UNITED STATES SENATE COMMITTEE
ON BANKING, HOUSING, AND URBAN AFFAIRS

WRITTEN TESTIMONY OF TRADEWEB MARKETS LLC

LEE OLESKY, CHIEF EXECUTIVE OFFICER

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Hearing on
"Building the New Derivatives Regulatory Framework:
Oversight of Title VII of the Dodd-Frank Act"

Tradeweb Markets LLC (***"Tradeweb"***) appreciates the opportunity to provide testimony to the Senate Committee on Banking, Housing, and Urban Affairs (the ***"Committee"***) with respect to the regulatory framework for and implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the ***"Dodd-Frank Act"*** or the ***"Act"***) under the proposed regulations from the Commodity Futures Trading Commission (***"CFTC"***) and U.S. Securities and Exchange Commission (***"SEC"***, together with the CFTC, the ***"Commissions"***).

I. <u>Background on Tradeweb</u>

Tradeweb is a leading global provider of electronic trading platforms and related data services for the over-the-counter fixed income and derivatives marketplaces. Tradeweb operates three separate electronic trading platforms: (i) a global electronic multi-dealer to institutional customer platform through which institutional investors access market information, request bids and offers, and effect transactions with, dealers that are active market makers in fixed income securities and derivatives, (ii) an inter-dealer platform, called Dealerweb, for U.S. Government bonds and mortgage securities, and (iii) a platform for retail-sized fixed income securities.[1]

Founded as a multi-dealer online marketplace for U.S. Treasury securities in 1997, Tradeweb has been a pioneer in providing market data, electronic trading and trade processing in OTC marketplaces for over 10 years, and has offered electronic trading in OTC derivatives on its

[1] Tradeweb operates the dealer-to-customer and odd-lot platforms through its registered broker-dealer, Tradeweb LLC, which is also registered as an alternative trading system ("ATS") under Regulation ATS promulgated by the SEC under the Securities Exchange Act of 1934. Tradeweb operates its inter-dealer platform through its subsidiary, Hilliard Farber & Co., Inc., which is also a registered broker-dealer and operates Dealerweb as an ATS. In Europe, Tradeweb offers its institutional dealer-to-customer platform through Tradeweb Europe Limited, which is authorized and regulated by the UK Financial Services Authority as an investment firm with permission to operate as a Multilateral Trading Facility. In addition, Tradeweb Europe Limited has registered branch offices in Hong Kong, Singapore and Japan and holds an exemption from registration in Australia.

institutional dealer-to-customer platform since 2005. Active in 20 global fixed income, money market and derivatives markets, with an average daily trading volume of more than $250 billion, Tradeweb's leading institutional dealer-to-customer platform enables 2,000 institutional buy-side clients to access liquidity from more than 40 sell-side liquidity providers by putting the liquidity providers in real-time competition for client business in a fully-disclosed electronic auction process. These buy-side clients comprise the majority of the world's leading asset managers, pension funds, and insurance companies, as well as most of the major central banks.

Since we began trading interest rate swaps in 2005, the notional amount of interest rate derivatives traded on Tradeweb has exceeded $6.5 trillion from more than 75,000 trades. Tradeweb has spent the last five years building on its derivatives functionality to enhance real-time execution, provide greater price transparency and reduce operational risk. Today, the Tradeweb system provides its institutional clients with the ability to (i) view live, real-time IRS (in six currencies, including U.S., Euro, Sterling, Yen), and Credit Default Swap Indices (CDX and iTraxx) prices from swap dealers throughout the day; (ii) participate in live, competitive auctions with multiple dealers at the same time, and execute an array of trade types (*e.g.*, outrights, spread trades, or rates switches); and (iii) automate their entire workflow with integration to Tradeweb so that trades can be processed in real-time from Tradeweb to customers' middle and back offices, to third-party affirmation services like Markitwire and DTCC Deriv/SERV, and to all the major derivatives clearing organizations. Indeed, in November 2010, Tradeweb served as the execution facility for the first fully electronic multi-dealer-to-customer interest rate swap trade to be cleared in the U.S., and in February 2011, Tradeweb completed the first fully-electronic multi-dealer-to-customer credit default swap trade to be executed and cleared in the U.S. Tradeweb's existing technology maintains a permanent audit trail of the millisecond-by-millisecond details of each trade negotiation and all completed transactions, and allows parties (and will allow SDRs and DCOs) to receive trade details and access post-trade affirmation and clearing venues. With such tools and functionality in place, Tradeweb is providing the OTC marketplace with a front-end swap execution facility.

As additional background, Tradeweb was established in 1997 with financial backing from four global banks that were active in, and interested in expanding and fostering innovation in, fixed income (U.S. Government bond) trading. After seven years of growth and expansion into 15 markets globally, in 2004, Tradeweb's bank-owners (which had grown from four to eight over that time) sold Tradeweb to The Thomson Corporation, which wholly-owned it until January 2008. Although the original bank-owners continued to be a resource for Tradeweb from 2004 to 2008, The Thomson Corporation recognized that bank ownership was an important catalyst of Tradeweb's development and sold through a series of transactions a strategic interest in Tradeweb to a consortium comprised of ten global bank owners. Today, Tradeweb is majority owned by Thomson Reuters Corporation (successor to The Thomson Corporation) and minority stakes are held by the bank consortium and Tradeweb management. Accordingly, Tradeweb was launched by market participants and has benefitted from their investment of capital, market expertise and efforts to develop and foster more transparent and efficient markets. With the support of its ownership and its board comprised of market and non-market participants, Tradeweb has, since its inception, brought transparency and efficiency to the OTC fixed income and derivatives marketplace.

II. Summary

Since 1998, Tradeweb has been operating a regulated electronic marketplace for the OTC fixed income marketplace and has played an important role in providing greater transparency and improving the efficiency of the trading of fixed income securities and derivatives. Indeed, Tradeweb has been at the forefront of creating electronic trading solutions which support price transparency and reduce systemic risk, the objectives of Title VII of the Dodd-Frank Act. Given that it has the benefit of offering electronic trading solutions to the buy-side and sell-side, Tradeweb believes that it can provide the Committee with a unique and valuable perspective on the regulatory framework for and the implementation of Title VII.

At the outset, Tradeweb is very supportive of the Dodd-Frank Act and its stated goals. We believe that increased price transparency and operational efficiency will lead to a reduction in systemic risk in connection with the trading of derivatives. However, it is important for this Committee, Congress as a whole, and the regulators to understand and give due consideration to the needs of market participants in promulgating rules for and implementing Title VII. The aim must be to achieve the goals of the Act without materially disrupting the market and the liquidity it provides to end users who use derivatives to manage their varying risk profiles. Market participants need confidence to participate in these markets and if careful consideration is not given to what the rules say and how they will ultimately be implemented, we fear that this confidence could be materially shaken.

As part of the Dodd-Frank Act, Congress created a new type of registered entity – known as a swap execution facility or "SEF." Congress expressly created SEFs to promote the trading of swaps on regulated markets, and provide a broader level of price transparency for end users of swaps. While the definition of a SEF has been the subject of much debate and speculation, the plain language of the Dodd-Frank Act requires the Commissions to recognize the distinction between SEF's on the one hand and designated contract markets (***"DCMs"***) or exchanges on the other. There was a recognition by Congress that alternatives to traditional DCMs and exchanges were necessary, particularly in light of the current working market structure and manner in which OTC derivatives trade. We applaud the direction of the regulation, but want to ensure that the Commissions adopt rules that are clear and allow for flexibility in the manner of execution for market participants.[2] This will give the end users choices, confidence and liquidity, and will do so in a regulated framework that promotes the trading of swaps, in an efficient and transparent manner on regulated markets.

To that end, the rules relating to Title VII must be flexible enough so as not to deter the trading of swaps on regulated platforms. By ensuring that the rules retain sufficient flexibility to allow end users to elect where and how they transact business, the Commissions will provide for

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[2] The term 'swap execution facility' has been defined in the Dodd-Frank Act as a trading system or platform in 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, including any trading facility, that- (A) facilitates the execution of swaps between persons; and (B) is not a designated contract market. The Dodd-Frank Act amends Section 1a of the Commodities Exchange Act with a new paragraph (50, and Section 761(a)(6) of the Dodd-Frank Act amends Section 3(a) of the Securities Exchange Act of 1934 by adding a new paragraph (77) (defining a "security-based swap execution facility"). We refer to both as a SEF in this submission.

the most competitive execution of trades and encourage the greatest liquidity in the market. Accordingly, the rules should not unduly limit the choices of execution methods available for market participants to manage their risks efficiently and effectively, or overly prescribe the manner in which market participants can choose to interact with each other to manage such risks (e.g., requiring a Request for Quote (***"RFQ"***) to be transmitted to a minimum of five market participants). If the rules regarding how market participants must interact with each other from a trading perspective and accessing liquidity are arbitrary and artificially prescriptive, and thus not flexible enough to accommodate the varying methods of execution, market participants simply will not participate and will seek alternative, less efficient markets to manage their risk. We certainly do not believe that is the ultimate goal of Title VII.

Further, the Dodd-Frank Act clearly contemplates that a SEF should have broad, reasonable discretion to establish how it implements the required regulatory framework. Overly prescriptive rules on the registration and administration of SEFs and their compliance with the Core Principles could place an unreasonable burden on existing swaps trading platforms prior to the effective date of the final rules and may also discourage new entrants into the swaps market. Congress and the Commissions should thoughtfully implement the rules to provide electronic swaps trading platforms with the flexibility required by the Dodd-Frank Act.

Similarly, arbitrary or artificially prescriptive ownership limits or governance requirements will deter investment of capital in new or existing platforms. A careful balance needs to be reached between safeguarding the system and encouraging private enterprise, which will allow end users access to choose among robust trading venues and clearing organizations. To be clear, we favor having an independent voice on the Board of registered entities, but the rules should not go so far as to make that the predominant voice – one that creates a conflict of interest on the opposite extreme.

Because of the overlapping nature of the proposed rules from the CFTC and SEC on each aspect of Title VII – including SEFs -- we believe it is imperative that the Commissions cooperate in developing final rules, which should be aligned to the greatest extent possible. Bifurcated rulemaking with respect to the swaps market will result in confusion and lack of confidence in the marketplace and could potentially drive participants away from the market altogether. It is also critically important that there is a consistent approach between regulators globally as overly rigid regulation in one jurisdiction will materially impact how other regulators promulgate rules in an effort to maintain a harmonized approach to overseeing the derivatives markets. The potential result is a movement of the market outside the U.S., and that would likewise be an unfortunate unintended consequence.

Finally, there has been a great deal of discussion recently about how best to implement Title VII and the currently proposed rules. There is no doubt that an overly hasty or ill thought-out timetable for implementation could directly impact the health of the derivatives markets by disenfranchising the inter-connected members of this complex eco-system, and implementing these regulations in one "big bang" is unrealistic. We believe the marketplace needs greater certainty in terms of how and when these regulations will be implemented, and we encourage Congress and the Commissions to seek public comment on these issues.

Tradeweb is supportive of the goals to reform the derivatives markets and indeed we provide the very solutions the regulation seeks to achieve, but we are concerned that the Commissions may overreach in their interpretation and implementation of Dodd-Frank, and in doing so create unintended consequences for end-users and the marketplace as a whole.

III. Background on the OTC Rates and Credit Derivatives Marketplace

There are generally two institutional marketplaces for over-the-counter (OTC) credit and rates derivatives: the dealer-to-customer market (institutional) and the interdealer market (wholesale). In the institutional market, certain dealers act as market makers and buy and sell derivatives with their institutional customers (*e.g.*, asset managers, corporations, pension funds, *etc*.) on a fully-disclosed and principal basis. In the institutional market, the provision of liquidity is essential for corporations, municipalities and government organizations (*i.e.*, end users), which have numerous different asset and liability profiles to manage. The need for customized risk management solutions has led to a market that relies on flexibility – so end-userscan adequately hedge interest rate exposure – and liquidity providers, who have the ability to absorb the varied risk profiles of end-users by trading standard and customized derivatives. These market makers then often look to the wholesale market – the market wherein dealers trade derivatives with one another – to obtain liquidity or offset risk as a result of transactions effected in the institutional market or simply to hedge the risk in their portfolios.

In the wholesale or inter-dealer market, brokers (***"IDBs"***) act as intermediaries working to facilitate transactions between dealers. There is no centralized exchange (i.e., derivatives are traded over-the-counter), and as a result, dealers look to IDBs to obtain information and liquidity while at the same time preserving anonymity in their trades. Currently, in the United States, these trades are primarily accomplished bilaterally through voice brokering. By providing a service through which the largest and most active dealers can trade anonymously, IDBs prevent other dealers from discerning a particular dealer's trading strategies, which in turn (i) reduces the costs associated with the market knowing a particular dealer is looking to buy or sell a certain quantity of derivatives, (ii) allows the dealer to buy or sell derivatives in varying sizes, providing stability to the marketplace, and (iii) enhances liquidity in the marketplace.

Both the wholesale and institutional derivatives markets trade primarily through bilateral voice trading, with less than 5% of the institutional business trading electronically. In these markets, trades are often booked manually into back office systems and trades are confirmed manually (by fax or other writing), and some (but not all) derivatives trades are cleared.

With the implementation of the Dodd-Frank Act, we expect that most of the interest rate and credit derivatives markets will be subject to mandatory clearing, and therefore be traded on a regulated swap market. Accordingly, with increased electronic trading, the credit and rates derivatives markets will be much more transparent (with increased pre-trade price transparency) and efficient, and systemic risk will be greatly reduced as the regulated swaps markets will have direct links to designated clearing organizations (***"DCOs"***) and swap data repositories (***"SDRs"***).

In light of the foregoing and with the forthcoming business conduct standards, we believe the trading mandate was not intended to be and does not need to be artificially and arbitrarily prescriptive to achieve the goals of the Dodd-Frank Act. Indeed, to do so, would undermine these goals. For example, by mandating a minimum of five liquidity providers from which a market participant can seek prices would likely reduce liquidity and effectively reduce the ability for end-users to adequately manage their risk. In short, regulated (i) swap market trading (without regard to trading model but with the appropriate transparency and regulatory oversight), (ii) clearing and (iii) reporting is what will accomplish the policy goals without hurting liquidity and disrupting the market. It is critical that the Commissions do not propose rules that artificially and unnecessarily hurt the market and undermine the goals of the Dodd-Frank Act.

IV. <u>Key Considerations for SEF Rulemaking</u>

SEFs

As noted above, it is imperative that the Commissions adopt rules that are clear and allow for flexibility in the manner of execution for market participants. This will give the market choices, confidence and liquidity, and will do so in a regulated framework that promotes the trading of swaps, in an efficient and transparent manner.

Consistent with the goals of the Dodd-Frank Act, for institutional users, a SEF should (i) provide pre-trade price transparency through any appropriate mechanism that allows for screen-based quotes that provide an adequate snapshot of the market (e.g., through streaming prices for standardized transactions and competitive real time quotes for larger or more customized transactions), (ii) incorporate a facility through which multiple participants can trade with each other (i.e., must have competition among liquidity providers), (iii) have objective standards for participation that maintain the structure of liquidity providers (like swap dealers) providing liquidity to liquidity takers (institutional buy-side clients), (iv) have the ability to adhere to the core principles that are determined to be applicable to SEFs, (v) provide access to a broad range of participants in the OTC derivatives market, allowing such participants to have access to trades with a broad range of dealers and a broad range of DCOs; (vi) allow for equal and fair access to all the DCOs and allow market participants the choice of DCO on a per trade basis, and (vii) have direct connectivity to all the SDRs.

In order to register and operate as a SEF, the “trading system or platform” must comply with the enumerated Core Principles in the Dodd-Frank Act applicable to SEFs. Regulators have the authority to determine the manner in which a SEF complies with the statutory core principles, and there is discretion for the Commissions to retain distinct regulatory characteristics for SEFs versus DCMs. It is critically important for the Commissions to apply the principles with flexibility given the market structure in which swaps are traded. Accordingly, regulators should interpret core principles in a way in which SEF’s can actually comply with them. While many of the SEF Core Principles are broad, principle-based concepts -- which make sense given the potential for different types of SEFs and trading models – some of the Core Principles are potentially problematic for SEFs that do not operate a central limit order book or clearing.

Ownership and governance

As noted above, Tradeweb was launched by market participants, and has benefitted from their investment of capital, market expertise, and efforts to foster the development of more transparent and efficient markets. With the help of its board, comprised of market and non-market participants, Tradeweb has since its inception brought transparency and efficiency to the fixed income and derivatives marketplace.

The success story of Tradeweb may not have been possible if overly prescriptive governance and ownership limits had been imposed at the time. It was highly unlikely that under those circumstances, any market participants would have made an investment. Moreover, beyond the initial seed capital, the banks' participation also allowed Tradeweb to continue to invest in its infrastructure and evolve with the market – thus building the robust and scalable architecture that has allowed it to expand to 20 markets, survive 9/11 (Tradeweb's U.S. office was in the North Tower of the World Trade Center), and develop connectivity with over 2000 institutions globally. Under the proposed rules of the CFTC and the SEC, ownership and independent director limits will be imposed on the different registered entities that will provide the technological infrastructure to the swaps market – from trading to clearing. Tradeweb believes that independent directors are a very good idea, in terms of bringing an independent perspective to the governing board, but their duties must be consistent with other board members. However, artificial caps on ownership or excessive minimum voting requirements for independent directors on the board (such as 51% of the voting power) go too far. As a practical matter, ownership limits will impair registered entities such as trading platforms and clearing organizations, from raising capital, and overly expansive independent director requirements will likewise hurt investment because investors will lack a sufficient say in how their investment will be governed. Moreover, Dodd-Frank provides other, more direct, ways in which to mitigate conflicts of interest, and employing each of these tools in a reasonable fashion will, in the aggregate, address the potential conflicts of interest without negatively impacting investment of capital and innovation in the marketplace.

For these reasons, we urge legislators and regulators to consider a more reasoned approach to mitigating conflicts of interest.

Implementation

Because of its technological experience and expertise, Tradeweb will be in a position to implement whatever trading rules are imposed by the CFTC and SEC for SEFs shortly after registration. However, as we note above, the implementation of Title VII of the Dodd-Frank Act will require cooperation between regulators (both domestically and abroad) in their rulemaking and implementation plan, as well as the cooperation and investment of market participants. It is critical therefore that in the first instance, the rulemaking is flexible but clear, and that each facet is implementation is thought through – because a lack of confidence in implementation will result in a lack of confidence in the marketplace, the result of which would be a marketplace which would not best serve the interests of the end user. We believe the marketplace needs greater certainty in terms of how and when these regulations will be implemented, and we encourage Congress and the Commissions to seek public comment on these issues.

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In sum, while we support the goals of the Dodd-Frank Act and believe increased regulatory oversight is good for the derivatives market, we want to emphasize that flexibility in trading models for execution platforms are critically important to maintain market structure so end-users can manage their risks in a flexible manner. If you have any questions concerning our comments, please feel free to contact us. We welcome the opportunity to discuss these issues further with the Committee and their members.