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Via Electronic Submission and Email

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

Re: Swap Execution Facilities and Trade Execution Requirement (RIN 3038–AE25)

Dear Mr. Kirkpatrick:

The Futures Industry Association ("**FIA**"")[1] appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("**Commission**" or "**CFTC**") notice of proposed rulemaking entitled "Swap Execution Facilities and Trade Execution Requirement" (the "**SEF NPRM**").[2] We agree that with the benefit of several years of experience with trading on swap execution facilities ("**SEFs**"), it is prudent for the Commission to consider whether rule amendments are appropriate to more fully realize Congress's objectives of promoting the trading of swaps on SEFs and promoting pre-trade price transparency in the swaps market.[3]

We respectfully submit these comments to request, among other things, that any final SEF rules: i) clarify, and do not disrupt established procedures for, the clearing of swaps that are executed on SEFs; and ii) address the operational challenges and costs that the SEF NPRM would impose on all market participants.

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[1] The Futures Industry Association is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members play a critical role in the reduction of systemic risk in global financial markets.

[2] Swap Execution Facilities and Trade Execution Requirement, Proposed Rule, 83 Fed. Reg. 61946 (Nov. 30, 2018).

[3] *See* Commodity Exchange Act ("**CEA**"), Section 5h(e), 7 U.S.C. § 7b-3(e) ("The goal of this section is to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market.").

More specifically, FIA—

- Requests legal certainty regarding the obligations of clearing futures commission merchants ("**FCMs**") with respect to swaps traded on SEFs, particularly with respect to FCMs' risk management obligations related to cleared block trades executed on or pursuant to the rules of a SEF ("**SEF block trades**" or "**SEF blocks**");

- Urges the Commission to build mechanisms into any final SEF rules to ameliorate the substantial operational challenges and costs to market participants that would result from the proposed amendments to the Commission's SEF rules; and

- Encourages the Commission to address the cross-border implications of its SEF regulatory framework in a holistic manner through a separate rulemaking, and to take care to assure that any changes to the SEF rules do not adversely affect liquidity on SEFs or analogous non-US trading platforms.

Many of FIA's members and their affiliates are active in physical commodities markets. These firms include financial institutions, brokerage firms, and trading firms, as well as commercial end users that rely on physical commodities, futures and over-the-counter ("**OTC**") derivatives to support their business activities (collectively, "**FIA's commodities members**"). FIA's commodities members share the views expressed above with respect to the operational challenges and costs, and the cross-border implications, of the SEF NPRM (while the foregoing clearing issues are not applicable to them). In addition, they also—

- Support eliminating the current "made available to trade" ("**MAT**") process for imposing trade execution mandates, but do not support the proposed solution that a swap that is subject to a Commission clearing mandate would automatically become subject to a trade execution mandate when a SEF lists it for trading;

- Ask that the Commission adopt a practical approach for making future trade execution mandate determinations;

- Urge the Commission to exempt swaps in package transactions that include a futures contract component from the trade execution requirement; and

- Do not believe the proposed blanket prohibition on pre-execution communications should be adopted.

We discuss each of these issues below, in turn.

FIA COMMENTS

I. The Commission Should Provide Legal Certainty Regarding Clearing FCMs' Risk Management Obligations Relating to SEF Trading

a. Block Trades

FIA takes no position on the merits of the amendment to the block trade definition proposed in the SEF NPRM. We note, though, that FIA has been engaged in dialogue with the Commission and its staff over the course of several years to address legal uncertainty regarding clearing FCMs' risk management responsibilities with respect to SEF blocks.[4] We respectfully request that the Commission use the opportunity afforded by the adoption of any final SEF rules to permanently eliminate this uncertainty by clarifying those responsibilities through rule text.

The uncertainty arises from the interplay between the Commission's definition of a "block trade" and staff's interpretation of the Commission's straight-through processing rules, as follows:

- Commission Regulation 1.73 sets forth the risk management obligations of clearing FCMs, including a requirement that an FCM screen trades against its risk-based limits in certain circumstances pursuant to Regulation 1.73(a)(2).[5]

- Commission Regulation 43.2 currently defines a "block trade" (*i.e.*, a swap transaction that is above the minimum block size and that is afforded a reporting time delay) to mean a publicly reportable swap transaction that, among other things, "[o]ccurs away from" a registered SEF's trading system or platform and is executed pursuant to the SEF's rules and procedures.[6]

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[4] *See, e.g.*, FIA's: i) letter dated October 23, 2013, to the Division of Clearing and Risk ("**DCR**") and Division of Market Oversight ("**DMO**"); ii) letter dated February 12, 2014 to DCR; iii) letter dated February 14, 2014, to DCR; iv) joint letter, with SIFMA, dated June 3, 2014, to DCR and DMO; v) letter dated October 22, 2014, to Timothy G. Massad, Chairman, and Mark P. Wetjen, Sharon Y. Bowen, and J. Christopher Giancarlo, Commissioners, CFTC; and vi) comment letter dated September 28, 2017 ("**Project KISS comment letter**").

[5] 17 C.F.R. § 1.73(a)(2). The method and timing of an FCM's screening obligation under Regulation 1.73(a)(2) is dependent upon the nature of the trade, recognizing that not all types of screens are possible on certain types of transactions. The language of subsections (ii) and (iii) of Regulation 1.73(a)(2) merely require an FCM to have systems "reasonably designed to ensure compliance with the limits." Such requirement is markedly different from the language of Regulation 1.73(a)(2)(i), which requires an FCM to "use automated means to screen orders for compliance with the limits." The different standard expressed in these subsections was intentional. Indeed, in the adopting Release, the Commission noted that it revised subsections (ii) and (iii) in response to comments received from, among others, FIA that "pre-execution" screening of orders is not feasible in all markets. *See* Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21278, 21288 (April 9, 2012).

[6] 17 C.F.R. § 43.2, definition of "block trade," paragraph (2).

- Staff guidance on straight-through processing issued on September 26, 2013 ("**STP Guidance**") provides that FCMs are required to screen SEF block trades on a pre-trade basis.[7]

Given that SEF blocks by definition "occur away from" the SEF, the STP Guidance is problematic because FCMs are not involved in the execution of SEF blocks, have no way to implement a pre-trade screen of SEF blocks, and have no way to force the counterparties to implement a screen of the trade prior to concluding the transaction.

On September 19, 2014, DMO issued no-action relief that permitted SEF blocks to be executed on a SEF (other than the SEF's Order Book functionality) subject to certain conditions, including that the FCM complete a pre-execution limit check pursuant to Rule 1.73 "at the time the order for a block trade enters the SEF's non-Order Book trading system or platform."[8] This condition is consistent with how FCMs can screen SEF blocks. However, DMO's original no-action letter on the issue did not provide legal certainty with respect to FCM compliance with Rule 1.73 for SEF blocks because it only *permitted*, but did not *require*, market participants to execute SEF blocks on the SEF trading system. Thus, swap counterparties could still execute SEF blocks away from the SEF without the FCM's knowledge or involvement.

Despite two extensions of this no-action relief,[9] it was not until November 2017 that DMO expressly acknowledged that "if the parties purport to execute a block trade away from the SEF without first obtaining a credit check, an FCM clearing unit that clears such trade and does not have knowledge of such purported execution is not in violation of the pre-execution credit check requirement under Commission regulation 1.73."[10] This Current No-Action Letter, though, is

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[7] *See* Staff Guidance on Swaps Straight Through Processing (Sept. 26, 2013), *available at* http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/stpguidance.pdf. As FIA previously has advised the Commission, a block trade that "occurs away from" a SEF is a transaction "executed bilaterally and then submitted for clearing," and therefore is subject to Commission Regulation 1.73(a)(2)(iii), which does not require a pre-trade screen. Indeed, such a block trade could not, by definition, be subject to Regulation 1.73(a)(2)(i), the only subsection of Regulation 1.73 that requires a pre-trade screen, because it is not an order. *See* Commission Regulation 1.3, definition of "order," 17 C.F.R. § 1.3 (defining "order" as "an instruction or authorization provided by a customer to a futures commission merchant . . . regarding trading in a commodity interest on behalf of the customer.") The STP Guidance states that Regulation 1.73(a)(2)(iii) applies only to bilateral transactions "not intended for clearing." Such a limitation on the scope of that section, however, is inconsistent with the language of the regulation itself, which states that it applies to transactions bilaterally executed and "then submitted for clearing." Notwithstanding the conflict between the STP Guidance and the language of the regulation, FIA has worked with the Commission to try to find a solution to the issue.

[8] *See* No-Action Relief for Swap Execution Facilities from Certain "Block Trade" Requirements in Commission Regulation 43.2, Letter No. 14-118 (DMO Sept. 19, 2014).

[9] *See*: i) Extension of No-Action Relief for Swap Execution Facilities from Certain "Block Trade" Requirements in Commission Regulation 43.2, Letter No. 15-60 (DMO Nov. 2, 2015), extending expiration date from December 15, 2015 to November 15, 2016; and ii) Extension of No-Action Relief for Swap Execution Facilities from Certain "Block Trade" Requirements in Commission Regulation 43.2, Letter No. 16-74 (DMO Oct. 7, 2016), extending expiration date to November 15, 2017.

[10] Extension of No-Action Relief for Swap Execution Facilities from Certain "Block Trade" Requirements in Commission Regulation 43.2, Letter No. 17-60 at 3 n.9 (DMO Nov. 14, 2017) (the "**Current No-Action Letter**").

time-limited and is currently scheduled to expire on November 15, 2020. And, like all staff relief, it does not necessarily reflect the views of the Commission or other Divisions, and can be readily modified, terminated, or restricted.

Clearing FCMs, therefore, remain in need of legal certainty regarding their obligations under Rule 1.73 with respect to SEF block trades. The SEF NPRM's proposed amendment to the definition of a "block trade" in Rule 43.2 would provide such certainty by requiring that a SEF block be executed "on" – rather than "away from" – the SEF. This amendment would enable clearing FCMs to perform risk-based screens on SEF blocks prior to execution on the SEF in the same manner as any other swap that is executed on the SEF.[11] We are aware, though, that requiring SEF blocks to be executed on a SEF may create challenges for other market participants. As stated, FIA takes no position on the merits or broader trading implications of the proposed amendment to the block trade definition.

Yet, regardless of the definition of a SEF block trade, the Commission could provide the legal certainty that FCMs need by a rule codifying the Current No-Action Letter and providing that an FCM satisfies its obligations under Rule 1.73 by screening such a swap for compliance with the FCM's risk-based limits when the swap has been reported to the SEF (or delivered to an affirmation hub or similar platform that screens the trade prior to reporting it to the SEF). FIA has requested such a confirmation on several occasions, including most recently in its Project KISS comment letter.[12]

We respectfully ask that the Commission not pass up the opportunity presented by a final SEF rulemaking to provide long-needed legal certainty to clearing FCMs with respect to their obligations under Rule 1.73 with respect to SEF block trades.

b. As Quickly as Technologically Practicable

Commission Regulation 39.12(b)(7) requires a registered derivatives clearing organization ("**DCO**") to establish standards to accept or reject transactions for clearing as quickly as would be technologically practicable as if fully automated systems were used (the "**AQATP standard**"). For swaps or other transactions that are executed competitively on or subject to the rules of a SEF or designated contract market ("**DCM**"), Regulation 39.12(b)(7)(ii) requires that a DCO accept or reject a transaction for clearing pursuant to the AQATP standard "after execution" of the transaction. For swaps that are not executed on or subject to the rules of a SEF or DCM, or are executed non-competitively on or subject to the rules of a SEF or DCM, Regulation 39.12(b)(7)(iii)

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[11] We understand that the proposed amendment to the "block trade" definition would not have any bearing on the application of clearing FCMs' risk management obligations to bilateral, non-competitive, privately negotiated, or OTC trades, executed neither on nor subject to the rules of a SEF, that are submitted for clearing. Commission Regulation 1.73(a)(2)(iii) provides that when a clearing FCM accepts transactions that were executed bilaterally and then submitted for clearing, it shall establish and maintain systems of risk management controls reasonably designed to ensure compliance with applicable risk-based limits. 17 C.F.R. § 1.73(a)(2)(iii). FCMs, however, are not required to perform pre-trade risk-based checks on such bilateral trades.

[12] *See* Project KISS comment letter, n.4, *supra*, at 12-13.

requires that a DCO accept or reject the swap for clearing pursuant to the AQATP standard "after submission" of the swap to the DCO.[13] Finally, the STP Guidance provides that the AQATP standard requires that a DCO accept or reject a swap that is executed competitively on or subject to the rules of a SEF or DCM within ten seconds after submission.[14]

The SEF NPRM proposes to consolidate the foregoing rules to establish one AQATP standard for registered DCOs for all transactions regardless of whether they are: i) executed competitively or non-competitively; ii) executed on or pursuant to the rules of a SEF or DCM; or iii) are swaps, futures contracts, or options on futures contracts. It further proposes that the ten-second standard established in the STP Guidance continue for registered DCOs under the proposed amendments to the AQATP standard. And it proposes that in all instances, the AQATP standard would apply to transactions after submission to the DCO (rather than after execution as currently provided for competitively executed transactions on or subject to the rules of a SEF or DCM).[15]

The SEF NPRM recognizes that "a DCO's ability to comply with the AQATP standard for accepting or rejecting a trade is distinct from the length of time it takes an entity such as a SEF or DCM to process and route a trade to the DCO."[16] Similarly, a DCO's compliance with the AQATP standard is distinct from the separate standard articulated by DCR that clearing FCMs must accept or reject a swap for clearing within 60 seconds,[17] and FIA understands that the proposed amendments to the AQATP standard for DCOs do not impact this expectation for clearing FCMs. This is particularly important with respect to cleared bilateral OTC swaps, where the clearing FCM receives the swap only after it has been submitted to the DCO.

FIA agrees that it is appropriate for the Commission to provide clarification with respect to the application of the AQATP standard in the clearing process. We understand that the proposed ten-seconds-after-submission AQATP standard for DCOs would not run until after the clearing FCM has accepted a trade for clearing.

c. Agency-Executed Transactions

Commission Regulation 1.73(a)(2)(iv) provides that if an FCM executes a customer order, but gives it up to another FCM for clearing, the executing firm and clearing FCM must enter into an agreement pursuant to which the executing firm will screen orders for compliance with the clearing FCM's risk-based limits.[18] These arrangements are necessary for give-up transactions executed on or subject to the rules of a DCM because give-up transactions are accepted for clearing before they are made known to the clearing FCM. The clearing FCM, therefore, has no ability to screen

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13 17 C.F.R. §§ 39.12(B)(7)(ii)-(iii).

14 *See* STP Guidance, n.7, *supra*, at 5.

15 SEF NPRM, 83 Fed. Reg. at 62022-23.

16 *Id.* at 62022.

17 Pursuant to the STP Guidance, staff articulated the view that FCMs are "deemed" to accept a SEF trade if it satisfies the FCM's pre-execution risk-based screen.

18 17 C.F.R. § 1.73(a)(2)(iv).

the transaction for compliance with its risk-based limits. If the clearing FCM rejects the transaction, the executing firm (or its FCM) must carry, transfer, or close out the transaction.

By contrast, the execution and clearing processes are materially different for SEF-executed swaps, which generally are entered into directly by the parties to the swap, who identify their respective clearing FCMs. Alternatively, if a party uses an agent to execute the swap, the agent will identify to the SEF the FCM expected to accept the trade for clearing. In either case, SEF-executed swaps are screened automatically before execution (as facilitated by the SEF, by either the SEF, the clearing FCM, or a credit hub) for compliance with the clearing FCM's risk-based limits. If the clearing FCM rejects the transaction, it is deemed void *ab initio* and no transaction in excess of the clearing FCM's limits will exist.

Because the clearing FCM has the opportunity to screen an agency-executed swap transaction on a SEF for compliance with its limits before the transaction is accepted for clearing, the executing agent does not need to screen swap orders for compliance with these limits. Accordingly, FIA's Project KISS comment letter requested confirmation that agency-executed transactions on a SEF are not "give-up" transactions under Regulation 1.73(a)(2)(iv).[19] FIA respectfully renews that request here.

We recognize that this issue was not explicitly addressed in the SEF NPRM. Nevertheless, given that the Commission is considering comprehensive changes to its SEF regulatory framework, the Commission should not pass up the chance to clarify this discrete aspect of SEF trading.[20]

II. The Commission Should Build Mechanisms into Any Final Rules to Address the Operational Challenges and Costs that These Proposals Would Impose on Market Participants

The rule amendments proposed in the SEF NPRM would effect a fundamental reconstruction of the "SEF ecosystem," and thus stand to change many of the ways in which market participants interact with, and trade on, SEFs. This reconstruction of the existing ecosystem would present tall operational challenges and impose substantial costs on all market participants, including FIA members that clear trades executed on SEFs (both larger FCMs as well as smaller, non-bank affiliated FCMs), and FIA's commodities members that trade on SEFs.

The following aspects of the SEF NPRM in particular would have substantial impacts on market participants each time they occur: i) determinations that new types of swaps are subject to a trade execution mandate: ii) the registration of new SEFs; and iii) existing SEFs' exercise of their discretion to change their rules based on their business models (*e.g.,* execution methods, products offered, etc.). Below, we discuss the substantial challenges and costs that the overhaul of the SEF

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[19] *See* Project KISS comment letter, n.4, *supra*, at 13. Such transactions are not treated as give-up transactions by market participants, as no give-up agreements are entered into.

[20] As noted, FIA's request has been publicly available since FIA submitted its Project KISS comment letter over a year ago. This would mitigate any concern about a lack of public notice if the Commission were to grant FIA's request.

ecosystem in these areas will have on market participants, including FIA members, and the need for the Commission to address these challenges and costs in any final rules.

First, each new trade execution mandate may expand the infrastructure, enhance the complexity, and increase the risk, for participants in the swap market. Each may compel market participants to onboard to SEFs, and adapt their systems and compliance programs to handle SEF trading of swaps that they may formerly have traded only on an OTC basis. It also may challenge clearing FCMs' capacity to handle data flow and manage risk-based limits across a widening range of products. It is simply not possible to "flip a switch" and come into immediate compliance every time a trade execution mandate is imposed for a new type of swap.[21]

Second, the SEF NPRM estimates that up to 60 swap broking entities (including interdealer brokers) and one single-dealer aggregator platform would have to register as SEFs as a result of the proposed SEF registration requirement.[22] Although the number ultimately may not be that high, as some of these entities may be folded into affiliated SEFs or disengage from activity that would now require registration, it is estimated that there will be dozens of new registered SEFs.[23]

With each new SEF registration, market participants that desire to trade, or to keep trading, through that platform (or who wish to join) must incur new onboarding costs, including costs of adapting to use any new systems and reviewing the new SEF's rulebook. To the extent the new SEF lists products that may (or must) be cleared, clearing FCMs that wish to facilitate house or customer flow on such SEFs must establish relationships with that SEF to fulfill the mandate of straight-through processing. A market participant's compliance function must be extended to include each new SEF with which it has a relationship, and training as to the new SEF's trading functionalities and rulebooks must be provided. Even allowing for some efficiencies with newly-registered SEFs as a result of having been through the process before, these challenges and costs will grow substantially with the registration of dozens of new SEFs.

Third, market participants also may become subject to rulebook amendments by the 23 currently registered SEFs, whose rulebooks already vary substantially on topics such as, for example, the SEF's inspection rights, notification requirements in connection with amended trades, rules relating to Permitted Transactions, exposure time on Order Books for certain trades, etc. In addition to rulebook changes that would be required by proposals in the SEF NPRM, registered SEFs also would be provided new discretion to change many of their existing rules based on their particular trading operations. In all likelihood, different SEFs will change different rules at different times and in different ways.

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21 *See also* discussion of the MAT process in Section IV, *infra*.

22 SEF NPRM, 83 Fed. Reg. at 62046, 62053.

23 *See* Keynote Address of Chairman J. Christopher Giancarlo Before the ABA Business Law Section, Derivatives & Futures Law Committee Winter Meeting at 8 (Jan. 25, 2019) ("**ABA Address**"), *available at* https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo63 ("We estimate dozens of new SEF registrants.").

Simply tracking these SEF rule changes will be challenging. Adapting systems to comply with new rules will be even more difficult and costly. To highlight just one example: If a SEF amends its rules to implement its own protocols and processes to correct error trades with respect to swaps rejected by a DCO due to an operational or clerical error, or accepted for clearing by a DCO that contains an operational or clerical error, FCMs will have to adapt their systems to accommodate two trade tickets bearing the same trade ID number. Yet, FCMs could not implement this system change with respect to swaps on any other SEF that elects to maintain an approach based on the current void *ab initio* concept. With 23 SEFs able to amend a variety of rules in a variety of ways, the resulting complexity will present significant operational challenges, and impose significant costs of compliance, for FCMs and other market participants.

Accordingly, FIA respectfully requests that the Commission build into any final rules appropriate mechanisms to assure that market participants have sufficient time to comply with such developments. For example, there is a potential for a final rulemaking to significantly increase the number of trade execution mandates for swaps that currently are required to be cleared.[24] Accordingly, we ask that the deadlines for compliance that the Commission has set out in proposed new Regulation 36.3(c) each be extended by 90 days (to 180, 270, and 360 days in proposed Regulations 36.3(c)(1), (2), and (3), respectively), running from the effective date of a trade execution mandate for any swap currently required to be cleared. With respect to swaps that are not currently required to be cleared, for the reasons discussed in Section IV, *infra*, we support the approach in proposed new Regulation 36.3(e) – *i.e.*, for the Commission to determine an appropriate compliance schedule at a future date. However, we ask that any final rulemaking provide certainty that such compliance deadlines will not be shorter than those provided for in current Commission Regulation 37.12(a).[25]

We further request that SEF rule amendments that directly impact the activities or obligations of market participants and that are undertaken as a result of a final SEF rulemaking by the Commission[26] provide an implementation period of at least 60 days, rather than the 10 business days permitted by Commission Regulation 40.6.[27] This will afford FCMs and other market

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[24] *See* SEF NPRM, 83 Fed. Reg. at 61979-80 n.280 ("[T]he Commission's proposed interpretation of the trade execution requirement may result in a significantly larger amount of additional [interest rate swap] trading volume on SEFs, given that the Commission believes that many, but not all, of [the] 85 percent of [interest rate swaps] that is subject to clearing requirement is currently listed on SEFs. Moreover, it is plausible that adopting this proposed interpretation would induce SEFs to list additional swaps subject to the clearing requirement, which would expand the amount of swaps trading that is subject to the trade execution requirement.").

[25] 17 C.F.R. § 37.12(a).

[26] If the SEF NPRM were adopted as proposed, these would include, for example, SEF rule amendments undertaken pursuant to the proposed amendments to Commission Regulations: i) 37.6(b)(2)(iii), 17 C.F.R. § 37.6(b)(2)(iii) (confirmations and trade evidence records); ii) 37.201, 17 C.F.R. § 37.201 (requirements for SEF execution methods and prohibition on pre-execution communications (*see also* discussion of pre-execution communications in Section VI, *infra*); iii) 37.203, 17 C.F.R. § 37.203 (rule enforcement program); iv) 37.405, 17 C.F.R. § 37.405 (risk controls); v) 37.702, 17 C.F.R. § 37.702 (financial integrity of transactions); and vi) 43.2, 17 C.F.R. § 43.2 (definition of the term "block trade").

[27] 17 C.F.R. § 40.6.

participants a more appropriate implementation period in which to address the operational challenges presented by the SEF's rule amendment in an efficient and orderly manner.

III. Cross-Border Implications

The SEF NPRM recites that the Commission "expects that it will clarify the cross-border jurisdictional reach of the SEF registration requirement in the future for foreign multilateral swaps trading facilities, including foreign swaps broking entities, pursuant to CEA section 2(i)." As a result, it proposes to delay (subject to certain conditions) the compliance date of the proposed SEF registration requirement for non-US entities for a period of two years from the effective date of any final SEF rules.[28]

FIA supports a delay in applying any new SEF registration requirement to non-US entities to allow the Commission to develop a cross-border rulemaking that encompasses SEF trading. We agree that avoiding unnecessary swap market fragmentation can best be accomplished by a holistic treatment of cross-border swap trading issues, rather than adopting new rules that have a cross-border impact in a piecemeal manner.

We note, though, that the proposed reconstruction of the Commission's SEF regulatory regime could have cross-border implications beyond the issue of SEF registration. To cite one example, a significant expansion of products subject to a CFTC trade execution mandate may exacerbate cross-border market fragmentation in products that are subject to mandatory trading in the United States, but are not subject to such a mandate in other jurisdictions.

FIA respectfully urges the Commission to carefully consider the potential global implications of, and to consult with its international regulatory colleagues regarding, any final SEF rulemaking. The Commission should take appropriate steps to assure that any final SEF rules do not create obstacles to US persons and non-US persons trading together in global pools of liquidity.

ADDITIONAL COMMENTS OF FIA'S COMMODITIES MEMBERS

FIA's commodities members share the views expressed in Sections II and III above (the issues discussed in Section I are not applicable to them). In addition, the proposed elimination of the MAT process, the treatment of certain package transactions, and the proposed ban on pre-execution communications are particularly important issues to FIA's commodities members. These issues are discussed below, in turn.

IV. The Commission Should Replace the MAT Process with a Practical Approach to Trade Execution Mandate Determinations

FIA's commodities members agree that the MAT process is an unworkable approach to implementing the CEA's trade execution mandate. SEFs benefit by a greater range of swaps being required to be executed on-SEF – even if the liquidity characteristics of such swaps make it

[28] SEF NPRM, 83 Fed. Reg. at 61961-62.

impractical to do so. Given this incentive, SEFs have an inherent conflict of interest in issuing MAT determinations under the current framework. FIA's commodities members, therefore, support the proposal to eliminate the current MAT process.[29]

However, FIA's commodities members do not support the proposed solution, whereby any swap that is subject to a clearing mandate also would become subject to a trade execution mandate when a SEF lists the swap for trading. The proposed solution is inconsistent with Congressional intent. More fundamentally, the SEF NPRM fails to fix the problem with the MAT process that market participants may be forced to trade swaps on a SEF due to decisions made by SEFs according to their own self-interest and without input from market participants.

FIA's commodities members believe that it is the Commission's responsibility to determine whether and when a trading mandate can appropriately take effect. We urge that the MAT process be replaced by a Commission determination as to whether a trade execution mandate is appropriate, and when any such mandate should take effect, for a swap that is required to be cleared. In making such determinations, the Commission should adopt a practical approach that: i) assesses whether mandatory SEF trading of the swap is appropriate in light of all relevant facts and circumstances concerning the market and the participants in that market; ii) mitigates the operational challenges inherent whenever swaps that have been trading on an OTC basis are required to be traded on a SEF instead; and iii) invites public comment on whether a trade execution mandate for the swap is warranted and, if so, on what timeframe.

a. Congressional Intent

The statutory phrase "makes the swap available to trade"[30] is not defined in the CEA. The SEF NPRM effectively defines it to mean "lists the swap." Yet, Congress easily could have used the phrase "lists the swap" if that is what it had intended. It has used the term "list" or a variant thereof in at least 16 places throughout the CEA.[31] Further, to read "make available to trade" to mean any swap that is "listed" for trading on a SEF improperly conflates the trade execution requirement with the clearing requirement. It also ignores CEA Section 5h(d)(1), which provides that the CFTC "may promulgate rules defining the universe of swaps that can be executed on a swap execution facility," and that such rules "shall take into account the price and nonprice requirements of

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[29] Many of FIA's commodities members are eligible for an exception from trade execution mandates with respect to their swaps that are subject to the end-user clearing exception. *See* CEA Section 2(h)(8)(B), 7 U.S.C. § 2(h)(8)(B). For a variety of reasons, though, it may not be possible to elect the end-user clearing exception for all swaps they enter into that may be subject to mandatory SEF trading. Accordingly, FIA's commodities members have a significant interest in the Commission's approach to the imposition of trade execution mandates.

[30] CEA Section 2(h)(8)(B), 7 U.S.C. § 2(h)(8)(B).

[31] Two of these places are in provisions relating to SEFs. *See* CEA Section 5h(b)(2), 7 U.S.C. § 7b-3(b)(2) (a SEF "may not list for trading") and CEA Section 5h(c), 7 U.S.C. § 7b-3(c) ("listing and executing trades of swaps"). Others include, for example, i) CEA Section 2(a)(1)(C)(i)(II), 7 U.S.C. § 2(a)(1)(C)(i)(II) ("listing for trading"); ii) CEA Section 4(b)(1)(B), 7 U.S.C. § 6(b)(1)(B) ("listed for trading on a registered entity"); iii) CEA Section 4a(a)(6)(A), 7 U.S.C. § 6a(a)(6)(A) ("contracts listed by designated contract markets"); iv) CEA Section 5(d)(3), 7 U.S.C. § 7(d)(3) ("the board of trade shall list on the contract market"); and v) CEA Section 5c(c)(1), 7 U.S.C. § 7a-2(c)(1) (a "registered entity may elect to list for trading").

counterparties to a swap and the goals of [promoting trading of swaps on SEFs and pre-trade price transparency]."[32]

Finally, the relevant legislative history demonstrates that this interpretive question was specifically foreseen at the time, and that "makes the swap available to trade" was not intended to mean "lists the swap." Senator Blanche Lincoln, the Chairman of the Senate Committee on Agriculture, Nutrition and Forestry with jurisdiction over the CEA amendments (including the SEF provisions) that were enacted as part of the Dodd-Frank Act, identified this issue and stated unequivocally as follows:

> In interpreting the phrase "makes the swap available to trade," it is intended that the CFTC should take a *practical rather than a formal or legalistic approach*. Thus, in determining whether a swap execution facility "makes the swap available to trade," the CFTC should evaluate not just whether the swap execution facility permits the swap to be traded on the facility, or identifies the swap as a candidate for trading on the facility, but also whether, as a *practical matter*, it is in fact possible to trade the swap on the facility. The CFTC could consider, for example, whether there is a minimum amount of liquidity such that the swap can actually be traded on the facility. *The mere "listing" of the swap by a swap execution facility, in and of itself, without a minimum amount of liquidity to make trading possible, should not be sufficient to trigger the Trade Execution Requirement*.[33]

In sum, the wording utilized by Congress, related SEF provisions enacted by Congress, and the statement of a leading Senator in the development of the CEA's SEF provisions all demonstrate that "makes available to trade" does not mean "lists."

b. A Practical Approach to Trade Execution Mandate Determinations

The fact that a swap meets the statutory requirements for a clearing mandate does not necessarily mean that it also is suitable for mandatory trade execution. Under the proposed automatic trade execution mandate for any swap that is required to be cleared and listed by a SEF, a small, newly-

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[32] CEA Section 5h(d)(1), 7 U.S.C. § 7b-3(d)(1). The SEF NPRM concludes that its proposed interpretation of "makes the swap available to trade" is consistent with the trade execution mandate in CEA Section 2(h)(8) because: i) "Congress had the ability to delineate a comprehensive statutory process for determining when a swap should be subject to the trade execution requirement, but did not do so . . ."; ii) "[i]n contrast, the clearing requirement, established by Congress concurrently with the trade execution requirement under the Dodd-Frank Act, sets forth a formal statutory process for the Commission to follow in determining which swaps must be submitted to a DCO for clearing"; and iii) "this placement of the trade execution requirement within the [CEA section 2(h) heading of] clearing requirement further supports the view that no additional framework was intended by Congress . . ." SEF NPRM, 83 Fed. Reg. at 61979 and n.275. Yet this analysis, too, disregards the rulemaking authority that Congress granted the Commission in CEA Section 5h(d)(1) – the CEA section that specifically governs SEFs. Congress granted the Commission explicit rulemaking authority with respect to the products that trade on SEFs; unlike with respect to clearing mandate determinations, it simply left the form and manner of the Commission's trade execution mandate determinations to the Commission's discretion.

[33] Cong. Rec. Vol. 156, Number 105, p. S5923 (July 15, 2010) (Sen. Lincoln) (emphasis added).

registered SEF seeking a first-mover advantage to boost its business could list a clearing-mandated swap and thereby trigger a market-wide trade execution mandate regardless of whether the SEF can provide sufficient liquidity to meet market participants' risk management needs. FIA's commodities members also are concerned that tying a trade execution mandate to a SEF's listing of a swap that is subject to mandatory clearing may require them to trade a swap on a SEF to which they do not have access, or for which they may have to pay more for access.

FIA's commodities members believe that, as Senator Lincoln observed in her remarks in the Congressional Record quoted above, the Commission instead should take a practical approach to the imposition of trade execution mandates. We respectfully submit that this practical approach should be characterized by three elements: i) consideration of the workability of a trade execution mandate for market participants that trade the swap as part of their business operations; ii) recognition of the operational challenges and costs imposed on all market participants when a swap is required to be traded on a SEF; and iii) an opportunity for market participants to be heard.

First, a practical approach to trade execution mandates should assure workable solutions for market participants that enter into the swap in connection with their business operations. FIA's commodities members often enter into swaps as part of complex commercial transactions such as infrastructure and inventory financing deals, where flexibility is required and a mandate to trade those swaps on a SEF may not be workable in the context of completing those transactions. Similarly, swaps entered into by FIA's commodities members frequently are tied to deliveries and supply chains for physical commodities, which again demands flexibility and may render SEF trading of certain swaps unworkable.

Second, a practical approach to trade execution mandates should address the operational challenges and costs that, as discussed above, the mandate will necessarily impose on all market participants involved in the trading and processing of the swap. These concerns are particularly acute for smaller commodities firms, many of which are in the agricultural sector, that may trade a variety of swaps episodically, and that often lack a sizable compliance department to cover trading on registered SEFs. These firms can be especially adversely affected when trading swaps on SEFs is mandated. Accordingly, a practical approach should include consideration of both *whether* and *when* a trade execution mandate should be imposed (thereby triggering the compliance schedule, as discussed above) in light of the operational burdens and monetary costs associated with compliance.

Third, a practical approach to trade execution mandates should be transparent to the public and afford market participants an opportunity to be heard. Both the CEA and the Commission's regulations provide for public comment as part of Commission decision-making on various issues. There is no reason that the Commission should not receive input from market participants and members of the public on an issue of such significance as a trade execution mandate.

c. Consideration of New Trade Execution Mandates

FIA's commodities members welcome Chairman Giancarlo's recent remarks that "bringing swaps subject to the clearing mandate into scope of the trading mandate should be done properly and,

perhaps, in stages with a relative degree of consensus of buy-side, sell-side and major SEF market participants."[34] We urge the Commission as a whole to adopt a similar view in any final SEF rulemaking.

However, we also urge the Commission not to attempt to define by rule an exhaustive set of specific standards for the imposition of new trade execution mandates. Such an effort would risk the same one-size-fits-all problem that afflicts the proposed "listed by a SEF" standard. As evidenced by the discussion above, the factors relevant to a trade execution mandate determination may be myriad, and the relative importance of those factors is likely to vary in each instance.

It may be appropriate for the Commission to provide, in a final SEF rulemaking, a non-exclusive list of factors that it will consider in making trade execution mandate determinations. The discussion above reveals several factors that may be relevant with respect to any given swap. These include, by way of example:

- The types of market participants trading the swap, and the purposes for which they are trading it (*i.e.*, the nature of the liquidity);

- The operational challenges the trade execution mandate will pose to market participants generally, and the impact of a trade execution mandate on markets and supply chains for physical commodities in particular;

- Characteristics of the swap, such as the complexity of its pricing structure;

- Characteristics of the SEFs listing the swap, such as their trading functionality, how many SEFs list the swap, how long those SEFs have listed the swap and how long they have been registered; and

- Characteristics of the market, such as the number of market participants trading the swap on a SEF, the number of liquidity providers for the swap, the ratio of dealer-to-dealer swaps vs. dealer-to-customer swaps executed on SEFs, and the number of transactions in the swap (and the notional volume of those transactions) on SEFs.

Given this broad diversity of potentially relevant considerations, the Commission should not attempt to set a fixed test for trade execution mandates in the context of a final rulemaking amending the SEF regulations. Rather, it should retain flexibility to consider all relevant facts and circumstances at the time the trade execution mandate determination is to be made.

Through the mandatory clearing determination process, the Commission and its staff will obtain a significant amount of information about any swap for which a clearing mandate is issued. The Commission, therefore, will be well-positioned to issue, at or about the same time as the clearing mandate (and at the present time, for swaps already required to be cleared), a Request for Comment with specific questions to assist its determination of whether the swap also should be subject to a

[34] *See* ABA Address, n.23, *supra*, at 6.

trade execution mandate (and, if so, on what timeframe). If it chooses, the Commission also could hold a public roundtable to receive additional information, and/or request one of its Advisory Committees to provide input as well. Armed with this information, the Commission can then make a well-informed trade execution mandate determination with respect to the swap in question.

For the reasons discussed above, trade execution mandate determinations require a practical approach with sufficient flexibility to achieve workable results. FIA's commodities members respectfully submit that this approach will best be achieved by the Commission making a reasoned determination after receiving public input on the particular attributes and trading circumstances of a swap for which it has issued a clearing mandate, rather than on an abstract basis in any final rulemaking regarding SEFs generally.

V. The Commission Should Exempt Swaps in Package Transactions that Include a Futures Contract Component from the Trade Execution Requirement

The SEF NPRM proposes to exempt one type of package transaction from the trade execution requirement. Specifically, proposed Regulation 36.1(d) would exempt a swap that is part of a package transaction that also includes the issuance of a bond in a primary market. FIA's commodities members respectfully request that any final rulemaking also exempt a swap that is executed as a component of a package transaction that includes a futures contract component.

Currently, the rules of both the Chicago Mercantile Exchange and ICE Futures US prohibit parties from using a swap that is executed on a SEF or DCM as the related component of an exchange-for-related-position ("**EFRP**") transaction.[35] The significant increase in the number of swaps required to be executed on a SEF or DCM anticipated to result from a final rulemaking will, therefore, cause a corresponding increase in the number of swaps that can no longer be the subject of EFRP transactions.

To prevent resulting market disruptions, FIA's commodities members request that the Commission exempt from the trade execution requirement swaps executed as part of package transactions in which another component is a futures contract.

VI. The Proposed Prohibition on Pre-Execution Communications Should Not Be Adopted

FIA's commodities members respectfully request that the Commission not adopt the proposed prohibition on pre-execution communications set out in the SEF NPRM. The sweeping ban on all such communications, as applied to swaps routinely entered into by FIA's commodities members, would be virtually impossible to administer at best, and at worst, would stymie legitimate

[35] *See* Chicago Mercantile Exchange Rule 538 and ICE Futures US Rule 4.06, and associated FAQ guidance. We recognize that the result we are requesting could be accomplished by the Exchanges withdrawing their rules prohibiting EFRPs that include a swap executed on a SEF or DCM. Nevertheless, we believe it would be appropriate for the Commission to do so by rule in order to ensure that there is legal certainty on this issue.

commercial business transactions that include a swap that is subject to a trade execution mandate as part of the terms.

The justification for the prohibition presented in the SEF NPRM focuses on pre-execution communications that constitute negotiation or arrangement of swaps. The SEF NPRM states that "[s]uch negotiation or arrangement, regardless of the method through which they may occur, *i.e.*, among participants themselves or through a swap broking entity, constitutes 'trading' that should occur on a SEF."[36] The proposed rule, however, is far broader. It would prohibit "engaging in *any* communications away from the swap execution facility regarding *any* swap subject to the trade execution requirement . . . ." (Emphasis added.)

As noted above, FIA's commodities members regularly enter into swaps as part of complex commercial business transactions such as, for example, infrastructure and inventory financing deals. Read literally, the proposed prohibition would prevent the parties to such a transaction from discussing even the fact that a swap would be entered into as a term of the transaction. Yet, these communications must take place, as the transactions cannot be undertaken without them.

Perhaps, notwithstanding its wording, the prohibition is not intended to apply to all communications about a swap to be executed as part of the transaction, but rather only to a subset of communications regarding the particulars of the swap that would be entered into. But even the attempt to articulate such a distinction highlights how difficult it would be to administer from a compliance perspective in this context. Communications about such a swap often arise in the context of communications about the overall transaction of which the swap is a part. From a compliance perspective, it would be virtually impossible to determine, and train business personnel in advance regarding, the point at which a permissible conversation about a transaction that involves a swap subject to a trade execution mandate would cross the line into a prohibited communication about that swap.

In short, the proposed blanket prohibition on all pre-execution communications is not workable with respect to many swaps entered into by FIA's commodities members. We respectfully request, therefore, that the Commission not adopt the proposed prohibition on pre-execution communications. If, however, the Commission determines to include such a prohibition in a final SEF rulemaking, FIA's commodities members further request that the Commission provide an exception for communications relating to swaps that are terms of a broader commercial transaction or, at a minimum, clearly define the types of communications that are prohibited in these circumstances.

[36] SEF NPRM, 83 Fed. Reg. at 61986.

VII. Conclusion

FIA appreciates the opportunity to comment on the SEF NPRM. Please contact Allison Lurton, Senior Vice President and General Counsel, at 202-466-5460, if you have any questions about this letter.

Respectfully submitted,

Walt L. Lukken
President and CEO

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Honorable Dan Berkovitz, Commissioner
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