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Invested in America

March 15, 2019

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Swap Execution Facilities and Trade Execution Requirement; Proposed Rule – RIN 3038-AE25, 83 Fed. Reg. 61946 (Nov. 30, 2018)

Dear Mr. Kirkpatrick:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] welcomes the opportunity to provide the Commodity Futures Trading Commission (the "**Commission**") with comments on the above proposal (the "**Proposal**") to amend the Commission's regulations governing swap execution facilities ("**SEFs**") and the trade execution requirement added to the Commodity Exchange Act (the "**CEA**") by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**").

We support the Commission's decision to consider changes to these regulations with a view to promoting trading on SEFs and pre-trade price transparency. We also support the Commission's efforts to review, clarify, and, where appropriate, codify the numerous staff guidance and no-action letters associated with these regulations.

We are concerned, however, that the Proposal does not account sufficiently for differences between the inter-dealer ("**D2D**") and dealer-to-client ("**D2C**") markets. Certain aspects of the Proposal, which are intended to fix issues in the D2D market, would impede liquidity formation and competition in the D2C market. More targeted measures could help achieve the Commission's goals without resulting in these unintended negative consequences.

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1 SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. 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.

In particular, we recommend that the Commission:

- Move forward with the proposed expansion of the SEF registration requirement, which would be sufficient to address most of the Commission's concerns regarding issues in the D2D market;

- Reconsider the broad expansion of the pre-execution communications ban, which would impose undesirable costs and burdens on the D2C market;

- Establish an objective test for which mandatorily cleared swaps must be traded on a SEF, which should take into account market-wide considerations, not just the mere listing of a type of swap by a single SEF or designated contract market ("**DCM**"); and

- In conjunction with any expansion of the SEF registration requirement or trade execution requirement, take steps to preserve U.S. access to foreign markets, including both comparably regulated markets and emerging markets.

Below we provide additional background on these recommendations and the market characteristics that inform them.

I. <u>Background: Differences Between the D2D and D2C Markets</u>

The Proposal is intended to promote SEF trading and pre-trade price transparency by providing SEFs with more flexibility in how they operate while also requiring that the entire liquidity formation process for a broad range of swaps take place on SEFs. To evaluate the Proposal, it accordingly is necessary to examine why liquidity formation for such swaps does not always take place on SEFs today. As described below, the reason is different as between the D2D and D2C markets.

A. <u>Liquidity Formation in the D2D Market</u>

In the D2D market, most swap transactions take place in relatively more liquid, standardized swaps. Somewhat less frequently, inter-dealer transactions also take place in certain forward-starting swaps and unwinds of open positions.

Dealers typically access liquidity for these transactions through voice brokers and electronic trading platforms. Bilateral negotiation between dealers is relatively less common. When conversational (as opposed to automated) trading occurs, instead it frequently takes place through a voice broker. Any given dealer typically has access to multiple brokers and platforms. Whether a dealer uses one broker or platform versus another typically depends on the type of transaction the dealer wishes to execute. Different brokers and platforms frequently offer better or more reliable liquidity in different transaction types (*e.g.*, one broker might be better for swaps spreads whereas another is better for swap curve or butterfly packages).

Accordingly, the liquidity formation process in the D2D market typically takes place with the involvement of a third-party broker or platform. The reason this process often does not occur on a SEF does not have to do with the economic characteristics of the process itself. Rather, it is because, as the Proposal notes, certain brokers and platforms operating in the D2D market have structured their operations to fit within the less prescriptively regulated introducing broker ("**IB**") registration category and rules permitting pre-execution communications to occur away from a SEF.

B. Liquidity Formation in the D2C Market

In the D2C market, counterparties frequently engage in bilateral pre-execution communications. These communications typically take place on the phone, in person, or over electronic chat between a client and a dealer's salesperson or relationship manager. These conversations proceed organically from discussion of market color or trade ideas to negotiation and execution of specific transactions. They frequently involve discussion of other asset classes (*e.g.*, securities, loans, foreign exchange) beyond cleared swaps, even outside the context of packaged transactions. In many instances the conversations cover the client's broader investment, trading, or other business activities, as well as non-swaps aspects of its relationship with the dealer (*e.g.*, commercial lending, underwriting, or prime brokerage).

Due to the fluid and variable nature of these conversations, and the longer time periods over which they take place, they do not translate to existing electronic execution methods, even request-for-quote ("**RFQ**") protocols. Clients therefore do not usually access liquidity solely through electronic trading platforms.

Clients also do not usually use a voice broker to attempt to source liquidity. A voice broker is not a substitute for a dealer's salesperson or relationship manager because voice brokers typically do not have the same client-centric expertise. Also, sharing details regarding a client's broader investment, trading, or other business activities with a voice broker would raise confidentiality concerns. Confidentiality concerns would also result from the typical voice broker execution process of issuing an RFQ-to-all and negotiating or arranging any resultant bids or offers, including through "work-up" sessions involving execution of a client's transaction in multiple lots with multiple contra-side parties.[2] Clients usually prefer to share their trading interest more selectively, with a smaller number of dealers who can provide liquidity for the overall transaction in a single execution. These dealers can then manage their risk over a longer period of time so as to minimize market impact, including potentially accepting basis risk by hedging in more standardized swaps. A voice broker cannot provide this service because it does not put its own capital at risk.

In addition, for swaps not currently subject to the trade execution requirement, clients can execute the swap on a SEF through any means, not just Order Book or RFQ-

2 *See* Proposal, 83 Fed. Reg. at 61598.

to-3. Therefore, restrictions on permissible SEF execution methods cannot be the reason why the parties choose to execute these swaps away from SEFs. Instead, unlike in the D2D market, key economic and commercial considerations—not differing levels of regulation—drive the structure of the liquidity formation process in the D2C market.

II. Discussion and Recommendations

A. Expand the SEF Registration Requirement

The Proposal would expand the SEF registration requirement to cover single-dealer aggregator platforms and swaps broking entities, including inter-dealer brokers currently registered as IBs.[3] This expanded SEF registration requirement is intended to move liquidity formation within swaps broking entities onto SEFs. Because swaps broking entities primarily function within the D2D market, this aspect of the Proposal relates primarily to that market.

We agree with the Commission that a SEF should encompass more than a mere trade-booking or post-trade processing engine. In particular, an individual or entity that facilitates the *trading* of swaps among multiple participants should register as a, or operate within a registered, SEF (or obtain an exemption from SEF registration).

B. Clarify the IB Registration Requirement

We also recommend that the Commission clarify when IB registration applies to activity involving swaps. In our view, an IB should encompass a person who solicits or accepts a client's swaps order as agent for *routing to, or placement on*, a registered or exempt SEF or DCM. If the person instead sought to *match* the client's order with trading interest from multiple other clients or dealers, the person should register as, or operate within, a SEF, as noted above. If the person solicited or accepted a client's swaps order or facilitated a client's swaps executions in connection with its own or an affiliate's swap dealing business, then the personnel soliciting and accepting the order for the swap dealer should be regulated as associated persons ("**APs**") of the registered swap dealer, without subjecting the entity employing the APs to regulation as a SEF or IB.[4]

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3 Proposal, 83 Fed. Reg. at 61956-57.

4 Since 2012, there has been some confusion regarding when an entity employing a swap dealer's APs must register as an IB or commodity trading advisor ("**CTA**"). On the one hand, a footnote in a Commission rule release stated that such registration is not required. *See* Adaptation of Regulations to Incorporate Swaps, 77 Fed. Reg. 66288, 66290 n.16 (Nov. 2, 2012). On the other hand, a subsequent no-action letter provided relief from IB and CTA registration to certain "agent affiliates" of registered swap dealers, but only under certain conditions. CFTC No-Action Letter 12-70 (Dec. 31, 2012). The Proposal, by expanding the SEF registration requirement, could cause even more confusion if it does not address this issue.

(footnote continued on next page)

C. Permit D2C Pre-Execution Communications

The Proposal would prohibit pre-execution communications relating to swaps subject to the trade execution requirement except in connection with package transactions. Unlike the proposed changes to the SEF registration requirement, this change would directly interfere with how clients in the D2C market access liquidity, imposing futures-style regulations[5] that are ill-suited to the swaps markets. Instead, we think the proposed application of the SEF registration requirement to swaps broking entities would be sufficient to address the Commission's concerns regarding liquidity formation and price discovery occurring away from SEFs in the D2D market.

1. Banning D2C Pre-Execution Communications Would Have Negative Consequences

Expanding the pre-execution communications ban would force dealers and their clients either to (a) eliminate bilateral pre-execution communications with each other relating to swaps subject to the trade execution requirement (other than package transactions); or (b) shift their pre-execution communications to SEF-sponsored telephone lines and chat systems. As described below, both alternatives would be problematic.

a) Eliminating Bilateral Communications Would Disintermediate Essential Client Relationships and Communications

As described in Part I.B. above, clients frequently source liquidity through bilateral pre-execution communications with dealers. These communications proceed organically and cannot be replaced entirely through electronic execution methods, such as RFQ. Without the ability to discuss their broader investment, trading, or other business activities or obtain market color, clients would face challenges in determining whether, when, and what type of swap to execute.

Specifically, we recommend that the Commission clarify that an entity whose employees solicit or accept clients' swaps orders or facilitate clients' swaps executions in connection with their own or an affiliate's swap dealing business need not register as a SEF <u>or</u> IB (or CTA), so long as the relevant employees are designated as APs of the relevant swap dealer or affiliate(s). From a policy perspective, the swap dealer registration framework is more appropriate to apply to such an entity's swaps activity than the IB or CTA registration framework because such a person is acting for, or on behalf of, a swap dealer as opposed to a client. Similarly, such an entity should not be required to register as a SEF because it is not facilitating multiple-to-multiple order interaction or execution (unlike brokers in the D2D market).

[5] DCMs have adopted rules and guidance that prohibit pre-execution communications (*e.g.*, for transactions executed on the trading floor) or impose conditions on such transactions requiring exposure to the DCM's electronic order book. *See, e.g.*, CME Group Rule 539 and Regulatory Advisory 1718-5. The Proposal would, counterintuitively, impose even more significant restrictions on pre-execution communications involving swaps than the restrictions that apply to futures under these rules and guidance.

Nor would it be desirable to force clients to use voice brokers. As noted above, voice brokers do not typically have the client-centric expertise possessed by dealers' salespeople and relationship managers. They are not as well-positioned to help a client discern what type of swap to execute, especially considering that different brokers frequently specialize in different transaction types and thus are better engaged once a party knows what type of swap he or she wishes to execute. Involving a voice broker at these early stages also would increase the likelihood of unwanted exposure of confidential information that goes beyond swaps transactions.

b) Shifting Bilateral Communications to SEF-Sponsored Systems Would Impose Significant Costs and Impede Competition, with No Discernible Benefit

Few, if any, SEFs currently offer functionalities to facilitate the full range of pre-trade communications commonly used in the D2C market, and the costs to building them (or integrating them with a SEF) could be substantial. If and when any SEFs begin to offer them, dealers and clients would face costs in switching their telephone and chat providers, including incorporating such telephone and chat systems into existing recordkeeping and supervision systems. Moreover, in-person meetings could not be replaced effectively with on-SEF telephonic or electronic communication. Conducting such meetings via SEF-sponsored telephone lines and chat systems reduces the human element that can drive the bespoke, sometimes lengthy negotiations that are emblematic of the D2C market.

Also, since dealers and clients would want to continue to have pre-execution communications, they would be forced to use a SEF that sponsors telephone lines or a chat system. As a result, SEFs that operate telephone lines or chat systems, particularly those that list swaps that are not generally available on other platforms, would be granted an effective monopoly over the execution of certain types of transactions. Such monopolies would allow such SEFs to increase fees, would promote consolidation in the SEF market, and would discourage technological innovation.

Moreover, moving bilateral pre-execution communications onto SEF-sponsored telephone lines and chat systems would not increase pre-trade price transparency. Indeed, to the extent confidentiality concerns led parties to avoid discussing other, non-swap transactions or strategies that have historically been part of the price discovery process, requiring pre-execution communications to occur on these SEF-sponsored systems might even reduce transparency.

Nor would moving these communications onto SEFs provide meaningful additional market integrity protections. Swap dealers are already subject to robust recordkeeping, supervision, and business conduct requirements applicable to their communications with clients. Requiring these communications to occur on a SEF would pose operational and technological challenges to dealers in complying with these requirements (*e.g.*, integrating a dealer's voice recording technology with a new SEF telephone system). Also, the Proposal would not require a SEF's automated trade surveillance system to cover orders entered into by electronic communications (such as instant messaging or email systems) that are not entered into an electronic trading system or platform. As a result, the Proposal would exclude most pre-execution communications from automated SEF surveillance, thus eliminating the main incremental market integrity benefit of requiring those communications to occur on SEF.[6]

2. **Excluding Certain Communications from the Ban Would Not Be an Effective Solution**

The Proposal requests comments regarding whether the Commission should allow an exception from the pre-execution communications ban for communications involving "market color" or that are intended to discern the type of transaction that a market participant may ultimately execute on a SEF.[7]

These exceptions would not effectively solve the issues described above because market participants would struggle to identify when a conversation has shifted into (or away from) communications that are covered. Indeed, more generally, the shifting and organic nature of conversations would cause both dealers and clients to face an enormous compliance challenge in identifying which communications are subject to the ban. As another example, a conversation can easily shift from discussing a swap subject to the trade execution requirement—which would need to occur on a SEF—to a swap not subject to that requirement—which could occur away from a SEF—and back again. Rather than constantly shifting between on-SEF and off-SEF modes of communication, market participants are likely to take a prophylactic, over-inclusive approach to compliance that further increases the costs and disruption imposed by the ban.

3. **Banning Pre-Execution Communications Is Not Necessary to Encourage Liquidity Formation and Price Discovery on SEFs**

The Proposal contains several other measures intended by the Commission to encourage liquidity formation and price discovery on SEFs. These measures include expanding the SEF registration requirement (as noted above), as well as eliminating restrictions on permissible execution methods for swaps subject to the trade execution requirement and various changes intended to reduce the operational costs and complexities associated with trading on a SEF. These measures would clarify when the SEF framework applies to intermediaries who facilitate swaps trading. They also would make it easier and less costly for SEFs to facilitate the liquidity formation and price discovery process. In addition, expanding the SEF registration requirement would eliminate the Commission's key concern with respect to off-SEF pre-trade communications, as brokers currently engaged in arranging cross-trades or other off-SEF

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[6] We also note that, even if pre-execution communications took place on one SEF, market participants may execute such transaction by RFQ on another SEF. Therefore, unless different SEFs allowed for integration across their different systems and communications platforms, it would still not be possible to maintain a complete audit trail of the trade in any one system.

[7] Proposal, 83 Fed. Reg. at 61988.

price-forming activity between customers would be required to register as a, or operate within a registered, SEF. Before imposing a disruptive pre-execution communications ban that would disintermediate essential client relationships, the Commission should first provide the market with an opportunity to adapt to these other changes.

D. Establish an Appropriate Scope and Compliance Schedule for the Trade Execution Requirement

Instead of requiring SEFs to designate a swap as being "made available to trade" ("**MAT**") based on a set of open-ended factors, the Proposal would expand the trade execution requirement to cover any swap that is both subject to the mandatory clearing requirement and listed for trading by a SEF or a DCM.

Although we agree that the current MAT process should be changed, we are concerned that the proposed approach would subject swaps to the trade execution requirement that, while perhaps currently subject to the clearing requirement, are ill-suited to trade on SEFs. This same concern applies to swaps currently listed on a SEF that are not yet subject to the clearing requirement but could be in the future. We recommend that the Commission instead adopt an objective test for which mandatorily cleared swaps must be traded on a SEF, which takes into account market-wide considerations, not just the mere listing of a type of swap by a single SEF or DCM.

1. Not All Mandatorily Cleared Swaps Listed by a SEF or DCM Are Suitable for Mandatory Trading

As described below, the Proposal inappropriately conflates mandatory clearing and listing by a SEF or DCM with suitability for mandatory trading.

a) Mandatory Clearing Is Not an Effective Proxy for Mandatory Trading

Whether a particular swap is suitable for mandatory clearing depends in large part on whether sufficient pricing data exists for a central counterparty (a "**CCP**") to margin the swap effectively. But the existence of such pricing data does not necessarily depend on there being a high level of trading activity or liquidity. For example, in the rate swap market, a CCP can derive pricing data from swap curves that do not depend on there being a material amount of trading activity at each point along the curve. In the credit default swap ("**CDS**") market, CCPs rely on measures such as requiring clearing members to submit prices for end-of-day settlement purposes to address less liquid positions, such as CDS on off-the-run indexes. If sufficient pricing data does exist for a swap for a CCP to margin the swap effectively, then often the counterparty credit risk mitigation benefits of central clearing over the life of the swap can justify a clearing mandate, even if new transactions in the swap occur only episodically.

In contrast, a swap that trades infrequently or only among a small number of market participants will not benefit from mandatory trading. The information leakage entailed by seeking liquidity from multiple sources (whether directly or with broker assistance) will tend to impair effective execution of the swap relative to bilateral negotiation methods. Subjecting less liquid swaps to mandatory trading is thus likely simply to shift bilateral negotiation onto SEF-sponsored systems, with the ensuing costs noted above.

b) SEFs Face a Conflict of Interest in Determining Which Swaps Are Subject to Mandatory Trading

In exercising discretion to determine which swaps are subject to the trade execution requirement, a SEF has a conflict of interest because it benefits economically from expanding participation, trading volume, and market share. This problem is not new, as the existing MAT determination process suffers from this conflict, which initially led to one SEF proposing an overbroad MAT determination that was subsequently narrowed based on market feedback.

The existing process at least requires a SEF to consider liquidity-related factors in reaching a MAT determination, which helps mitigate a SEF's conflict of interest (albeit insufficiently).[8] The Proposal, however, would exacerbate the conflict by replacing the already discretionary MAT determination process with a SEF's discretionary listing decisions, which are made solely on the basis of the SEF's self-interest. The natural result of this change is that SEFs would be incentivized to compete on the basis of an aggressive swaps listing strategy rather than on the basis of providing superior trading platform services.

2. Expanding the Trade Execution Requirement to Cover All Mandatorily Cleared Swaps Listed by a SEF or DCM Would Impose Significant Costs

Even with an expansion of permissible SEF execution methods and pre-execution communications, expanding the trade execution requirement to cover any swap subject to mandatory clearing if it is listed by even a single SEF or DCM would pose several additional costs and problems.

First, the Proposal presents the risk that a single, less commonly used SEF—or SEFs only used by one market segment, such as D2D SEFs—could list a type of swap. This problem is particularly notable because many buy-side firms frequently have onboarded to only one or two SEFs. If the one or two SEFs to which a firm has access do not list all the swaps listed by every other SEF, then the firm would be forced to choose between bearing the costs of onboarding to and using a different SEF versus ceasing to trade in the swaps that its preferred SEF does not list. The costs of onboarding to a SEF are not trivial. In addition to any direct membership or subscription fee imposed by a SEF, there are indirect costs that result from joining a SEF, such as: changes to

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8 A SEF presently has wide latitude for how it assesses and weighs the six prescribed liquidity factors when reaching a MAT determination. *See* 17 C.F.R. § 37.10(b), 38.12(b).

technology and trading infrastructure (including order management systems), new documentation, and the installation of a compliance framework (including training and surveillance) that is consistent with the different rulebooks and technological specifications of each SEF.[9] The end result would be to increase trading costs and foster risk management and market inefficiencies.[10]

Second, even if a firm has access to a SEF that lists all the types of mandatorily cleared swaps it wishes to trade, it would face increased trading costs because SEFs typically charge fees for each executed trade. In addition, the firm would bear material costs, and need a lengthy transition period, to make changes to its technology (such as order management systems and application programming interfaces) to support trading all those types of swaps on that SEF.

3. Expanding the Trade Execution Requirement to Cover All Mandatorily Cleared Swaps Listed by a SEF or DCM Would Have Limited Benefits

Although some swaps that are not currently subject to the trade execution requirement (*e.g.*, spot-starting, fixed-to-floating CAD swaps in liquid tenors and potentially certain additional tenors of spot-starting, fixed-to-floating USD swaps) might evidence sufficient liquidity to support mandatory trading, subject to further data-based analysis, there would be few benefits to expanding the trade execution requirement to cover less liquid swaps (*e.g.*, block trades, rate swaps in less liquid currencies or with non-standard tenors, forward start rate swaps with non-standard tenors, rate swaps with non-par/MAC coupons, or rate swaps with amortizing notional amounts).

Most of these less liquid swaps currently do not trade frequently enough for parties to take advantage of multilateral forms of execution (*e.g.*, RFQ-to-2+, Order Book, auction, or voice broker assistance). Instead, parties entering into these liquid swaps are likely to use SEF execution methods that mimic bilateral negotiation (*e.g.*, RFQ-to-1, chat) and, where permissible, engage in pre-execution communications. In such instances, requiring market participants to execute on a SEF would provide little to no pre-trade price transparency or market integrity benefits. But doing so would impose associated costs, including the costs of onboarding to a SEF for market participants newly subject to mandatory trading. We also note that, even absent mandatory trading, there is significant price transparency for cleared swaps because such swaps are required to be reported to a swap data repository and disseminated to the public in real time.

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[9] In addition to dealers and clients, there are other costs imposed on market participants, such as futures commission merchants, credit hubs, and middleware vendors, who all must connect to a SEF for it to function effectively.

[10] If the Commission makes changes to the rules regarding impartial access to SEFs, the Commission should take those changes into account when considering the scope of the trade execution requirement, given the role that a single SEF could play in triggering application of the trade execution requirement to market participants who may not have access to such SEF.

4. Recommendation 1: Take into Account Market-Wide Liquidity When Subjecting Swaps to Mandatory Trading

In light of the considerations described above, we recommend that the Commission adopt an objective test for which mandatorily cleared swaps must be traded on a SEF or DCM, which takes into account market-wide liquidity.

a) Alternative A: Quantitative Thresholds for Which Swaps Are Subject to the Trade Execution Requirement

We believe that the ideal framework for determining which swaps are subject to the trade execution requirement would be for the Commission, in consultation with an advisory committee consisting of a cross-section of market participants, to establish quantitative thresholds for when the requirement applies to a given type of swap. The Commission could then adjust these thresholds periodically so as to account for changing market dynamics and gradually increased trading on SEFs. We recommend that the Commission incorporate the following liquidity factors into its quantitative thresholds:

(1) the minimum number of SEFs listing the swap for at least one year;

(2) a minimum number of market participants (of all types) trading the swap on-SEF;

(3) a minimum number of on-SEF liquidity providers for the swap;

(4) a minimum number of transactions in the swap executed on a SEF; and

(5) notional volume of the swap executed on SEFs.[11]

Like existing MAT determinations, but unlike mandatory clearing determinations, these criteria should be applied relatively granularly to swaps defined based on specific terms as to tenor, currency, underlying index, coupon type, etc.

Adopting this objective approach would be consistent the text and legislative history of the CEA as amended by Dodd-Frank. In drafting the language of the CEA related to the mandatory trading requirement, Congress could have made a swap subject to the requirement when a DCM or SEF "listed" a swap, language which Congress used in the same section of the CEA. Instead, Congress chose the phrase "makes the swap available to trade," suggesting something more than listing the swap should be required before subjecting a swap to the trade execution requirement. In addition, the Senate's legislative history demonstrates that Congress interpreted this phrase to mean that "[t]he mere 'listing' of the swap by a [SEF], in and of itself, without a minimum amount of

[11] The Commission should measure the fourth and fifth proposed quantitative thresholds over a reasonable time period.

(footnote continued on next page)

liquidity to make trading possible, should not be sufficient to trigger the Trade Execution Requirement."[12] Moreover, Congress included Section 5h(d) in the CEA, which authorizes the Commission to adopt rules defining the universe of swaps that can be executed on a SEF, taking into account price and non-price requirements of swap counterparties, with swaps falling outside that universe permitted to be executed through any other available means of interstate commerce. Finally, such a quantitative approach would also be consistent with the recommendations contained in the U.S. Treasury's report on capital markets.[13]

The Commission could adopt this objective approach through any of several means. One alternative would be for the Commission to modify its interpretation of "made available to trade." Another would be for the Commission to adopt new rules defining the universe of swaps that can be executed on a SEF pursuant to CEA Section 5h(d). Finally, the Commission could maintain its proposed approach of applying the trade execution requirement to all swaps subject to mandatory clearing and listed by a SEF or DCM, but also exercise its authority pursuant to CEA Section 4(c) to adopt an exemption from the trade execution requirement for swaps that do not satisfy the quantitative thresholds set forth above.

In addition, in order to provide time for (a) market participants to onboard to SEFs and (b) additional SEFs to list a swap that becomes subject to the trade execution requirement, we recommend that the Commission increase the transition period for applying that requirement to new types of swaps to 9 months for swaps between registered swap dealers and 18 months for swaps to which one or both parties are not a registered swap dealer.

b) <u>Alternative B: Require Listing by Multiple SEFs/DCMs and Establish Swap-Specific Compliance Schedules</u>

If the Commission does not adopt the approach that we recommend above, then as an alternative we recommend, at a minimum, the Commission adjust the proposed new MAT framework (*i.e.*, where listing by a single SEF or DCM triggers the trade execution requirement) to require that a type of swap be listed on multiple SEFs/DCMs that, taken together, are broadly accessible to different types of market participants (*e.g.*, dealers and clients) before the type of swap becomes subject to the trade execution requirement. Then, once a type of swap becomes subject to the trade execution requirement, the Commission should assess market conditions, including liquidity of the swap, and propose a swap-specific compliance schedule.

In our view, this alternative approach would clearly be a logical outgrowth of the Proposal. With respect to the MAT framework, this approach would be broadly

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12 Statement of Sen. Lincoln, p. S5923, Congressional Record, 111th Congress; *see* Adaptation of Regulations to Incorporate Swaps, 77 Fed. Reg. at 66289.

13 U.S. Treasury Department, *A Financial System That Creates Economic Opportunities: Capital Markets* 145 (Oct. 2017).

consistent with the Proposal, but take into account the possibility that not all market participants have (or, under the proposed impartial access rules, be permitted to have) access to all SEFs/DCMs. With respect to the compliance schedule, the Proposal already sets forth two compliance schedules for comment: (1) a staggered schedule for categories of counterparties (either 90, 180, or 270 days), which would apply to swaps that are currently listed by a SEF or DCM but not yet subject to the trade execution requirement; and (2) an open-ended placeholder for the Commission to establish schedules with respect to swaps that SEFs and DCMs list in the future. This alternative approach merely would preserve Commission discretion for both those swaps already listed by SEFs and swaps that SEFs list in the future, with exercise of such discretion subject to a further notice and comment process similar to the manner in which the Commission has established compliance schedules for new mandatory clearing determinations.

c) Alternative C: Re-Propose Modifications to the Trade Execution Requirement

If the Commission does not adopt either of the alternatives that we recommend above, then it should under no circumstances adopt the proposal to subject all mandatorily cleared swaps currently listed by a SEF or DCM to the trade execution requirement with a mere transition period of 90, 180, or 270 days depending on the statuses of the parties to a swap. Adopting that proposal would be costly and disruptive, for the reasons we describe above. Instead, the Commission should finalize other aspects of the Proposal while also re-proposing and requesting comment on alternative approaches to establishing the scope and compliance schedule for the trade execution requirement. In this situation, the Commission also could consider delaying the effectiveness of the other changes to the SEF framework until it finalized a revised approach to the trade execution requirement.

5. Recommendation 2: Adopt Additional Exemptions from the Trade Execution Requirement

The Proposal would adopt only three exemptions from the trade execution requirement, covering transactions in swaps listed only on exempt SEFs, swap transactions for which a clearing exception or exemption has been elected and associated requirements met, and swap transactions executed as components of package transactions that include the issuances of bonds in primary markets. We recommend that the Commission adopt three additional exemptions.

First, the Commission should adopt an exemption for a swap transaction executed as a component of a package transaction that include a component that is a futures contract. Currently, the rules of both the Chicago Mercantile Exchange ("**CME**") and the Intercontinental Exchange ("**ICE**") prohibit parties from using a swap that is executed on a SEF or DCM as the related component of an exchange for related position transaction

("**EFRP**").[14] As a result, an exemption from the trade execution requirement is necessary to ensure that EFRPs for swaps covered by the requirement remain permissible following adoption of the Proposal. Alternatively, CME and ICE could accomplish this needed change by withdrawing their guidance prohibiting EFRPs that include a swap executed on a SEF or DCM.

Second, the Commission should adopt an exemption addressing market outages and limited hours of operation. Specifically, if the only SEF/DCM that lists a type of swap subject to the trade execution requirement (or, if the Commission amends its impartial access rules, the only SEF/DCM listing that type of swap to which a market participant can have access) experiences a market outage or has limited hours of operation, then market participants unable to access the SEF/DCM should be eligible for an exemption from the trade execution requirement so long as they report their transactions in the swap to the SEF/DCM once it reopens.

Third, the Commission should adopt an exemption continuing to permit (but not require) market participants to execute block trades away from a SEF/DCM, but pursuant to the SEF's/DCM's rules. More so than other types of swap transactions, block trades benefit from bilateral negotiation over longer periods of time, during which time a liquidity provider can assess market conditions and engage in hedging activity designed to mitigate the market impact of executing the block trade. These negotiations benefit less from intermediation by a SEF, and requiring them to be executed on a SEF would raise elevated confidentiality concerns. In addition, this exemption should apply if there is a market outage at the only SEF/DCM where a market participant can trade a swap, even if other SEFs or DCMs list the swap.

E. <u>Preserve U.S. Access to Foreign Markets</u>

The Proposal's expansion of the SEF registration and trade execution requirements could result in foreign brokers, platforms, and counterparties avoiding interactions with U.S. firms and certain of their affiliates in order to avoid becoming subject to additional U.S. regulation. This dynamic is likely to exist in both well-developed and emerging markets. As described below, the Commission should take steps to mitigate the potential negative effect of this dynamic on U.S. access to foreign markets.

1. <u>Permit Foreign Branches of U.S. Banks to Access Foreign SEFs</u>

Currently, Commission staff take the position that the SEF registration requirement applies to a multilateral swaps trading platform located outside the U.S. if the platform permits access, directly or indirectly, by U.S. persons, regardless of whether

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[14] *See* ICE Futures Rule 4.06, CME Rule 538, and related FAQs.

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such non-U.S. platform offers swaps subject to mandatory trading.[15] Foreign swaps trading platforms generally have interpreted this guidance to apply when they permit access by the foreign branches of U.S. banks. As a result, many such platforms have withdrawn access by foreign branches, who instead have been forced to trade off-facility in the relevant foreign markets. Although the Commission's recent grant of exemptions to EU-regulated trading facilities helped mitigate this issue by permitting foreign branches to access the now-exempt facilities, foreign branches still face issues trading on-facility in other foreign jurisdictions (*e.g.*, trading on FX trading venues in Asia).

Expanding the scope of the SEF registration requirement to capture swaps broking entities and swap dealer aggregator platforms would exacerbate the issue. It would expand the policy, outside of the EU context where there is an exemption, of dividing the swaps trading market into U.S. and non-U.S. markets, resulting in U.S. participants lacking sufficient access to liquidity from non-U.S. sources. U.S. banks can only access foreign platforms by having their foreign affiliates access the platform and then entering into back-to-back, inter-affiliate swaps with their foreign affiliates. This process is not only inefficient but also has negative margin and capital implications for U.S. banks.

Applying the SEF registration requirement in this manner is incongruent with similar Commission rules. For example, to preserve U.S. bank access to foreign markets, the Commission permits foreign swap dealers to transact with U.S. banks' foreign branches without triggering Commission registration requirements.[16] By taking a different approach to SEF registration, the Commission effectively is encouraging U.S. banks to trade off-facility, in contradiction to Dodd-Frank's goals. In addition to the transitional relief for foreign swaps broking entities provided for in the Proposal, we would further recommend that the Commission adopt guidance permitting the foreign branches of U.S. banks to access foreign swaps trading platforms and broking entities without causing such platforms and entities to trigger SEF registration. As part of this guidance, the Commission should clarify that such platforms and entities would only need to register, or obtain an exemption from registration, if they permit access *within* the U.S. (*e.g.*, to U.S. customers, not foreign branches of U.S. banks).[17]

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[15] Division of Market Oversight, Commission, *Guidance on Application of Certain Commission Regulations to Swap Execution Facilities* 2 (Nov. 15, 2013); *see* Core Principles and Other Requirements for Swap Execution Facilities, 78 Fed. Reg. 33476, 33481 n.88 (June 4, 2013).

[16] *See* Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292, 45324 (Jul. 26, 2013).

[17] For additional detail regarding these recommendations and the reasons for them, see SIFMA and FIA, *Promoting U.S. Access to Non-U.S. Swaps Markets: A Roadmap to Reverse Fragmentation* (Dec. 14, 2017), https://www.sifma.org/wp-content/uploads/2017/12/Non-US-Trading-Platform-and-CCP-White-Paper-12-14-2017.pdf.

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2. Mitigate Conflicts and Inconsistencies with Foreign Jurisdictions' Trade Execution Requirements

Expanding the CEA's trade execution requirement to cover additional types of swaps would raise two issues in the cross-border context.

First, the CEA's trade execution requirement could conflict with similar requirements in foreign jurisdictions. For example, Commission policy currently subjects the foreign branches of U.S. banks to the trade execution requirement when they trade with any non-U.S. person (other than trades in so-called "emerging market" branches that fall below a 5 percent *de minimis* threshold) and subjects non-U.S. swap dealers to the trade execution requirement when they trade with a guaranteed affiliate.[18] If these transactions take place in a jurisdiction that applies its own trade execution requirement to the swap in question, then the two requirements will conflict with each other unless there is a mutual recognition framework making local foreign trading venues and U.S. SEFs/DCMs eligible for the parties to use to satisfy both requirements. This conflict was poised to arise in the EU when it began to implement its trade execution requirement in 2018, but fortunately the CFTC and EU adopted a mutual recognition framework in late 2017. Similarly, to avoid this conflict in connection with proposed expansion of the CEA's trade execution requirement to cover additional types of swaps that are covered by trade execution requirements in other foreign jurisdictions, the Commission should coordinate the timing of any such expansion with the adoption of mutual recognition frameworks for venues in the relevant foreign jurisdictions.

Second, certain types of swaps covered by the proposed expansion of the CEA's trade execution requirement may not be subject to similar trade execution requirements abroad, or the CEA's trade execution requirement might apply to different categories of market participants than foreign trade execution requirements (*e.g.*, due to different definitions of "financial entity" or similar categories). If trading with a U.S. person, the foreign branch of a U.S. bank, or a guaranteed affiliate would subject a foreign market participant to a U.S. trade execution requirement that would not apply if it traded with someone else, then the foreign market participant will trade with someone else unless it believes that the liquidity and pricing available on U.S. SEFs is superior to the what is available in the local over-the-counter market. This dynamic is likely deter foreign market participants from transacting with U.S. firms and their foreign branches and affiliates. To address this issue, the Commission should (a) coordinate the implementation of any expanded trade execution requirement with appropriate substituted compliance determinations for key foreign jurisdictions and (b) retain relief from the trade execution requirement for a *de minimis* amount of trading volume in other foreign jurisdictions.

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[18] *See* Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, *supra* note 16, at 45369.

If you have any questions concerning our comments, please feel free to contact the undersigned. SIFMA welcomes the opportunity to discuss these issues further with the Commission and its staff.

Sincerely,

Kyle Brandon
Managing Director, Head of Derivatives Policy
SIFMA

cc: Honorable J. Christopher Giancarlo, Chairman
Honorable Brian Quintenz, Commissioner
Honorable Rostin Behnam, Commissioner
Honorable Dan Berkovitz, Commissioner
Honorable Dawn Stump, Commissioner
Mr. Amir Zaidi, Director, Division of Market Oversight