

Swaps Trading 2.0: CFTC Proposes Long-Awaited SEF Rule Overhaul

December 20, 2018

On November 5, 2018, the Commodity Futures Trading Commission (“**CFTC**”) voted, on a 4-1 basis (with Commissioner Daniel Berkovitz dissenting), to propose rule amendments (the “**SEF Proposal**”) to overhaul its regulation of swap execution facilities (“**SEFs**”) and its implementation of the Dodd-Frank Act’s requirement (the “**mandatory trading requirement**”) that certain swaps be executed on a SEF or designated contract market (“**DCM**”).¹ The CFTC also separately voted unanimously to request comment on the practice of post-trade name give-up for anonymous executions on SEFs (the “**Name Give-Up Comment Request**”).²

The SEF Proposal is the most significant achievement to-date in a journey commenced by Chairman J. Christopher Giancarlo almost four years ago when, as a minority party Commissioner at the time, he released a white paper setting forth his vision for an alternative swaps trading framework.³ Consistent with that white paper and a second white paper released by Chairman Giancarlo earlier this year,⁴ the SEF Proposal contains reforms in the following key areas:

- (1) **Flexible Execution Methods.** The SEF Proposal would eliminate the requirement that a transaction in a swap covered by the mandatory trading requirement (a “**Required Transaction**”) be executed on a SEF through either (a) an Order Book or (b) a Request-

¹ See 83 Fed. Reg. 61946 (Nov. 30, 2018). The comment deadline for the SEF Proposal is February 13, 2019.

² See 83 Fed. Reg. 61571 (Nov. 30, 2018). The comment deadline for the Nave Give-Up Comment Request is January 29, 2019.

³ See J. Christopher Giancarlo, “Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank” (Jan. 29, 2015) ([link](#)) (the “**2015 SEF Paper**”).

⁴ See J. Christopher Giancarlo and Bruce Tuckman, “Swaps Regulation Version 2.0: An Assessment of the Current Implementation of Reform and Proposals for Next Steps” (Apr. 26, 2018) ([link](#)) (the “**Swaps 2.0 Paper**”). Our Alert Memorandum regarding the Swaps 2.0 Paper can be found [here](#).
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for-Quote (“**RFQ**”) to at least three unaffiliated participants (“**RFQ-to-3**”);

- (2) **Expanded Mandatory Trading Requirement.** The SEF Proposal would eliminate the process through which SEFs and DCMs designate specific types of swaps as made available to trade (“**MAT**”), instead expanding the mandatory trading requirement to cover all types of swaps that both (a) have been designated for mandatory clearing by the CFTC and (b) are listed for trading by a SEF or DCM;
- (3) **Expanded SEF Registration Requirement.** The SEF Proposal would expand the SEF registration requirement to cover swaps broking entities (including interdealer brokers) and single-dealer aggregator platforms;
- (4) **Regulation of SEF Personnel.** The SEF Proposal would introduce a new category of market professionals, known as SEF trading specialists, who would be subject to proficiency testing, ethics training, trading conduct standards, and fitness qualifications; and
- (5) **Reduced Regulatory Burdens on SEFs.** So as to promote flexibility and reduce regulatory burdens, the SEF Proposal would amend several of the requirements applicable to registered SEFs, including impartial access requirements, straight-through-processing requirements for cleared swaps, confirmation and other documentation requirements for uncleared swaps, and various requirements related to the internal operations of SEFs (*e.g.*, rules related to the chief compliance officer (“**CCO**”) of a SEF, trade surveillance, financial resources, and recordkeeping).

Importantly, the SEF Proposal would not allow SEFs merely to process the execution of Required Transactions arranged or negotiated elsewhere. Rather, the entire trading process would need to take place with the involvement of SEF personnel or systems. In particular, the SEF Proposal would prohibit any communications regarding Required Transactions from occurring away from a SEF, except in connection with so-called “package transactions.” It would also eliminate the ability to execute a block trade away from a SEF but pursuant to a SEF’s rules. The SEF Proposal’s interpretation of the SEF registration requirement would also cover anyone facilitating “trading” activity among multiple participants, not merely someone facilitating the “execution” of transactions.

The central goal of the SEF Proposal is to expand trading on SEFs for a broader range of swaps. The SEF Proposal would accomplish this goal *directly* by expanding the mandatory trading requirement, as well as *indirectly* by permitting a broader range of SEF execution methods, expanding the SEF registration requirement, and reducing the regulatory burdens on SEFs. The SEF Proposal thus represents a major shift from the CFTC’s existing approach to SEFs, which instead has been aimed at promoting pre-trade price transparency and competition *only* for the most liquid types of swaps.

In considering the SEF Proposal, market participants are likely to focus on such questions as:

- ***How will expanding the permitted methods for executing Required Transactions affect swap market pricing, competition, and liquidity?*** The CFTC expressed the view that market participants can, in selecting their execution methods, select the method that is most efficient and cost-effective.⁵ But in their statements accompanying the SEF Proposal, Commissioners Behnam⁶ and Berkovitz⁷ expressed concern regarding the SEF Proposal's broad expansion of permitted execution methods.
- ***What will be the impact of expanding the mandatory trading requirement and prohibiting pre-execution communications away from SEFs?*** For those mandatorily cleared swaps that market participants currently execute on SEFs voluntarily—which comprise large portions of the interest rate swap (“IRS”) and credit default swap (“CDS”) markets⁸—the impact of these changes is likely to be concentrated with block trades currently permitted to be negotiated away from a SEF. But for other types of mandatorily cleared swaps—especially less liquid swaps that customers routinely execute bilaterally with dealers, such as IRS with non-standard tenors or amortization features or off-the-run CDS—the parties do not find the involvement of a SEF to be desirable. Also, as these swaps are not currently Required Transactions, parties can execute them on a SEF through any means, not just Order Book or RFQ-to-3. Therefore restrictions on permissible SEF execution methods cannot be the reason why the parties choose to execute these swaps away from SEFs. To accommodate these types of swaps, SEFs could perhaps respond by providing messaging, email, or telephone systems that mimic existing bilateral communication mechanisms. But even so, market participants might consider whether certain transaction types remain inappropriate for negotiation via a SEF. For these transaction types, existing and proposed swap dealer regulations, such as recordkeeping and associated person qualification and proficiency requirements, might also provide many of the same benefits as using a SEF.

⁵ See 83 Fed. Reg. at 62057. In support, the CFTC cited data indicating that market participants executing swaps via RFQ often select more than the minimum required three recipients, which the CFTC expects would continue to be the case even absent a rule setting forth a minimum number of recipients. *Id.* at 62061.

⁶ See *id.* at 62142.

⁷ See *id.* at 62145.

⁸ According to the International Swaps and Derivatives Association (“ISDA”), for 2018 year-to-date, 56% of the total traded notional for IRS was executed on SEF and 79% of the total traded notional for CDS was executed on SEF. ISDA SwapsInfo Weekly Analysis: Week Ending December 14, 2018.

- ***How will affording SEFs more discretion regarding access criteria affect swap market pricing and liquidity?*** Commissioners Behnam and Berkovitz expressed concerns that allowing SEFs to adopt more selective access criteria would impair competition and worsen pricing. But others might argue that permitting such criteria could enhance pricing and liquidity by helping liquidity providers mitigate the adverse selection issues that can characterize “all-to-all” markets.
- ***What is the appropriate scope of the SEF registration requirement?*** Since 2013, many market participants have been concerned by the CFTC’s view that the SEF registration requirement extends to facilities that solely execute swaps not subject to the mandatory trading requirement. The SEF Proposal would expand that view.
- ***What will be the cross-border impact of the SEF Proposal?*** The SEF Proposal acknowledges that it would likely require several foreign trading venues and brokers to register as SEFs, and it proposes a two-year transition period for some of these entities. But other aspects of the proposal are also likely to have a cross-border impact. For example, expanding the types of swaps covered by the mandatory trading requirement could affect whether non-U.S. persons want to conduct U.S. swaps business, especially if those non-U.S. persons would not be required to trade those types of swaps on a regulated trading venue in their home country jurisdictions. Ultimately, the cross-border impact of the SEF Proposal will depend on other forthcoming CFTC rule proposals, as presaged by another white paper recently published by Chairman Giancarlo.⁹

Market participants will also wish to consider the potential operational, legal, and risk management implications of changes to straight-through processing and documentation requirements. The following memorandum provides more details regarding these issues and other aspects of the SEF Proposal.

⁹ See J. Christopher Giancarlo, “Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-U.S. Regulation” (Oct. 1, 2018) ([link](#)) (the “**Cross-Border 2.0 Paper**”). Our Alert Memorandum regarding the Cross-Border 2.0 Paper can be found [here](#).

BACKGROUND

- Title VII of the Dodd-Frank Act amended the Commodity Exchange Act (the “CEA”) to establish a new swaps regulatory framework, including establishing SEFs as a new category of derivatives trading platforms. The Dodd-Frank Act requires SEFs to comply with fifteen core principles. The CFTC implemented this regulatory framework by adopting Part 37 of the CFTC Regulations in 2013.¹⁰
- The CFTC now seeks comprehensively to reform existing SEF rules and regulations in light of its acquired experience in administering its rules and regulations and in observing the associated effect on the swaps market over the past five years, including by adopting or codifying existing staff guidance and staff no-action relief promulgated by the CFTC.

SUMMARY**(1) LIBERALIZATION OF EXECUTION FUNCTIONALITIES***Status Quo*

- Currently, for Required Transactions, a SEF is required to facilitate execution of the swap through an Order Book¹¹ or RFQ-to-3. A SEF must maintain an Order Book for all swaps it

lists for trading, even for swaps not subject to the mandatory trading requirement.

SEF Proposal

- Under the SEF Proposal, a SEF would be permitted to offer flexible methods of execution for all swaps that it lists, whether or not the swap is a Required Transaction. For any swap that it lists for trading, a SEF would be permitted to offer any method of execution consistent with the SEF definition under the CEA, *i.e.*, “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.”¹²
- Consistent with this change, a SEF would also no longer be required to maintain an Order Book for all swaps that it lists for trading, or require that execution of Required Transactions occur through any specified means, including Order Book or RFQ-to-3.¹³
- In response to the potential criticism that allowing a SEF to offer flexible methods of execution could reduce the benefits of pre-trade price transparency provided by an Order

¹⁰ See Core Principles and Other Requirements for Swap Execution Facilities, 78 Fed. Reg. 33476 (Jun. 4, 2013) (“**SEF Core Principles Final Rule**”); Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade, Swap Transaction Compliance and Implementation Schedule, and Trade Execution Requirement Under the Commodity Exchange Act, 78 Fed. Reg. 33606 (Jun. 4, 2013).

¹¹ An “Order Book” is defined as (i) an “electronic trading facility,” as that term is defined in 7 U.S.C. § 1(a)(16); (ii) a “trading facility,” as that term is defined in 7 U.S.C. § 1(a)(51); or (iii) a trading system or platform in which all market participants have the ability to enter

multiple bids and offers, observe or receive bids and offers entered by other market participants, and transact on such bids and offers. See 17 C.F.R. § 37.3(a)(3).

¹² See 7 U.S.C. § 1a(50).

¹³ In his dissenting statement, Commissioner Berkovitz argues that although the Order Book and RFQ-to-3 execution methods are unsuitable for certain swaps, they should not be eliminated for all swaps. See 83 Fed. Reg. at 62146. Commissioner Berkovitz notes that the SEF Proposal overlooks certain data that demonstrates that RFQ-to-3 has been providing competitive prices and low transaction costs. *Id.* at 62144.

Book or an RFQ-to-3,¹⁴ the SEF Proposal points to a Commission staff research paper that found that, for index CDS subject to the mandatory trading requirement, approximately 45 percent of RFQs were sent to three liquidity providers and the remaining 55 percent were sent to four or more. Thus, a majority of market participants are voluntarily sending RFQs to more than the minimum required number of market participants. As noted above, the CFTC would expect this to continue to be the case even absent a rule setting forth a minimum number of required recipients.

- At the same time, the SEF Proposal would require that a SEF establish general, disclosure-based trading and execution rules for any execution method that it offers. A SEF's rules would be required to describe: (i) protocols for each trading system or platform offered; (ii) the use of discretion in trading systems or platform; and (iii) the general sources and methodology for generating market pricing information.

This liberalization of execution functionalities is consistent with recommendations made in the Swaps 2.0 Paper and is intended to accommodate the expansion of Required Transactions to include less liquid swaps.

This change would mean that market participants would be able to use a broad range of execution methods for swaps that are subject to the mandatory trading requirement and tailor their trading strategies based on the individual swap transaction at hand.

One question commenters might have is how this liberalization of execution functionalities would be viewed by European authorities, whose decision in December 2017 that the legal and supervisory framework applicable to SEFs and DCMs is equivalent to the framework applicable to European trading venues under the Market in Financial Instruments Regulation specifically mentioned the CFTC's existing Order Book and RFQ-to-3 requirements as relevant to the equivalence analysis. Anticipating this question, in his statement accompanying the SEF Proposal, Chairman Giancarlo asserts that the equivalence agreement for swaps trading platforms between the CFTC and the European Commission was made with full knowledge and understanding of the changes advocated in the 2015 SEF Paper.¹⁵

(2) EXPANDED MANDATORY TRADING REQUIREMENT

Status Quo

- The mandatory trading requirement applies to all swaps that are subject to the mandatory clearing requirement, unless no SEF or DCM "makes the swap available to trade," *i.e.*, MAT.¹⁶
- Currently, a SEF or DCM must make an affirmative determination as to which swaps subject to mandatory clearing are also MAT, based on factors such as trading volume and frequency of execution. Once a swap is MAT, such swap must be executed on a SEF or DCM unless some other exception or exemption applies.

¹⁴ In his concurring statement to the SEF Proposal, Commissioner Behnam expressed his view that the liberalization of execution functionalities in the SEF Proposal goes too far. In his opinion, there should be a more limited and targeted expansion of methods of execution that focuses on those methods that promote pre-trade transparency. *Id* at 62142.

¹⁵ *Id* at 62141.

¹⁶ *See* 7 U.S.C. § 2(h)(8).

- There have been no new MAT determinations since 2014, and, according to the SEF Proposal, only approximately seven to nine percent of total reported IRS traded notional are MAT.¹⁷

SEF Proposal

- The SEF Proposal would eliminate the MAT determination process for SEFs and DCMs. Instead, it would apply the mandatory trading requirement to any swaps that are both (i) subject to the mandatory clearing requirement and (ii) listed by a SEF or DCM for trading.
- This change would effectively eliminate the distinction between products subject to mandatory clearing and mandatory trading. According to the SEF Proposal, the goal of this change would be to increase liquidity on SEFs and in turn promote increased pre-trade price transparency by increasing the number of swaps that are traded on SEFs.

The proposed rule would significantly expand the number of swaps that would be subject to the mandatory trading requirement.

This expansion would subject a large number of less liquid swaps to limitations on pre-trade communications, including off-the-run CDS, IRS in non-standard tenors or with amortizing notional amounts and forward-starting CDS and IRS.¹⁸ Many customers do not execute these swaps on SEFs because they are less frequently offered for trading on SEFs. Also, customers are more concerned about information leakage

for these less frequently traded swaps, especially when negotiating the swaps over longer periods of time.

Another source of costs for customers could be the bifurcation of U.S. and non-U.S. liquidity. Notwithstanding any expansion of the CFTC's mandatory trading requirement, subject to non-U.S. law non-U.S. market participants will have the option to execute transactions off-venue with each other outside the U.S. Accordingly non-U.S. market participants will only trade on SEFs to the extent that they benefit from the liquidity and pricing available on SEFs.

It is also notable that the Cross-Border 2.0 Paper recommended expanding the mandatory trading requirement to apply to swap transactions between non-U.S. counterparties that are arranged, negotiated, or executed by U.S.-located personnel or agents. Unless non-U.S. market participants already want to trade on SEFs absent the mandatory trading requirement, expanding that requirement in this manner could push non-U.S. persons to avoid interaction with U.S.-located personnel or agents. This is particularly true for less liquid swaps, which are unlikely to be subject to foreign mandatory trading requirements.

Exemptions from the Mandatory Trading Requirement

Status Quo

- Currently, swap transactions that are eligible for an exception or exemption from mandatory clearing, including the end-user exception, are

¹⁷ At the same time, the SEF Proposal acknowledges that more than 55 percent of the total reported IRS notional has been executed on SEFs since 2015. The SEF Proposal does not provide similar statistics for CDS.

¹⁸ The SEF Proposal indicates that the following swaps would likely become Required Transactions since they are currently subject to the clearing requirement and also listed by at least one SEF or DCM: (i) various swaps in the interest rate asset class including fixed-to-floating swaps denominated in U.S. dollars, pound sterling, and euros with

non-benchmark tenors (whole and partial) that range from 28 days to 50 days; fixed-to-floating swaps in additional denominations with whole and partial tenors ranging from 28 days up to 30 years; basis swaps, overnight index swaps, and forward rate agreements with different denominations and tenors; and (ii) various CDX and iTraxx index CDS in older series (prior to the most recent off-the-run series) and additional tenors, as well as new CDS indices.

not required to be executed on a SEF because they are not required to be cleared. Additionally, block trades and package transactions can in certain cases be negotiated or executed away from a SEF.

SEF Proposal

- The CFTC proposes certain exemptions from the mandatory trading requirement, including:
 - Swap transactions involving swaps that are listed for trading only by a SEF exempt from registration pursuant to CEA section 5h(g);¹⁹
 - Swap transactions for which any exception or exemption from mandatory clearing applies;
 - Swap transactions that are executed as a component of a package transaction²⁰ that include a component that is a new issuance bond; and
 - Swap transactions between “eligible affiliate counterparties”²¹ that elect to clear such transactions, notwithstanding the availability of an exemption from clearing for swaps between affiliates under CFTC Regulation 50.52.

¹⁹ Given that many SEFs that are exempt from registration are non-U.S., this exemption would alleviate the burden that a U.S. market participant would face if the only venue where it could execute a swap subject to the mandatory trading requirement was a foreign exempt SEF.

²⁰ A package transaction consists of two or more component transactions where (i) execution of each component transaction is contingent upon the execution of all other component transactions and (ii) the component transactions are priced or quoted together as one economic transaction with simultaneous or near simultaneous execution of all components.

²¹ Counterparties are “eligible affiliate counterparties” if (i) one counterparty holds, directly or

Current no-action relief provides for relief from the mandatory trading requirement for a much broader set of package transactions than just new issuance bonds, including package transactions involving futures.²² The CFTC does not propose to codify or extend this current relief which could effectively eliminate the ability to execute such package transactions. For example, both CME and 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”).²³ As a result, an exception from the mandatory trading requirement would be necessary to ensure that EFRPs for MAT swaps would remain possible following adoption of the SEF Proposal.

Significantly More Limited Exceptions from Pre-Trade Communication Restrictions

Status Quo

- Although CFTC rules currently prohibit off-SEF pre-arrangement or pre-negotiation of Required Transactions, there are exceptions for pre-arranged or pre-negotiated swaps that (i) constitute “block trades,” (ii) are executed on a SEF via an Order Book with a time delay between bids and asks, or (iii) are otherwise allowed pursuant to a SEF’s rules.

indirectly, a majority ownership interest in the other counterparty or (ii) a third party holds, directly or indirectly, a majority ownership interest in both counterparties. See 17 C.F.R. §§ 50.52(a)(1)(i)-(ii).

²² See CFTC Letter No. 17-55, Re: Extension of No-Action Relief from Sections 2(h)(8) and 5(d)(9) of the Commodity Exchange Act and from Commission Regulations 37.3(a)(2) and 37.9 for Swaps Executed as Part of Certain Package Transaction (Oct. 31, 2017).

²³ See ICE Futures Rule 4.06, CME Rule 538, and related FAQs.

SEF Proposal

- The SEF Proposal would eliminate the existing exceptions for pre-arranged or pre-negotiated swaps described above.
- Under the SEF Proposal, a SEF would be required to prohibit its participants from engaging in pre-execution communications that occur away from the SEF related to Required Transactions, including the negotiation of swaps that will later be executed on the SEF. This prohibition would not apply to swaps that are not Required Transactions.
- The SEF Proposal would provide an exception to this prohibition on pre-execution communications for components of a “package transaction,” which includes at least one component that is not a Required Transaction.
- The SEF Proposal separately would (1) require participants seeking to execute a block trade to do so on a SEF and (2) eliminate the requirement that block trades “occur away” from a SEF, thereby codifying and making generally applicable existing no-action relief specific to block trades intended to be cleared.²⁴
- The CFTC has requested comment on potential exceptions for pre-execution communications (i) involving “market color” or (ii) intended to discern the type of transaction to be executed.

As noted above, the expansion of the mandatory trading requirement would result in a corresponding expansion of the scope of products covered by the prohibition on pre-execution communications, which the SEF Proposal would in turn expand by eliminating

exceptions for block trades and principal/agency cross trades, among others.

The elimination of the current pre-execution communication prohibition exceptions would be mitigated by the fact that swaps broking entities, including voice brokers, would be subject to the SEF registration requirement. Therefore, many of the pre-execution communications that currently occur off of SEFs through brokers would, under the SEF Proposal, occur on SEFs.

Further, the SEF Proposal appears to envision a system under which SEFs would host telephone conference lines, proprietary instant messaging or email systems, or similar communications systems on which market participants may engage in pre-trade communications bilaterally that would be considered to occur on the SEF. The CFTC does not suggest that any other intermediation by a SEF or SEF trading specialist, as defined below, would be required for such communications.

In evaluating the incremental benefits of requiring these bilateral communications to occur on a SEF, commenters might consider that (i) swap dealers are already subject to comprehensive daily trading records requirements, including voice recording and (ii) although SEFs generally are subject to greater market surveillance obligations than swap dealers, the SEF Proposal would clarify that a SEF’s automated trade surveillance system is not required to cover orders entered into by voice or other electronic communications (such as instant messaging or email systems) that are not entered into an electronic trading system or platform, thereby excluding much of the pre-

²⁴ The most recent extension of the time-limited relief is contained in CFTC Letter No. 17-60, Re: Extension of No-Action Relief for certain Swap Execution Facilities from

Certain “Block Trade” Requirements in Commission Regulation 43.2 (Nov. 14, 2017).

trade communications from automated SEF surveillance.²⁵

Also, an exception for “market color” or some other means to provide generalized advice is likely to be critical to ensure that a strict interpretation of the proposed pre-trade communications restrictions do not push nearly all communications related to IRS or CDS transactions onto SEFs.

*Registry of Registered Entities Listing Swaps
Subject to the Mandatory Trading Requirement*

Status Quo

- The CFTC currently provides information on its website regarding which swaps are Required Transactions and posts submitted MAT determinations.

SEF Proposal

- In light of the increase in the number of swaps that are expected to be subject to the mandatory trading requirement, the CFTC proposes to form a registry of Required Transactions and the SEFs and DCMs that list such swaps.
- As a corresponding requirement, a SEF or DCM would be required to submit Form TER, which would specify the swaps that such SEF or DCM lists that are or become subject to the clearing requirement.
- A SEF or DCM would also be required to publish its Form TER on its website and promptly amend any inaccuracies contained therein.

Compliance Schedule

Status Quo

- CFTC rules currently delay the application of the mandatory trading requirement until at least thirty days have passed after a MAT determination for a particular class of swaps is deemed approved or certified.²⁶

SEF Proposal

- The CFTC would adopt a new compliance schedule for the mandatory trading requirement for the additional swaps that become subject to the requirement based on the type of market participant.
- The proposed compliance schedule is as follows:

Participant Type	Compliance Date
Category 1 Entities: swap dealers, major swap participants, security-based swap dealers, or major security-based swap participants	90 days following effective date

²⁵ Additionally, requiring communications to occur on a SEF could complicate a swap dealer’s ability to comply with existing daily trading records requirements, as swap dealers would be required to maintain records of communications delivered and received through a third-

party system, which could pose a number of legal, operational and technological challenges.

²⁶ See 17 C.F.R. §§ 37.12, 38.11.

Participant Type	Compliance Date
Category 2 Entities: commodity pools, private funds as defined in section 202(a) of the Investment Advisers Act of 1940, or persons predominantly engaged in activities related to the business of banking, or in activities that are financial in nature	180 days following effective date
Other Counterparties	270 days following effective date

(3) EXPANDED SEF REGISTRATION REQUIREMENT

Status Quo

- Generally, a facility that offers a trading system or platform which allows multiple market participants to execute or trade swaps with multiple other participants (a “**multiple-to-multiple**” platform) must register as a SEF or DCM.
- The Commission previously determined that “one-to-many” systems or platforms (“**single-dealer platforms**”) and aggregation services that enable access to multiple SEFs do not meet the definition of SEFs and therefore are not required to register as SEFs.²⁷

SEF Proposal

- The SEF Proposal would codify previous Commission guidance requiring any entity

meeting the statutory definition of a SEF (*i.e.*, a “multiple-to-multiple” platform) to register as a SEF, regardless of whether it only facilitates trades in swaps that are not subject to the mandatory trading requirement.²⁸

Single-Dealer Aggregator Platforms

- The SEF Proposal would apply the SEF registration requirement to entities that aggregate single-dealer platforms to allow market participants to obtain pricing and execute swaps with multiple single-dealer liquidity providers away from SEFs. The CFTC distinguishes such platforms from (i) single-dealer platforms, on which a single dealer acts as the exclusive liquidity provider for multiple customers and (ii) SEF aggregation services, which merely provide a portal through which market participants may access multiple SEFs.

Swaps Broking Entities

- The SEF registration requirement would also apply to swaps broking entities, including interdealer brokers, that facilitate swaps trading between multiple market participants through bids and offers on non-registered voice or electronic platforms. In support of subjecting interdealer brokers to SEF registration, Chairman Giancarlo notes that introducing brokers (“**IBs**”) are not currently subject to the conduct and compliance requirements that are appropriate for swaps trading.²⁹

Effective Date for Domestic Platforms to Register

- If adopted, the expanded scope of the SEF registration requirement will take effect after a six-month delay, subject to certain conditions.

²⁷ See SEF Core Principles Final Rule at 33481-83.

²⁸ See SEF Core Principles Final Rule at 33481 n. 88.

²⁹ See 83 Fed. Reg. at 62140.

Consistent with Chairman Giancarlo's goals as set forth in the Swaps 2.0 Paper, the expanded SEF registration obligations are intended to increase the price discovery and liquidity formation that occurs on SEFs, as opposed to non-SEF platforms.

The Commission estimates that one single-dealer aggregator platform and approximately 60 swaps broking entities, including 10 to 20 foreign swaps broking entities, would be required to register as SEFs if the proposal is adopted in its current form.

If an entity operates both a registered SEF and an affiliated unregistered swaps broking entity, such entity may comply with the registration requirement by integrating its non-SEF trading platform or system into the SEF affiliate.

Foreign Swaps Trading Facilities

- A foreign multilateral swaps trading facility, including a foreign swaps broking entity, would also be subject to the SEF registration requirement if its activity fell within the Commission's jurisdiction and it was not subject to exemptive relief. The Commission plans to separately provide guidance on the cross-border application of the SEF registration requirement.³⁰

Effective Date for Foreign Platforms to Register

- The SEF Proposal would provide for a two-year delay with respect to registration of foreign multilateral swaps trading facilities, subject to certain conditions.

"Multilateral trading facilities" ("MTFs") and "organised trading facilities" ("OTFs") located

in the E.U. would not be eligible to rely on the two-year delay period and would be required to apply for an exemption from SEF registration under the terms of the CFTC's MTF and OTF Exemptive Order. Notably, however, on December 3, 2018, the CFTC amended its original order to add an additional four MTFs and OTFs to bring the total number of eligible facilities to twenty, including facilities that do not list currently MAT swaps.³¹

(4) REGULATION OF SEF PERSONNEL

Status Quo

- SEF personnel often serve as interdealer brokers in the wholesale swaps markets or otherwise facilitate trading in connection with orders that will be executed on the SEF. Such personnel are not currently subject to any formal registration, training, or professionalism requirements, unless they associate with a registered IB or other CFTC-registered intermediary.

SEF Proposal

- The SEF Proposal would establish a category of market professionals called "SEF trading specialists," defined as (i) any person employed by a SEF to facilitate swaps trading or execution, including discussing market color with market participants, negotiating trade terms, issuing RFQs, and arranging bids and offers and (ii) any supervisor of such person. The CFTC would exclude individuals acting in a ministerial or clerical capacity, but individuals who are not directly employed by the SEF and individuals who facilitate swaps trading through swaps broking entities, such as interdealer brokers, would be covered.

³⁰ See Cross-Border 2.0 Paper.

³¹ See CFTC Exemption Order, In the Matter of the Exemption of Multilateral Trading Facilities and Organised Trading Facilities Authorized Within the European Union from the Requirement to Register with the Commodity

Futures Trading Commission as Swap Execution Facilities (Dec. 8, 2017), amended by CFTC Amendment To Appendix A to Order of Exemption (Dec. 3, 2018) (the "MTF and OTF Exemptive Order").

- Although a SEF trading specialist would not be required to register with the Commission or the National Futures Association (“NFA”),³² a SEF would be required to ensure that SEF trading specialists meet certain proficiency requirements, undergo periodic ethics training, and are not subject to statutory disqualifications. A SEF would also be required to establish and enforce a code of conduct for, and diligently supervise, SEF trading specialists.

The NFA is currently developing a swaps proficiency requirements program that would apply to associated persons of certain CFTC registrants. A SEF trading specialist may be able to satisfy the SEF Proposal’s proficiency requirements through participation in the NFA’s swaps proficiency requirements program.

(5) REDUCING REGULATORY BURDENS ON SEFs

Impartial Access

Status Quo

- Under current CFTC rules and guidance, SEFs are subject to strict impartial access requirements, effectively requiring each SEF to permit access to all eligible contract participants (“ECPs”) and restricting the ability of a SEF to employ or permit enablement mechanisms that would prevent any SEF participant from interacting or trading with all other SEF participants.
- The current impartial access rules extend to independent software vendors as well as market participants.

- The rules also currently require comparable fee structures for ECPs and independent software vendors receiving comparable access to, or services from, the SEF.

SEF Proposal

- The SEF Proposal would consolidate existing SEF impartial access guidance and rules into a requirement that SEFs’ impartial access rules are transparent, fair, and non-discriminatory as applied to all or similarly situated market participants. SEFs would be able to determine which market participants are similarly situated for this purpose.
- The SEF Proposal would eliminate the requirement to extend impartial access to independent software vendors. It also would allow SEFs to tailor eligibility and onboarding criteria to account for differences in the dealer-to-dealer and dealer-to-client markets, including limiting access based on the type of market participant or swap product.
- The CFTC also clarified that trading prerequisites and participation criteria for accessing certain platforms or trading products would also be required to be transparent, fair, and non-discriminatory. SEF trading specialists would be permitted to exercise discretion in facilitating trading and execution, as long as any use of discretion would be administered in a fair and non-discriminatory manner.
- The SEF Proposal would eliminate the requirement that SEFs provide comparable fee structures to ECPs and independent software vendors, so long as such fees do not discriminate against certain market participants. The proposal would further require SEFs to maintain documentation of

³² In his dissenting statement, Commissioner Berkovitz raises the concern that, although SEF trading specialists would engage in key customer-facing functions, they would not be required to register with the CFTC. Further, unlike associated persons of IBs, a SEF trading

specialist would not have a duty to supervise its employees or agents, which in turn would limit the SEF trading specialist’s individual responsibility. *See* 83 Fed. Reg. at 62149.

any decision to limit a market participant's access to the SEF.

The SEF Proposal is intended to address the aspects of the previous impartial access requirement that favored “all-to-all” trading environments, as in the futures markets, and therefore limited a SEF's ability to adapt its operations to the differences inherent in the swaps market structure. The SEF Proposal adopts the view, previously laid out in the 2015 SEF Paper, that the Dodd-Frank Act mandated “impartial,” not “open,” access, which permits distinct dealer-to-customer and dealer-to-dealer markets.³³

Post-Trade Name Give-Up

- The Commission also requested comment on “post-trade name give-up” for cleared swaps, *i.e.*, the practice of disclosing the identity of each swap counterparty to the other after a trade has been anonymously matched and executed. While counterparties to uncleared swaps rely on post-trade name give-up to track credit exposure and payment obligations, certain SEFs also continue the practice for cleared swaps.
- The Name Give-Up Comment Request cites concerns that name give-up practices may deter buy-side participation on certain SEF platforms (particularly, dealer-to-dealer platforms) because they provide execution information to dealers from which they may be able to determine non-dealer participants' trading strategies and positions.

- The Name Give-Up Comment Request also cites the potential benefits of post-trade name give-up, including providing market participants with the ability to identify potentially abusive pricing or trading practices.

In his dissenting statement to the SEF Proposal, Commissioner Berkovitz argues that the practice of name give-up for cleared swaps should be banned altogether, as it could deter non-dealers from seeking to participate on dealer-only platforms.³⁴ Note that proposed changes to the current impartial access requirements (also opposed by Commissioner Berkovitz) would permit platforms to restrict participation to dealers regardless of whether name give-up were permissible.

In his concurring statement to the SEF Proposal, Commissioner Behnam questioned whether it was appropriate to exclude post-trade name give-up from the SEF Proposal and related rulemaking. He was concerned that, by only issuing a request for comment, instead of a rule proposal, the CFTC could be seen as effectively endorsing the status quo.³⁵ Ultimately, if the CFTC chooses to include post-trade name give-up in the same rulemaking as the SEF Proposal, it would likely need to issue a new proposed rule, which could delay finalization of the SEF Proposal.

³³ In support of his perspective, Chairman Giancarlo, noted that if Congress intended for “impartial access” to mean that every SEF must provide an all-to-all trading environment, then it would not have allowed a SEF to establish its own rules for limiting access to market participants. *See* 83 Fed. Reg. at 62141. However, Commissioner Berkovitz warned that the changes proposed to the impartial access requirement could allow dealers to establish dealer-only liquidity pools with more favorable

prices and to hamper pricing competition on SEFs for customers. *Id.* at 62144.

³⁴ *Id.* at 62145.

³⁵ *See* 83 Fed. Reg. at 62143.

Straight-Through Processing*Status Quo*

- In 2013, the Division of Clearing and Risk and the Division of Market Oversight issued joint guidance for futures commission merchants (“FCMs”), SEFs, DCMs and derivatives clearing organizations (“DCOs”) with respect to straight-through processing (“STP”) of swaps traded on a SEF or DCM that are intended to be cleared (the “**2013 Staff STP Guidance**”).³⁶
 - The 2013 Staff STP Guidance requires a SEF to facilitate pre-execution credit screening for swaps intended to be cleared and requires market participants to identify a clearing FCM before each order.
 - Further, under the current regime, a SEF or DCM and a registered DCO must coordinate to ensure the “straight-through processing” of swap transactions that are intended to be cleared.
 - In particular, a SEF is required to coordinate with each registered DCO to facilitate “prompt and efficient” transaction processing and a DCO is required to coordinate with the relevant SEF or DCM to facilitate “prompt, efficient, and accurate” processing of all transactions.
 - A DCO is further required to establish standards to accept or reject transactions for clearing as quickly as would be technologically practicable if fully automated systems were used (the “**AQATP**” standard). Subsequently, the 2013 Staff STP Guidance clarified that a DCO must
- meet a ten-second time frame in order to satisfy its obligation under the AQATP standard.
- In a follow-up letter to the 2013 Staff STP Guidance (the “**2015 Supplementary Staff Letter**”),³⁷ the CFTC staff further clarified that a SEF or a DCM is also obligated under the AQATP standard, at least to the extent that the SEF or DCM uses a third-party affirmation hub acting as its agent, to make sure that the DCO receives the transaction no later than ten minutes after execution.
 - The 2013 Staff STP Guidance also provided that a SEF should have rules that render trades that are rejected from clearing as “void *ab initio*.” Essentially, that means that swap transactions that are executed on a SEF and subsequently rejected by the DCO from clearing are “void,” even if the rejection was due to an error other than a rejection from clearing for credit reasons, *e.g.*, an operational or clerical error. The 2013 Staff STP Guidance also clarified that breakage agreements are prohibited with respect to swaps rejected from clearing.
 - Swaps subject to mandatory trading that are rejected from clearing due to an operational or clerical error, or for which an error is discovered post-clearing, are not generally permitted to be corrected by entering into an offsetting trade or a new trade with the correct terms due to (i) the requirement that such swaps be traded either via an Order Book or RFQ-to-3 and (ii) the prohibition on pre-arranged trading. However, market participants have been able to rely on time-limited no-action relief for such error trades,³⁸

³⁶ See CFTC Staff Guidance on Swaps Straight-Through Processing (Sept. 26, 2013).

³⁷ See CFTC Letter No. 15-67, Re: Straight Through Processing and Affirmation of SEF Cleared Swaps (Dec. 21, 2015).

³⁸ The most recent extension of the time-limited relief is contained in CFTC Letter No. 17-27, Re: No-Action Relief for Swap Execution Facilities and Designated Contracted Markets in Connection with Swaps with

which permits a SEF to allow market participants to pre-arrange corrective trades and execute them through means other than an Order Book or RFQ-to-3.

SEF Proposal

Pre-Trade Credit Checks

- The SEF Proposal would codify the existing guidance, contained in the 2013 Staff STP Guidance, requiring a SEF to facilitate pre-execution credit screening for swaps intended to be cleared and market participants to identify a clearing FCM before each order.

SEFs' and DCMs' Routing of Trades to DCOs

- The SEF Proposal would revise the “prompt and efficient” standard applicable to SEFs for the processing of swap transactions to a “prompt, efficient, and accurate” standard, in order to conform to the equivalent standard for DCOs.
- The SEF Proposal would also provide that the current ten-minute time frame set forth in the 2015 Supplementary Staff Letter would not apply to the processing and routing of transactions. Instead the “prompt, efficient, and accurate” standard would apply to the processing and routing of swaps from a SEF to a DCO via third-party manual affirmation hubs. The SEF Proposal notes that imposing a specific time standard would be inconsistent with the proposed expansion of execution functionalities.

The CFTC acknowledges in the SEF Proposal that imposing a specific deadline on a SEF for processing and routing transactions to a DCO is not conducive to how many SEFs operate, particularly those that use voice-based or voice-assisted trading systems or platforms. Elimination of the ten-minute deadline for swap processing and routing would help

accommodate the wider ranges and types of entities that would be subject to SEF regulation following expansion of the SEF registration requirement as discussed above.

DCO's Acceptance or Rejection of a Swap Transaction

- The SEF Proposal clarifies that the AQATP standard applies to a registered DCO's acceptance or rejection of a transaction from a SEF or DCM when a DCO receives the transaction.
- The CFTC further proposes to establish a single AQATP standard for registered DCOs for all agreements, contracts, and transactions, not just swaps.

Void Ab Initio

- In lieu of the current no-action relief for error trades under CFTC Letter No. 17-27, the SEF Proposal would allow a SEF to implement its own protocols and processes to correct error trades with respect to a swap (i) rejected by a DCO due to an operational or clerical error or (ii) accepted for clearing by a DCO that contains an operational or clerical error. However, a SEF would continue to be required to void trades that are rejected by a DCO from clearing due to credit reasons.

While not expressly addressed in the SEF Proposal, given that error trades, and other trades rejected for non-credit reasons, would no longer be considered void *ab initio*, presumably breakage agreements would be permitted for swaps that are intended to be cleared. An expanded use of breakage agreements would also be consistent with the use of enablement mechanisms in connection with the

Operational or Clerical Errors Executed on a Swap Execution Facility or Designated Contract Market (May 30, 2017).

liberalization of the impartial access requirements discussed above.

Error Trade Policies

- The SEF Proposal would require a SEF to establish certain baseline procedural requirements for error trades, in an effort to conform the protocols and processes that SEFs adopt to address error trades. Rules designed to harmonize SEF protocols and processes would include:
 - Defining an error trade as any swap transaction executed on a SEF that contains an error in any term, including price, size, or direction;
 - Requiring a SEF to establish and maintain rules and procedures to help resolve error trades in a “fair, transparent, consistent, and timely manner”; and
 - Establishing a minimum set of notification requirements.
- A SEF would also be able to establish non-reviewable ranges that would fall outside of the scope of the error trade protocols.

Due to the SEF Proposal’s liberalization of execution functionalities for swaps subject to mandatory trading, SEFs and market participants would no longer need to rely on the no-action relief for error trades with respect to execution of such trades, although exceptions from the prohibition on pre-arranged trading under SEF rules would still be necessary.

Confirmations and Other Documentation

Status Quo

- Under the current regime, a SEF is required to provide each counterparty to a swap a written “confirmation” that contains all of the terms of the swap transaction at the time of execution for both cleared and uncleared swaps. A confirmation is defined as the consummation of legally binding documentation that memorializes the agreement of the counterparties to all terms of the swap. Such confirmations are currently required to legally supersede any previous agreement relating to the swap.
- A SEF is allowed to meet these requirements for uncleared swaps by incorporating by reference the relevant terms set forth in other agreements relating to the swap, as long as such agreements have been submitted to the SEF *prior to* execution.
- In the context of uncleared swaps, the CFTC has provided time-limited no-action relief to address the technological and operational challenges of meeting these swap requirements.³⁹ Such no-action relief allows a SEF to incorporate relationship terms from previous agreements by reference without needing to actually receive copies of those agreements prior to execution of the transaction.⁴⁰
- Further, current rules require that the confirmation of a swap transaction take place at the same time as execution.

³⁹ The most recent extension of such no-action relief is contained in CFTC Letter No. 17-17, Re: Extension of No-Action Relief for Swap Execution Facility Confirmation and Recordkeeping Requirements under Commodity Futures Trading Commission Regulations 37.6(b), 37.1000, 37.1001, 45.2, and 45.3(a) (Mar. 24, 2017).

⁴⁰ However, a SEF relying on this relief would be required to memorialize relationship terms contained in a separate agreement that such SEF would not have reviewed at the time of incorporation.

SEF Proposal

- The SEF Proposal would establish separate swap transaction documentation requirements for cleared and uncleared swaps. Existing requirements would continue to apply to cleared swaps.
- A revised framework would apply to uncleared swaps, under which a SEF would memorialize the terms of an uncleared swap transaction with a “trade evidence record” instead of a confirmation. The trade evidence record would not need to include all of the terms of the swap transaction such as relationship terms that are usually contained in underlying bilateral documentation between the counterparties. The trade evidence record would supersede any conflicting term in any previous agreement relating to the relevant swap transaction. The CFTC proposes that the trade evidence record would contain, at a minimum, the “economic terms” of a particular swap transaction.
- The SEF Proposal would also require confirmation of a swap transaction to take place “as soon as technologically practicable” after the execution of the swap transaction on the SEF in lieu of the current requirement that the confirmation take place at the same time as execution.
- In connection with these proposed changes to the swap documentation requirements, the Commission requested comment on:
 - Whether there should be a specified minimum set of terms that must be included in a trade evidence record (e.g., material economic terms);
 - Whether any “primary economic terms” (as defined in CFTC Regulation 45.1) should be required to be included in a trade evidence record;
 - Whether the trade evidence record should serve as evidence of a legally

binding agreement upon the counterparties;

- Whether the trade evidence record should, as with the confirmation for cleared swaps, legally supersede any previous agreement as opposed to superseding only conflicting terms in prior agreements; and
- Whether a SEF should be allowed to incorporate by reference underlying, prior agreements into any trade evidence record associated with a particular swap transaction.

The concept of a trade evidence record alleviates the issue that SEFs faced in having to incorporate idiosyncratic terms into confirmations for uncleared transactions. This problem does not exist with respect to cleared swaps because the counterparties to such swaps typically rely on the relevant DCO’s rules and contract specifications instead of separately documented and individually negotiated relationship terms. However, some of the changes noted in the SEF Proposal’s requests for comment would reintroduce some of these problems for uncleared swaps.

Other Key Amendments to SEF Core Principles

- In addition to the issues addressed above, the CFTC Proposal would amend a number of requirements applicable to SEFs that would affect the governance and operation of SEFs. Among these amendments, the SEF Proposal would:
 - Eliminate the temporary SEF registration regime and revise Form SEF and its related exhibits and processes to generally update, clarify, or streamline existing requirements;
 - Adopt a notification requirement for any transfer of a controlling equity interest in a SEF;

- Replace certain enumerated SEF financial resource requirements with more general standards;
- Simplify the required procedures for a SEF to conduct investigations and prepare investigation reports;
- Streamline required audit trail data, including by eliminating the enumerated lists of required audit trail data;
- Introduce changes to clarify and streamline a SEF's disciplinary program requirements, including by (i) allowing the use of compliance staff in place of disciplinary panels, (ii) eliminating detailed rules and guidance for hearings, disciplinary panel adjudications, and emergency disciplinary action, and (iii) allowing SEFs more discretion to use warning letters versus sanctions, with corresponding changes to the CFTC's review of SEFs' adverse actions;
- Narrow a SEF's monitoring obligations and provide a SEF with greater flexibility to create its own monitoring systems;
- Require a SEF to establish a direct and independent clearing agreement with each registered DCO or exempt DCO to which such SEF submits swap transactions for clearing;
- Clarify that a SEF only needs to maintain adequate financial resources to cover the operating costs needed to comply with the SEF core principles and CFTC regulations for a one-year period, as calculated on a rolling basis;
- Require each SEF to prepare and submit an up-to-date questionnaire each year demonstrating the SEF's compliance with requirements related to system safeguards; and
- Amend current requirements regarding a SEF's CCO, including (i) updating the requirements related to the contents and submission of the annual compliance report, (ii) clarifying permissible reporting lines for the CCO, (iii) aligning a SEF's senior officer's oversight responsibilities over the CCO with the board's, (iv) providing a non-exhaustive list of a CCO's requisite qualifications, (v) clarifying and streamlining CCO duties, and (vi) tailoring the CCO recordkeeping requirement.

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