



October 6, 2015

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Commodity Futures Trading Commission Title VII Swap Execution Facility and Trade Execution Regulatory Framework and Implementation

Dear Mr. Kirkpatrick:

The Securities Industry and Financial Markets Association ("**SIFMA**")¹ appreciates the continuing efforts of the Commodity Futures Trading Commission ("**CFTC**" or "**Commission**") and its staff in developing the swap execution facility ("**SEF**") and related trade execution regulatory framework. We are supportive of the Commission's continued efforts in seeking to facilitate further industry dialogue, most recently at a public roundtable on the "made available to trade" determination process,² in addition to considering past discussions and comments we have submitted aimed at informing topics relevant to the Commission's work in this area.

We agree with Chairman Timothy Massad's recent statement that, while the progress to date in developing a robust trade execution regime has been significant, the work is not finished.³ We therefore present the following comments, which are intended to identify areas of the regulatory framework that require further consideration in light of current market practice, or because they depend on temporary no-action relief letters to avoid causing severe market and trading disruption. In furtherance of contributing more sustained and lasting solutions to some of the remaining issues, these comments reflect our members' concerns and experiences to date operating under the current Commission regulations and related temporary no-action relief.

¹ SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over \$2.4 trillion for businesses and municipalities in the U.S., serving clients with over \$16 trillion in assets and managing more than \$62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

² See CFTC's *Division of Market Oversight Public Roundtable on Made Available to Trade*, U.S. COMMODITY FUTURES TRADING COMM'N (July 15, 2015), available at <http://www.cftc.gov/PressRoom/PressReleases/matroundtableparticipant071515>.

³ See *Keynote Address Timothy G. Massad before the District of Columbia Bar (Washington, DC)*, U.S. COMMODITY FUTURES TRADING COMM'N (July 23, 2015), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-26> ("The progress we have made to date is significant. It is a tribute to the dedication and tireless efforts of the CFTC's staff. Their work has been extraordinary. But our work is not finished. On the contrary, there remains a good deal of important work to accomplish in all of these areas.") [hereinafter "*D.C. Bar Keynote Address*"].

We believe that the specific comments set out below will help ensure the nascent SEF regulatory framework continues to develop in a fair and robust manner, serving the Commission's stated goals while ensuring markets continue to operate efficiently and effectively. We further hope that these comments will assist the Commission as it looks to enhance swap market liquidity, reduce market fragmentation and minimize regulatory uncertainty.

We note also that there are other concerns in the context of the execution framework that we do not address below, but for which permanent or revised policies are still needed – for example, with respect to post-trade confirmation protocols and the "made available to trade" ("**MAT**") determination process. We note that other commenters are contributing to the ongoing discussion on these issues.⁴

1. PACKAGE TRANSACTIONS

Package transactions form an important part of the swaps market and allow market participants to appropriately hedge and allocate risks. The CFTC staff's current no-action relief relating to package transactions is set to expire on November 14, 2015, or February 15, 2016, depending on the type of package.⁵ While we appreciate Chairman Massad's statement that he intends to seek a further extension of the relief for remaining packages until late 2016,⁶ in order to provide legal certainty the CFTC should adopt a permanent package transaction regulatory framework.

Such framework should accomplish the following:

- A package should be viewed as an integrated unit when assessing whether it should be subject to the trading mandate, noting also that certain non-swap components of the package may be subject to separate and potentially conflicting regulatory regimes.
 - A package should not be subject to the trading mandate solely because one or more of its swap components meet the requirements for a MAT determination. The RFQ-to-3 execution method may be inappropriate for a package transaction, even if the package transaction's swap components are relatively liquid when viewed in isolation.
 - When executing a package containing a MAT swap, where the package viewed as an integrated whole does not meet the requirements for a MAT determination,

⁴ See *SIFMA AMG Submits Comments to the CFTC in Response to Commissioner Giancarlo's White Paper and in Regards to the SEF Regulatory Framework*, SIFMA Asset Management Group (May 11, 2015), available at <http://www.sifma.org/issues/item.aspx?id=8589954630> [hereinafter "**SIFMA AMG White Paper Comments**"]; Re: *CFTC Division of Market Oversight Roundtable Regarding the Made Available to Trade Process*, Investment Company Institute (Aug. 17, 2015), available at <https://www.ici.org/pdf/29262.pdf>. The MAT determination process was recently the subject of a roundtable hosted by the CFTC's Division of Market Oversight. See *Public Roundtable: The Made Available to Trade Process*, U.S. Commodity Futures Trading Comm'n (July 15, 2015), available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/transcript071515.pdf>.

⁵ *Extension of No-Action Relief from the Commodity Exchange Act Sections 2(b)(8) and 5(d)(9) and from Commission Regulation § 37.9 and Additional No-Action Relief for Swap Execution Facilities from Commission Regulation § 37.3(a)(2) for Swaps Executed as Part of Certain Package Transactions*, CFTC Letter No. 14-137 (Nov. 10, 2014) [hereinafter "**CFTC Letter No. 14-137**"].

⁶ See *Remarks of Chairman Timothy Massad before the 3rd Annual OTC Derivatives Summit North America*, U.S. COMMODITY FUTURES TRADING COMM'N (Sept. 29, 2015), <http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-28> [hereinafter "**OTC Derivatives Summit Remarks**"].

participants should be permitted to execute the MAT swap component either off-SEF or on-SEF. Execution on-SEF should be permitted to occur away from the SEF's "Required Transaction" execution methods, as described in Section 37.9(a)(2) of the CFTC's regulations (the "**Required Transaction Execution Methods**").

- The current resubmission relief for swap legs that are subject to the Required Transaction Execution Methods and have been rejected from clearing should be made permanent.

Subjecting the swap component of package transactions to the Required Transaction Execution Methods creates increased execution risk for the package as a whole. Further, when applied to package transactions, the Commission's current void ab initio policy, which we discuss further below, increases execution risk, as participants may have to unwind the non-swap component of a package transaction because the swap component failed to clear. We appreciate the CFTC's time-limited no-action relief to address this issue.⁷ Nonetheless, a permanent framework is needed.

As the SIFMA Asset Management Group ("**SIFMA AMG**") noted in a recent letter to the CFTC's Division of Market Oversight,⁸ SEFs are still in the process of developing infrastructure and rules relating to package trading. We are concerned about both technological readiness and the relevant SEF rule frameworks, which in some cases would conflict with the orderly execution of certain widely traded package transactions if the swap components of such package transactions become subject to the trade execution mandate. In particular, and as discussed in greater detail in SIFMA AMG's letter, once the CFTC's current relief expires, conflicts between the CFTC's regulations and both the Chicago Mercantile Exchange and Intercontinental Exchange rules may result in a de facto prohibition of "Exchange for Related Position Transactions" ("**EFRPs**").⁹ These rules prohibit EFRPs where the swap component is traded on-SEF, regardless of the execution method used. If the swap components are required to be traded on a SEF, whether or not the execution method is mandated, there would be a direct conflict between the rules. The permanent framework should therefore clarify that neither execution on a SEF nor a particular execution method is required for any component of a package that is not in its entirety subject to a MAT determination, and should ensure that derivatives clearing organizations ("**DCOs**") cannot prohibit trading in package transactions that are executed on-SEF. We encourage the CFTC to adopt a permanent regulatory framework immediately in advance of the expiration of the current relief on November 14, 2015 to prevent market disruption or uncertainty (or at least extend relief until a permanent solution is developed).

We note that certain package categories may never be appropriate for MAT determinations, regardless of the MAT status of the swap component. For example, MAT/New Issuance Bond packages (as that term is defined in CFTC Letter No. 14-137) are bespoke structures that are

⁷ See *No-Action Relief from the Commodity Exchange Act Sections 2(b)(8) and 5(d)(9) and from Commission Regulation § 37.9 for Swaps Executed as Part of Certain Package Transactions and No-Action Relief for Swap Execution Facilities from Compliance with Certain Requirements of Commission Regulations § 37.9(a)(2), § 37.203(a) and § 38.152 for Package Transactions*, CFTC Letter No. 14-62 (May 1, 2014); *Extension of No-Action Relief for Swap Execution Facilities and Designated Contract Markets from Compliance with Certain Requirements of Commission Regulations § 37.9(a)(2), § 37.203(a) and § 38.152 for Package Transactions*, CFTC Letter No. 14-121 (Sept. 30, 2014).

⁸ *Comment on the Division of Market Oversight's Public Roundtable Regarding the Made Available to Trade; Request for Further Relief from Trade Execution Requirements for Package Transactions*, SIFMA AMG (Aug. 17, 2015), available at <http://www.sifma.org/comment-letters/2015/sifma-amg-submits-comments-to-the-cftc-on-made-available-to-trade-determinations/>.

⁹ *Id.*

customarily developed and priced at the request of a specific customer.¹⁰ In such packages, the terms of the swap form an integral part of the pricing for the bond, which combined with the package transaction's bespoke, customer-driven purpose, means that neither that customer nor the market as a whole would benefit from execution via the Required Transaction Execution Methods. Restricting execution of such packages to the Required Transaction Execution Methods would deprive customers using these structures of the pricing certainty needed at the time the relevant bond is priced and would not enhance price transparency. We encourage the CFTC to consider this as part of the approach to the package transaction regulatory framework.

2. ENHANCING LEGAL CERTAINTY FOR SWAP TRANSACTIONS THAT ARE SUBMITTED FOR CLEARING

We appreciate the CFTC staff's efforts to address the issues caused by executed transactions that fail to clear, or for which operational or clerical errors are identified after clearing, through time-limited no-action relief.¹¹ That said, while temporary no-action relief is helpful, the expiration of the temporary no-action relief will not bring about the complete elimination of errors or scenarios whereby executed transactions fail to clear. As such, we now encourage the CFTC to address the remaining concerns with the void ab initio policy¹² and the CFTC's temporary error correction relief by developing a permanent comprehensive policy framework that will promote legal certainty for transactions that are submitted for clearing but that either fail to clear or that require subsequent error correction. To accomplish this, the CFTC should:

- encourage DCOs to establish error correction technology;
- establish a permanent resubmission policy framework for transactions that have failed to clear, which should
 - expand the current temporary framework to include transactions that fail to clear for a broader range of reasons than is currently permitted; and
 - permit transactions to be resubmitted more than once, if necessary.

The straight through processing guidance (the "**STP Guidance**")¹³ originally implementing the void ab initio policy was released two years ago, and was motivated by Staff's concern that if a trade was not immediately declared void ab initio upon rejection from clearing, "it would enable parties to evade the clearing requirement by deliberately entering trades that exceeded their credit limits and then enforcing them as bilateral trades."¹⁴ The market has now had the experience of operating with straight through processing first-hand. While we agree that straight through processing has been helpful in reducing breakage, the STP Guidance and Section 1.73 of the CFTC's regulations only

¹⁰ The current relief for MAT/New Issuance Bond packages is set to expire on February 12, 2016. *See* CFTC Letter No. 14-137, *supra* note 5.

¹¹ *See No-Action Relief for Swap Execution Facilities and Designated Contract Markets in Connection with Swaps with Operational or Clerical Errors Executed on a Swap Execution Facility or Designated Contract Market*, CFTC Letter No. 15-24 (Apr. 22, 2015); CFTC Letter No. 14-137, *supra* note 5.

¹² *See Staff Guidance on Swaps Straight-Through Processing*, U.S. COMMODITY FUTURES TRADING COMM'N (Sept. 26, 2013), <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/stpguidance.pdf>.

¹³ *See id.*

¹⁴ *See id.* at 5.

require that futures commission merchants screen orders for compliance with risk-based limits ("**FCM Limit Checks**"), and therefore do not help to reduce breakage caused by rejection by a DCO.

Notwithstanding the best efforts of market participants and the CFTC, "executed" swaps do in certain instances continue to fail to clear. These failures occur in a wide array of circumstances in which the parties intend to execute a transaction, and, in the absence of the transaction being declared void ab initio, intend to work to clear the transaction as quickly as possible. It is often difficult to discover precisely why a transaction has failed to clear without a substantial and time-consuming investigation, and even when the reason is known, it is often unclear whether such failure should be properly characterized as arising due to an "operational or clerical error".

The void ab initio policy will come under greatest stress during periods of high market volatility, when swap transactions may be more likely to be rejected from clearing. Rejecting transactions in these circumstances may, in turn, cause cascading market failures and increased systemic risk. Developing a robust resubmission process will help prevent the risk of such failures and thereby reduce systemic risk.

We also encourage the CFTC to consider adopting a policy framework that addresses the allocation of costs relating to clearing failures. We would recommend that such framework provide for cost allocation on a non-discriminatory basis, either by setting out market-wide guidelines for how costs associated with swaps that fail to clear should be allocated, or by requiring SEFs or DCOs to establish their own rules that would allocate such costs.

The costs associated with a clearing failure include both the cost of losing a contract struck at the price the parties agreed to, and the cost of exiting any related hedge. If these costs cannot be properly allocated in the event a swap transaction fails to clear, they would ultimately be reflected in the price of the swap ex ante (raising the cost of swap execution for all market participants).

Under the void ab initio policy, the costs associated with clearing failures are not allocated to the party who caused the failure to clear, and therefore that party has no incentive to modify its behavior to reduce clearing failures. Allocating costs to the party that is responsible for the clearing failure will naturally incentivize market participants to ensure they take all steps necessary to avoid causing a clearing failure, and thereby advance the goals of clearing certainty and the benefits of straight through processing.

We note that, the current incentive structure penalizes parties that hedge their exposure, because these parties face the added cost of unwinding their hedge (without compensation). Hedging is critical for prudent risk management and the Commission's swaps clearing policy should not adversely affect or create a disincentive to it.

3. BLOCK TRADES

We appreciate the CFTC staff's time-limited no-action relief permitting the use of a SEF trading system or platform to facilitate the execution of block trades.¹⁵ This relief, however, is set to expire on December 15, 2015.¹⁶

¹⁵ In particular, see *No-Action Relief for Swap Execution Facilities from Certain "Block Trade" Requirements in Commission Regulation 43.2*, CFTC Letter No. 14-118 (Sept. 19, 2014) [hereinafter "**CFTC Letter No. 14-118**"].

We note that the "block trade" concept was initially addressed in the CFTC's Real-Time Public Reporting of Swap Transaction Data rulemaking (the "**Real-Time Reporting Rule**"),¹⁷ which significantly predates the rule implementing the execution mandate and the minimum trading requirements.¹⁸ Under Section 43.2 of the Real-Time Reporting Rule, block trades must, by definition, "[o]ccur[] away from the registered swap execution facility's or designated contract market's trading system or platform." Pursuant to Section 37.9 of the CFTC's regulations, all transactions that are subject to the trade execution requirement (other than those which the parties treat as block trades) must be executed in accordance with the Required Transaction Execution Methods. Therefore these requirements have been interpreted to mean that block trades cannot be executed on a SEF using any execution method,¹⁹ thereby necessitating the no-action relief.²⁰

We believe that this is an unduly restrictive reading that is based on the operation of the futures model. Instead, the reference to a SEF's "trading system or platform" in Section 43.2 should be read as a reference to a SEF's Required Transaction Execution Methods only.

Clarifying that a "block trade" may be executed in any way other than through a SEF's Required Transaction Execution Methods will provide additional flexibility to market participants to select the best forum for executing their large swaps, while making it clear that using a SEF for such purposes is not prohibited.

Further, for the reasons identified by Commissioner Giancarlo, we also encourage the CFTC to reconsider more generally its approach to categorizing swaps by mandated execution methods. We particularly agree with Commissioner Giancarlo that the current "occurs away" requirement could result in market fragmentation and may therefore decrease overall liquidity in the swaps market.²¹

¹⁶ We note that the International Swaps and Derivatives Association ("**ISDA**") and SIFMA AMG have both raised the issue of FCM Limit Checks and block trades. See *Petition for Rulemaking to Amend Parts 1 (General Regulations under the Commodity Exchange Act), 37 (Swap Execution Facilities) and 43 (Real-Time Public Reporting) of the Commodity Futures Trading Commission Regulations*, ISDA (June 15, 2015), available at <https://www2.isda.org/attachment/NzY2Mg==/ISDA%20CFTC%20Petition.pdf>; *SIFMA AMG White Paper Comments*, *supra* note 4.

¹⁷ *Real-Time Public Reporting of Swap Transaction Data*, 77 Fed. Reg. 1182 (Jan. 9, 2012).

¹⁸ *Core Principles and Other Requirements for Swap Execution Facilities*, 78 Fed. Reg. 33476 (June 4, 2013).

¹⁹ See *Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades*, 78 Fed. Reg. 32866, 32904 n.425 (May 31, 2013).

²⁰ In particular, see CFTC Letter No. 14-118, *supra* note 15.

²¹ J. Christopher Giancarlo, Comm'r, U.S. Commodity Futures Trading Comm'n, *Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank* at 52 (Jan. 29, 2015), available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf> [hereinafter "**White Paper**"]. We note that while the futures market in practice currently operates on the basis that block trades occur away from the relevant exchange, the regulatory model for futures is more expansive: it permits a designated contract market ("**DCM**") to establish alternative execution procedures for a block trade, provided that such rules do not impede Core Principle 9. *Alternative Executive, or Block Trading, Procedures for the Futures Industry*, 64 Fed. Reg. 31195 (June 10, 1999). DCM rules, in turn, may define a "block trade" as a "privately negotiated" transaction, but do not necessarily require that all trades meeting a minimum size are executed in a particular manner. See, e.g., ICE Futures U.S., Inc., *Trading Rules*, Rule 4.07 (September 20, 2012), available at https://www.theice.com/publicdocs/rulebooks/futures_us/4_Trading.pdf; CME & CBOT, *Market Regulation Advisory Notice, Block Trades: Rule 526* (November 8, 2013), available at <https://www.cmegroup.com/rulebook/files/cme-cbot-ra1313-3-block-trades.pdf>. Thus, large trades in the futures market can occur on or away from the relevant exchange at the discretion of the market participants and the DCMs.

4. CROSS-BORDER TRANSACTIONS

Chairman Massad recently addressed the issue of cross-border transactions in swaps trading at his keynote address before the D.C. Bar²² and at the Third Annual OTC Derivatives Summit for North America.²³ We appreciate Chairman Massad's continued commitment to enhance cross-border regulatory cooperation, which would aid in minimizing instances of market disruption or fragmentation.

We believe that the time is ripe for considering cross-border trade execution issues and the impediments to equivalence or substituted compliance determinations. The trade execution regulatory regime, both here and globally, is still being developed. As these regimes become more fully formed, it will become increasingly difficult to coordinate across regimes, and there may be a natural tendency towards divergence, as seems to be the case in other areas of the law. Coordinating now will help to forestall divergence and ensure a coordinated, comprehensive global regulatory framework is in place.

We note that the European MiFIR and MiFID regimes as currently contemplated take a more flexible approach towards execution methods than the U.S. regime. We continue to encourage the U.S. and European regulators to work together towards a consistent approach. We believe the CFTC should consider allowing additional execution models and support Commissioner Giancarlo's position on this issue.²⁴ Divergence between the U.S. and European requirements for methods of execution may affect the ability of U.S. and European regulators to make substituted compliance or equivalence determinations. We also encourage the U.S. and European regulators to coordinate block trade regimes and, in particular, block size thresholds.

SIFMA looks forward to discussing these issues further with the Commission and Commission staff. Please contact me at 212-313-1280 or kbrandon@sifma.org if you have any questions.

Yours sincerely,



Kyle Brandon
Managing Director

cc: Honorable Timothy Massad, Chairman
Honorable Sharon Bowen, Commissioner
Honorable J. Christopher Giancarlo, Commissioner

Mr. Vincent McGonagle, Director, Division of Market Oversight
Mr. David Van Wagner, Chief Counsel, Division of Market Oversight

²² *D.C. Bar Keynote Address*, *supra* note 3.

²³ *See OTC Derivatives Summit Remarks*, *supra* note 6.

²⁴ *See White Paper*, *supra* note 21, at 21-27.