics Ltd.
London, England & New York, New York — April 2000 to April 2001

Executive Vice President.

Brown Raysman Millstein Felder & Steiner LLP
New York, New York — September 1997 to April 2000

Partner, Corporate & Finance.

Giancarlo & Gleiberman
New York, New York & Washington, DC — January 1992 to September 1997

Founding Partner.

Curtis, Mallet-Prevost, Colt & Mosle
London, England — December 1988 to December 1991
New York, New York — October 1985 to December 1988

Associate Attorney.

Mudge, Rose, Guthrie, Alexander & Ferdon
New York, New York — September 1984 to October 1985

Associate Attorney.

EDUCATION

Vanderbilt University School of Law
Nashville, Tennessee — 1981-1984

***Juris Doctor*,** May 1984. Associate Research Editor, Vanderbilt Journal of Transnational Law. President, International Law Society.

Skidmore College
Saratoga Springs, New York — 1977-1981

Bachelor of Arts, May 1981. ***Phi Beta Kappa*.** College Honors. Government

Department Honors. Secretary of Periclean Honor Society. Member of Winter Term Scholarship Committee. Contributing Editor to Politea Magazine.

Dwight-Englewood (Preparatory) School
Englewood, New Jersey 1970-1977

PROFESSIONAL

Member: NY (1985) Bar. Founding Co Editor-in-Chief, eSecurities, Trading and Regulation on the Internet, (Leader Publications). Chairman: Internet Securities Legal Practices Forum, May 24-25, 1999, New York City. Panelist: Securities Trading on the Internet, January 24 – 25, 2000, New York City. Board Memberships: The French Academy of Bergen County; Borough of Haworth, NJ, Board of Adjustment.

PUBLICATIONS

"SuperMontage: What's Wrong With The Nasdaq's New Market System?" eSecurities (Leader Publications), (March, 2001).

"Issuer Liability for Hyper linked Content," eSecurities (Leader Publications), (July, 2000).

"SEC Internet Report" (with Sarah Hewitt & Peter J. Fusco), The National Law Journal, (January 24, 2000).

"Online Shareholder Actions: Coho Revolt Raises Issues of Proxy Rules," eSecurities (Leader Publications), (Oct., 1999).

"Corporate Finance: International Regulation of Internet Securities," (with Sarah Hewitt) New York Law Journal, (July 8, 1999).

"*Securities Law in Practice:* SEC Amends Rule 504 to Fight Fraud," New Jersey Law Journal, (July 5, 1999).

"What You Need to Know about [Alternative Trading Systems]," eSecurities (Leader Publications), (December 1998).

Giancarlo, *Methods of Doing Business Abroad*, 1998 N.J. INST. FOR CONTINUING LEGAL EDUC. 69.

"Using New Jersey Limited Liability Companies as Vehicles for Overseas Investment in the United States," International Law and Organizations Section Newsletter (New Jersey State Bar Association), (June 1995).

"United States Business Law: *A Handbook for the British Entrepreneur,*" (2nd. Ed.) self-published, March 1995. (1st. Ed., June 1993)

"Foreign Investment in Hungary," International Law and Organizations Section Newsletter (New Jersey State Bar Association), November 1992.

"Reciprocal Sales of US and UK Mutual Funds," International Financial Law Review, June 1986 (co-written with A. Francke & M. Day).

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
J. Christopher Giancarlo	GFI Group Inc.; WMBAA
3. Business Address and telephone number: [redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify? ☐ Yes ☑ No	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify? ☐ Yes ☑ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature: J. Christopher Giancarlo	

Please attach a copy of this form to your written testimony.