Prepared Remarks
of
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For The CFTC Roundtable on the "Futurization of Swaps"

January 31, 2013

Good Morning, my name is George Harrington and I am the Global Head of Fixed-Income Trading at Bloomberg L.P. based in New York. I want to thank the Commission for giving me this opportunity to present our thoughts and the concerns of our clients on these important issues.

Bloomberg L.P. (Bloomberg) is an independently owed provider of market data, analytics, and trade execution to more than 375,000 users globally. Since 2005, Bloomberg has hosted electronic trading in the derivatives market through 24 dealers to more than 1000 end user clients. In the credit default swap (CDS), Interest Rate Swap, Commodity and Foreign currency swap markets Bloomberg L.P. is a provider of electronic trading platforms and connectivity to the central clearinghouses represented here today. Since 2006, through our Broker Dealer Bloomberg Tradebook, LLC, we operate a global multi-futures commission merchant (FCM) independent software vendor that provides sophisticated trading technology and execution algorithms for over 25 futures markets across 90 FCMs. Our interest in this debate is to assure that our customers on both the buy-side and sell-side have unfettered access to data and trading services across the broadest range of investment options allowed for by regulation.

Listing a futures contract based on or that replicates swaps is not a new idea and it is not a construct of the Dodd-Frank legislation. Over the past decade there have been multiple attempts by exchanges to launch swap futures contracts, none of which have developed significant liquidity to become viable. The requirement of Dodd-Frank that over-the-counter (OTC) derivatives be centrally cleared may in fact lead to a viable swap future product. However, futurization should not be forced on the market as a result of disparate minimum liquidation times set forth in Commission rule 39.13.

When trying to understand the reasoning behind having a one day minimum liquidation time for financial futures and options, and a five day minimum liquidation time for centrally cleared financial swaps, we can find no economic argument. The most obvious reason – a difference in the implied risk of the products - is not a factor that we have seen quantified. Of even more concern – there is no mention of differences in the liquidity of the instruments. Today, there is no question that there is significantly more liquidity in cleared financial swaps than in cleared financial swap futures. In that light, the establishment of a margining regime that favors financial futures over financial swaps runs the risk of increasing systemic risk.

Another major concern is that forcing futurization – which the Commission has done with the margin rule – risks undermining the central goals of Dodd-Frank. For the topics we are discussing today, the United States Congress had three main objectives: (1) Greater pre-trade price transparency in the market; (2) Reduced Systemic Risk through Central Clearing; and (3) Public Dissemination of Pricing through Swap Data Repositories.

1. To accomplish the first objective, the concept of the swap execution facility (SEF) was envisioned by Congress. When the SEF rules are finalized by this Commission, we expect they will require electronic trading through the display of executable quotes or a request for quote (RFQ) system. Both of these will be in an all-to-all format – forestalling any exclusivity in pricing. This represents a dramatic change in the current form of the OTC market, where the great majority of deals are negotiated over the phone on a bilateral basis and displayed electronically. Represented in this room today are at least five firms that intend to launch SEFs, which assures a competitive market. However, a margining regime that dramatically favors futures over swaps lowers the value of the SEF, to the point of potentially making it unviable from a business perspective.
2. Central Clearing is nearly universally agreed to be safer for the market, with little objection. Futurization will not have an impact on Central Clearing since both swaps and futures will have the same requirements to clear – but with different margining regimes. To the point I made earlier, a lower margining requirement for a lower liquidity instrument actually increases the systemic risk in these clearing houses.
3. Swap Data Repositories were envisioned as public dissemination tools for all swap activity. The public good to be served by these utilities was to avoid opaqueness in pricing that was at the heart of the AIG situation in 2008/2009 financial crisis. If the market is pushed toward futurization by this rule, we could end up in a position of far lower transparency than was envisioned by Congress. The SDR rules call for public price dissemination as soon as is technologically possible for swap trades executed via a SEF, and after a reasonable delay for block exempt trades. Although they generally do it within ten minutes of a trade, futures exchanges are only required to publicly disclose prices on a next day basis – this is obviously a worse outcome.

One last point we would like to make is on the risks of moving swap trading off-shore by creating an uncompetitive regulatory environment. Global organizations with specific investment needs will continue to utilize the swap market. If the cost of executing these transactions is priced prohibitively high by the Commission, they will likely look abroad to achieve their financing needs. In summary, we believe that the push towards central clearing is positive for the market. Forced futurization, however, driven by major and illogical differences in margin, will be bad for American consumers and for the markets. Again, we thank the Commission for the opportunity to be here today, and are happy to answer any questions you have to the best of our ability.