March 15, 2019

By Electronic Submission

Commodity Futures Trading Commission
Christopher Kirkpatrick, Secretary
1155 21st Street, N.W.
Washington, DC 20581

Re: Public Comment on Swap Execution Facilities and Trade Execution Requirement (RIN 3038-AE25); Public Comment on Request for Comment on Post-Trade Name Give-Up on Swap Execution Facilities (RIN 3038-AE79).

Ladies and gentlemen,

Better Markets, Inc.[1] ("Better Markets") appreciates the opportunity to provide comments on the Commodity Futures Trading Commission's ("CFTC") proposal to implement substantial revisions to regulations governing the trading protocols and operations of swap execution facilities ("SEFs").[2] Better Markets also appreciates the opportunity to provide comments on the proposed elimination of the made-available-to-trade process ("MAT Process") for establishing the trade-execution requirement under section 2(h)(8) of the Commodity Exchange Act ("CEA").[3]

Although the CFTC should always explore improvements the U.S. derivatives market structure and SEF regulations, in particular, the current proposal is deeply flawed in critical respects and too often conflicts with the letter and explicit statutory objectives of the CEA. The CFTC's proposed rulemaking therefore must be withdrawn, re-thought, and, if appropriate, re-proposed to avoid significant disruption of the SEF marketplace, the likely costly unintended consequences to the U.S. financial system, and the potential for post-rulemaking litigation, which will only increase regulatory uncertainty in the markets and

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

2 See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946 (proposed November 30, 2018), available at https://www.govinfo.gov/content/pkg/FR-2018-11-30/pdf/2018-24642.pdf ("SEF Proposal"). See also 7 U.S.C. § 7b–3 (establishing the SEF registration requirement and setting forth a core principles regulatory framework) and 7 U.S.C. § 1a(50) (defining SEFs as "trading system[s] or platform[s] in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility[ies] or system[s], through any means of interstate commerce, including any trading facility[ies], that facilitate[] the execution of swaps between persons; and is not a designated contract market").

3 Id. See also 7 U.S.C. § 2(h)(8). The CEA is codified at 7 U.S.C. 1 et seq.

render effective CFTC oversight all but impossible.[4] The SEF proposal also would dangerously dismantle many of the critical pillars of the multilateral swap execution framework adopted in the aftermath of the 2008 financial crisis and improperly codify statutory interpretations that are inconsistent with the plain language and intent of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").[5] For these reasons, Better Markets urges the CFTC to reconsider its proposal in almost all respects. However, it supports the CFTC's proposal in one critical respect: abolishing the MAT Process for establishing the trade execution requirement and instead relying, in part, upon the CFTC's clearing determination process under CEA section 2(h).[6]

Better Markets appreciates the opportunity also to provide comments in response to the request for comment on the practice of disclosing counterparty names upon execution of cleared transactions on swap execution facilities ("Name Give-Up").[7] The practice of Name Give-Up (1) does not support any legitimate risk management objective in connection with cleared, anonymously executed swaps; (2) promotes continued access to privileged liquidity by a very small number of dominant swap dealers, contrary to the statutory purposes and core principles of the SEF regulatory framework; and (3) deters SEF participation on account of trading advantages provided to dealers that collect and analyze counterparty trading information. Despite these realities, a handful of dealers has prevented SEFs from eliminating the practice of Name Give-Up and facilitating a transition to a better diversified, more liquid, and more transparent market structure.

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[5] Public Law 111-203, 124 Stat. 1376 (2010).

[6] 7 U.S.C. § 2(h).

[7] See Commodity Futures Trading Commission, Post-Trade Name Give-Up on Swap Execution Facilities, 83 Fed. Reg. 61571 (Nov. 30, 2018), available at https://www.gpo.gov/fdsys/pkg/FR-2018-11-30/pdf/2018-24643.pdf.

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I. The Dodd-Frank Act was adopted in the aftermath of the 2008 financial crisis to address numerous risks arising from trading in the dealer-dominated over-the-counter derivatives market structure.

Memories are short. A little more than ten years ago, the worst financial crisis since the Great Depression exposed the significant risks that can arise when a handful of dominant dealers control trading in the derivatives markets. The ultimate consequence was economic harm on tens of millions of Americans, many of whom have suffered and are still suffering from un- and under-employment,[8] low wages,[9]

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[8] In the immediate aftermath of the 2008 financial crisis, the U6 total unemployment and underemployment rate published by the U.S. Bureau of Labor Statistics reached a peak of 17.1%, which was more than twice the highest measure in 2007. See U.S. Bureau of Labor Statistics, Total unemployed, plus all marginally attached workers plus total employed part time for economic reasons [U6RATE], retrieved from FRED, Federal Reserve Bank of St. Louis (March 15, 2019), available at https://fred.stlouisfed.org/series/U6RATE. Unemployment and underemployment rates increased dramatically during and after the 2008 financial crisis and remained high by historical standards well into 2010, when they began a steady decline. Id. However, the U6 rate returned to 2007 levels only in 2017 and even then, with substantial geographical variation. Id. The headline U1 unemployment rate followed a similar trend, reaching its peak in 2010 and steadily declining to 2007 levels for the first time in 2017. See U.S. Bureau of Labor Statistics, Persons Unemployed 15 weeks or longer, as a percent of the civilian labor force [U1RATE], retrieved from FRED, Federal Reserve Bank of St. Louis (March 15, 2019), available at https://fred.stlouisfed.org/series/U1RATE.

[9] Median household income dropped significantly in the aftermath of the 2008 financial crisis, reaching its low in 2012 before beginning a steady return to pre-crisis levels over the next five years. See U.S. Census Bureau: U.S. Department of Commerce, Economics and Statistics Administration, Household Income: 2017 (ACSBR/17-01), G. Guzman (Sept. 2018), available at https://www.census.gov/content/dam/Census/library/publications/2018/acs/acsbr17-01.pdf. Notably, it took almost a full decade after the 2008 financial crisis for U.S. households to again achieve 2007 median income levels, again with substantial geographic variation. Id. See also U.S. Census Bureau: U.S. Department of Commerce, Economics and Statistics Administration,

excessive student loans,[10] damaged credit records,[11] lost equity in their homes,[12] and more.[13] The devastation caused by the 2008 financial crisis—exacerbated by the over-the-counter ("OTC") derivatives market structure—has required one of the longest continuous expansions in U.S. economic history for many families to begin an incremental recovery from these effects.[14] Many families still have not recovered. Indeed, numerous studies have concluded that a majority of Americans remain economically worse off today than they were in 2007 by a number of measures.[15]

Income and Poverty in the United States: 2017, Current Population Reports (P60-263), Pg. 11, Figure 4, K. Fontenot, J. Semega, and M. Kollar (Sept. 2018) (noting that, in the aftermath of the 2008 financial crisis, the number of families in poverty reached its highest recorded level since 1959), available at https://www.census.gov/content/dam/Census/library/publications/2018/demo/p60-263.pdf.

[10] Total outstanding student loan debt, accelerated by diminished employment prospects in the aftermath of the 2008 financial crisis, reached an aggregate balance of $1.46 trillion in 2018; transitions into serious delinquency on student loan debt remain well above pre-crisis levels. See Federal Reserve Bank of New York, Research and Statistics Group, Quarterly Report on Household Debt and Credit: 2018: Q4 (Released Feb. 2019), available at https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/hhdc_2018q4.pdf.

[11] Total delinquent balances on household debt, including severely derogatory balances, dramatically increased in the aftermath of the 2008 financial crisis, reaching a peak in 2009 and remaining well above 2006 levels to date. Id at 11. In addition, the number of new consumers with foreclosures and bankruptcies dramatically increased during and immediately after the 2008 financial crisis. Id at 17.

[12] See, e.g., Federal Housing Finance Agency, U.S. House Price Index Report—4Q 2018, National Statistics Appendix, Pgs. 7-12 (Feb. 2, 2019), available at https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2018Q4_HPI.pdf (measuring significant declines in the "FHFA House Price Index History for U.S." during and immediately after the 2008 financial crisis). See also J. Gallin, R. Malloy, E. Nielsen, P. Smith, and K. Sommer, Federal Reserve Board, Divisions of Research & Statistics and Monetary Affairs, Measuring Aggregate Housing Wealth: New Insights from an Automated Valuation Model (2018-064), Staff Working Papers in the Finance and Economics Discussion Series, 30-31, Fig. 3: Aggregate Own-Use Housing Wealth (Aug. 2018), available at https://www.federalreserve.gov/econres/feds/files/2018064pap.pdf (comparing the dramatic loss of housing wealth across three measures and noting that "the ACS measure fell by 14 percent from peak to trough, the *Financial Accounts* fell by 29 percent from peak to trough, and the AVM measure splits the difference between these two, falling by 21 percent from peak to trough").

[13] The 2008 financial crisis had immense personal and social consequences, potentially influencing suicide, divorce, child neglect, substance abuse, and other rates. These human tragedies are too often overlooked when considering the impacts of financial crises, and while they can be difficult to measure, they are very real. See, e.g., Child neglect linked to parental unemployment (Nov. 2017), available at http://www.ox.ac.uk/news/2017-11-02-child-neglect-linked-parental-unemployment (finding that the crisis-linked unemployment measurably increased rates of child neglect); see also, e.g., P. Agrrawal, D. Waggle, D. Sandweiss, Suicides as a response to adverse market sentiment (1980-2016) (Nov. 2, 2017), available at https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0186913 (noting the increase in suicides as a result of the Great Recession of 2008 and finding a correlation between changes in gross domestic product as a result of such financial crises and certain stress-induced behavioral changes).

[14] See U.S. Bureau of Labor Statistics, Gross Domestic Product [GDP], retrieved from FRED, Federal Reserve Bank of St. Louis (March 15, 2019), available at https://fred.stlouisfed.org/series/GDP/. If gross domestic product remains positive in the coming months, the U.S. will have entered its longest continuous economic expansion in modern U.S. history before finalizing SEF regulations arising from the current SEF Proposal.

[15] See, e.g., R. Barnichon, C. Matthes, A. Ziegenbein, Federal Reserve Bank of San Francisco, Economic Letter 2018-19, The Financial Crisis at 10: Will We Ever Recover?, available at https://www.frbsf.org/economic-research/files/el2018-19.pdf (finding "a large fraction of the gap between current GDP and its pre-crisis trend level is associated with the 2007–08 financial crisis" and concluding that "GDP is unlikely to revert to the level implied by its trend before the crisis"). For another study of the devastating effects of the 2008 financial crisis, see See T. Atkinson, D. Luttrell, and H. Rosenblum, Federal Reserve Bank of Dallas, Staff Paper No. 20, How Bad Was It? The Costs and Consequences of the 2007-09 Financial Crisis (July 2013), available at https://www.dallasfed.org/~/media/documents/research/staff/staff1301.pdf. Better Markets previously estimated that the total cost of the financial crisis may exceed more than $11 trillion in lost gross domestic product alone. See Better Markets, The Cost of the Crisis: $20 Trillion and Counting (July 2015), available at https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis_1.pdf.

In the midst of this anomalous period of economic expansion, it is worth pausing to consider the tendency for most people—including, of course, executives in the financial industry—to forget even the very recent past and to yield to pressures from shareholders, management, and others to "get up and dance while the music is playing."[16] **But this time is not different.**[17] The music will stop, inevitably exposing undetected, misunderstood, or ignored imbalances and risks within the financial system. The CFTC's primary responsibility must be to anticipate that inevitability and limit the damage that will be inflicted on those participating in and depending on the derivatives markets when it does, including working Americans that inevitably will bear the consequences.

The OTC derivatives markets historically have been controlled by a small group of Wall Street dealers, but those markets do not exist for them. Derivatives have become inextricably tied to the non-financial economy—the productive economy—through their potential to impact the pricing of a broad range of everyday commodities and less understood, but real, risks incidental to global trade, debt-enabled business expansions, and credit issuances. In the standardized derivatives markets, like the futures markets, those commodities range from traditional agricultural commodities, like wheat, that feeds our families,[18] to the oil that heats our homes and is often required to complete our daily commute to work or receive packages in the mail.[19] In the swap markets, those commodities more commonly include deconstructed financial risks that—properly used and regulated—can be designed to help companies manage borrowing costs and credit exposures—and ideally, encourage the real economy lending that assists companies in

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[16] This is a reference to a statement made prior to the 2008 financial crisis by Chuck Prince, former Citigroup Chairman and Chief Executive. Prince famously stated as follows: "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing," M. Nakamoto, Citigroup chief stays bullish on buy-outs, Financial Times (July 9, 2007), available at https://www.ft.com/content/80e2987a-2e50-11dc-821c-0000779fd2ac. Recognizing the potential for things to get "complicated," Prince continued to permit the very trading activities that ultimately resulted in Citigroup receiving the single largest taxpayer-funded bank "bailout" package in the entire 2007-09 financial crisis period. For additional information, see Special Inspector General for the Troubled Asset Relief Program, Extraordinary Financial Assistance Provided to Citigroup, Inc. (SIGTARP 11-002) (Jan. 13, 2011), available at https://www.sigtarp.gov/Audit%20Reports/Extraordinary%20Financial%20Assistance%20Provided%20to%20Citigroup,%20Inc.pdf. For a more detailed explanation of Prince's quote, see Better Markets Comment Letter to the CFTC and other financial regulatory agencies Re: Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 2-5 (October 17, 2018), available at https://bettermarkets.com/sites/default/files/Better%20Markets%20Comment%20Letter%20on%20New%20Volcker%20Rule%20Proposal.pdf.

[17] See C. Reinhart and K. Rogoff, This Time is Different: Eight Centuries of Financial Folly (2009) (cataloguing serial debt crises over eight centuries and discussing common narratives in each post-crisis generation that market stability will persist indefinitely).

[18] The enumerated commodities in CEA section 1a(9) include "wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles . . . in which contracts for future delivery are presently or in the future dealt in." 7 U.S.C. § 1a(9). There are three major U.S. wheat futures contracts traded on designated contract markets ("DCMs"): (1) soft red winter wheat and hard red winter wheat contracts traded through the Chicago Board of Trade, an exchange owned by the CME Group; and (2) hard red spring wheat contracts traded through the Minneapolis Grain Exchange. See Chicago SRW Wheat Futures Contract Specifications, available at https://www.cmegroup.com/trading/agricultural/grain-and-oilseed/wheat_contract_specifications.html; see also KC HRW Wheat Futures Contract Specifications, available at https://www.cmegroup.com/trading/agricultural/grain-and-oilseed/kc-wheat_contract_specifications.html; see also Hard Red Spring Wheat Futures Contract Specifications, available at http://www.mgex.com/contract_specs.html.

[19] ICE Futures U.S. and NYMEX, a CME Group designated contract market ("DCM"), each facilitate trading in a broad range of energy-related futures contracts, including contracts on crude oil for various delivery points and other "exempt commodities" within the meaning of CEA section 1a(20). See 7 U.S.C. § 1a(20). See also, e.g., Crude Oil Futures Contract Specs, available at https://www.cmegroup.com/trading/energy/crude-oil/light-sweet-crude_contractSpecs_futures.html.

expanding plants, investing in research and development, improving technology, scaling operations, and employing people.[20]

However, this nexus of the derivatives markets to the real economy contains both promise and peril. If the derivatives markets are properly regulated and used for risk-reducing activities (and the limited market-making and speculative activities necessary to facilitate them), derivatives can serve the above socially useful purposes. But if they are not, derivatives can perversely increase the risks they exist to reduce. They can also transfer resources to financial institutions that would be better used to make investments in the real economy; in essence, siphoning resources away from more productive economic activities. The externalities in such cases reach far beyond any immediate effects on financial institutions and markets. The ultimate effects fall on farmers and factory workers seeking to feed their families, for example, which is why clearing and trading mandates have been imposed on contracts for the future delivery of agricultural commodities since at least the 1930s.[21] **Congress has long recognized that open, transparent, liquid, and fair derivatives markets are the most critical safeguard against financial downturns and other risks in derivatives trading.**

The best evidence of that reality may be the performance of regulated futures markets during the 2008 financial crisis, which—despite insufficiencies—remained orderly during the most significant financial crisis in generations.[22] It is not surprising therefore that Congress modeled its swaps market structure reforms, in part, on the exchange-traded futures model.[23] Consider the five regulatory pillars of the reforms built largely upon the foundation of the clearing and trading infrastructure for standardized futures contracts:

(1) The creation of SEFs, a new category of regulated, open, and transparent multilateral swaps trading venues intended to fundamentally transform the over-the-counter markets as they existed in 2008;

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[20] For example, the CFTC's trade execution requirement currently applies to interest rate and index credit derivatives that have been "made available to trade" on SEFs and DCMs. See the CFTC's summary of swaps subject to the trade execution mandate, available at https://www.cftc.gov/sites/default/files/idc/groups/public/@otherif/documents/file/swapsmadeavailablechart.pdf.

[21] See 7 U.S.C. § 6(a). For a concise review of the regulation of agricultural commodities since the 1930s, see Commodity Futures Trading Commission, 75 Fed. Reg. 65586 (Oct. 26, 2010), available at https://www.govinfo.gov/content/pkg/FR-2010-10-26/pdf/2010-26951.pdf (discussing implementation of Public Law 74–675, 49 Stat. 1491 (1936), which, among other things, set forth the original list of enumerated commodities and changed the name of the "Grain Futures Act" to the "Commodity Exchange Act").

[22] For example, clearinghouses associated with most standardized derivatives trading venues "proved resilient during the [2008 financial] crisis, continuing to clear contracts even when bilateral markets dried up . . . Lehman had derivative portfolios at a number of [clearinghouses] across the world and, with one exception, these were auctioned, liquidated or transferred within weeks of the default without exhausting the collateral Lehman had provided . . . One example is the unwinding of Lehman's interest rate swaps portfolio cleared in London (66,390 trades, $9 trillion notional), which used up about a third of the margin held, so that neither the [clearinghouse] nor its members sustained any losses." U. Faruqui, W. Huang, E. Takats, Clearing risks in OTC derivatives markets: the CCP-bank nexus, BIS Quarterly Review, 73 (Dec. 2018), available at https://www.bis.org/publ/qtrpdf/r_qt1812h.pdf. The world's largest clearinghouse located in the U.S. moved $12.7 billion in market-to-market settlements on January 23, 2008 alone, without any significant disruptions. See Commodity Futures Trading Commission, Written Testimony of Acting Chairman Walter Lukken before the House Committee on Agriculture 1, 4 (October 15, 2008).

[23] The SEF definition in CEA section 1a(50) is based on and immediately precedes the "Trading Facility" definition in CEA section 1a(51), though there are important differences (e.g., whether trading interest must be "open" to and not solely made by multiple participants). See 7 U.S.C. §§ 1a(50) and 1a(51).

(2) The implementation of automated execution-to-clearing ("E2C") processing and risk management to improve the efficiency, participation, speed, and finality of swaps trading in furtherance of the clearing and trading mandates (i.e., straight-through processing throughout the swaps market structure);

(3) The introduction of broad clearing and trade execution mandates for swaps (i.e., requiring use of central counterparties and exchanges or exchange-like swaps trading venues);

(4) The introduction of pre-trade transparency to swaps trading in relatively liquid markets; and

(5) The public reporting of swaps across the markets, including appropriately delayed reporting for block transactions carrying the potential to impose significant distortions or execution risks.

These pillars, in conjunction with other reforms in the Dodd-Frank Act, were intended to fundamentally **transform**—***not codify***—the OTC derivatives markets as they existed in 2008. Indeed, the new swaps market structure and regulatory framework is intended to address deficiencies that played a significant (though not the only[24]) role in transmitting risks and panic across the financial system in the lead-up to and during the 2008 crisis—especially proliferation of complex, leveraged positions maintained between a concentrated set of dealers.[25]

The CFTC's SEF Proposal needlessly and often baselessly undermines these fundamental pillars in violation of the clear commands of the CEA.[26] In addition, we explain below how the SEF Proposal in some cases, eliminates the pillars' instrumental value in advancing the CEA's explicit statutory goals for

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[24] The Federal Reserve summed up the 2008 financial crisis concisely in its recent financial stability report: "In the years leading up to the 2007–09 financial crisis, many parts of the U.S. financial system grew dangerously overextended. By early 2007, house prices were extremely high, and relaxed lending standards resulted in excessive mortgage debt. Financial institutions relied heavily on short-term, uninsured liabilities to fund longer term, less-liquid investments. Money market mutual funds and other investment vehicles were highly susceptible to investor runs. **Over-the-counter derivatives markets were largely opaque.** And banks, especially the largest banks, had taken on significant risks without maintaining resources sufficient to absorb potential losses." See Board of Governors of the Federal Reserve System, Financial Stability Report, 7 (November 2018), available at https://www.federalreserve.gov/publications/files/financial-stability-report-201811.pdf.

[25] Id (noting that "[r]eforms to derivatives markets have rendered them less opaque and have reduced credit exposures between derivatives counterparties"). The Government Accountability Office's ("GAO") concise explanation of the role of derivatives in the 2008 financial crisis is worth citing: " . . . FSOC noted that OTC derivatives generally were a factor in the propagation of risks during the recent crisis because of their complexity and opacity, which contributed to excessive risk taking, a lack of clarity about the ultimate distribution of risks, and a loss in market confidence. In contrast to other OTC derivatives, credit default swaps exacerbated the 2007-2009 crisis, particularly because of AIG's large holdings of such swaps, which were not well understood by regulators or other market participants. Furthermore, the concentration of most OTC derivatives trading among a small number of dealers created the risk that the failure of one of these dealers could expose counterparties to sudden losses and destabilize financial markets. See Government Accountability Office, Report to Congressional Requesters: Financial Regulatory Reform, Financial Crisis Losses and Potential Impacts of the Dodd-Frank Act (Jan. 2013), available at https://www.gao.gov/assets/660/651322.pdf.

[26] The primary rulemaking proposed to be revised is the rulemaking implementing new CEA section 5h, the regulatory cornerstone of the SEF market structure reforms. See, e.g., Commodity Futures Trading Commission, 78 Fed. Reg. 33476 Core Principles and Other Requirements for Swap Execution Facilities (June 4, 2013), https://www.govinfo.gov/content/pkg/FR-2013-06-04/pdf/2013-12242.pdf ("SEF Core Principles Rulemaking").

the SEF framework—promoting regulated SEF trading and increasing pre-transparency in the swaps markets.[27]

- Section II explains how the CFTC's SEF Proposal, and related actions, encourage continued OTC trading through single-dealer platforms and enables mandated U.S. trading to occur through exempted trading venues in violation of CEA section 3(a)-(b), CEA section 5h(e), and CEA section 5h;

- Section III explains how the CFTC's SEF Proposal conflicts with longstanding E2C processing requirements that are critical to maintaining a financial markets infrastructure that can support multilateral trading, in contravention of CEA section 5h(e)'s statutory objectives and in violation of CEA section 5h; and

- Section IV explains how the CFTC's new interpretation of the phrase "makes available to trade" in CEA section 2(h)(8)(B) would be a more intuitive, logical, and plain reading of the statute and better serve CEA section 5h(e)'s statutory objectives than the CFTC's extra-textual and unlawful made-available-to-trade process.

The SEF Proposal, on the whole, violates and undermines, rather than implements and advances, statutory requirements and objectives.

II. The CFTC's misconstruction of CEA section 5h(a)(1) is based on arbitrary and capricious reasoning that violates the CEA's letter and intent and is plainly inconsistent with Congress' statutory objectives.

In the aftermath of the 2008 financial crisis, Congress adopted CEA section 2(h)(8)(A)[28] requiring market participants to execute swaps subject to CEA section 2(h)(1)(A)'s clearing requirement ("Clearing Requirement")[29] on DCMs,[30] SEFs,[31] and certain exempt facilities,[32] subject to a narrow exception in CEA section 2(h)(8)(B).[33] For present purposes, the threshold regulatory concern is the CFTC's interpretation of the categories of trading venues that must register as SEFs under CEA section 5h(a)(1)[34] and therefore

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27 CEA section 5h(e); 7 U.S.C. 7b–3(e) (stating that "[t]he goal of this [SEF] section is to promote the trading of swaps on swap execution facilities and to promote pre-trade transparency in the swaps market").

28 7 U.S.C. § 2(h)(8)(A).

29 See 7 U.S.C. § 2(h)(1)(A).

30 7 U.S.C. § 7(d)(1)-(23) (setting forth twenty-three core principles applicable to DCMs).

31 7 U.S.C. § 7b-3(f)(1)-(15) (setting forth fifteen core principles applicable to SEFs facilitating trading in swaps).

32 7 U.S.C, § 7b-3(g).

33 7 U.S.C. § 2(h)(8)(B). See our discussion of this exception in section IV below.

34 7 U.S.C. § 7b-3(a)(1).

bring trading protocols and operations into compliance with the SEF definition in CEA section 1a(50)[35] and the fifteen core principles governing SEFs in CEA section 5h.[36]

Unfortunately, the CFTC's interpretation of the SEF registration provision is based on arbitrary and capricious reasoning that violates the CEA's letter and is plainly inconsistent with statutory objectives. The CFTC's misconstruction of CEA section 5h(a)(1) and the implications of a proper construction of that provision are discussed at length below.

A. The CFTC's misconstruction of the SEF registration requirement continues to violate the letter and intent of the CEA section 5h(a)(1).

The CFTC's interpretation of the SEF registration provision, CEA section 5h(a)(1), conflicts with any reasonable construction of its language. The statutory language of the SEF registration provision reads as follows:

> No person may operate a ***facility*** for the trading or processing of swaps unless the facility is registered as a [SEF] or as a [DCM].[37]

In interpreting this statutory prohibition, the CFTC must first determine the meaning and scope of the term "facility," which is not defined in the CEA. It must turn, therefore, to standard methods of statutory interpretation, which account not only for the plain meaning of the term "facility" but also the context of the term "facility" within the SEF regulatory framework, the use of the term "facility" in related CEA provisions, the legislative history of the SEF registration provision, and the explicit rule of construction and statutory objectives set forth in CEA section 5h(e). Each of these requires that the CFTC give effect to the CEA's broad statutory mandate that facilities for trading or processing of swaps be registered as SEFs and subject to comprehensive federal oversight.

The plain meaning of the term "facility" as used in CEA section 5h(a)(1) requires that the CFTC broadly construe the SEF registration requirement. The ordinary and dictionary meanings of the term "facility" are instructive: "something that makes an action, operation, or course of conduct easier" or "that is built, installed, or established to serve a particular purpose."[38] Another definition defines "facility" as "[a] special feature of a service or machine, which offers the opportunity to do or benefit from something."[39] In other words, a "facility" quite logically is a service or mechanism that ***facilitates*** something else. Thus, as a threshold matter, the plain meaning of the undefined term "facility" in CEA section 5h(a)(1) can be reasonably interpreted only as a prohibition on the operation of any unregistered service or mechanism that facilitates swaps trading or processing.[40] The CFTC explains in the SEF Proposal that the term "trading" means "negotiating or arranging swaps transactions" and further, that "negotiating or arranging" consists

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35 7 U.S.C. § 1a(50).

36 7 U.S.C. § 7b-3(f)(1)-(15).

37 7 U.S.C. § 7b-3(a)(1) (emphasis added).

38 Merriam-Webster Dictionary (2019), Definition of Facility, available at https://www.merriam-webster.com/dictionary/facility.

39 Oxford Living Dictionaries, Oxford University Press (2019), Definition of Facility, available at https://en.oxforddictionaries.com/definition/facility.

40 This is not a case, where, for example, the CFTC sets forth equally plausible interpretations of an ambiguous statutory provision in which its administrative expertise would have relevance to a resolution of conflicting but reasonable interpretations.

of "***facilitating*** the interaction of bids and offers."[41] Thus, by the CFTC's own acknowledgement, the language of CEA section 5h(a)(1) contemplates SEF registration of any service or mechanism through which swaps are negotiated or arranged (or orders are managed).[42]

The undefined term, "facility," used in CEA section 5h(a)(1) must be understood in its statutory context. Indeed, well-established canons of statutory interpretation require the CFTC to construe the term "facility" in CEA section 5h(a)(1) in a manner that is consistent with its use and meaning elsewhere in the CEA.[43] Congress uses the term "facility" to describe numerous services or mechanisms that ***facilitate*** functions within the derivatives infrastructure (e.g., **execution facilities** to enable bilateral transactions in CEA § 1a(51),[44] **clearing facilities** to enable processing and novation in § 1a(15),[45] and **recordkeeping facilities** to support swaps data management and reporting in § 1a(48)).[46] In addition, multiple CEA

[41] See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61990 (proposed November 30, 2018) (emphasis added).

[42] For purposes of this comment letter, CEA section 5h(a)(1)'s use of the term "processing" is less pertinent than the CFTC's view of facilities for the "trading" of swaps. Therefore, this comment letter emphasizes the term, "trading," in CEA section 5h(a)(1). However, in the Final SEF Core Principles Rulemaking, the CFTC briefly discussed the meaning of "processing" for purposes of CEA section 5h(a)(1), noting that "[t]he SEF NPRM stated that the registration provision in CEA section 5h(a)(1) could be read to require the registration of entities that solely engage in trade processing." Id at 33479. The CFTC determined that the word "processing," in effect, should be read out of the statute: "[E]ntities that solely engage in trade processing would not meet the SEF definition in CEA section 1a(50) because they do not provide the ability to execute or trade a swap as required by the definition. Accordingly, swap processing services would not have to register as a SEF under CEA section 5h(a)(1)." Id at 33483. Although we do not address the meaning of the term, "processing," the CFTC's emphasis on whether processing entities "provide the ability to execute or trade" seems equivocal and potentially at odds with a plain reading of CEA section 5h(a)(1).

[43] The Presumption of Consistent Usage and Meaningful Variation (among other names given to similar rules of construction—e.g., the Identical Words Presumption) and In Pari Materia canons of statutory interpretation have been employed for decades by legal scholars and the courts. The Presumption of Consistent Usage, in essence, provides that when the same word is used in different parts of the same statute, Congress intended those words to have the same meaning. See, e.g., Robinson v. City of Lansing, 782 N.W.2d 171, 182 (2010) (stating, "unless the Legislature indicates otherwise, when it repeatedly uses the same phrase in a statute, that phrase should be given the same meaning throughout the statute."). Conversely, the Presumption of Meaningful Variation provides that when Congress uses a particular word in one part of a statute, and then uses a different word in the same statute, Congress must be presumed to have intended the different words to have different meanings. In Pari Materia is a canon of statutory construction that means, in essence, that language must be construed in the broader context of a statutory framework. The Latin phrase translates as "of the same material." See, e.g., Fla. Dep't of Highway Safety & Motor Vehicles v. Hernandez, 74 So.3d 1070, 1076 (Fla. 2011) (noting that a statute that allowed the state to suspend the driver's license of any person who refused to submit to a "lawful" breathalyzer must be read in pari materia with a related statute that provided a definition of a lawful breath-alcohol test).

[44] 7 U.S.C. § 1a(51) (excluding from the definition of "Trading Facility" any "person or group of persons solely because the person or group of persons constitutes, maintains, or provides an electronic facility or system that enables participants to negotiate the terms of and enter into bilateral transactions as a result of communications exchanged by the parties and not from the interaction of multiple bids and multiple offers within a predetermined, non-discretionary automated trade matching and execution algorithm").

[45] 7 U.S.C. § 1a(15) (defining "Derivatives Clearing Organization," with certain exclusions,. as "a clearinghouse, clearing association, clearing corporation, or similar entity, facility, system, or organization that, with respect to an agreement, contract, or transaction (i) enables each party to the agreement, contract, or transaction to substitute, through novation or otherwise, the credit of the derivatives clearing organization for the credit of the parties; (ii) arranges or provides, on a multilateral basis, for the settlement or netting of obligations resulting from such agreements, contracts, or transactions executed by participants in the derivatives clearing organization; or (iii) otherwise provides clearing services or arrangements that mutualize or transfer among participants in the derivatives clearing organization the credit risk arising from such agreements, contracts, or transactions executed by the participants").

[46] 7 U.S.C. § 1a(48) (defining "Swap Data Repository" as "any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for swaps").

definitions use a variation of the disjunctive phrase, "facility or system," suggesting that Congress understood the term "facility" to have a close relationship to the term "system."[47] The term "system" has a technological connotation, however, while the term, "facility," has long been used in financial statutes as a general descriptor for *services or mechanisms that facilitate* various functions within the financial markets infrastructure. Thus, a broad contextual interpretation of CEA section 5h(a)(1) is consistent not only with Congress' use of the term, "facility," elsewhere within the CEA but also the use of that term in the Securities and Exchange Act of 1934[48] and regulatory frameworks governing financial markets.[49]

The CEA's statutory structure supports a broad construction of CEA section 5h(a)(1) as well. Compound terms including the word "facility" are defined in CEA sections 1a(51) ("Trading Facility"),[50] 1a(16) ("Electronic Trading Facility"),[51] and 1a(50) ("Swap Execution Facility").[52] The term "facility"

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[47] This phrase appears in the SEF definition itself. See 7 U.S.C. § 1a(50) (defining SEF as "a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the **facility or system**, through any means of interstate commerce, including any trading facility that (A) facilitates the execution of swaps between persons; and (B) is not a designated contract market").

[48] See 15 U.S.C. § 78c(a)(2) (defining the term "facility" to mean any exchange's "premises, tangible or intangible property whether on the premises or not, any right to use of such premises or property or **any service thereof for the purpose of effecting or reporting a transaction on an exchange** (including, among other things, **any system of communication to or from the exchange**, by ticker or otherwise, **maintained by or with the consent of the exchange**) and any right of the exchange to the use of any property or service"); see also 15 U.S.C. § 78c(a)(1) (defining "exchange" to include "any organization, association, or group of persons . . . which constitutes, maintains, or provides a market place or ***facilities*** for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and **the market facilities maintained by such exchange**") (emphasis added).

[49] For example, the Financial Industry Regulatory Authority ("FINRA") has published rules and guidance pertaining to the reporting of OTC transactions in equity securities to Trade Reporting Facilities, Alternative Display Facilities, and OTC Reporting Facilities. See FINRA's Trade Reporting Frequently Asked Questions (updated Oct. 15, 2018), available at http://www.finra.org/industry/trade-reporting-faq. In addition, a number of non-U.S. regulations and/or directives use the term "facility" to describe mechanisms for executing various types of financial transactions. For example, Multilateral Trading Facility ("MTF") is a regulatory category of trade execution venues for financial instruments subject to the Markets in Financial Instruments Directives ("MiFID"). See, e.g., MiFID Article 4(15) (describing an MTF as "a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments—in the system and in accordance with non-discretionary rules—in a way that results in a contract"). Organized Trading Facilities ("OTFs") are regulated trading venues that provide additional discretion to operators within the MiFID execution framework.

[50] 7 U.S.C. § 1a(51) (defining "Trading Facility" as "a person or group of persons that constitutes, maintains, or provides a physical or ***electronic facility*** or system in which multiple participants have the ability to execute or trade agreements, contracts, or transactions (i) by accepting bids and offers made by other participants that are open to multiple participants in the ***facility*** or system; or (ii) through the interaction of multiple bids or multiple offers within a system with a pre-determined non-discretionary automated trade matching and execution algorithm" and excluding "a person or group of persons solely because the person or group of persons constitutes, maintains, or provides an ***electronic facility*** **or system that enables participants to negotiate the terms of and enter into bilateral transactions as a result of communications exchanged by the parties** and not from the interaction of multiple bids and multiple offers within a predetermined, non-discretionary automated trade matching and execution algorithm").

[51] 7 U.S.C. § 1a(16) (defining "Electronic Trading Facility" as "a trading facility that (A) operates by means of an electronic or telecommunications network; and (B) maintains an automated audit trail of bids, offers, and the matching of orders or the execution of transactions on the ***facility***").

[52] 7 U.S.C. § 1a(50) (defining SEF as "a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the ***facility*** or system, through any means of interstate commerce, including any trading facility that (A) facilitates the execution of swaps between persons; and (B) is not a designated contract market"). See also, e.g., 7 U.S.C. § 7b-3(f)(7) (requiring SEFs to "establish and enforce rules and procedures for ensuring

alone is used within the statutory definitions of numerous other statutory provisions, for example CEA sections 1a(6) ("Board of Trade"),[53] 1a(37) ("Organized Exchange"),[54] CEA sections 1a(15) ("Derivatives Clearing Organization"),[55] and 1a(48) ("Swap Data Repository").[56] From a structural perspective, then, the term "facility" in CEA section 5h(a)(1), at a minimum, must be interpreted as more inclusive than the defined terms set forth in CEA sections 1a(51), 1a(16), and 1a(50), which define ***specific types of facilities***. That is, the general term "facility" must carry a meaning that is both (a) distinct from the more specific defined terms that include the term "facility" in CEA sections 1a(51), 1a(16), and 1a(50); and (b) consistent with its use as an undefined, stand-alone term within CEA sections 1a(6), 1a(37), 1a(15), and 1a(48).[57] Congress could have used one or more of the defined terms in place of the term "facility"—most relevantly, SEF, as the CFTC contends is implied—to establish the scope of CEA section 5h(a)(1). But clearly and unambiguously, it chose not to. To the contrary, it chose a general term repeatedly used elsewhere in the CEA, and logically, one that captures a broad array of services or mechanisms for facilitating derivatives markets functions that Congress intended to bring under federal oversight.[58]

The evolution of CEA section 5h(a)(1) during the Dodd-Frank Act legislative process further supports a broad SEF registration mandate. The initial House of Representatives' ("House") version of Title VII of the Dodd-Frank Act—the Over-the-Counter Derivatives Markets Act of 2009—did not use the

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the financial integrity of swaps entered on or through ***the facilities of the [SEF]***, including the clearance and settlement of the swaps pursuant to [CEA] section 2(h)(1)).

[53] 7 U.S.C. § 1a(6) (defining "Board of Trade" as "any organized exchange or other trading facility").

[54] 7 U.S.C. § 1a(7) (defining "Organized Exchange" as a "trading facility that (A) permits trading (i) by or on behalf of a person that is not an eligible contract participants; or (ii) by persons other than on a principal-to-principal basis; or (B) has adopted (directly or through another non-governmental entity) rules that (i) govern the conduct of participants, other than rule that govern the submission of order or execution of transactions on the trading facility; and (ii) include disciplinary sanctions other than the exclusion of participants from trading").

[55] 7 U.S.C. § 1a(15) (defining "Derivatives Clearing Organization," with certain exclusions,. as "a clearinghouse, clearing association, clearing corporation, or similar entity, ***facility***, system, or organization that, with respect to an agreement, contract, or transaction (i) enables each party to the agreement, contract, or transaction to substitute, through novation or otherwise, the credit of the derivatives clearing organization for the credit of the parties; (ii) arranges or provides, on a multilateral basis, for the settlement or netting of obligations resulting from such agreements, contracts, or transactions executed by participants in the derivatives clearing organization; or (iii) otherwise provides clearing services or arrangements that mutualize or transfer among participants in the derivatives clearing organization the credit risk arising from such agreements, contracts, or transactions executed by the participants").

[56] 7 U.S.C. § 1a(48) (defining "Swap Data Repository" as "any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, swaps entered into by third parties for the purpose of providing a centralized recordkeeping ***facility*** for swaps").

[57] The Rule Against Surplusage directs that the proper interpretation of a statute is the one in which Congress' language is presumed to be meaningful and deliberate; i.e., an interpretation in which every word, phrase, or section is given effect. See, e.g., Begay v. United States, 553 U.S. 137, 143 (2008) (applying the canon to limit the meaning of "violent felony" to not apply to felony drunk driving).

[58] The term, "facility," as mentioned above, is used in seven independent definitions in CEA section § 1a, which are relevant to trading, clearing, and recordkeeping functions within the derivatives markets. 7 U.S.C. § 1a. The General Terms canon of statutory interpretation provides that general terms must be given their general meaning and afforded their full and fair scope, without being arbitrarily limited. This canon reflects the legislative reality that it is frequently useful to legislate on categories without knowing or having the information to anticipate each possible permutation that could fall within such a category. See, e.g., United States v. South Half of Lot 7 & Lot 8, Block 14, 910 F.2d 488, 490-91 (8th Cir. 1990).

term, "facility," in the proposed new SEF registration provision but instead sought to amend the CEA as follows:

> No person may operate a **swap execution facility** unless the facility is registered under this section.[59]

Another House version of Title VII of the Dodd-Frank Act—the Derivative Markets Transparency and Accountability Act—similarly would have amended the CEA to add a new SEF registration provision as follows:

> A person may not operate a **swap execution facility** unless the facility is registered under this section or is registered with the Commission as a designated contract market . . . .[60]

These provisions each diverged from the formulation used in the registration provision of the U.S. Senate's Restoring American Financial Stability Act of 2010,[61] which initially provided for SEF registration as follows:

> No person may operate a **facility** for the trading or processing of swaps unless the facility is registered as a swap execution facility or as a designated contract market under this section.[62]

Faced with competing language, Congress deliberately determined to proceed with the U.S. Senate formulation using only "facility" in CEA section 5h(a)(1),[63] as ratified in the Dodd-Frank Act's CEA amendments.[64]

For each of the above reasons, the CEA forecloses the CFTC's existing interpretation of CEA section 5h(a)(1). The only logical reading of CEA section 5h(a)(1) is that Congress intended ***first*** to prohibit unregulated trading of swaps ("No person may operate a ***facility*** for the trading or processing of swaps"). It intended ***second*** to channel that trading activity into a regulated, multilateral trading environment (i.e., a trading venue meeting the SEF definition's multiple-to-multiple requirement). In other words, the goal was

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59 See Over-the-Counter Derivatives Markets Act, House Amdt. 517, H14547, H14553 Cong. Rec.—House (December 10, 2009), available at https://www.congress.gov/crec/2009/12/10/CREC-2009-12-10-pt1-PgH14496-4.pdf.

60 See House Amdt. 519, H14690 Cong. Rec.—House (December 10, 2009), available at https://www.congress.gov/crec/2009/12/10/CREC-2009-12-10-pt1-PgH14496-4.pdf.

61 See Restoring American Financial Stability Act of 2010, 661 (May 20, 2010), available at https://www.govinfo.gov/content/pkg/BILLS-111hr4173pp/pdf/BILLS-111hr4173pp.pdf. Similar language was used in the previous version of the bill. See S3217, Title VII—Wall Street Transparency and Accountability, 590 (Apr. 15, 2010), available at https://www.govinfo.gov/content/pkg/BILLS-111s3217pcs/pdf/BILLS-111s3217pcs.pdf.

62 See Restoring American Financial Stability Act of 2010, 661 (May 20, 2010), available at https://www.govinfo.gov/content/pkg/BILLS-111hr4173pp/pdf/BILLS-111hr4173pp.pdf.

63 The Dodd-Frank Wall Street Reform and Consumer Protection Act, Conference Report to Accompany H.R. 4173, 111-517, House of Representatives (June 29, 2010), available at https://www.congress.gov/111/crpt/hrpt517/CRPT-111hrpt517.pdf.

64 See, e.g., NLRB v. Catholic Bishop, 440 U.S. 490, 515 (1979) (Brennan, J., dissenting) (finding rejected amendments informative). Moreover, the initially proposed statutory structure mirrored the statutory approach to requiring the registration of Derivatives Clearing Organizations ("DCOs") in CEA section 5b(a). 7 U.S.C. 7a-1(a). In relevant part, that section of the CEA states that "it shall be unlawful for a DCO . . . to perform the functions of a DCO" with respect to certain types of transactions, unless such DCO "is registered with the Commission." 7 U.S.C. 7a-1(a). Note that Congress did not prohibit a SEF from performing the functions of a SEF in an analogous way; it prohibited the operation of a *facility* for trading or processing swaps, a much broader formulation that must be given effect as a matter of law, legislative history, public policy (as discussed below), and common sense.

to **transform** the trading environment from one in which Wall Street dealers and a handful of privileged clients benefit from closed, non-transparent facilities to one in which trading would be conducted in an open, transparent, multilateral trading environment.

This is fully supported by the legislative context of the SEF registration provision. CEA section 5h(a)(1) was passed in the immediate aftermath of the 2008 financial crisis when Congress was intently focused on the risks arising from concentrated OTC derivatives trading activities, especially those occurring within a few dominant Wall Street dealers (some of whom were recently insolvent or close to it, and each of whom received various and substantial forms of direct and indirect taxpayer support to stem systemic risks arising, in part, from such activities). Even if CEA section 5h(a)(1) could be viewed as ambiguous (and it cannot), in this legislative context, it is inconceivable that Congress would have sought to encourage continued single-dealer domination of OTC trading for a significant percentage of CFTC-regulated derivatives markets.

CEA section 5h(e) puts any remaining doubt of congressional intent further to rest in explicitly clarifying that the goal of the SEF regulatory framework—***as a rule of statutory construction***[65]—is to promote the trading of swaps on SEFs and pre-trade transparency in the swaps markets.[66] These statutory objectives therefore must inform the CFTC as it chooses between reasonable interpretations; or differently stated, the CFTC must resolve ambiguities, if any, in a manner that is consistent with stated Congressional objectives.[67] Thus, even if one disagrees with a faithfully broad construction of CEA section 5h(a)(1), it is simply not possible to square the CFTC's interpretation with the dual policy objectives of promoting trading on SEFs and promoting pre-trade transparency in the swaps markets. The CFTC's interpretation would effectively codify the pre-crisis OTC derivatives market structure in material respects for far too significant a percentage of the CFTC-regulated derivatives markets.[68] That is not reasonable, and it is a violation of the letter, spirit, and intent of the law.

Nevertheless, the CFTC continues to take a tortured view of the SEF registration requirement, reading CEA section 5h(a)(1) in conjunction with the SEF definition itself (which requires registration only of those firms providing multiple-to-multiple functionality within the meaning of CEA section 1a(50)).[69]

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[65] 7 U.S.C. § 7b–3(e) (setting forth a "Rule of Construction" for the SEF regulatory framework).

[66] Id. (providing that "[t]he goal of [CEA section 5h] is to promote trading of swaps on [SEFs] and to promote pre-trade transparency in the swaps market).

[67] Indeed, in the Final SEF Core Principles Rulemaking, the CFTC acknowledged that "**[t]he registration provision is written in broad language and could be read to require the registration of any facility for the trading or processing of swaps.**" See, e.g., Commodity Futures Trading Commission, 78 Fed. Reg. 33476, 33481 Core Principles and Other Requirements for Swap Execution Facilities (June 4, 2013). The Prefatory Materials canon of statutory construction provides that purpose clauses, like CEA section 5h(e), are permissible indicators of meaning, though not dispositive. See, e.g., A. Scalia and B. Garner, Reading Law: The Interpretation of Legal Texts 221 (2012).

[68] Numerous comments in the congressional record contradict the CFTC's SEF registration framework as well. See, e.g., Statement of Sen. Lincoln (stating that "[t]he major components of the derivatives title include . . . [that] [a]ll swaps 'traded' must be traded on either a designated contract market or a swap execution facility" and emphasizing that "[i]t is a sea change for the $600 trillion swaps market"). Statement of Senator Lincoln, 156 Congressional Record 5869, S5920 (July 15, 2010), available at https://www.govinfo.gov/content/pkg/CREC-2010-07-15/pdf/CREC-2010-07-15.pdf.

[69] The CFTC codified its interpretation of the SEF registration requirement in CFTC Regulation § 37.3(a)(1), providing that CEA section 5h(a)(1) applies only to "facilities" that meet the SEF definition in CEA section 1a(50). Specifically, CFTC Regulation § 37.3(a)(1) requires any person operating a facility that "offers a trading system or platform in which more than one market participant has the ability to execute or trade swaps with more than one other market participant on the system or platform" to register the facility as a SEF or as a DCM. 17 C.F.R. § 37.3(a)(1).

That interpretation—affirmed in the SEF Proposal—is arbitrary, capricious, an abuse of discretion, and not in accordance with common sense or law. Again, as mentioned, it is counter to a plain reading of the statute. CEA section 5h(a)(1) does not contain language that would restrict the prohibition on operating an unregistered facility for the trading of swaps. There is no reference to multiple-to-multiple trading functionality in CEA section 5h(a)(1); nor is any such reference reasonably implied by the ordinary or dictionary meanings of the term "facility" or the use of the term "facility" elsewhere in the CEA. In addition, the CFTC's interpretation was considered and rejected by Congress. Finally, the CFTC's interpretation undermines, rather than advances, statutory objectives.

It is not permissible, and is actually indefensible, for the CFTC to misconstrue the CEA section 5h(a)(1) to apply only to those facilities that operate on a multilateral basis; such a view all but ensures continued trading in dealer-dominated OTC markets in direct violation of a statutory mandate to promote precisely the opposite: multilateral trading on SEFs with pre-trade transparency.

1. Single-dealer facilities for the trading of swaps must register as SEFs and transform their operations to comply with the CEA's SEF definition and core principles.

A broad SEF registration interpretation that is firmly grounded in the CEA's text, structure, and purposes, as discussed above, would require a significant number of presently unregulated one-to-many facilities for the trading of swaps (i.e., single-dealer platforms) to register as SEFs and transform their operations in compliance with the SEF definition in CEA section 1a(50)[70] and Part 37's core principles.[71] The operation of captive, non-transparent, and non-competitive single-dealer platforms controlled by individual Wall Street dealers would mostly come to an end. CFTC-regulated derivatives trading would migrate to multilateral facilities that would better serve statutory objectives than a dealer-dominated derivatives market structure that substantially limits participation on SEFs and pre-trade transparency and, in essence, replicates the pre-2008 financial crisis markets.

The SEF Proposal, instead, affirms an extra-textual interpretation of CEA section 5h(a)(1) that further empowers Wall Street dealers to operate unregistered single-dealer platforms outside of the SEF regulatory framework.[72] That interpretation is indefensible as a matter of law, as noted, but it is also unnecessary as a matter of policy. Under existing SEF regulations**,** the CFTC has not adopted required modes of execution for illiquid or uncleared swaps (i.e., Permitted Transactions[73]), meaning it remains permissible within the existing SEF regulatory framework to execute such swaps with a single dealer of choice.[74] This can occur, moreover, without disclosure of trading interest to others in the market and through the most common OTC method of execution—the telephone.[75] In such circumstances, there can be little legitimate concern about the "unintended" effects of requiring registration of single-dealer

[70] 7 U.S.C. § 1a(50).

[71] 7 U.S.C. § 7b–3(f).

[72] See CFTC Regulation § 37.3 (requiring SEF registration of "[a]ny facility that offers a trading system or platform in which more than one market participant has the ability to execute or trade any swap, regardless of whether such swap is subject to the trade execution requirement under section 2(h)(8) of the Act . . . with more than one other market participant on the system or platform). 17 C.F.R. § 37.3.

[73] 17 C.F.R. § 37.9(a)(1) (defining Permitted Transaction to "mean any transaction not involving a swap that is subject to the trade execution requirement in section 2(h)(8) of the [CEA]").

[74] 17 C.F.R. § 37.9(c)(2) (providing that a SEF "may offer any method of execution for each Permitted Transaction").

[75] Id.

platforms. SEFs can today and would continue tomorrow to facilitate bilateral trading between SEF participants. Such single-dealer trading at least would be brought into a multilateral trading environment, however, and subject to the full panoply of SEF regulations ensuring a measure of fairness, transparency, and market integrity.

In addition, for relatively liquid swaps (i.e., Required Transactions),[76] existing SEF regulations require use only of a limited Request-for-Quote ("RFQ")[77] mode of execution[78] and do not impose a best execution requirement across markets or modes of execution.[79] Thus, even for the standardized swaps markets, SEF participants can trade with a single, disclosed counterparty after seeking—and not necessarily receiving—competitive quotes from no fewer than two other disclosed dealers. These SEF regulations demand reconsideration and strengthening. But as the CFTC itself has argued, the current regulatory balance at least somewhat advances explicit statutory objectives while mitigating concerns about the dissemination of trading intent and the so-called "winner's curse" for dealers.[80] The latter concerns would simply vanish under the CFTC's proposal to eliminate required modes of execution[81] and minimum trading functionality[82]—each an ill-advised proposed measure that, if adopted, would only strengthen the legal and policy arguments already supporting comprehensive CFTC oversight of single-dealer swaps trading platforms.

The dealers understandably will not welcome additional transparency, competition, and federal oversight, given their *private* interests in maintaining the present CEA section 5h(a)(1) market structure. But the *public* interest in these outcomes is clear, as concisely articulated by the CFTC in the SEF Proposal itself:

> Ensuring that . . . swaps trading activity occurs on a registered SEF should concentrate the liquidity formation on SEFs and provide oversight benefits and efficiencies that enhance

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[76] 17 C.F.R. § 37.9(a)(1) (defining Required Transaction to "mean any transaction involving a swap that is subject to the trade execution requirement in section 2(h)(8) of the CEA").

[77] 17 C.F.R. § 37.9(a)(3) (defining Request-for-Quote System to mean "a trading system or platform in which a market participant transmits a request for a quote to buy or sell a specific instrument to no less than three market participants in the trading system or platform, to which all such market participants may respond").

[78] 17 C.F.R. § 37.9(a)(2)(i)(A)-(B) (stating that "[e]ach Required Transaction that is not a block trade . . . shall be executed on a [SEF] in accordance with one of the following methods of execution: (A) An Order Book as defined in § 37.3(a)(3); or (B) A Request for Quote System, as defined in paragraph (a)(3) of this section, that operates in conjunction with an Order Book as defined in § 37.3(a)(3)").

[79] See Commodity Futures Trading Commission, Core Principles and Other Requirements for Swap Execution Facilities 78 Fed. Reg. 33476, 33498 (June 4, 2013) (noting, for example, that "[u]nder the SEC's SB–SEF proposal, an RFQ requester must execute against the best priced orders of any size within and across a SEF's modes of execution, a requirement that the [CFTC] is not recommending at this time").

[80] Id.

[81] See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61953 (proposed November 30, 2018) (explaining proposed adoption of "[n]ew general, disclosure-based trading and execution rules under Core Principle 2 that apply to any execution method offered by a SEF" and emphasizing that "[t]hese proposed rules would replace the § 37.3(a)(2) minimum trading functionality requirement and the execution methods prescribed under § 37.9 for Required Transactions, thereby allowing a SEF to offer flexible methods of execution for swaps subject to the trade execution requirement"). See, e.g., Proposed § 37.201(a)(1)-(3).

[82] Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61953 (proposed November 30, 2018).

market integrity. The proposed application of the SEF registration requirement should help to ensure that the entire swaps trading process, including pre-trade and post-trade protocols, occurs on a SEF in most cases . . . The transition of greater trading to a SEF should improve market oversight by allowing a SEF to monitor a broader swath of the swaps market, which would result in an enhancement of the Commission's own oversight capabilities.

> Further, increased swaps trading on a SEF also should benefit market participants, including [by], among other things, [increasing] protections to mitigate abusive trading or other market disruptions via a facility's audit trail, trade surveillance, market monitoring, recordkeeping, and anti-fraud and market manipulation rules. Additionally, the use of SEF mechanisms would help to enhance post-trade efficiencies and facilitate compliance with related Commission requirements, including pre-trade credit screening and the submission of transactions for clearing and reporting.[83]

The CFTC noted the above in connection with its proposal to require SEF registration of Single-Dealer Aggregator Platforms, which Better Markets supports in the absence of a revision of the CEA section 5h(a)(1) interpretation. However, given the prominence of single-dealer trading, these positive effects are more likely to manifest from registration of dozens of single-dealer platforms than registration of a single Single-Dealer Aggregator Platform.

2. Single-Dealer Aggregator Platforms would not be required to register as SEFs under a CEA section 5h(a)(1) interpretation grounded in the CEA's statutory text, context, and purposes.

The CFTC proposes to interpret CEA section 5h(a)(1) to require Single-Dealer Aggregator Platforms,[84] unlike SEF Aggregator Portals,[85] to register as SEFs.[86] In our view, the CFTC's distinction

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[83] Id at 62053.

[84] In connection with proposed amendments to § 37.3(a)(1), the CFTC describes a Single-Dealer Aggregator Platform as "a trading system or platform that aggregates multiple Single-Dealer Platforms and, thus, enables multiple dealer participants to provide executable bids and offers, often via two-way quotes, to multiple non-dealer participants on the system or platform." Id at 61956. The CFTC reasons that "[a] Single-Dealer Aggregator Platform, in contrast [to a SEF Aggregator Portal], acts as more than a mere portal because it provides a system or platform for multiple-to-multiple participant swaps trading or execution, thereby subjecting it to the SEF registration requirement." Id at 61957.

[85] The CFTC characterizes SEF Aggregator Portals as "services or portals that enable market participants to access multiple SEFs, each of which provides a trading system or platform that facilitates the trading or execution of swaps between multiple participants." Id.

[86] In other words, the CFTC correctly acknowledges that trading facilities permitting access to numerous single-dealer platforms were being used to conduct an end-run around the SEF registration requirement and execute swaps without the regulatory requirements attendant to that trading activity. The construction of CEA section 5h(a)(1) above would appropriately transform single-dealer aggregators into SEF aggregators, however, as all such single-dealers would be required to register as SEFs, absent an exemption granted under CEA section 5h(g). The SEC characterizes single-dealer aggregators, as organized in 2011, as follows: "A variant of the single-dealer model is an aggregator-type platform that combines two or more single-dealer RFQ platforms. In such a platform, a customer who has access to the platform, which is determined solely at the discretion of its operator and of the dealers involved, may see indicative quotes from multiple dealers at once instead of seeing quotes only from one dealer as in the single-dealer RFQ platform. Although a participant can simultaneously view quotes from multiple dealers, the participant can request a firm quote from only one dealer at a time. One feature of the aggregated single-dealer platform as compared to the bilateral negotiation and single-dealer models described above is the ability of a participant in the aggregated single-dealer platform to see indicative quotes from multiple dealers. However, customers are not afforded an opportunity to send RFQs to multiple dealers at the same time to promote competitive pricing. Also, like the single-dealer electronic platform, there is no post-trade reporting of transactions and thus there is no post-trade transparency." See Securities and Exchange Commission, Registration and Regulation of Security-Based Swap Execution Facilities; Proposed Rule, 76 Fed. Reg. 10948, 10952 (Feb. 28, 2011), available at

between "platforms" and "portals" elevates form over substance.[87] Aggregator platforms and aggregator portals each facilitate order routing for the completion of transactions elsewhere. In a faithful interpretation of CEA section 5h(a)(1), Single-Dealer Aggregator Platforms would be used to route transactions solely to registered facilities subject to the full panoply of SEF regulations; Single-Dealer Aggregator ***Platforms*** therefore would be treated logically in the same manner as SEF Aggregator ***Portals***, because Single-Dealer Aggregator Platforms literally ***would be*** SEF Aggregator Portals. Because of its continued reliance on an impermissible interpretation of CEA section 5h(a)(1), however, the CFTC can achieve that sensible and lawful regulatory outcome only through suspect reasoning—excluding all single-dealer platforms and one specific type of aggregator from SEF registration (the SEF Aggregator) while including another type of aggregator (the Single-Dealer Aggregator) operating the same, or a very similar, model. Meanwhile, at least one Single-Dealer Aggregator Platform has for years facilitated trading through RFQs to multiple dealers in a manner that is almost indistinguishable from the multilateral trading protocols supposedly available only through SEFs. These interpretive acrobatics all but prove that the current registration approach is too dependent on "splitting hairs." The CFTC's interpretive approach could be harmonized, as above, under a SEF registration interpretation consistent with statutory text, which would also promote the CEA's core objectives.

If the CFTC continues to apply the existing extra-textual CEA section 5h(a)(1) interpretation, however, we would support bringing federal oversight to Single-Dealer Aggregator Platforms. Like the CFTC, we would fail to see a meaningful conceptual distinction between a hypothetical multilateral SEF that permits one market participant to access liquidity from eight specific dealers and a hypothetical Single-Dealer Aggregator Platform that facilitates access to the same eight dealers but solely through single-dealer trading screens. Disseminating trading interest to eight hypothetical dealers, in essence, facilitates multilateral trading and is consistent not only with CEA section 5h(a)(1) but also CEA section 1a(50). That is what is necessary to satisfy the CFTC's existing view on facilities requiring SEF registration. Yet, we again stress that the CFTC would have incentivized continued bilateral trading with Wall Street dealers by requiring the registration of Single-Dealer Aggregator Platforms and affirming its previous view that single-dealer platforms, in isolation, do not have to register as SEFs. Dozens of such single-dealer platforms will continue to facilitate swaps trading outside of the SEF regulatory framework in contravention of the CEA, and the CFTC will oversee what it estimates to be a single aggregator platform that very well may cease to exist once such a rule is adopted.[88]

3. CEA section 5h(g) provided SEF-specific exemptive authority for facilities subject to a U.S. prudential regulator's comparable and comprehensive supervisory and regulatory framework in contemplation of a broad SEF registration requirement that included bank-affiliated single-dealer platforms.

The Dodd-Frank Act's exemptive authority clarifies Congress' concern that single-dealer platforms operating a facility for the processing or trading of swaps must register as SEFs. Congress provided the

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https://www.govinfo.gov/content/pkg/FR-2011-02-28/pdf/2011-2696.pdf. The SEC distinguishes that type of aggregator from what it terms "multi-dealer RFQ" platforms that permit participant to seek executable orders from multiple dealers at the same time. Id.

[87] See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61957 (proposed November 30, 2018) (providing that "a SEF Aggregator Portal does not meet the statutory SEF definition because **it merely provides a portal through which its users may access multiple SEFs** . . . A Single-Dealer Aggregator Platform, in contrast, **acts as more than a mere portal because it provides a system or platform for multiple-to-multiple participant swaps trading or execution**).

[88] Id at 62046 (proposed November 30, 2018) (stating that "the Commission estimates and assumes that . . . one Single-Dealer Aggregator Platform of which it is aware would register as SEFs").

CFTC authority to "**defin[e]** the universe of swaps that ***can*** be executed on a [SEF]" as long as the CFTC "take[s] into account . . . the goal of [the statutory SEF framework] as set forth in [the rule of construction in] subsection (e)."[89] The word "can" is key to the meaning of that provision, because it makes clear that Congress intended to broadly require swaps trading on SEFs but to permit the CFTC to exercise authority to ***limit*** the universe of SEF-tradeable instruments, where such limitation would not conflict with the statutory goals of promoting SEF trading and pre-trade transparency. In other words, Congress provided that non-SEF OTC dealer markets must be restricted to trading in those swaps that cannot be traded on a SEF. Congress therefore provided in CEA section 5h(d)(2) that "all swaps that are not required to be executed through a [SEF] as **defined** [by the CFTC] . . . may be executed through ***any other***" (non-SEF) "available means of interstate commerce."[90]

Notwithstanding the broad language in CEA section 5h(a)(1), Congress therefore contemplated the potential for *limited* continued processing or trading through unregistered facilities. If a facility is operated by a U.S. Bank Holding Company ("BHC") (or another prudentially regulated legal entity within the BHC),[91] for example, such facility for the trading of swaps that the CFTC determined cannot be executed on SEFs pursuant to CEA section 5h(d)(2) ("Non-SEF Swaps") would be required to seek an exemption under the CFTC's exemptive authority in CEA section 5h(g).[92] Upon receiving an exemption under CEA section 5h(g), the unregistered facility could facilitate trading in Non-SEF Swaps. Indeed, that is the only logical basis for the exemptive authority provided to the CFTC for ***bank and BHC-affiliated facilities*** subject to comparable, comprehensive supervision and regulation on a consolidated basis by a **U.S.** prudential regulator.

In short, requiring SEF registration of single-dealer platforms is a matter of regulatory will; there is clear statutory authority to provide the way. Bank and BHC-affiliated dealers operating single-dealer platforms do not dispute that they operate facilities for trading (including arranging or negotiating) swaps with U.S. persons and persons closely financially connected to U.S. persons; nor do they have to, because the CFTC's current construction of CEA section 5h(a)(1) permits unregistered single-dealer platforms to facilitate such activities on a bilateral basis. Even if the CFTC views the statutory basis for SEF registration as less than clear in such cases (which it is not), we fail to understand, and the CFTC fails to provide, a persuasive countervailing legal and policy rationale for continued operation of unregistered trading platforms for a significant portion of the derivatives markets.

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[89] 7 U.S.C. § 7b–3(d)(1) (authorizing the CFTC to promulgate rules defining the universe of swaps that can be executed on a swap execution facility" but requiring that such "rules shall take into account the price and nonprice requirements of the counterparties to a swap and the goal of this section as set forth in subsection (e)").

[90] 7 U.S.C. § 7b–3(d)(2) (providing "[f]or all swaps that are not required to be executed through a swap execution facility as defined in paragraph (1), such trades may be executed through any other available means of interstate commerce").

[91] The Dodd-Frank Act, among other things, prompted changes in legal entity structures and booking models that resulted in trading revenues in insured depository institutions decreasing as a percentage of BHC total trading revenue since the 2008 financial crisis. See U.S. Office of the Comptroller of the Currency, Quarterly Report on Bank Trading and Derivatives Activities, Third Quarter 2018, 1, 4 (December 2018), available at https://www.occ.gov/topics/capital-markets/financial-markets/derivatives/pub-derivatives-quarterly-qtr3-2018.pdf (stating that "[b]efore the financial crisis, trading revenue at banks typically ranged from 60 percent to 80 percent of consolidated BHC trading revenue" but noting that [s]ince the financial crisis and the adoption of bank charters by the former investment banks, the percentage of bank trading revenue to consolidated BHC trading revenue has fallen and is now typically between 30 percent and 50 percent").

[92] 7 U.S.C. 7 U.S.C. § 7b–3(d)(2).

4. The CFTC must apply CEA section 5h(A)(1) to interdealer broking entities, but such brokers should be registered as introducing brokers as well and eligible for judiciously provided exemptions.

The CFTC proposes to apply CEA section 5h(a)(1) to approximately 60 interdealer brokers[93] that facilitate multilateral swaps trading based on its observation that the Final SEF Core Principles Rulemaking has "enable[d] the operation of multiple-to-multiple trading systems or platforms for a broad range of swaps outside of the SEF regulatory framework."[94] The CFTC explains that "the activities of these [swaps broking] entities—firms operating trading systems or platforms that facilitate swaps trading primarily between swap dealers—trigger the SEF registration requirement because they allow multiple participants to *trade* swaps with multiple participants in a manner consistent with the language of CEA sections 5h(a)(1) and 1a(50)."[95] The CFTC's proposal is consistent with the regulatory outcome that would arise under the faithful interpretation of CEA section 5h(a)(1) discussed above. However, the "because" statement perpetuates the CFTC's misconstruction of CEA section 5h(a)(1).[96] The threshold CEA section 5h(a)(1) analysis, again, turns on whether broking entities operate facilities for the trading or processing of swaps. If no person may operate a facility for the trading of swaps, then it also must be true that no person may operate a multilateral voice-enabled facility for the trading of swaps, which simply is a more specific type of facility that also requires SEF registration under a proper construction of CEA section 5h(a)(1).

The CFTC's proposal is ambiguous on whether dual introducing broker ("IB") and SEF registration would be required of interdealer brokers operating facilities for the trading of swaps. A logical read of the SEF Proposal, however, indicates that SEF registration would be required in lieu of IB registration. For example, the CFTC contends that SEF registration better addresses IB activities in connection with SEF trading than the IB registration regime,[97] and it proposes a new, extra-statutory, and unregistered category of intermediaries—SEF trading specialists—that appear to impose ethics, proficiency, and other requirements that would already apply to IBs and their associated persons ("APs") under CFTC and NFA

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93 Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62046 (proposed November 30, 2018) (stating that "the Commission estimates and assumes that 60 such swaps broker entities and the one Single-Dealer Aggregator Platform of which it is aware would register as SEFs").

94 Id at 61958-59.

95 Id. at 61957 (emphasis original).

96 The CFTC emphasizes the multilateral nature of these facilities in assessing whether interdealer brokers must register as SEFs, but multilateral trading need not be conducted through the interdealer brokers' facilities to require registration under CEA section 5h(a)(1). That is because, again, the registration provision does not reference the SEF definition or constrain the registration requirement in the manner interpreted by the CFTC, nor can the CEA and these provisions reasonably be construed to do so. The threshold concern with respect to CEA section 5h(a)(1) is whether the interdealer brokers facilitate trading or processing of swaps. To date, the CFTC has violated the clear command of Congress and all but forgotten the lessons of the first decade of the 2000s when the OTC derivatives markets proved indisputably incapable of regulating themselves, managing risks, providing fair and competitive markets, and avoiding the buildup of systemic risk across the U.S. financial system.

97 Id at 61959 (proposed November 30, 2018) ("Although many interdealer brokers are registered as IBs pursuant to CEA section 4f and are subject to the Commission's rules and regulations, the Commission believes that these requirements are neither intended nor sufficient for the regulation and oversight of such interdealer brokers' multiple-to-multiple trading activity . . . Given that these interdealer brokers operate trading systems or platforms outside of the SEF regulatory framework that are very similar to the activity that occurs on trading systems or platforms that are located within interdealer brokers' registered affiliated SEFs, the Commission believes such activity would be more appropriately subject to a SEF-specific regulatory framework.").

regulations.[98] If dual IB-SEF registration were contemplated, such newly proposed ethics, proficiency, and other requirements would be duplicative. Moreover, the CFTC states in a discussion of the diligent supervision requirements[99] that "to the extent that some of these [interdealer broker] SEFs were ***previously registered with the Commission and operated as IBs*** . . . proposed § 37.201(c)(6) would impose certain ***analogous requirements***."[100] The characterization of interdealer brokers as SEFs "previously registered with the [CFTC] and operated as IBs" and the reference to "analogous requirements," as opposed to the IB requirements directly, strongly suggests that the CFTC proposes to require SEF registration instead of—and not in addition to—IB registration.

However, the CFTC cannot absolve interdealer brokers of IB registration requirements in connection with their swap-related intermediary activities, absent the exercise of valid exemptive authority.[101] The Dodd-Frank Act explicitly added the phrase "or swap" to the IB definition in CEA section 1a(31),[102] and as a result, the IB definition currently includes "any person . . . who solicits or accepts orders for the purchase or sale of futures contracts, ***swaps*** and other [CFTC]-regulated financial products."[103] CEA section 4d(g), in turn, makes it unlawful for any person to act as an IB in connection with such swaps activities, unless such person is registered as an IB.[104] The CFTC therefore **cannot** permit IBs to meet the registration requirement under CEA section 4d(g) through the SEF registration requirement under CEA section 5h(a)(1), without the exercise of valid exemptive authority. No such exemptive authority appears to be relied upon or even mentioned in the SEF Proposal.

The CFTC struggles reasonably with the conceptual challenge of delineating intermediation that occurs through (1) a service or mechanism that facilitates swaps trading (i.e., a "facility") and functionally resembles the types of facilities regulated as trading venues under the securities and derivatives laws; and (2) personnel that facilitate voice-based and/or electronic trading, which functionally resemble traders and

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98 Id at 61982 (proposed November 30, 2018) (noting that the "proposed rules would enhance professionalism requirements for certain SEF personnel 'SEF trading specialists'—that operate as part of a SEF's trading system or platform, *e.g.* voice-based trading functionalities, by facilitating trading and execution on the facility" and specifically, "would require SEFs to ensure minimum proficiency and conduct" of such SEF trading specialists).

99 17 C.F.R. § 166.3.

100 Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61992 (proposed November 30, 2018).

101 The CFTC has authority to effect an exemption from certain IB requirements for dually registered IB-SEFs under CEA section 4(c). 7 U.S.C. § 6(c). The IB-SEF exemption should be conditional, however, continuing to apply appropriate IB regulatory requirements to dually registered SEFs that rely upon it. Those would include, at a minimum, special audit and examinations authority, requirements relating to access to records, and enforcement authorities that may be relevant to the activities of the SEF. In addition, the CFTC should not provide a blanket exemption for a dually registered IB-SEF from the statutory disqualification provisions with respect to itself and associated persons.

102 7 U.S.C. § 1a(31). In addition, CFTC Regulation § 1.3(mm) defines an IB as "any person who, for compensation or profit, whether direct or indirect, (i) is engaged in soliciting or accepting orders for the purchase or sale of any…swap…and (ii) does not accept any money, securities or property (or extent credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom." 17 C.F.R. § 1.3(mm).

103 Id (emphasis added). There are certain exclusions to this definition.

104 7 U.S.C. § 6d(g).

brokers in regulated futures and securities markets.[105] We believe such delineation is neither necessary nor possible. Indeed, in proposing to implement an almost identical statutory framework for the trading of security-based swaps ("SBSs") under the Dodd-Frank Act, the SEC proposed an SBS SEF registration framework in which brokers would be required to register as SBS SEFs but **also** would be eligible for partial exemptions from "broker" registration otherwise required pursuant to section 15(a)(1) and (b) of the Securities Exchange Act.[106] If the CFTC were to similarly determine that voice broking entities require registration as SEFs and IBs—and if the CFTC were to further determine that IBs may be eligible for an appropriate partial exemption from IB requirements[107]—there can be little doubt that voice-broking SEF entities would seek to avail themselves of such exemption. In essence, the CFTC would permit a dually registered IB-SEF solely on account of broking activity with respect to swaps to meet many, but perhaps not all, IB regulatory requirements ***through its registration as a SEF and compliance with SEF core principles***.[108] IB swaps solicitation and trading activities would be subject to the full panoply of SEF regulations and SEF self-regulatory organization ("SRO") requirements—at the registered legal entity-level—while selected IB and AP requirements would continue to apply both at the legal entity and natural person-level.[109]

Thus, while giving effect to its proposal to require SEF registration of interdealer brokers, the CFTC must also retain essential elements of the IB regulatory framework, including IB and AP registration. The CFTC proposes that SEF trading specialists be internally designated as part of the SEF and subject to the SEF's rules.[110] But a critical element of regulatory supervision is absent; the ability to disqualify a person

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105 The SEC acknowledges the challenge of delineating intermediation in its proposed rules governing security-based swap execution facilities. See, e.g., Securities and Exchange Commission, Registration and Regulation of Security-Based Swap Execution Facilities; Proposed Rule, 76 Fed. Reg. 10948, 10955 (Feb. 28, 2011).

106 Id. at 10959. 15 U.S.C. 78o(a)(1) and (b). Section 15(a)(1) generally provides that, absent an exception or exemption, a broker or dealer that uses the mails or any means of interstate commerce to effect transactions in, or to induce or attempt to induce the purchase or sale of, any security must register with the SEC. Section 15(b) generally provides the manner of registration of brokers and dealers and other requirements applicable to registered brokers and dealers. With respect to potentially duplicative regulation, the SEC noted as follows: "As the Commission noted in its discussion regarding the exemption from the definition of "exchange" for SB SEFs, the Exchange Act, as amended by the Dodd-Frank Act, sets forth a comprehensive regulatory framework for SB SEFs. The Commission believes that this framework indicates that Congress did not intend for entities that meet the definition of SB SEF in Section 3(a)(77) of the Exchange Act and that comply with Section 3D of the Exchange Act and the rules and regulations thereunder (including the registration as a SB SEF) also to be subject to all of the requirements set forth in the Exchange Act and the rules and regulations thereunder applicable to brokers." Id.

107 Many interdealer brokers are already registered as IBs. Part 3 sets forth the registration and regulatory requirements for IBs, among other registered entities. See 17 C.F.R. Part 3. For example, IBs are required to register with the National Futures Association ("NFA") and comply with NFA regulations. See 17 C.F.R. § 3.2. CFTC Regulation § 155.4 sets forth trading standards for IBs. See 17 CFR § 155.4.

108 Technically, the exemption would not permit IBs to meet applicable requirements "through SEF registration," but we phrase it that way because that would be the practical effect. In addition, any such person would not be permitted to engage in any activity that independently would require IB registration. In such case, the person could be acting independent of the SEF registration requirement as an IB and, as such, would be required to also comply with applicable IB registration requirements.

109 See, e.g., 17 C.F.R. 166.3. CFTC § 166.3 requires IBs, APs, and other CFTC registrants that act in a supervisory capacity to diligently supervise the activities of employees and agents relating to their business as a CFTC registrant.

110 This is based on the CFTC's conclusion that "[f]rom a regulatory perspective. . . SEF trading specialists—whether operating as part of a fully voice-based system or as a voice-assisted system with electronic-based features—are an integral part of their respective SEF's trading system or platform." See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61989 (proposed November 30, 2018).

from registration, along with a duty of reporting and updating with respect to filing requirements.[111] Swaps broking entities that meet the definition of an IB must remain registered as IBs, and individuals involved in soliciting or accepting orders at such IBs (or involved in supervising such individuals), must be required to register as APs.[112] Because such IBs and their APs remain within the purview of the CFTC and NFA's regulations governing statutory disqualifications, trade practices, reporting, professional testing, training standards, diligent supervision, and other requirements, the CFTC's proposed SEF trading specialist regulations covering these areas would be, at best, duplicative. This element of the SEF Proposal therefore must be abandoned in favor of retaining existing regulatory safeguards (e.g., registration, Form 8-R reporting, examinations, and disciplinary oversight incidental to National Futures Association ("NFA") membership).[113]

In other words, the CFTC need not reinvent the wheel. It instead should simply require that which the CEA already commands—dual registration, and perhaps judicious exemptions for dually registered IB-SEFs from duplicative requirements. That approach avoids unintended consequences, in particular relieving SEF trading specialists from personal accountability (meaning, regulatory liability) for misconduct.[114]

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111 For example, section 3.10(a)(2) requires each natural person who is a principal of an applicant for registration to execute a Form 8–R to, among other things, be listed as a principal of a registrant. 17 C.F.R. § 3.10(a)(2).

112 7 U.S.C. § 6f(a). See also 17 C.F.R. Part 3. IBs and their associated persons are required to register with the CFTC pursuant to NFA procedures. 17 C.F.R. §§ 3.10, 3.12. Each IB must be a member of a registered futures association, a category currently limited to the NFA. 17 C.F.R. § 170.17. In addition, such entities are subject to, among other requirements, training standards and proficiency testing. See 7 U.S.C. §§ 6p, 21(p). Certain registrants are subject to various financial and reporting requirements. See, e.g., 17 C.F.R. § 1.10 (financial reports of FCMs and IBs), § 1.17 (minimum financial requirements for FCMs and IBs), as well as trading standards, e.g., 17 C.F.R. Part 155 (trading standards for floor brokers, FCMs, and IBs). Registrants are subject to prohibitions against fraud and manipulation. 7 U.S.C. § 9; 17 C.F.R. Part 180. Applicants for registration are subject to statutory disqualifications pursuant to CEA section 8a(2) based on related past convictions that involve fraud or other acts of malfeasance. 7 U.S.C. § 12a(2). In addition, an "associated person" of an IB is defined as any natural person who is associated with an introducing broker as a partner, officer, employee, or agent (or any natural person occupying a similar status or performing similar functions), in any capacity which involves the solicitation or acceptance of customers' orders (other than in a clerical capacity) or the supervision of any person or persons so engaged. 17 C.F.R. § 1.3.

113 The NFA is a registered futures association, SRO, and regulatory service provider for IBs, APs, and SEFs, among other types of CFTC registrants and registered entities. For additional information on the NFA, see https://www.nfa.futures.org/about/index.html.

114 See definition of SEF trading specialist in Proposed § 37.201(c)(1). Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61989 (proposed November 30, 2018). The CFTC proposes to define a "SEF trading specialist" under § 37.201(c)(1) as "any natural person who, acting as an employee (or in a similar capacity) of a SEF, facilitates the trading or execution of swap transactions . . . or who is responsible for direct supervision of such persons." The CFTC proposes to require that these designated persons comply with numerous requirements that already would be applicable to IBs and their APs. For example, the proposed SEF trading specialist framework for statutory disqualifications, along with questionable exclusions, would be unnecessary under a proper analytical approach, because dually registered IB-SEFs would remain subject to current statutory disqualification requirements and exclusions. See Proposed § 37.201(c)(2) (proposing to provide that [n]o swap execution facility shall permit a person who is subject to a statutory disqualification under sections 8a(2) or 8a(3) of the Act to serve as a SEF trading specialist if the swap execution facility knows, or in the exercise of reasonable care should know, of the statutory disqualification, subject to proposed exclusions in Proposed § 37.201(c)(2)(ii)(A)-(B)). The following requirements would be duplicative as well: (1) Proposed § 37.201(c)(3) (proposing to require SEFs to establish and enforce standards and procedures to ensure that SEF trading specialists have the "proficiency and knowledge" necessary to "[f]ulfill their responsibilities to the [SEF] as SEF trading specialists," among other things; (2) Proposed § 37.201(c)(4) (proposing to require SEFs to establish and enforce policies and procedures to ensure that SEF trading specialists "receive ethics training on a periodic basis"); and (3) Proposed § 37.201(c)(6) (requiring that SEF trading specialists be diligently supervised).

Moreover, the CFTC's apparent substitution of newly proposed SEF SRO responsibilities on SEF trading specialists for "analogous IB requirements" is really not a substitution at all, because the CFTC introduces unnecessary, and potentially harmful, discretion to each SEF's implementation of these new regulations. For example, the most basic proposed ethics requirement—the SEF Code of Ethics—does not set forth specific elements that must be included in the code, even where prohibited conduct, like fraud or manipulation, would independently constitute a violation of federal law and IB regulations.[115] Should the CFTC proceed with an unlawful exclusion of the IB registration framework for interdealer brokers (and it should not), the Guidance in Appendix B—in addition to Proposed § 37.201(c)—should at least be codified as regulatory ***requirements***, not guidance on best practices.

It is patently insufficient to require ***a*** standard of conduct, without providing some basic regulatory parameters on what would meet that standard. Yet, the CFTC provides simply that SEFs shall require SEF trading specialists to "satisfy standards of conduct as established by the SEF[s]" and explains only that SEFs *may* require certain types of conduct. That is not much to go on. It would be difficult to reasonably disagree with required SEF codes of conduct that would require SEF personnel, for example, (1) to act in an honest and ethical manner and observe high standards of professionalism; (2) handle orders with fairness and transparency;[116] and (3) not engage in fraudulent, manipulative, or disruptive conduct.[117] Regulatory deference has been provided to an impermissible level when even "these items [are included] for SEF **consideration**" and the primary regulator affirms that "a SEF may include **different** or additional standards as well."[118] This essentially reduces SEF ethics "requirements" in the SEF Proposal to suggestions (and suggestions in lieu of important requirements that otherwise would be mandated by statute under the IB framework).

The above stated, the proposed SEF registration *outcome* for interdealer brokers (i.e., registering multilateral voice brokers as SEFs) is not just conceptually sensible but actually compelled by the CEA.[119] It alleviates the need to engage in legal contortions to distinguish facilities for the trading of swaps from multilateral voice brokerage operations regulated as IBs, and it harmonizes with the SEC's approach to that agency's long overdue SB-SEF regulations pursuant to mostly identical statutory language. Moreover, it would encourage fair competition and trading on SEFs,[120] among other statutory objectives, because it

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115 Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61991 (proposed November 30, 2018) (proposed November 30, 2018) (providing that the proposed ethics standards "are intended to be general and principles-based" and "for a SEF's consideration").

116 The CFTC should not provide mere guidance, for example, that if "[t]he SEF adopts a new discretionary approach to prioritizing or managing competing bids on its voice-based or voice-assisted trading system, then the SEF's ethics training should address how its trading specialists should appropriately conduct themselves under such new protocols." It is a reasonable, and minimal, regulatory expectation to require SEF personnel specifically to comply with ethical obligations tailored to the treatment of orders and trading interest, in particular where the SEF framework provides discretion in those areas. Id.

117 Id at 61991 (noting that the proposed ethics training requirement under § 37.201(c)(4) "aims to ensure that SEFs foster and maintain a high level of professionalism, integrity, and ethical conduct among their trading specialists").

118 Id (emphasis added). In addition, bringing SEF personnel into compliance with majestic ethical formulations, like "be a good employee," should not be sufficient to "demonstrate compliance to the Commission compliance with the requirements of § 37.201." See Proposed § 37.201(c)(7).

119 We stress "outcome" in this sentence, because as mentioned, CEA section 5h(a)(1) compels SEF registration of all facilities for the trading of swaps and does not limit such registration to multilateral facilities.

120 CEA section 5h(e); 7 U.S.C. 7b–3(e) (stating that "[t]he goal of this [SEF] section is to promote the trading of swaps on swap execution facilities and to promote pre-trade transparency in the swaps market").

would impose uniformity in the CEA section 5h(a)(1) interpretation across the marketplace. In this regard, the CFTC notes the following:

> Some interdealer brokers have registered components of their trading systems or platforms as SEFs. Other interdealer brokers have operated very similar trading systems or platforms outside of the structure of a SEF, often through registered IB entities, and have interacted with a SEF solely as participants of the SEF . . .
>
> Notably, many interdealer brokers have maintained the latter approach by operating both a SEF platform and a non-SEF trading system or platform simultaneously, using the latter to facilitate the interaction of bids and offers and bringing the resulting arranged swaps to the SEF for execution.[121]

The CFTC rightly observes that "[t]his bifurcated approach has existed despite the close similarities among interdealer broker trading systems or platforms, whether they are registered or not as SEFs . . ."[122] and that "the operation of multiple-to-multiple swaps trading systems or platforms by swaps broking entities, including interdealer brokers outside of SEFs has frustrated the[] statutory goals and moved liquidity formation away from SEFs."[123]

The CFTC therefore proposes to better ensure the integrity of the swaps markets by bringing interdealer voice brokers properly into the SEF registration framework. The CFTC again rightly concludes that "[a]llowing [voice trading] activities to occur away from a SEF and submitting any resulting transactions to a SEF for execution effectively makes the SEF a trade-booking or trade-processing engine, which is inconsistent with the statutory language and goals of the CEA related to SEFs."[124] It further notes that "[i]nterdealer brokers currently operate trading systems or platforms outside of the SEF regulatory framework, yet act as participants on SEFs, resulting in multiple-to-multiple trading that is opaque not only to the SEF where the negotiated or arranged trade is eventually routed to for execution, but also to the [CFTC] and the general marketplace."[125] We agree. Swaps executed ***on SEF*** already are too often executed through RFQ mechanisms that require minimal pre-trade transparency. The transparency that is provided too often only benefits the specific legal entity requesting quotes, and not the market as a whole.[126] Taking that even further to permit continued off-SEF trading as a matter of course pretends to channel trading activities into the SEF regulatory framework, while undermining the very reasons for its existence: to promote competitive trading and pre-trade transparency in the swaps markets.[127]

The noted booking protocol is especially concerning in light of the documented history of abuses in the swaps markets involving interdealer brokers, including in the markets for interest rate and credit

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121 See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61958 (proposed November 30, 2018).

122 Id.

123 Id at 61959.

124 Id.

125 Id.

126 See 17 C.F.R. § 37.9(a)(3).

127 CEA section 5h(e); 7 U.S.C. 7b–3(e) (stating that "[t]he goal of this [SEF] section is to promote the trading of swaps on swap execution facilities and to promote pre-trade transparency in the swaps market").

derivatives subject to the trade execution mandate. Indeed, numerous global benchmarks, like the London Interbank Offer Rate ("LIBOR")[128] and ISDAFIX,[129] have been manipulated by interdealer brokers and employees of many of the largest dealers working with such brokers. The LIBOR and other benchmark manipulation cases, both civil and criminal,[130] make clear that interdealer brokers would benefit from discipline imposed by SEF regulatory requirements,[131] in particular requirements relating to the monitoring of trading and trade processing,[132] maintenance of records,[133] ensuring listed[134] swaps are not readily susceptible to manipulation,[135] and implementing compliance program requirements.[136] SEF trading would also facilitate a transition to electronic trading as individual markets mature, which itself would dampen the types of market practices that led to the numerous enforcement actions and criminal proceedings brought to preserve some measure of integrity in financial benchmarks. Better Markets has pointed out in the past that much of the global benchmark misconduct was aided by "the continued use of 19th Century technology, the telephone, rather than by the use of almost universally available 21st Century computer technology,"[137] which facilitates federal oversight, internal audit trails and reviews, and more equitable dissemination of information and trading practices.[138]

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[128] The London Interbank Offered Rate ("LIBOR") was a benchmark interest rate managed by a UK bank trade association, the British Bankers' Association, that was supposed to represent the borrowing rate for interbank funds in a particular currency, in reasonable market size, immediately prior to 11:00 a.m. London time.

[129] The ISDAFIX was a leading global benchmark referenced in a range of interest rate products. For example, USD ISDAFIX rates and spreads are published for various maturities of U.S. Dollar-denominated swaps and have been used for cash settlement of options on interest rate swaps, or swaptions, and as a valuation tool for certain other interest rate products, including CME-listed interest rate swap futures contracts.

[130] Between June 2012 and June 2018, the CFTC, Federal Reserve, and Department of Justice's Criminal Division resolved dozens of individual and corporate civil and criminal actions relating to manipulation or attempted manipulation of prominent financial benchmarks. For a convenient list, see Collyer Bristow LLP, Global Benchmark Manipulation Tracker, available at http://www.collyerbristowbenchmarktracker.com/united-states/.

[131] The fifteen SEF core principles are statutorily codified in CEA section 5h(f). See 7 U.S.C. § 7b–3(f).

[132] See 7 U.S.C. § 7b–3(f)(4) (requiring SEFs to "establish and enforce rules or terms and conditions defining, or specifications detailing (i) trading procedures to be used in entering and executing orders traded on or through the facilities of the SEF; and (i) procedures for trade processing of swaps on or through the facilities of the SEF").

[133] See 7 U.S.C. § 7b–3(f)(10) (requiring SEFs to "maintain records of all activities relating to the business of the facility, including a complete audit trail, in a form and manner acceptable to [the CFTC] for a period of 5 years).

[134] The term "listed," as we use it here, means any swap that an interdealer facility or its brokers makes available to clients for execution.

[135] See 7 U.S.C. § 7b–3(f)(3) (requiring SEFs to "permit trading only in swaps that are not readily susceptible to manipulation").

[136] See 7 U.S.C. § 7b–3(f)(15) (requiring SEFs to establish compliance programs under the oversight and management of a Chief Compliance Officer).

[137] Better Markets Letter to G. Gensler, Chairman, Commodity Futures Trading. Commission, Re: RFQs, Voice Brokers, Illegal Rate Rigging & the proposed SEF Rules; RIN 3038-AD18: Core Principles and Other Requirements for SEFs (April 12, 2013), available at https://bettermarkets.com/sites/default/files/documents/Letter-%20CFTC-%20SEF%20Rules%20and%20ISDAfix-%204-12-13.pdf.

[138] See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61959-61960 (proposed November 30, 2018) (acknowledging that SEF monitoring and surveillance requirements may

ICAP's Yen derivatives desk, for example, knowingly disseminated false and misleading information concerning Yen borrowing rates to affect the fixing of Yen LIBOR to the advantage of multiple favored bank clients.[139] In that case, bank traders, in essence, threatened to pull business from the ICAP Yen derivatives desk—with significant implications for ICAP commissions and bonuses—to ensure ICAP Yen brokers acquiesced to repeated demands to facilitate the manipulation of Yen LIBOR.[140] Faced with such consequences, ICAP deliberately disseminated false or misleading information to affect Yen LIBOR, and ICAP's brokers later marketed manipulative services to a trader that inherited the portfolio of the senior bank trader previously engaged in Yen LIBOR activities.[141] ICAP acknowledged that it failed to implement adequate policies, procedures, and internal controls governing broker conduct and communications. The consent order involved substantial undertakings relating to monitoring, auditing, compliance program requirements, and other matters.[142]

Numerous civil and criminal actions against large banking interests have involved interdealer brokers as well. J.P. Morgan Chase Bank, N.A. ("JPM")[143] traders, for example, knowingly submitted, and caused to be submitted by interdealer brokers, interest rate swaps ("IRSs") information to influence the U.S. Dollar ISDAFIX. Not unlike the fact pattern in the ICAP case, JPM did not report in good faith where its trading desks would bid or offer IRSs to others dealers with good credit but rather, where certain tenors would need to be to benefit JPM's proprietary positions. The JPM traders intended to affect pricing information disseminated through an interdealer broker's 19901 screen, which was used to disseminate IRS information that served as one component of the ISDAFIX methodology. The JPM traders submitted quotes and executed trades at specific times that were most likely to affect rates on the 19901 screen (as they said internally, to "muscle the fix at 11") and thereby impact the interdealer broker's reference rates and spreads and the USD ISDAFIX.

These two examples demonstrate the value of channeling trading activities into the SEF regulatory framework. If such misconduct occurred on a SEF, at a minimum, it would be both easier to detect and easier for the CFTC, the U.S. Department of Justice, and other regulators to *prove* and therefore specifically and generally deter. From a market integrity standpoint, therefore, Better Markets strongly agrees with the CFTC's proposal to register interdealer brokers as SEFs:

> Requiring interdealer brokers to either register as SEFs or carry out their multiple-to-multiple trading activities within a SEF would also enhance market integrity and

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be "especially beneficial based on the role of interdealer brokers in the manipulation of ISDAFIX, a benchmark for swap rates and spreads for IRS; and the [LIBOR], an average benchmark for short-term interest rates used to determine floating rates for IRS.").

139 In the Matter of ICAP Europe Limited, CFTC Docket No. 13-38, Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act Making Findings and Imposing Remedial Sanctions (September 25, 2013), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enficaporder092513.pdf.

140 Id at 22-23 ("Periodically, when the Yen LIBOR fixing did not move in the direction he requested, the Senior Yen Trader threatened to take UBS business from ICAP. In response, Derivatives Broker 1 and Yen Desk Head urgently pressed Cash Broker 1 to modify his Suggested LIBORs.").

141 Id at 9.

142 Id at 38.

143 Enforcement Order re: JP Morgan Chase Bank, N.A. Attempted Manipulation of U.S. Dollar ISDAFIX Benchmark, CFTC Docket No. 18–15 (June 18, 2018), available at https://www.cftc.gov/sites/default/files/2018-06/enfjpmorganchasebanknaorder061818_0.pdf.

> monitoring because such activities would become subject to the SEF core principles and regulations, as well as direct regulatory oversight of a SEF in its capacity as a self-regulatory organization ("SRO"). For example, Core Principle 2 requires SEFs to establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means to capture information that may be used in establishing whether rule violations have occurred. These requirements enable SEFs to more comprehensively monitor for, among other things, potential abusive trading practices such as fraud and manipulation.[144]

That stated, we again emphasize that dual IB-SEF registration is far better suited to the immense discretionary authority that interdealer brokers have in voice-based SEFs (than the CFTC's apparent proposal to require SEF registration alone). The CFTC acknowledged the higher risk of misconduct in voice-based SEFs as follows:

> A voice-based or voice-assisted SEF trading system or platform is unique among SEF execution methods. Unlike a trading system or platform that executes orders and facilitates trading through generally automated means, trading specialists that comprise part of the voice-based or voice-assisted systems **usually exercise a level of discretion and judgment in facilitating interaction between bids and offers** from multiple market participants. That discretion and judgment is informed by their knowledge and understanding of market conditions, which are based upon information obtained from observing historical activity and gauging potential or actual trading interest from communications with participants.[145]

If anything, that discretion merits the higher regulatory standards attendant to dual registration.

B. The CFTC should codify its statutory interpretation with respect to SEF registration in the regulations themselves, not solely in preamble discussion.

Better Markets agrees, in principle, that CEA section 5h(a)(1)'s scope should be clear from the SEF registration provision in 37.3(a)(1).[146] Relying on preamble language, and even footnotes within the preamble (e.g., footnote 88), of the SEF Core Principles Final Rule is not an ideal means (and perhaps a legally insufficient means) for providing the contours of the threshold SEF registration provision.[147] **For this reason, separate and apart from the policy judgments that would be codified in the SEF Proposal's registration provisions, Better Markets supports inclusion of threshold registration interpretations in the text of the SEF regulations.**[148] Burying critical policy judgments in the 88th

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144 See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61959 (proposed November 30, 2018).

145 Id at 61989.

146 See 17 C.F.R. § 37.3(a)(1) for the current SEF registration provision.

147 See, e.g., Commodity Futures Trading Commission, Core Principles and Other Requirements for Swap Execution Facilities, 78 Fed. Reg. 33476, 33481, fn. 88 (June 4, 2013), available at https://www.gpo.gov/fdsys/pkg/FR-2013-06-04/pdf/2013-12242.pdf.

148 Better Markets agrees with the CFTC's proposal to amend § 37.3(a)(1) to codify the existing interpretation of CEA section 5h(a)(1) that registration should be required without regard for whether its listed swaps are subject to CEA section 2(h)(8)'s trade execution requirement. In other words, the CFTC's proposed amendment would clarify that "the trade execution requirement is not a determinant of whether an entity must register as a SEF." Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61956 (proposed November 30, 2018).

footnote of a several-hundred-page final release, for example, does not reflect a best practice in the adoption of federal regulations. Potential registrants and the public should not have to engage in the regulatory equivalent of "Where's Waldo?" to find and apply the law.

Moreover, the CFTC should seek a credible deterrent against industry misconduct by ensuring that its SEF regulations do not invite procedural attacks against interpretations of CEA section 5h(a)(1). Incorporating registration requirements directly within regulatory provisions through required administrative process therefore is not only more transparent but it is less vulnerable to legal challenge as well.

C. The CFTC's order exempting certain multilateral trading facilities and organized trading facilities was improperly executed and contrary to the letter and intent of the SEF regulatory framework.

The CFTC has not adopted a formal procedural framework for administering exemptions from SEF registration pursuant to CEA section 5h(g),[149] which authorizes the CFTC to exempt, conditionally or unconditionally, a foreign-located or foreign-operated facility from SEF registration if the CFTC finds such facility is "**subject to comparable, comprehensive supervision and regulation on a consolidated basis by . . . the appropriate governmental authorities in the home country of the facility**."[150] This statutory exemptive power is not without limit or subject to the unfettered discretion of the CFTC. Even unconditional exemptions under CEA section 5h(g) require critical statutory elements be met as part of any exemptive finding:

- First, there must be a finding that there is supervision and regulation of the foreign-located or foreign-operated SEF;
- Second, such SEF must be supervised and regulated on a consolidated basis;
- Third, such SEF must be supervised and regulated by an appropriate governmental authority;
- Fourth, such governmental authority must be in the home country of the facility;
- Fifth, such supervision and, separately, regulation must be comparable to the CFTC's SEF regulatory framework; and
- Sixth, such supervision and, separately, regulation must be comprehensive, meaning each must cover the full panoply of SEF regulatory issues covered in the CFTC's SEF regulations.

The CFTC must make a finding on each element above for any exercise of CEA section 5h(g)'s exemptive authority to be valid.

The CFTC issued an order in December 2017 ("2017 Exemptive Order") that exempted certain MTFs and OTFs authorized within the European Union ("EU") from the CEA's SEF registration requirement based on a finding that the applicable EU regulatory frameworks satisfy the CEA section 5h(g)

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149 7 U.S.C. § 7b-3(g).

150 Id.

standard for granting an exemption from SEF registration.[151] However, that order fails to address elements required to execute a valid exemption from SEF registration under CEA section 5h(g) and has never been published in the Federal Register.

This is particularly troubling in light of the questionable cross-border policy implicated by the CFTC's exemption. Most of the MTFs and OTFs eligible to rely on the CFTC's exemptive order already operate CFTC-registered SEFs, either directly or through an affiliate or similar financial interest. Here is a full list of MTFs and OTFs noted in Appendix A, with a notation as to whether they have a CFTC-registered SEF within their corporate structure:

No.	MTFs and OTFs the CFTC Intended to be Eligible to Rely on the 2017 Exemptive Order	CFTC-Registered Affiliates of the MTFs and OTFs the CFTC Intended to be Eligible to Rely on the 2017 Exemptive Order
1	Bloomberg Multilateral Trading Facility Limited (MTF)	Bloomberg SEF LLC
2	GFI Brokers Limited (OTF)	BGC Derivatives Markets, L.P., GFI Swaps Exchange LLC
3	BGC Brokers LP (OTF)	
4	Dowgate (MTF)	***None.***
5	EBS MTF (MTF)	NEX SEF Limited, Chicago Mercantile Exchange, Inc.
6	NEX SEF Limited (MTF)	
7	ICAP Global Derivatives (MTF)	ICAP Global Derivatives Limited, ICAP SEF (US) LLC
8	ICAP Securities (OTF)	
9	ICAP WCLK (MTF)	
10	iSWAP (MTF)	
11	Sunrise Brokers LLP (OTF)	***None.***
12	Trad-X (MTF)	Tradition SEF, Inc.
13	Tradition (OTF)	
14	Tradeweb Europe Limited (MTF)	TW SEF LLC, DW SEF LLC
15	Tullett Prebon Europe (OTF)	tpSEF Inc.
16	Tullett Prebon Europe (MTF)	

The above chart clearly demonstrates that MTFs and OTFs largely operate in conjunction with CFTC-registered SEFs. In such circumstances, the incremental costs of operating dually registered SEFs and MTFs or OTFs would be exceedingly minimal, especially in relation to the immense benefits of abiding by the statutory mandates to promote pre-trade transparency and regulated trading of swaps under the Dodd-Frank Act. Indeed, in all but two instances, SEFs that the CFTC identified as eligible to rely on the exemption could leverage technology, compliance, and other resources between affiliates.

[151] Order of Exemption: In the Matter of the Exemption of Multilateral Trading Facilities and Organized Trading Facilities Authorized Within the EU from the Requirement to Register with the Commodity Futures Trading Commission as Swap Execution Facilities (Dec. 8, 2017) (finding with respect to EU requirements for MTFs and OTFs—including requirements under the EU's Markets in Financial Instruments Regulation ("MiFIR"), the EU's amended Markets in Financial Instruments Directive ("MiFID II"), and the EU's Market Abuse Regulation—comparable, comprehensive supervision and regulation to the CFTC's SEF regulations)., available at https://www.cftc.gov/sites/default/files/idc/groups/public/@requestsandactions/documents/ifdocs/mtf_otforder12-08-17.pdf.

The substance of the order, in any event, is deficient. First, the Markets in Financial Instruments Regulation ("MiFIR"), and other "regulations," establish EU requirements with respect to MTFs and OTFs and most critically, bind each home country's registrants *without further action by member states*. It is reasonable therefore to view the concession of regulatory authority by member states as the equivalent of a ratification by the appropriate governmental authority in the home country of the facility. The amended Markets in Financial Instruments Directive ("MiFID II"), in contrast, merely sets forth objectives with respect to the regulation of MTFs and OTFs that do not have the force of law until transposed by member states into national laws. As such, the CFTC's reliance on MiFID II provisions in the 2017 Exemptive Order is not only imprudent as a policy matter but statutorily insufficient as a basis for elements of the required comparability finding. **A directive without the force of law cannot be deemed comparable to a CFTC regulation imposing specific obligations. Indeed, it cannot even be reasonably viewed as a regulation *in the home country of the facility* per the statutory requirement;** that would require, in these cases, consideration of the United Kingdom's regulations implementing the directive, an analysis not conducted or even attempted in connection with the 2017 Exemptive Order. For these reasons, and others, the 2017 Exemptive Order is invalid and cannot be relied upon by MTFs and OTFs to escape CFTC oversight and registration.

That would be problematic enough. ***But the CFTC literally provides no analysis to support its assertion that the cited regulations and directives are comparable and comprehensive.*** Neither the scope of the EU regulatory framework nor the nature of any individual provision relating to a critical legal, regulatory, or policy issue—such as impartial access to markets—is mentioned. Contrast that approach with the one taken in the early stages of the trading mandate, where division staff conditioned no-action relief on a number of granular SEF requirements.[152] Nevertheless, the CFTC concludes "transactions involving swaps that are subject to CEA section 2(h)(8) may be executed on an MTF or OTF listed in Appendix A," which we have demonstrated means, in effect, that the CFTC has sanctioned the migration of U.S.-regulated trading[153] to the unregistered affiliates of the very same companies previously facilitating CFTC-regulated trading between U.S. persons. We struggle to understand the legally cognizable rationale for this concession and violation of the CEA's statutory objectives—in particular, to promote trading on SEFs.

D. The CFTC's SEF registration delays for U.S. interdealer brokers and Single-Dealer Aggregation Platforms are reasonable, but the two-year registration delay for foreign brokers is excessive.

The SEF Proposal would delay application of the SEF registration requirement with respect to newly scoped (1) swaps broking entities, including interdealer brokers, for a six-month period; and (2) foreign swaps broking entities, ***including foreign interdealer brokers that facilitate swaps trading for U.S. persons***, for a two-year period, provided the subject applicant submits a CFTC request with certain

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[152] See CFTC Letter No. 14-16, No Action, Division of Market Oversight and Division of Swap Dealer and Intermediary Oversight, Conditional No-Action Relief with respect to Swaps Trading on Certain Multilateral Trading Facilities Overseen by Competent Authorities Designated by European Union Member States (February 12, 2014), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/14-16.pdf (requiring multilateral trading facilities seeking no-action relief to meet U.S. regulatory standards and requirements relating to multilateral trading schemes; a sufficient levels of pre-trade price transparency; a sufficient levels of post-trade price transparency; non-discriminatory access by market participants; and an appropriate level of oversight).

[153] The exempt SEF regime, we note, is applicable only if the registration requirement under CEA section 5h is first applicable to the facility involved in the trading or processing swaps. That might be the case for a U.S.-located or U.S.-operated facility, or a facility permitting trading with U.S. counterparties or non-U.S. counterparties with a close nexus to the U.S. financial system.

information.[154] The CFTC states that the delayed compliance date in relation to the 10-20 expected foreign swaps broking entities[155] is appropriate on account of the intended release of new cross-border guidance covering, among other things, the regulatory treatment of swaps broking entities involved in non-U.S. activities.

It is eminently reasonable for the CFTC to facilitate an orderly transition to a new regulated business model, and staggering compliance dates may be an effective means for doing so. But such delays in compliance dates must be reasonable and proportionate to the administrative and compliance requirements imposed by the regulatory framework involved. In our view, two years is excessive in relation to the implementation requirements for foreign swaps broking entities, the most prominent of whom have U.S. SEF affiliates. In this context, moreover, SEF registration of swaps brokers that "currently facilitate trading, i.e., negotiation or arrangement, of swaps transactions ***for U.S. persons***"[156] is long overdue. Indeed, there are no discernable legal and policy bases for the CFTC to permit such facilities for the multiple-to-multiple execution of swaps involving ***U.S.*** counterparties to be excluded from SEF registration in the first instance.

In addition, significantly longer delays for SEF registration of foreign swaps broking entities provides them an unfair competitive advantage relative to their U.S. counterparts. We cannot think of any public interest served by amplifying incentives to migrate U.S. trading to non-U.S. locales and unregistered swaps broking platforms. Yet, the CFTC states the following:

> [T]he Commission does not anticipate that this delay would draw trading volume away from domestic SEFs. The Commission understands that market participants generally use Eligible Foreign Swaps Broking Entities to trade swaps outside of standard business hours in the U.S. and/or to access liquidity in other non-U.S. markets.[157]

That claim is baseless and counterintuitive speculation. It utterly fails to acknowledge the siren song of regulatory arbitrage, in particular where differences in the regulatory treatment of different swaps broking entities persists for an extended period of time. Furthermore, in actuality, the CFTC intends to delay SEF registration for foreign brokers for ***more than two years***, because the SEF Proposal provides that the foreign swaps broking entities would have two years from the "*effective date* of any final rule adopted from this notice."[158] The effective date is frequently 60 days or more subsequent to the publication of final regulations in the Federal Register, and apparently, the CFTC intends the two-year SEF registration delay would begin

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[154] Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62046 (proposed November 30, 2018).

[155] Id at 62054.

[156] With respect to the CFTC's proposed delay of the SEF registration requirement for foreign interdealer brokers, the CFTC explains the following: ". . . [T]he [CFTC] proposes to delay the compliance date of the registration requirement only with respect to foreign swaps broking entities, including foreign interdealer brokers, that **currently facilitate trading, i.e., negotiation or arrangement, of swaps transactions for U.S. persons** ("Eligible Foreign Swaps Broking Entities") for a period of two years, subject to certain conditions and starting from the effective date of any final rule adopted from this notice." See Id at 61962.

[157] Id at 62054.

[158] Id at 61962.

no sooner than the date published at that time. That is unreasonable and in no way commensurate with the regulatory requirements contemplated.

In contrast, the six-month compliance period seems reasonable and proportionate, provided the CFTC remains firm on the inevitable requests for additional time that are sure to follow any final rule expanding the SEF registration requirement. However, instead of speculating on the likely consequences of a longer delayed registration period, and in particular instead of imposing different SEF registration timelines on different segments of the markets, the CFTC should provide for near-term provisional registration of foreign interdealer broker SEFs seeking SEF registration. That approach proved effective in the initial implementation of the SEF regulatory framework and is a far better approach than maintaining an excessive SEF registration delay of two years, for example, with anti-competitive effects that incentivize non-U.S. trading and regulatory arbitrage.

III. Significant multilateral trading in the derivatives markets will be possible only in a market structure that embraces straight-through processing to minimize market, credit, and operational risk.

Prior to the 2008 financial crisis and the Dodd-Frank Act's market structure reforms, swaps were traded OTC in bilateral transactions in which trading and pricing were controlled by a handful of swap dealers.[159] These transactions were mostly executed pursuant to minimally customized legal templates published by a derivatives trade association, the International Swaps and Derivatives Association, Inc. ("ISDA").[160] That, in itself, is unremarkable. In bespoke transactions with structured terms and few market participants interested in the associated risks, bilateral documentation is necessary to ensure dealers can appropriately manage risk exposures from the transactions (e.g., ensuring the availability and quality of collateral, and specifying circumstances in which such collateral must be posted). But in transactions with relatively standardized terms and a larger number of market participants interested in the associated risks, executing and maintaining bilateral documentation is unnecessarily complex and risk enhancing in certain respects.

The unnecessary operational complexity presented by bilateral documentation in the OTC market structure can be demonstrated with basic mathematics. Consider an OTC market structure in which eight hypothetical corporate end-users seek to manage their balance sheet risks. If each enters a trading relationship with a single dealer, that would require eight bilateral ISDA master agreements. However, if

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[159] Four systemically important dealers continue to exercise significant market power in the derivatives markets today and have subsidiaries and affiliates involved in every material function of the financial markets, including trading, clearing, reporting, and even self-regulatory functions.

[160] The trade association was rebranded from the International Swap Dealers' Association presumably to give the appearance that ISDA's interests were broader than protecting its swap-dealer members (though that is precisely what it was founded to do). See Sean M. Flanagan, The Rise of a Trade Association: Group Interactions within the International Swaps and Derivatives Association, 6 Harv. Negotiation L. Rev. 211 (Spring 2001). The bespoke nature of swaps is frequently wildly overstated, though we acknowledge that there are a number of types of derivatives that may not be sufficiently standardized to permit useful exchange trading and clearing. Nevertheless, as the CFTC has acknowledged, "[s]wap counterparties have typically relied on the use of **industry-standard legal documentation**, including master netting agreements, definitions, schedules, and confirmations, to document their swap trading relationships. This documentation, such as the ISDA Master Agreement and related Schedule and Credit Support Annex ("ISDA Agreements"), as well as related documentation specific to particular asset classes, offers a framework for documenting uncleared swap transactions between counterparties." Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61973 (proposed November 30, 2018); See also Commodity Futures Trading Commission, Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 FR 55904, 55906 (Sept. 11, 2012).

these eight hypothetical end-users enter into bilateral contracts with each of the four dominant dealers (hoping to reduce trading costs through competition), that would require 32 bilateral contracts, with varying terms and conditions, across the OTC derivatives markets. In a hypothetical OTC market structure with 1,000 such end-users and 100 swap dealers, a competitive market in which each dealer could execute swaps with each market participant would require execution of 100,000 bilateral contracts, again with varying terms and conditions. Participation in the swaps markets can exceed these hypothetical numbers, so although these hypotheticals are stylized, the operational complexities and risks incident to a competitive OTC market structure should be clear. In addition to managing thousands of such contracts (e.g., ISDA master agreements), individual confirmations must be executed for each transaction under the master agreements, increasing documentation complexities exponentially—and also operational, legal, settlement, market, credit, and other risks as well.

It is not surprising, then, that operational risk management in the pre-crisis OTC derivatives market structure proved severely deficient. In June 2007, the U.S. Government Accountability Office documented that processes and risk management practices at the largest swap dealers were **"an accident waiting to happen"**:[161]

> After trading volumes grew exponentially between 2002 and 2005, **the 14 largest credit derivatives dealers**—including U.S. and foreign banks and securities broker-dealers—**accumulated backlogs of unconfirmed trades totaling over 150,000 in September 2005.** These backlogs resulted from reliance on inefficient manual confirmation processes that failed to keep up with the rapidly growing volume and because of difficulties in confirming information for trades that end-users transferred to other parties without notifying the original dealer. Although these trades were being entered into the systems that dealers used to manage the risk of loss arising from price changes (market risk) and counterparty defaults (credit risk), the credit derivatives backlogs increased dealers' operational risk by potentially allowing errors that could lead to losses or other problems to go undetected . . .[162]

This assessment, if anything, is optimistic. The "accident waiting to happen" in reality rendered it all but impossible for the dealers to know the precise extent of their legally cognizable derivatives exposures.[163] The potential for such unknown risks to manifest, in turn, played a significant role in spreading panic and risks during the 2008 financial crisis, threatening to bankrupt the U.S. financial system, sending the U.S.

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[161] Government Accountability Office, Report to Congressional Requestors: Credit Derivatives, Confirmation Backlogs Increased Dealers' Operational Risks, but Were Successfully Addressed after Joint Regulatory Action, GAO-07-716, June 2007), available at https://www.gao.gov/assets/270/261958.pdf ("Having unconfirmed trades could allow errors to go undetected at dealers and later result in losses, a situation that an official from the United Kingdom's regulator of credit derivatives dealers characterized as "an accident waiting to happen.").

[162] Id.

[163] The CFTC noted operational risk concerns in the 2012 clearing determination: "With only limited checks on the amount of risk that a market participant could incur, great uncertainty was created among market participants. A market participant did not know the extent of its counterparty's exposure, whether its counterparty was appropriately hedged, or if its counterparty was dangerously exposed to adverse market movements. Without central clearing, a market participant bore the risk that its counterparty would not fulfill its payment obligations pursuant to a swap's terms (counterparty credit risk). As the financial crisis deepened, this risk made market participants wary of trading with each other. As a result, markets quickly became illiquid and trading volumes plummeted. The dramatic increase in 'TED spreads' evidenced this mistrust. These spreads increased from a long-term average of approximately 30 basis points to 464 basis points." Commodity Futures Trading Commission, Clearing Requirement Determination under Section 2(h) of the CEA; Final Rule, 77 Fed. Reg. 74284, 74285 (December 13, 2012), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2012-29211a.pdf.

economy into a tailspin, and diminishing the economic prospects of tens of millions of Americans still struggling to recover from a decade of lost income and economic growth.

In other words, the OTC derivatives market structure revealed itself prior to and during the 2008 financial crisis as a source of significant operational risk. It had devastating and ironic consequences, though, when latent legal, settlement, market, credit, and other risks finally manifested and proved a function, in part, of the market structure itself.[164] The failure of self-interest and moral suasion to correct these issues demonstrates the importance of enforceable market structure regulations and the incentives they create for market participants. Federal regulators encouraged the dealers to remedy documentation and risk management deficiencies for years[165] and at least one high profile default should have been regarded as the canary in the coal mine when it led to widespread interpretive, operational, and credit issues in the energy derivatives markets.[166]

This history is reasonably well understood. Less well understood, however, is that bilateral documentation in the OTC market structure served as an impediment to multilateral trading. Bilateral documentation limited the number of potential dealers available to counterparties and prevented them from considering competitive trading interest.[167] This remained, moreover, long after trading activities exploded in segments of the markets and could have transitioned to a multilateral, exchange-trading model.[168] The

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164 This is "ironic," because the very purpose of bilateral credit agreements is to memorialize the terms of swaps transactions and reduce a variety of risks to the dealers (e.g., market, credit, operational, and settlement risks).

165 Even with regulatory pressure and a concerted effort in the industry to address confirmation issues, the largest 14 dealers maintained thousands of unconfirmed trades years later. See, e.g., Government Accountability Office, Report to Congressional Requesters: Credit Derivatives: Confirmation Backlogs Increased Dealer's Operational Risks, but Were Successfully Addressed after Joint Regulatory Action (GAO-07-716) (June 2007).

166 Here, of course, we refer to Enron's spectacular failure and the spillover effects of its default on an immense number of derivatives contracts, as well the closure of its single-dealer platform. The solution: clearing and trading on electronic platforms. Consider the following testimony by the Acting CFTC Chairman encouraging further clearing in the early months of the 2008 financial crisis: "After Enron's demise in 2001, the OTC energy derivatives markets 'locked up' because many energy companies lacked the requisite financial standing to back their off-exchange trades. In response, the New York Mercantile Exchange (NYMEX) sought and received approval from the CFTC in 2002 to clear OTC energy products for the first time. Today, a significant number of OTC energy derivatives are cleared through regulated clearinghouses, which has reduced systemic risk and allowed regulators a greater window into this marketplace." See Commodity Futures Trading Commission, Written Testimony of Acting Chairman Walter Lukken before the House Committee on Agriculture 1, 4 (October 15, 2008). Regrettably, none of the chaos ensuing from the Enron episode led Congress or the regulators to formally reconsider the advantageous regulatory treatment of trading (and later, clearing) "swaps" rather than futures contracts. That took the 2008 financial crisis.

167 This complemented other anti-competitive measures. For example, the dominant dealers historically used bundled services, such as prime brokerage, as a means to mask the true execution costs of channeling specific transactions into the OTC derivatives market structure. The dealers also limited pre-trade and post-trade information available to counterparties, which impeded progress towards central clearing, because reliable transaction information is requisite to properly marking positions for margin and other risk management purposes. The tools for retaining control over the OTC derivatives infrastructure are limited only by the imagination of the dealers.

168 There has been momentum in recent years to futurize swaps exposures through a variety of technical products, including interest rate swap futures contracts. For an interesting analysis of recent uses of such swap futures products relative to interest rate swaps, see Greenwich Associates, LLC, Total Cost Analysis of Interest-Rate Swaps vs. Futures (2015), available at https://www.greenwich.com/sites/default/files/reports_pdf/IS-Cost_IR_Swaps-2015-GR.pdf. However, strips of Eurodollar futures have provided risk exposures that are economically similar (but not identical) to the risk exposures provided by fixed-for-floating interest rate swaps referencing LIBOR since 1981. In essence, the contract price reflects the market's view of the 3-month U.S.-dollar LIBOR rate—a commonly used reference rate in interest rate derivatives—on the settlement date of the contract, which has long made it a hedging instrument for swaps. See, e.g., I. Kawaller, Comparing Eurodollar Strips to Interest Rate Swaps, Journal of Derivatives (January 1994) (noting that "[t]hose seeking to convert a floating-interest rate exposure to a fixed-rate, or

dealers' perpetuation of the bilateral OTC market structure, nevertheless, successfully sabotaged the development of a multilateral trading environment in which an optimal number of market participants could compete for trades and provide pricing and other information to inform trading decisions.[169] The end result was good for the profitability of the dealers—that is, until the end of 2007. For everyone else, the consequence was a derivatives market structure controlled by a handful of too-big-to-fail financial institutions with incentives to limit transparency and competition. Counterparties paid a premium to get into derivatives positions; and paid even more to get out. In the midst of a financial crisis, the worst possible position for a counterparty is to have positions priced and controlled through various economic means by a dealer that metaphorically stands in front of the exit door.

Progress has been made in reforming the OTC derivatives market structure since the 2008 financial crisis. The less emphasized cornerstone of those reforms has been straight-through processing ("STP") within the execution-to-clearing ("E2C") workflow, which has reduced operational, market, credit, and other risks in the exchange and SEF-traded segments of the derivatives markets, largely eliminating the need for bilateral ISDA trading documentation.[170] This STP infrastructure has built the foundation for multilateral trading by dramatically reducing legal and operational impediments to participating in and making markets.[171] In time, the STP-enabled SEF market structure promises to further reduce execution risks and remaining impediments to liquidity formation.

But STP is not merely *beneficial* to the derivatives markets. Full STP throughout the E2C workflow is the sine qua non of the Dodd-Frank Act's vision for regulated trading on SEFs. In our view, it is requisite to the achievement of the CFTC's objectives to support liquidity formation on SEFs, broader and more diverse competition in derivatives pricing, and increased pre-trade transparency. The STP-enabled SEF market structure not only addresses historical deficiencies in the OTC derivatives markets but also introduces new risk-reducing efficiencies as well. But it is also a threat to the profitability of the OTC derivatives business model. The CFTC therefore must regard the specious contentions relating to the need for "flexibility" in the STP standards as what they are: mechanisms for extracting revenues from the OTC market structure.

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vice versa, have two choices . . . [in] interest rate swaps or eurodollar strip hedges" and that "[c]onceptually, each solution will accomplish the same end . . . using different institutional market mechanisms").

169 The more public problem with the dealers making themselves indispensable to the derivatives market structure, of course, is that it all but ensured government assistance would be necessary to contain the fallout of an insolvency.

170 The CFTC's proposal "acknowledges that cleared and uncleared swaps raise different issues with respect to confirmation requirements and [that] the current SEF requirements create difficulties for the latter type of swap transaction." Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61973 (proposed November 30, 2018). The CFTC therefore proposes to revise CFTC Regulation § 37.6(b). 17 C.F.R. § 37.6(b). The CFTC's current proposal sensibly establishes different requirements for cleared and uncleared swaps, retaining the current confirmation standard for cleared swaps and introducing the "trade evidence record" for the economic terms of uncleared swaps. The necessity of an independent confirmation standard for uncleared swaps based on the operational complexities of uploading and maintain documentation on SEFs demonstrates the value of promoting trading in cleared, standardized swaps markets and also the anti-competitive effects of bilateral documentation requirements. See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61973 (proposed November 30, 2018). The trade evidence record, if adopted, should require that that such records include publicly reportable information concerning the economic terms of the transaction; if the CFTC limits the information in the trade evidence record to economic terms (which we do not necessarily believe should be the case), there is little reason to revise the "upon execution" standard. 17 C.F.R. 37.6(b).

171 That competition, moreover, is focused on the economic terms of transactions, not on the threat of pulling or the inducement of providing ancillary services.

A. The STP regulatory framework for the routing and acceptance of trades has improved the derivatives market structure and substantially advanced CEA section 5h(e)'s statutory objectives.

The SEF regulatory framework implements G20 commitments to fundamentally reform the OTC derivatives market structure and facilitate a transition to multilateral, electronic derivatives trading. Most relevantly, the G20 agreed in 2009 to require trading of all standardized OTC derivatives "on exchanges or electronic trading platforms, where appropriate," and to require "clear[ing] through central counterparties."[172] The CFTC published the U.S. SEF regulatory framework meeting that commitment in 2013,[173] in conjunction with closely related regulations governing block trading,[174] the trade execution mandate,[175] and STP throughout the E2C workflow.[176] These regulations, though imperfect, were hard fought victories against financial interests with much to lose from the Dodd-Frank Act's derivatives market structure reforms. Those victories also have proven reasonably successful in establishing a foundation from which the CFTC can advance statutory objective to promote SEF trading and pre-trade transparency is the swaps markets.[177]

Multilateral trading must be built, first and foremost, on the foundation of an appropriately broad clearing mandate, which facilitates the migration of risks from individual counterparties to central

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172 See G20 Declaration of the Summit on Financial Markets and the World Economy, The White House President George W. Bush, (November 15, 2008), available at http://www.fsb.org/wp-content/uploads/pr_151108.pdf (stating that prudential regulators must "insist that market participants support exchange traded or electronic trading platforms for CDS contracts; expand derivatives market transparency; and ensure that the infrastructure for OTC derivatives can support growing volumes"); See also G20 Leaders' Statement, the Pittsburgh Summit (September 24-25, 2009), available at http://www.fsb.org/wp-content/uploads/g20_leaders_declaration_pittsburgh_2009.pdf (stating that "[a]ll standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest"). These commitments have been affirmed numerous times since 2009. Yet, as of November 2018, there were platform trading frameworks in only 14 of the G20 jurisdictions, with varying measures of success in bringing regulated trading and pre-trade transparency to the derivatives markets. Financial Stability Board, Implementation and Effects of the G20 Financial Regulatory Reforms: 28 November 2018 Annual Report 1, 13 (Nov. 28, 2018), available at http://www.fsb.org/wp-content/uploads/P281118-1.pdf.

173 Commodity Futures Trading Commission, 78 Fed. Reg. 33476 Core Principles and Other Requirements for Swap Execution Facilities (June 4, 2013).

174 See Commodity Futures Trading Commission, Procedures To Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 78 Fed. Reg. 32866 (May 31, 2013), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2013-12133a.pdf; see also Commodity Futures Trading Commission, Real-Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1182 (Jan. 9, 2012), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2011-33173a.pdf.

175 See Commodity Futures Trading Commission, 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; Final Rule, 78 Fed. Reg. 33606 (June 4, 2013), available https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2013-12250a.pdf.

176 See Commodity Futures Trading Commission, Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21307 (Apr. 9, 2012), available at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-7477a.pdf.

177 Other jurisdictions globally have followed the U.S.'s lead. The Markets in Financial Instruments Directive and Markets in Financial Instruments Regulation—as further specified in Commission Delegated Directives and Commission Delegated Regulations and technical standards developed by the European Securities and Markets Authority—essentially build on the foundation of the U.S.'s STP principles and requirements.

clearinghouses. Clearing, though not a panacea for all that ails the derivatives markets,[178] mitigates systemic risk arising from complex, bilateral credit exposures by novating a given counterparty's derivatives positions to a single credit exposure to a CFTC-regulated clearinghouse ("DCO").[179] The DCO, in turn, limits leverage through margin requirements,[180] safeguards and limits the form of collateral posted to support positions,[181] and mutualizes default and non-default risks[182] (among other disciplining financial resources and risk management requirements on clearing members).[183] Most important for present purposes, by eliminating the necessity of maintaining bilateral documentation *with trading counterparties*, **clearing facilitates a multilateral trading environment in which market participants have the ability to transact with the largest available number of counterparties in the marketplace**. This, in turn, creates a virtuous feedback loop—initially reducing impediments to trading and resulting in more liquid and stable markets, and subsequently attracting even more trading interest that reduces hedging and other costs further.

To achieve these outcomes, the clearing infrastructure requires near real-time processing of swaps throughout the E2C workflow (e.g., prompt coordination,[184] routing,[185] processing,[186] and trade acceptance

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[178] Although counterparty credit risks are generally reduced through central clearing, these risks are migrated and transformed, not eliminated. The failure of a large clearinghouse is not inconceivable, and correlated losses in stressed banking entities with clearing memberships present a too-often overlooked regulatory concern. See, e.g., U. Faruqui, W. Huang, E. Takats, Clearing risks in OTC derivatives markets: the CCP-bank nexus, BIS Quarterly Review, 73 (Dec. 2018), available at https://www.bis.org/publ/qtrpdf/r_qt1812h.pdf. As recently as September 2018, a single trader's default was reported to have expended approximately two-thirds of the commodities default fund at Nasdaq Clearing AB, a Swedish clearinghouse. Id at 75. This, of course, argues for strong, comprehensive regulation of central clearinghouses, not perpetuation of the OTC derivatives market structure.

[179] See 7 U.S.C. § 1a(15)(A)(i) (defining a DCO as "a clearinghouse, clearing association, clearing corporation, or similar entity, facility, system, or organization that, with respect to an agreement, contract, or transaction . . . enables each party to the agreement, contract, or transaction to substitute, through novation or otherwise, the credit of the derivatives clearing organization for the credit of the parties").

[180] See 7 U.S.C. § 7a–1(c)(2)(D)(iii) (requiring DCOs to "limit the exposure of the [DCO] to potential losses from defaults by members and participants" through "margin requirements and other risk control mechanisms"). See also 7 U.S.C. § 7a–1(c)(2)(D)(iv) (requiring DCOs to collect "sufficient" margin to "cover potential exposures in normal conditions"); 7 U.S.C. § 7a–1(c)(2)(D)(v) (requiring DCOs to establish risk-based and regularly reviewed models and parameters used in setting margin requirements).

[181] See 7 U.S.C. § 7a–1(c)(2)(F)(i) (requiring DCOs to establish standards and procedures that are designed to protect and ensure the safety of member and participant funds and assets). See also 7 U.S.C. § 7a–1(c)(2)(F)(ii) (requiring DCOs to "hold member and participant funds and assets in a manner by which to minimize the risk of loss or of delay in the access by the DCO to the assets and funds").

[182] See, e.g., 7 U.S.C. § 7a–1(C)(2)(G) (requiring DCOs to "have rules and procedures designed to allow for the efficient, fair, and safe management of events during which members or participants . . . become insolvent . . . or . . . otherwise default on the obligations of the members or participants to the [DCO]").

[183] See 7 U.S.C. § 7a–1(c)(2)(A)-(R).

[184] CFTC Regulation § 37.702(b)(2) requires a SEF to coordinate with each registered DCO to which it submits transactions for clearing to develop rules and procedures to facilitate ''prompt and efficient'' transaction processing in accordance with the requirements of § 39.12(b)(7). 17 C.F.R. § 37.702(b)(2).

[185] CFTC Regulation § 37.702(b)(1) requires a SEF to ensure that it has the capacity to route transactions to the DCO in a manner acceptable to the registered DCO for purposes of clearing. 17 C.F.R. § 37.702(b)(1).

[186] CFTC Regulation § 39.12(b)(7)(i)(A) requires each registered DCO to coordinate with a relevant SEF or DCM to develop rules and procedures to facilitate "prompt, efficient, and accurate" processing of all transactions, including swaps submitted to the registered DCO for clearing by the SEF or DCM. 17 C.F.R. § 39.12(b)(7)(i)(A).

by clearinghouses,[187] futures commission merchants ("FCMs"),[188] SEFs,[189] and affirmation services[190]). Indeed, STP within the E2C workflow is a critical foundation for liquid, multilateral markets, because even an exceedingly minimal lack of trade or clearing certainty is sure to be used by dealers to justify "breakage" agreements[191] and similar mechanisms that limit competition in the markets—i.e., limit the liquidity providers with which counterparties can interact. Such mechanisms are unnecessary, however, if the risks addressed by them are eliminated; that is why swaps not sent to and accepted for clearing within a short, specific period of time must be declared void ab initio. Voiding trades that are not properly and promptly sent to or accepted for clearing—without exception—not only renders bilateral breakage agreements unnecessary, for example, but also incentivizes SEFs, market participants, middleware providers, and other infrastructure firms to make investments necessary to ensure that trades do not get voided in the first instance.[192]

The E2C workflow logically begins at the point of execution. Market participants can have trade certainty only if there is clearing certainty; and they can have clearing certainty only if they know definitively, **prior to execution**, that the counterparty's guarantor—the clearing FCM—is willing to stand behind the particular transaction. Pre-execution credit checks,[193] therefore, ensure resting and responsive

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[187] CFTC Regulation § 39.12(b)(7)(ii)–(iii) each further require a registered 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. 17 C.F.R. § 39.12(b)(7).

[188] CFTC Regulation § 1.74 requires clearing FCMs to coordinate with DCOs to establish systems that enable the FCM, or the DCO acting on its behalf, to accept or reject each trade "as quickly as would be technologically practicable if fully automated systems were used." 17 C.F.R. § 1.74. Related CFTC division guidance has provided that SEFs must (1) ensure clearing FCMs are identified in advance on an order-by-order basis; and (2) facilitate pre-execution credit screening of orders for compliance with risk- based limits in accordance with CFTC Regulation § 1.73. See CFTC Joint Staff Guidance, Divisions of Market Oversight and Clearing and Risk, Staff Guidance on Swaps Straight-Through Processing (September 26, 2013) ("2013 STP Guidance"), available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/stpguidance.pdf.

[189] SEFs must coordinate with DCOs in processing transactions for clearing under CFTC Regulation § 37.702(b)(2). 17 C.F.R. § 37.702(b)(2). The 2013 STP Guidance accordingly expressed the view that a SEF must route swaps to a DCO in compliance with the "as quickly a technologically practicable" standard applicable to DCOs. 2013 STP Guidance at 4.

[190] The 2013 STP Guidance requires swaps that are routed to a DCO through a SEF's use of a post-execution affirmation hub (e.g., Markitwire) to meet the CFTC Regulation § 37.702(b) STP standard. 2013 STP Guidance at 4. See 17 C.F.R. § 37.702(b). The Divisions later permitted SEFs to send trades to be manually affirmed prior to routing the trade to the DCO, provided they are routed to the DCO within 10 minutes. See CFTC Letter No. 15–67, Divisions of Market Oversight and Clearing and Risk, Straight Through Processing and Affirmation of SEF Cleared Swaps (Dec. 21, 2015) ("2015 STP Guidance"), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/15-67.pdf.

[191] Breakage agreements, in essence, are contracts that allocate financial responsibilities and exposures should a swap between counterparties be nullified on account of some action subsequent to execution. The 2013 STP Guidance prohibits breakage agreements within the SEF E2C workflow.

[192] These are not necessarily limited to technology investments. For example, with respect to the use of affirmation hubs, such investments might include hiring sufficient staff to prioritize affirming trades so that they can be timely released to the DCO.

[193] CFTC Regulation § 1.73(a)(1) requires each clearing FCM to establish risk-based limits for each proprietary account and each customer account that are based on position size, order size, margin requirements, or similar factors. 17 C.F.R. § 1.73(a)(1). Similarly, CFTC Regulation § 1.73(a)(2)(i) states that when a clearing FCM provides electronic market access or accepts orders for automated execution, the FCM must use automated means to screen orders for compliance with such risk-based limits. 17 CFR § 1.73(a)(2)(i). CFTC Regulation 1.73(a)(2)(ii) states that when a clearing FCM accepts orders for non-automated execution, the FCM must establish and maintain systems of risk controls reasonably designed to ensure compliance with the limits. 17 C.F.R. § 1.73(a)(2)(ii). CFTC Regulation § 1.73(a)(2)(iii) states that when a clearing FCM accepts transactions that were executed bilaterally and then submitted for clearing, the FCM must establish and maintain systems of risk controls reasonably designed to ensure compliance with the limits. 17 C.F.R. § 1.73(a)(2)(iii).

orders are executable before being disseminated.[194] This requires FCM clearing arrangements to be in place with SEF market participants prior to trading on SEFs and also substantial clearing FCM investments in interoperable, cross-market pre-trade credit screening functionalities. It also has required the CFTC to provide strict guidance that, in essence, denies clearing FCMs an ability to reconsider trades enabled in pre-execution credit limits.[195]

Pre-execution credit checks, in turn, enable timely acceptance of trades at two critical points in the E2C workflow: (1) the SEF's near real-time submission of the executed trade to the chosen DCO, especially for electronic trades;[196] and (2) the DCOs' receipt of the trade information and determination to accept or reject the trade for clearing.[197] With respect to the former, the CFTC's divisions have long provided guidance that SEFs' routing and submission of trades to the DCO should align with the "as quickly as technologically practicable" DCO acceptance standard ("AQATP Standard") but in no event be later than ten minutes following execution.[198] With respect to the latter, the CFTC's divisions have long required DCOs to meet the AQATP Standard by accepting or rejecting submitted trades within 10 seconds.[199] In other words, the STP standards reflect longstanding market practices and regulatory requirements and guidance.[200]

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194 The 2013 Staff STP Guidance provided that (1) a clearing FCM must be identified in advance for each counterparty on an order-by-order basis, if the transaction is intended to be cleared; and (2) a SEF must facilitate pre-execution screening in accordance with CFTC Regulation § 1.73 on an order-by- order basis However, the CFTC must thread the needle carefully on pre-execution credit checks and other matters, because SEF participation requirements (e.g., required representations concerning FCM trading guarantees) may seek types of assurances or financial arrangements that simply are not feasible (or that are feasible only at great expense) for non-dealer participants in the markets. Such requirements, like documentation requirements, have legitimate risk management purposes but can also be used to limit SEF participation and therefore competition with the dealers.

195 See 2013 STP Guidance at 3 (providing that "orders which have satisfied the Clearing FCMs' pre-execution limits are deemed accepted for clearing and thereby subject to a guarantee by the Clearing FCM upon execution" and clarifying that "Clearing FCMs may not reject a trade that has passed its pre-execution filter because this would violate the requirement that trades should be accepted or rejected for clearing as soon as technologically practicable").

196 CFTC Regulation § 37.702(b) and § 39.12(b)(7) require SEFs and registered DCOs, respectively, to coordinate with one another to facilitate the clearing of swap transactions executed on or through SEFs. Commodity Futures Trading Commission, Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21278, 21283 (Apr. 9, 2012).

197 CFTC Regulation § 39.12(b)(7)(ii)–(iii) each require a registered 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. 17 C.F.R. § 39.12(b)(7). CFTC Regulation § 37.702(b)(2) requires a SEF to coordinate with each registered DCO to which it submits transactions for clearing to develop rules and procedures to facilitate "prompt and efficient" transaction processing in accordance with the requirements of § 39.12(b)(7). 17 C.F.R. § 37.702(b)(2).

198 See 2015 STP Guidance at 3 (noting that "the AQATP standard may be met if trades are routed to and received by the relevant DCO no more than 10 minutes after the execution of the trade"). CFTC Regulations § 37.702(b) and § 39.12(b)(7) require SEFs and DCOs, respectively, to coordinate to facilitate the clearing of swaps executed on or through the SEF in accordance with the AQATP Standard. 17 C.F.R. §§ 37.702(b) and 39.12(b)(7). The 10-minute standard is hardly tied to technologically limitations as the AQATP Standard might intuitively suggest. It arose from a CFTC agreement with ISDA to preserve ***manual*** affirmation to reduce DCO submission errors subsequent to execution on voice-trading platforms.

199 2013 STP Guidance at 5.

200 Indeed, the CFTC and the CFTC's divisions issued most of the relevant regulations and guidance setting forth STP standards for FCMs, DCOs, and others in 2012 and 2013, approximately six years ago. See generally Commodity Futures Trading Commission, Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21307 (Apr. 9, 2012).

The CFTC and CFTC division regulatory requirements and guidance collectively accomplish most of what is necessary to establish STP throughout the E2C workflow and facilitate the transition to a multilateral derivatives market structure. The CFTC's staff guidance, in particular, provides the near-immediate (1) trade routing and (2) "acceptance or rejection for clearing in close to real time [that] is crucial for both effective risk management and for the efficient operation of trading venues."[201] The CFTC's priority, therefore, must be to codify that progress and prevent a handful of dealers and interdealer brokers from using market power to get "between the wall and the wall paper," as Forbes once remarked about the wholesale brokerage model in the U.S. treasury markets.[202]

1. The CFTC's proposed codification of guidance relating to pre-execution credit screening promotes responsible risk management and trading on SEFs.

The CFTC proposes to require SEFs to facilitate pre-execution credit screening and to require market participants to identify the FCM guaranteeing trades before trading interest is disseminated to other market participants.[203] These proposed requirements are reasonable and consistent with statutory objectives, the 2013 STP Guidance, and existing FCM and SEF functionalities.[204] Proposed §§ 37.702(b)(2)–(3) codify STP standards that are essentially identical to provisions discussed in the 2013 STP Guidance. For example, with respect to Proposed § 37.702(b)(2), the CFTC proposes that SEFs be required to provide for the financial integrity of transactions "[b]y requiring that each market participant identify a clearing member in advance for each counterparty on an order-by-order basis."[205] This language mirrors the 2013 STP Guidance almost verbatim. In this regard, the 2013 STP Guidance provided that "because a SEF must 'facilitate' STP under Regulation § 37.702(b), no trade intended for clearing may be executed on or subject to the rules of a SEF unless a clearing member has been identified in advance for each party on an order-by-order basis."[206] Proposed § 37.702(b)(3) similarly provides that SEFs are required to "facilitate[e] pre-execution screening by each clearing [FCM] in accordance with the requirements of § 1.73 . . . on an order-by-order basis,"[207] which, again, mirrors related language in the 2013 STP Guidance.[208]

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[201] Commodity Futures Trading Commission, Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21278, 21285 (Apr. 9, 2012) ("STP Rulemaking"). See also Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62082 (proposed November 30, 2018).

[202] Thomas Jaffe, Getting between the wall and the wallpaper (Oct. 20, 1997), available at https://www.forbes.com/forbes/1997/1020/6009066a.html#7d354a61363d.

[203] See Proposed §§ 37.702(b)(2)-(3).

[204] See 2013 STP Guidance at 2-3.

[205] Proposed § 37.702(b)(2). In this regard, we encourage the CFTC to consider whether excising the phrase "for each counterparty" would change the nature of this requirement in light of any changes to the proposed definition of "market participant" in the final version, if any, of Proposed § 37.2(b). See Proposed § 37.2(b) (defining "market participant" to mean "any person who accesses a swap execution facility in the following manner: (1) Through direct access provided by a swap execution facility; (2) Through access or functionality provided by a third-party; or (3) Through directing an intermediary that accesses a swap execution facility on behalf of such person to trade on its behalf.").

[206] 2013 STP Guidance at 3 (discussing the interaction of pre-execution risk controls in CFTC Regulation § 1.73 with STP standards in § 37.702(b), among other provisions).

[207] Proposed § 37.702(b)(3).

[208] 2013 STP Guidance at 3 (stating that SEFs must "facilitate pre-execution screening by each Clearing FCM in accordance with Regulation 1.73 on an order- by-order basis").

Pre-execution credit screening of SEF orders and identification of clearing FCMs ensure the financial integrity of SEF transactions and facilitate prompt and efficient transaction routing and clearing. Moreover, these STP standards, and related FCM requirements, reflect longstanding CFTC and CFTC division policy that already has been implemented by the FCM and SEF community.[209] Indeed, it is doubtful that FCMs would be able to meet their obligations under CFTC Regulation § 1.73 without SEFs complying with the substance of the Proposed §§ 37.702(b)(2)-(3).[210] We therefore support the CFTC's proposal in this regard. However, related STP guidance that "orders which have satisfied the Clearing FCM's pre-execution limits are deemed accepted for clearing and thereby subject to a guarantee by the Clearing FCM **upon execution**"[211] should be codified as well. That codification need not be made in part 37. But a final regulation constituting a logical outgrowth of the STP proposal should provide that "a Clearing FCM may not seek to reject a trade that has satisfied pre-execution screening, because this would undermine the requirement that trades be accepted or rejected for clearing under the AQATP Standard."[212] In our view, the CFTC must enhance trade and clearing certainty through continued application of that guidance in regulatory text.

2. SEFs must execute direct and independent clearing services arrangements as an appropriate risk management measure. The CFTC's misconstruction of the routing "capacity" requirement, however, nullifies the CFTC's rationale for proposed elimination of CFTC Regulation § 37.702(b)(1).

The CFTC proposes a reasonable improvement to its regulatory requirement relating to clearing arrangements under SEF Core Principle 7.[213] Proposed § 37.701(b) would add a new subsection to CFTC Regulation § 37.701 to require a SEF to have an "independent" clearing services agreement with each DCO to which the SEF routes swaps for clearing.[214] The proposed SEF clearing services agreement would be required even where the SEF routes swaps to DCOs through a third-party maintaining a separate regulatory services agreement with the relevant DCOs.[215] This is a sensible proposal that would support the current DCO coordination requirement for SEFs in CFTC Regulation § 37.702(b)(2).[216] Moreover, such

209 See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62081 (proposed November 30, 2018).

210 17 C.F.R. § 1.73.

211 2013 STP Guidance at 3.

212 2013 STP Guidance at 3. See also 17 C.F.R. § 1.74.

213 7 U.S.C. § 7b-3(f)(7) (requiring SEFs to "establish and enforce rules and procedures for ensuring the financial integrity of swaps entered on or through the facilities of the [SEF], including the clearance and settlement of the swaps pursuant to [CEA] section 2(h)(1)).

214 See Proposed § 37.701(b). The clearing services agreements sensibly would be required for cleared swaps routed both to DCOs and clearinghouses that the CFTC determines to exempt from registration as a DCO.

215 This is important to ensure the CFTC has meaningful supervisory oversight of the means by which SEFs coordinate with DCOs in their implementation of regulatory responsibilities under CFTC Regulation § 39.12(b)(7)(i)(A). See Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62019 (proposed November 30, 2018) ("The Commission believes that maintaining a direct agreement between a SEF and DCO, notwithstanding the use of a third-party provider, is consistent with § 37.702(b), which requires each SEF to coordinate with a DCO to develop rules and procedures to facilitate prompt and efficient processing of transactions in accordance with the DCO's obligations under § 39.12(b)(7)(i)(A)."). See 17 C.F.R. § 39.12(b)(7)(i)(A). CFTC Regulation § 39.12(b)(7)(i)(A) requires each DCO to coordinate with DCMs and SEFs to develop rules and procedures to facilitate "prompt, efficient, and accurate" processing of transactions to the DCO for clearing.

216 17 C.F.R. § 37.702(b)(2). The SEF coordination requirement is proposed to be retained in Proposed § 37.702(b)(1).

agreements further responsible risk management, because, as the CFTC acknowledges, "the terms established in a direct clearing agreement between the SEF and DCO should help the SEF and DCO resolve any problems that arise at the DCO that could diminish the SEF's ability to submit transactions for clearing."[217]

The CFTC proposes, in addition, to eliminate what it characterizes as a "duplicative" requirement[218] under CFTC Regulation § 37.702(b)(1), which ensures SEFs have "the capacity to route transactions" to DCOs "in a manner acceptable to the DCO[s] for purposes of clearing."[219] The CFTC does not further explain the "duplicative" characterization. However, the plain language of CFTC Regulation § 37.702(b)(1) indicates that it is not a duplicative provision at all. There are two elements in CFTC Regulation § 37.702(b)(1): (1) the SEF must have the **capacity** to route transactions to DCOs; and (2) such routing must be done within the SEF's capacity in a manner that is acceptable to the DCOs for the purposes of clearing.[220] The CFTC did not explain its use of the term "capacity" in CFTC Regulation § 37.702(b)(1) in the SEF Core Principles Rulemaking[221] or STP Rulemaking.[222] But the ordinary and dictionary meanings are instructive: "the facility or power to produce, perform, or deploy."[223] Other dictionaries define the term to mean "[t]he ability or power to do or understand something."[224] Noted synonyms include the term "capability."[225] It must be reasonably concluded, therefore, that CFTC Regulation § 37.702(b)(1) requires SEFs to have the "capability," "power," or "ability" to perform the internal activities necessary to route swaps to DCOs in a manner that ensures prompt, efficient, and accurate clearing within the 10-second AQATP Standard. If a DCO requires use of a particular programming language, program interface, or infrastructure technology, for example, CFTC Regulation § 37.702(b)(1) requires SEFs to adapt routing operations in a manner acceptable to the DCO for purposes of clearing (i.e., SEFs must make investments to meet the DCO's submission requirements).

That view is consistent with the CFTC's use of the term "operational capacity" in multiple places in CFTC Regulation § 39.12,[226] a subsection of which is referenced in CFTC Regulation § 37.702(b)(2). References to "operational capacity" in a similar regulatory context are suggestive of a technological or

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[217] See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62080 (proposed November 30, 2018).

[218] See Id at 62021.

[219] 17 C.F.R. § 37.702(b)(1).

[220] Id.

[221] See Commodity Futures Trading Commission, 78 Fed. Reg. 33476, 33535 Core Principles and Other Requirements for Swap Execution Facilities (June 4, 2013).

[222] Commodity Futures Trading Commission, Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21278, 21309 (April 9, 2012).

[223] Merriam-Webster Dictionary (2019), Definition of Capacity, available at https://www.merriam-webster.com/dictionary/capacity.

[224] Oxford Living Dictionaries, Oxford University Press (2019), Definition of Capacity, available at https://en.oxforddictionaries.com/definition/capacity.

[225] Merriam-Webster Dictionary (2019), Definition of Capacity, available at https://www.merriam-webster.com/dictionary/capacity.

[226] 17 C.F.R. § 39.12(a)(3) (requiring clearing members to have "adequate operational capacity" to meet obligations arising from participation in the DCO). See also 17 C.F.R. § 39.12(b)(1)(vii) (requiring DCOs to consider factors in determining product eligibility for clearing that include "operational capacity" to address any unusual risk characteristics of the product).

infrastructure meaning as well. In our view, that, coupled with the fact that the capacity in question is intended enable "routing" of swaps "in a manner that is acceptable to the DCOs," suggests a required minimum technological or systems **compatibility** that reaches beyond the mere coordination on "transaction processing" rules and procedures required under CFTC Regulation § 37.702(b)(2).[227] In other words, SEFs must consult DCOs to ensure that "rules and procedures" facilitate prompt, efficient, and accurate routing to such DCOs,[228] but such required documentation and process requirements were intended to supplement—and not replace—the requirement that SEFs also ensure that they have *the capacity* to route transactions in accordance with DCO specifications. These distinct requirements must be retained, in particular because the STP framework is highly dependent on infrastructure capabilities throughout the E2C workflow.

Perhaps most critically, however, the 2013 STP Guidance provided that SEF-executed swaps must be routed to DCOs in accordance with the AQATP Standard based on the CFTC divisions' interpretation of CFTC Regulation § 37.702(b)(1).[229] Eliminating that regulatory provision, without codifying the guidance, repeals the AQATP Standard for the routing of swaps to DCOs, which is profoundly unwise and violates the CEA's risk management directives. Indeed, that proposed act alone substantially undermines the STP framework that establishes the foundation for multilateral trading in the derivatives markets. Yet, the CFTC does not mention this implication at all in the SEF Proposal but rather states that the provision is "duplicative" (and without even mentioning what it duplicates), denying meaningful public comment on a critical change to SEF-related requirements supporting the STP framework.

3. SEFs must be required to accommodate the AQATP Standard in facilitating prompt, efficient, and accurate processing and routing of trades to DCOs.

Proposed § 37.702(b)(1) would require SEFs to coordinate with DCOs to develop rules and procedures that facilitate "prompt, efficient, and accurate" processing "and routing" of swaps transactions in accordance with § 39.12(b)(7)(i)(A) ("Qualitative STP Standard").[230] The CFTC's addition of the word "accurate" to the CFTC Regulation § 37.702(b)(2) standard in accordance with the cognate DCO provision in CFTC Regulation § 39.12(b)(7)(i)(A) is sensible, albeit intended to provide countervailing controls considerations to balance the usual STP emphasis on efficiency, immediacy, and trade and clearing certainty. We discuss concerns about that below. But there are much more concerning technical and policy objections to the proposed Qualitative STP Standard.

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[227] 17 C.F.R. § 37.702(b)(2). CFTC Regulation § 37.702(b)(2) requires SEFs to "coordinat[e] with each [DCO] to which it submits transactions for clearing, in the development of rules and procedures to facilitate prompt and efficient transaction processing" in accordance with Part 39.

[228] The CFTC reasonably proposes to add the word "accurate" to the phrase, "prompt and efficient," to align requirements for SEFs in CFTC Regulation § 37.702(b)(2) with cognate language applicable to DCOs (but see our concern and acknowledgement of its intended change in the meaning of the provision below). The CFTC also reasonably proposes to add the phrase, "and routing," after the word, "processing," in CFTC Regulation § 37.702(b)(2), which we believe more specifically addresses the role of SEFs in the clearing process.

[229] 17 C.F.R. § 37.702(b)(1). 2013 STP Guidance at 3-4 (emphasizing that "the Divisions remind participants that the trade must still be routed 'as quickly as would be technologically practicable if fully automated systems were used" and citing to "17 C.F.R. § 39.12(b)(7)").

[230] Proposed § 37.702(b)(1).

With respect to technical objections, the CFTC proposes to revise the internal reference in CFTC Regulation § 39.12(b)(7) and insert a more specific reference to § 39.12(b)(7)(i)(A).[231] In citing the more specific proposed provision, however, the CFTC also proposes to change the meaning of paragraph (b)(2)'s "prompt, efficient, and accurate" standard, because the more specific reference ***excludes*** Proposed § 39.12(b)(7)(ii), which would otherwise require SEFs to develop rules and procedures to facilitate prompt, efficient, and accurate processing and routing of transactions "in accordance with the requirements" of the DCO AQATP Standard. CFTC Regulation § 37.702(b)(2), in contrast, requires the coordination of rules and procedures to facilitate prompt and efficient transaction processing in accordance with all of the relevant provisions relating to DCO timing of acceptance, including the AQATP Standard applicable to DCO routing.

This difference in effect is intended, albeit not discussed in that context. The CFTC proposes elsewhere, for example, that "[f]or the avoidance of doubt . . . the AQATP standard does not apply to the processing and routing of transactions."[232] That is a clear reversal of the CFTC and CFTC staff's longstanding views. Even the (too) lenient 10-minute affirmation standard articulated in the CFTC staff's 2015 STP Guidance was an interpretation of the AQATP Standard applicable to the routing of transactions. Although it adapted the AQATP Standard to the specific methods of execution most benefitted by manual post-execution trade affirmation,[233] the 2015 STP Guidance provided that the CFTC "intended for **the AQATP standard** to take into account the need to refine and reduce errors in order **to facilitate prompt and efficient transaction processing.**"[234] The CFTC's characterization of the proposed change in the regulatory citation as a "non-substantive" amendment[235] is therefore misleading, in particular as it would eliminate a reference to the very provision that served as the basis for the 2013 STP Guidance and the 2015 STP Guidance.[236]

More broadly, however, the CFTC's determination to disapply the AQATP Standard to the routing of swaps to DCOs lacks a defensible policy rationale. First, the Qualitative STP Standard defers too significantly to the industry to decide for itself the point at which transaction routing is considered "prompt, efficient, and accurate" within the meaning of Proposed § 37.702(b)(1). That kind of deference makes little sense in this context. Clear, bright-line STP standards are necessary to further the purposes of the SEF framework—in particular, promoting multilateral trading on SEFs through trade and clearing certainty—for the reasons discussed above. A malleable STP standard without a quantitative backstop instead disincentivizes continued progress towards and investments in real-time STP throughout the E2C

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231 Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62021 (proposed November 30, 2018).

232 Id.

233 2015 STP Guidance at 3 (stating that the "[s]taff believes that **the Commission intended for the AQATP standard to take into account the need to refine and reduce errors** in order to facilitate prompt and efficient transaction processing" and noting that "**the AQATP standard may be met if trades are routed to and received by the relevant DCO no more than 10 minutes after the execution of the trade**").

234 Id.

235 Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62021 (proposed November 30, 2018) (stating that the CFTC "proposes a non-substantive amendment to specify that a SEF's obligation to coordinate with DCOs should be in accordance with the DCO's obligations under § 39.12(b)(7)(i)(A)").

236 2013 STP Guidance at 4-5 (noting that "DCR previously interpreted 'as soon as technologically practicable' [standard in CFTC Regulation § 39.12(b)(7)] to be 60 seconds," observing that "[r]ecent data received by DCR shows that DCOs now accept at least 93% of trades within three (3) seconds or less, and 99% of trades within ten (10) seconds or less," and interpreting "as soon as technologically practicable" as "within 10 seconds").

workflow. The derivatives market structure also historically has been dominated by a small number of dealers that would have strong financial incentives and numerous means for pressuring SEFs into accommodating sub-optimal routing standards within the Qualitative STP Standard. Finally, and most critically, the proposed Qualitative STP Standard is an accommodation to a certain method of execution (e.g., voice execution) requiring manual controls and interventions and, in essence, establishes STP standards based on a market structure that is already too dependent on human judgments and procedures. Any manual trade workflow will be difficult to scale to trade counts in an improved multilateral market structure, which is why the CFTC codified regulations requiring SEFs to develop policies and procedures to facilitate trade routing within an AQATP Standard focused on "technological practicability" where "fully automated systems were used."[237] If the industry cannot serve the public interest in meeting the AQATP Standard for voice-trading, then it should migrate to fully automated systems and electronic trading.

For these reasons, we cannot agree that the AQATP Standard should not apply to SEF routing of swaps to DCOs for clearing.[238] It is sensible to distinguish an STP requirement that addresses pertinent SEF functions in the marketplace—to process and route swaps to the DCO[239]—but we agree with the CFTC staff that it is precisely that routing function that demands near instantaneous processing consistent with the AQATP Standard.[240] The CFTC acknowledges that the Qualitative STP Standard would "result in varying lengths of time for transactions to be processed and routed to a DCO, including some longer instances, *e.g.,* a time period that exceeds ten minutes."[241] That in itself would be too deferential and all but impossible to enforce. But the CFTC further provides "that [the] exact time frame [for routing] would depend on swap market practices and technology, as well as market conditions at the time of execution."[242] **That is an illusory requirement that, in essence, does not require anything at all.** As a result, in time, the latency permitted and encouraged by the Qualitative STP Standard will be used to further undermine the development of a multilateral SEF framework.[243]

Better Markets proposes that the CFTC codify the 2013 STP Guidance that SEF routing must accommodate the AQATP Standard and that policies, procedures, and controls be reasonably designed to ensure compliance with that standard. For trades executed electronically, including through RFQ

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237 CFTC Regulation § 39.12(b)(7)(ii)–(iii) each further require a registered 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. 17 C.F.R. § 39.12(b)(7).

238 See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62021 (proposed November 30, 2018) ("For the avoidance of doubt, the Commission proposes that the AQATP standard does not apply to the processing and routing of transactions.").

239 Id.

240 2013 STP Guidance at 4.

241 Id at 62022.

242 Id.

243 2013 STP Guidance at 5 ("Experience indicates that pre-trade checks will make [DCO] rejection a rare event and that STP has made the time between execution and any rejection a matter of seconds. This combination of rarity and minimal financial exposure to the parties obviates the need to have so-called "breakage agreements" between market participants. The imposition of such agreements would be an impairment to impartial access to SEFs."). **The CFTC determined not propose this critical element of its 2013 STP Guidance.**

Systems[244] and Order Books[245] (which must be retained in the SEF regulatory framework), we propose that the AQATP Standard reflect its original intent—that is, routing to DCOs as soon as automated trading protocols responsibly permit, usually in seconds or less. For voice-executed transactions requiring manual affirmation before routing to the DCO, we propose multiple requirements within the AQATP Standard as discussed below.

4. The CFTC must apply the AQATP Standard to trades routed to affirmation hubs. However, it should establish specific SEF trade-routing requirements for (1) post-execution routing to affirmation hubs, and (2) post-routing timing and release of trades to DCOs, each within the AQATP Standard.

The CFTC proposes to "flexibly" interpret the Qualitative STP Standard to facilitate use of post-trade affirmation services.[246] In essence, as noted above, the Qualitative STP Standard contemplates SEF routing to DCOs within timeframes determined by the market itself.[247] This is a remarkable reversal of the CFTC staff's judgment in the 2013 STP Guidance, where multiple divisions interpreted the "prompt and efficient" standard in CFTC Regulation § 37.702(b)(2)[248] to require SEF-executed swaps affirmed by third-party service providers[249] be routed pursuant to the AQATP Standard.[250] The 2015 STP Guidance affirmed that view again, requiring affirmed trades to be submitted to DCOs no later than ten minutes after such trades are executed.[251]

The CFTC's proposed change in policy is indefensible. The CFTC notes, first, that "it has observed that many SEFs, particularly those that offer voice-based or voice-assisted trading systems or platforms, have not been able to meet the [10-minute] time frame when using manual affirmation hubs."[252] That

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244 17 C.F.R. § 37.9(a)(3) (defining Request-for-Quote System to mean "a trading system or platform in which a market participant transmits a request for a quote to buy or sell a specific instrument to no less than three market participants in the trading system or platform, to which all such market participants may respond").

245 17 C.F.R. § 37.9(a)(2)(i)(A)-(B) (stating that "[e]ach Required Transaction that is not a block trade . . . shall be executed on a [SEF] in accordance with one of the following methods of execution: (A) An Order Book as defined in § 37.3(a)(3); or (B) A Request for Quote System, as defined in paragraph (a)(3) of this section, that operates in conjunction with an Order Book as defined in § 37.3(a)(3)").

246 See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62022 (proposed November 30, 2018).

247 See, e.g., Id ("The 'prompt, efficient, and accurate' standard may result in varying lengths of time for transactions to be processed and routed to a DCO, including some longer instances, *e.g.,* a time period that exceeds ten minutes.").

248 This interpretation involved the two terms "prompt" and "efficient," but not the term "accurate," which we assume the CFTC proposes to clarify the countervailing risk management concerns expressed by ISDA and other industry participants contemplated by the more deferential Qualitative STP Standard.

249 Affirmation hubs, in essence, provide counterparties an opportunity to review the terms of voice-executed trades prior to being affirmed, released for clearing, and routed to the DCO.

250 2013 STP Guidance at 4 (providing that the use of affirmation hubs is permissible, provided trades are routed "as quickly after execution as would be technologically practicable if fully automated systems were used)." See also 2015 STP Guidance at 3 (providing that "the AQATP standard may be met if trades are routed to and received by the relevant DCO no more than 10 minutes after the execution of the trade").

251 Id.

252 See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62022 (proposed November 30, 2018).

observation is undoubtedly correct, but it is also irrelevant. The 10-minute standard that seems to trouble voice-assisted trading systems—a euphemism for SEFs operated by interdealer brokers—was proposed by none other than ISDA, the trade association for their dealer clients. In Best Practice Principles on Swaps Straight-Through Processing, ISDA confirms that the CFTC agreed with ***ISDA's proposal*** that the AQATP Standard would be met "if trades are routed to and received by the relevant DCO no more than 10 minutes after the execution of the trade."[253] The CFTC's divisions themselves acknowledge acceptance of ISDA's proposal in the opening paragraph of the 2015 STP Guidance.[254] **However, the CFTC apparently is not satisfied to accommodate the industry ask, because it now proposes to defer to the industry even more than the industry proposes to defer to itself.** That kind of overweening deference—to unenforceable, majestic standards that can be papered over with a few hours work—cannot be allowed govern public policy in the derivatives markets.

The CFTC contends that "a specific [STP] time frame may also limit the use—and therefore the benefits—of affirmation hubs" and that "a rigid time frame for processing and routing trades from a SEF to a DCO is inappropriate under the proposed regulatory framework."[255] However, a plain English translation of that readily reveals its inappropriateness: STP poses too high an error rate for voice-executed swaps intended for clearing, and market participants do not want to make the investments in personnel and technology necessary to manage those risks and/or ensure prompt affirmation. We agree, in fact, that a specific STP timeframe within the AQATP Standard could limit the use of affirmation hubs. But that is because strict STP requirements would encourage market participants to invest in automated controls and in all likelihood, engage in more electronic trading, which does not require a separate, manual affirmation process. In turn, such incentives would encourage responsible risk management. **If the CFTC is correct that "certain execution methods such as voice execution . . . may have a relatively high error rate compared to other execution methods such as electronic trading," the solution required by statute would be to incentivize trading in a less error prone method of execution, not to accommodate a known deficiency.[256]**

Moreover, the CFTC's proposal does not address the fact that active dealer-to-client ("D2C") SEFs already require manual affirmation of cleared swaps on shorter timeframes than the 2015 STP Guidance. In some cases, SEFs have built affirmation functionality that, in essence, transmits trade data into a brief affirmation session before the SEF enables submission to DCOs. For example, Rule 533(f) of the Bloomberg SEF LLC Rulebook relating to cleared swaps states that "[i]f manual affirmation of a Trade in Cleared Swaps is required prior to presentation of the Trade to a Clearing House, a Participant must affirm

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253 See ISDA Best Practice Principles on Swaps Straight-Through Processing (June 13, 2016), available at https://www.isda.org/a/pKiDE/stp-wg-stp-general-principles-final.pdf ("On December 21, 2015, the CFTC responded to a letter from ISDA proposing a plan for reducing Straight-Through Processing ("STP") timeframes for certain interest rate swap contracts executed on SEFs or DCMs with the intention of being cleared (link). ISDA's proposed plan was a response to concerns raised by CFTC staff that STP rates were not compliant with previously issued staff guidance regarding routing of trades to clearing via third-party hubs. **The CFTC response agreed with ISDA's proposal that the AQATP standard may be met if trades are routed to and received by the relevant DCO no more than 10 minutes after the execution** . . . .").

254 See also 2015 STP Guidance at 1 ("This letter responds to a letter received from the International Swaps and Derivatives Association, Inc. ("ISDA") on July 27, 2015, that the Commodity Futures Trading Commission ("Commission") **accept ISDA's proposed compliance with the requirement** that derivatives clearing organizations ("DCOs"), swap execution facilities ("SEFs") and designated contract markets ("DCMs") develop rules and procedures so that DCOs can accept or reject trades for clearing as quickly after execution as would be technologically practicable if fully automated systems were used ("AQATP")").

255 See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62022 (proposed November 30, 2018).

256 Id at 62081.

the Trade **within 5 minutes after execution of the Trade**."[257] More aggressively, TrueEX LLC's Rulebook sets forth Core RFQ Protocols that require affirmation in a 30-second Affirmation Session.[258] Meanwhile, tpSEF,[259] ICAP Global Derivatives Limited,[260] and GFI Swaps Exchange LLC[261]—traditional interdealer voice brokers—all have codified the 10-minute affirmation standard. **The CFTC's flexibility, it seems, is a solution in search of a problem.**

The CFTC apparently understands that the Qualitative STP Standard impairs the critical E2C workflows mentioned above:

> [T]he Commission believes that the proposed qualitative standard for swaps routed via third-party affirmation hubs could reduce the financial integrity of the trades facilitated by the SEF as compared to the alternative of establishing a bright-line static deadline, such as the ten-minute timeframe discussed by the Divisions in the 2015 Supplementary Staff Letter. As a result, a SEF could argue that it complies with the Commission's qualitative interpretation of the "prompt, efficient, and accurate" standard even though the swap could have been processed and routed more quickly if the Commission would have established a bright-line standard, *e.g.,* the ten-minute timeframe articulated in the 2015 Supplementary Staff Letter.[262]

This admission is fatal to the CFTC's proposal. The CFTC has neither set forth a compelling policy justification nor a legal basis to propose regulations acknowledged to "reduce the financial integrity of trades facilitated by SEFs." That violates statutory directives and constitutes an abuse of discretion based on arbitrary and capricious reasoning.

Timely affirmation of trades to facilitate fewer DCO rejections is sensible, and the use of affirmation hubs is acceptable within the confines of the STP framework. But it cannot be better from a public interest perspective to establish rules codifying the regulatory equivalent of a Rube Goldberg machine, where each link in the chain of mechanisms marks up and slows down transaction processing and the costs ultimately are passed onto the end-user. The CFTC must prioritize the public interest commands of the CEA—to promote trading on SEFs and pre-trade transparency—not unnecessary revisions to

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[257] Bloomberg SEF LLC Rulebook, Rule 533(f), Cleared Swaps (August 9, 2018), available at https://data.bloomberglp.com/professional/sites/10/BSEF-Rulebook2.pdf (emphasis added).

[258] trueEX Rulebook, pg. 107, Table 1204—Core RFQ Protocols (October 17, 2018) , available at https://www.trueex.com/system/rules/attachments/000/000/022/original/trueEX_Rulebook_Final_%2810.17.18%29.pdf?1539788029.

[259] tpSEF Inc. Rulebook, Rule 4013.A.(c), pg. 47 (November 19, 2018), available at https://www.tullettprebon.com/swap_execution_facility/documents/tpSEF%20-%20Rulebook.pdf?201934.

[260] ICAP Global Derivatives Limited Facility Rulebook, Rule 204(i)(1) (December 13, 2018), available at https://www.icap.com/~/media/Files/I/ICAP-Corp-V3/pdfs-SEF/Copy%20of%20IGDL%20Facility%20Rulebook%20v%2043%20Filed%2011292018%20Effective%2012132018%2023.pdf.

[261] GFI Swaps Exchange LLC, Rule 542, pg. 56 (January 9, 2017), available at https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=2ahUKEwj-.nMqP9OvgAhUBmlkKHTDcBmQQFjABegQICRAC&url=http%3A%2F%2Fwww.gfigroup.com%2F%3Fmedia_dl%3D5246&usg=AOvVaw2GDQheXPlbSbXl_hweivwL.

[262] See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62081 (proposed November 30, 2018).

longstanding guidance that the CFTC acknowledges will "reduce the financial integrity of the trades facilitated by SEFs."

The CFTC suggests that "market and technological developments" may remedy the issues presented by the Qualitative STP Standard and states that the there is an "inherent incentive to confirm all trades in a timely manner" and make such investments.[263] That is true; there are inherent incentives to engage in responsible risk management. But as the 2008 financial crisis all too clearly demonstrated, there are numerous countervailing incentives as well. For example, there are strong incentives to maintain the voice-enabled market structure (and its relative opacity and lucrative commission structure) and to keep personnel and technology costs at a level that makes prioritizing the affirmation of trades in short periods of time too costly to implement. The 2008 financial crisis proved that profit maximization can and too often does overwhelm the inherent incentives to engage in responsible risk management and meaningful self-policing.

More fundamentally, though, the CFTC must be mindful of the fact that the current state of computing power within the derivatives infrastructure is simply irrelevant to the question of whether trades can be affirmed and routed within 10 minutes. It can be done—as a technological matter, and at reasonable expense. The trade routing challenge noted by the market is a consequence of ***manual intervention*** in the trade workflow, which simply cannot be scaled responsibly without some automated risk management functionality to support it. Thus, rather than permitting latency and risks associated with unaffirmed trades to persist, the "inherent incentives" we would emphasize are the ones arising from the costs of voice-related error trades—that is, costs associated with voice-executed swaps being improperly booked and managed in front office and downstream risk systems (e.g., error trade resolution, short-term margin requirements). Electronic trading does not have that problem, because front and middle office controls are designed to prevent booking in most such cases.

The AQATP Standard therefore encourages (1) trading through methods of execution that provide better booking controls, and (2) investments that otherwise must be long delayed in the interest of the industry's short-term profitability. The proposed Qualitative STP Standard, on the other hand, codifies a bottleneck in the SEF infrastructure and empowers dealers to leverage principles-based standards to undermine the transition to electronic trading. The reasons proffered for the latter approach are manifestly insufficient.

Even ISDA agrees that "it is possible for the industry to make significant improvement[s]" with respect to the routing of swaps through affirmation hubs[264] and that "the industry should [have] be[en] able to review all swaps within 10 minutes after execution" **three years ago**.[265] Thus, the CFTC must confidently proceed to codify the AQATP Standard and apply specific STP timeframes on trade routing that are not only possible but routinely accomplished in the markets. Better Markets proposes the following three-part STP framework for affirmation routing:

- First, that the CFTC require trades to be routed from SEFs to affirmation hubs immediately upon execution in accordance with the AQATP Standard;

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263 See Id.

264 See International Swaps and Derivatives Association, Inc. Letter to the Division of Market Oversight ("DMO") and Division of Swap Dealer and Intermediary Oversight ("DSIO"), Re: Straight Through Processing and Affirmation of SEF Cleared Swaps (July 27, 2015), available at https://www.isda.org/a/fKiDE/isdas-proposed-plan.pdf.

265 2015 STP Guidance at 3.

- Second, that the CFTC require trades routed to affirmation hubs to be released for clearing immediately upon completion of the affirmation by the later of the two counterparties, in accordance with the AQATP Standard; and

- Third, that the CFTC require affirmation windows be no longer five minutes, beginning immediately upon the SEFs' routing of the trade to the affirmation hub.

We defer to the CFTC's judgment on whether a regulation to that effect requires a 6-month phase-in period consistent with the current 10-minute affirmation standard, such that affirmation services providers and market participants can make trade workflow adjustments or investments as necessary to meet the new 5-minute standard.

In considering our recommendation, we ask that the CFTC note that the 2015 STP Guidance permits SEF trade routing pursuant to a 10-minute STP post-execution standard[266] but also provides unreasonable flexibility for SEFs to determine whether that 10-minute standard is applicable. The guidance, more specifically, acknowledged that if an error is detected, trades may be routed to the DCO ***more than 10-minutes after execution***, which, in itself, disincentivizes investments that reduce errors through automated controls. The CFTC must abandon that loophole and avoid introducing new ones in the any final regulation arising from the SEF Proposal. Strict, quantitative STP standards limit rent seeking and incentivize market participants to reduce operational, credit, and market risks in the derivatives markets.

5. The CFTC's proposed codification of the AQATP Standard for DCO acceptance is a critical measure to support the STP framework and an E2C workflow that supports multilateral trading.

Proposed revisions to CFTC Regulation §§ 39.12(b)(7)(ii)–(iii) would collapse the existing STP requirements into a single AQATP Standard applicable to all swaps submitted to DCOs, without regard to the mode of execution used in the transaction.[267] In addition, the CFTC would apply the AQATP Standard to the "submission," as opposed to "execution," of all swaps transmitted to DCOs for clearing.[268] We agree with both proposed changes. First, the CFTC must maintain the AQATP Standard. For the reasons noted above, the AQATP Standard is a critical element of the E2C workflow for facilitating a derivatives market transition to multilateral trading. Second, given the necessity of automated DCO trade acceptance and risk management, DCOs are unlikely to develop controls strongly tied to a swap's specific method of execution, which is information that must originate with the SEF, not the DCO. Eliminating intermediate controls and procedures relating to method-of-execution messaging, we agree, may "lead to even more efficient trade processing, routing, and clearing since these extra steps are being removed from the [STP] requirements."[269]

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[266] 2015 Guidance at 3.

[267] See Proposed § 39.12(b)(7)(ii). See also 17 C.F.R. §§ 39.12(b)(7)(ii)–(iii).

[268] See Proposed § 39.12(b)(7)(ii) (requiring each DCO shall have rules that provide that the DCO will "accept or reject for clearing all agreements, contracts, and transactions as quickly after submission to the [DCO] as would be technologically practicable if fully automated systems were used"). See also 17 C.F.R. § 39.12(b)(7)(ii) (for competitively executed transaction, providing that DCOs "shall have rules that provide that the [DCOs] will accept or reject for clearing as quickly **after execution** as would be technologically practicable if fully automated systems were used"). But see 17 C.F.R. § 39.12(b)(7)(iii) (for off-exchange or non-competitively executed swaps, providing that DCOs "shall have rules that provide that the [DCOs] will accept or reject for clearing as quickly **after submission** to the [DCOs] as would be technologically practicable if fully automated systems were used").

[269] Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62080 (proposed November 30, 2018).

Third, although the AQATP Standard might be fairly characterized as applying to swaps ***received*** by the DCO, not simply ***submitted***, we take the view that "submitted" as presently used in CFTC Regulation § 39.12(b)(7)(iii)[270] is a reasonable standard that appropriately contemplates technological and procedural coordination with SEFs. The "submission" standard also incentivizes SEFs and DCOs to make investments in technology and controls necessary to ensure submitted transactions are, in fact, received and accepted within the AQATP Standard.

Most importantly, although the CFTC provides that Proposed § 39.12(b)(7)(ii)'s AQATP Standard is meant to be interpreted in a manner that is "consistent with the views expressed by the Divisions in the 2013 Staff STP Guidance" (i.e., that DCOs must continue to accept or reject trades within ten seconds of "submission"),[271] it does not codify the 10-second standard. Doing so, however, would strengthen the enforceability of the AQATP Standard. The STP policy does not appear to be in question. The CFTC provides that acceptance or rejection of swaps for clearing "in close to real time is crucial both for effective risk management and for the efficient operation of trading venues"[272] and notes that it seeks to "reinforce SEFs' and DCOs' mutual obligation to work with one another to ensure the prompt, efficient, and accurate processing and routing of swaps from SEFs to DCOs."[273] The CFTC also acknowledges that "99 % of all trades are accepted or rejected from clearing within ten seconds or less"[274] and its longstanding view that "the performance standard would require action in a matter of milliseconds or seconds, or at most, a few minutes, not hours or days."[275] Moreover, even if the CFTC determines the 10-second AQATP Standard is insufficient in light of future market or technological developments (or that codification perversely disincentivizes infrastructure improvements), the AQATP Standard would remain the operable language if the 10-second AQATP Standard were provided, for example, in the nature of safe harbor. Finally, the CFTC also always retains authority to adopt a stricter standard in light of advancements in market infrastructure and clearing capabilities and practices.

For these reasons, we recommend that the CFTC simply codify the existing guidance, principles of which were affirmed in the proposal. Such codification would promote trade and clearing certainty, market efficiency, financial integrity of transactions, and better encourage "market participants to work together to process, route, and ultimately clear swap transactions as appropriate" and intended by the CFTC's STP framework.[276] It would also provide *regulatory* certainty by providing the CFTC's imprimatur on longstanding, CFTC-staff-level STP guidance.

6. SEFs must not be provided discretion to determine whether to treat error trades as void ab initio when rejected for clearing by DCOs.

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[270] 17 C.F.R. § 39.12(b)(7)(iii).

[271] See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62079 (proposed November 30, 2018).

[272] Id at 62024. See also Id at 62082.

[273] See Id at 62082.

[274] See Id at 62081.

[275] Id at 62023.

[276] See Id 62082. In addition, in establishing the uniform AQATP DCO standard across the modes of execution, the CFTC enhances trade and clearing certainty and therefore promotes multilateral trading and statutory objectives. Id at 62023-24.

The CFTC divisions have issued long-standing STP guidance that swaps rejected by DCOs for reasons unrelated to "operational" or "clerical" errors must be treated as void ab initio.[277] The "operational and clerical error" exception to void ab initio was based on concerns raised by interdealer brokers and their dealer clients that erroneous rejections due to "operational" or "clerical" errors exposed market participants to significant execution risks in the event that they are required to seek competitive execution in the markets at some subsequent time.[278] The CFTC staff ultimately issued no-action relief from prohibitions on pre-arranged trading, and other relevant SEF requirements, for "any type of error other than a rejection from clearing due to credit reasons."[279]

Flexibility to permit non-competitive re-execution of DCO rejected trades risks setting forth an exception to the void ab initio policy that may be swallowed by the rule. The CFTC therefore must (1) codify a uniform requirement across the derivatives markets that DCO rejected trades are void ab initio and (2) abolish the "operational and clerical" error exception. These two measures together would incentivize improvements to pre-trade and post-trade processes and controls and encourage continued migration to electronic trading.

The CFTC instead proposes to defer to SEFs to determine whether to implement rules and procedures permitting corrections to trades, including those rejected by DCOs for operational and clerical reasons.[280] In this regard, the CFTC proposes to permit SEFs to determine "whether to maintain an approach based on the void *ab initio* concept for trades rejected from clearing due to non-credit related errors"[281] as they determine "best suited to [their] particular market[s]."[282] This deference conflicts with the CFTC's own legitimate concerns about the uniform adoption of error trade rules across the derivatives markets:[283]

> Notwithstanding the existence of error trade rules and protocols across different SEFs, market participants have stated that those rules and protocols, and the manner in which they are applied, have been inconsistent in some respects. Participants have cited a number of such examples, including inconsistent approaches to notifying SEFs of alleged error

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277 2013 STP Guidance at 5.

278 ISDA's proposal to the Division of Market Oversight ("DMO") and Division of Swap Dealer and Intermediary Oversight ("DSIO"), for example, noted that "members are concerned that there still remain some significant risks associated with trade execution and submission to clearing which require a trade verification step following execution and prior to submission to the DCO." In that case, ISDA was concerned both about trades being voided and trades being *accepted* erroneously and resulting in margin requirements and reputational concerns. See International Swaps and Derivatives Association, Inc. Letter to the Division of Market Oversight ("DMO") and Division of Swap Dealer and Intermediary Oversight ("DSIO"), Re: Straight Through Processing and Affirmation of SEF Cleared Swaps (July 27, 2015), available at https://www.isda.org/a/fKiDE/isdas-proposed-plan.pdf.

279 Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61999. Fn. 431 (proposed November 30, 2018); See also CFTC Division of Market Oversight and Division of Clearing and Risk, No-Action Relief for Swap Execution Facilities and Designated Contract Markets in Connection with Swaps with Operational or Clerical Errors Executed on a Swap Execution Facility or Designated Contract Market (NAL No. 17–27) (May 30, 2017), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/17-27.pdf.

280 Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62000 (proposed November 30, 2018).

281 Id at 62001 (emphasis original).

282 Id.

283 Id at 62000.

> trades; the varying factors that SEFs consider in evaluating alleged error trades; and the level of notification provided to other market participants regarding alleged errors. Therefore, some market participants— particularly those that are participants of multiple SEFs—have recommended that the Commission adopt some general error trade policy requirements to promote a more consistent approach.[284]

Wirth respect to concerns about the "manner in which [error trade rules] are applied," the CFTC reasonably proposes to require SEFs to establish and maintain rules and procedures that facilitate resolution of error trades in a "fair, transparent, consistent, and timely manner."[285] Such rules reasonably would be required to provide the SEF with the authority to adjust trade terms and cancel trades; and specify means for market participants to notify SEFs of error trades, including time limits for such notifications.[286] But nothing in the proposal addresses limitations on SEFs' discretion to interfere with critical market integrity measures, like the policy of imposing void ab initio on all trades rejected by DCOs to ensure trade and clearing certainty within the market infrastructure.

The CFTC inquires even whether it should permit corrective error trade policies for swaps legitimately rejected by DCOs for credit reasons.[287] In this all-or-none approach, the CFTC must proceed with none. Proposed § 37.203(e)(1) would define "error trade" as "any swap transaction executed on a SEF that contains an **error in any term, including price, size, or direction**.[288] But the economic terms of submitted swaps, like notional amounts ("size")—even if incorrectly included in a swap's terms—in reality are not possible to distinguish from other credit rejections in which the notional amount was correct. Asking DCOs and SEFs to figure out for *which* credit-related reason a trade was rejected in real-time, in dynamic markets, and inevitably based on discretionary, qualitative standards, simply asks too much for little (or maybe no) benefit to the markets. Indeed, permitting credit-related rejections to be addressed in error trade rules increases the amount of manual intervention necessary in the markets, because trade and clearing disputes, inevitably, must increase.

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[284] Id.

[285] Proposed § 37.203(e)(2).

[286] Id. Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62001 (proposed November 30, 2018). The proposal requires SEFs to notify market participants "as soon as practicable" that a swap is (1) under review pursuant to rules and procedures; (2) has been determined to be or not to be an error trade; and (3) how the error trade will or will not be resolved through adjustments or cancellation. Proposed § 37.203(e)(3). However, the proposed rules permit SEFs to make error trade information available *when* they choose, based on the "countervailing concerns of potential market disruptions caused by the announcement of a potentially erroneous trade that has been disseminated to the SEF's participants." Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62001 (proposed November 30, 2018). Although we agree that SEF error trade policies, procedures, and controls would be a "beneficial practice that promotes a fair and orderly trading market for . . . market participants," the CFTC must be more specific. See Id at 62000. It should require, for example, that all SEFs limit error trades to reasonably established, periodically reviewed, and consistently applied no-bust ranges akin to those used in other CFTC regulation trading venues, like DCMs.

[287] See Id at 62002 (asking whether the CFTC's proposed definition of "error trade" is "sufficient to include those trades where an incorrect term (e.g., incorrect notional amount) results in a rejection by a DCO ostensibly due to credit reasons, but where the DCO otherwise would have accepted the trade had the trade included the correct terms").

[288] Proposed § 37.203(e)(1).

The proposed "flexibility"[289] to undermine void ab initio policy will perpetuate complexities in the derivatives markets, including, we suspect, through enablement mechanisms supposedly necessary to manage the risks *created by such flexibility* in the first place. The CFTC must therefore provide some reasonable limitation on SEFs to ensure each implements a straightforward void ab initio regulation for DCO rejections uniformly across the SEF trading environment. Deference to SEFs would serve only to reduce trade and clearing certainty, disincentivize risk-reducing investments in the derivatives infrastructure, perpetuate unnecessary and complex error trade workflows, and impede progress toward multilateral, electronic trading. All of these consequences violate the CEA and/or explicit statutory objectives.

We emphasize, again, that electronic trading is significantly less susceptible to "operational and clerical" errors than voice trading. Even ISDA has noted that post-execution validation processes are most frequently unnecessary in the electronic trading context, because the error trade rate is measurably low:

> **It is generally acknowledged that in the Electronic environment the opportunity for operational or clerical error is significantly small, perhaps non existent**, to the extent that appropriate controls exist to ensure real time communication of up to date information between market participants and infrastructures. As a result, **there should not be any need for a post execution validation for transactions which are Electronic, as existing controls and checks should occur pre trade or at the point of trade for these transactions**.[290]

Thus, by the dealers' own acknowledgement, void ab initio should have a "perhaps non-existent" negative effect on the electronically traded markets. Operational and other risks are best mitigated when cleared swaps are submitted and accepted for clearing as soon as **technologically** practicable. In the modern computer age in which high frequency traders conduct trading activities using microwaves on micro-second (soon to be nanosecond) intervals, this is a strict standard.[291] Indeed, the term "practicable" is a better standard than "possible" only because there are diminishing risk management returns in the micro-second range to justify the relatively significant technological costs of building out a derivatives infrastructure that increasingly approaches an instantaneous limit. However, when the discussion on clearing submission and acceptance is not centered on improvements to a micro-second technological build, the returns to investment in trade and clearing certainty are likely to be extremely large relative to the per transaction-level costs.

Moreover, by requiring void ab initio policies and facilitating a multilateral, STP market infrastructure, the CFTC would promote responsible risk management. Consider, for example, the execution risks affected by a strict void ab initio policy:

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289 The SEF Proposal in a number of key areas characterizes the CFTC's proposed actions in unmistakably deregulatory terms, using euphemisms like "flexible" or variants more than 130 times and at times contrasting principles-based regulations with existing regulatory provisions that are "rigid."

290 See International Swaps and Derivatives Association, Inc. Letter to the Division of Market Oversight ("DMO") and Division of Swap Dealer and Intermediary Oversight ("DSIO"), Re: Straight Through Processing and Affirmation of SEF Cleared Swaps (July 27, 2015).

291 See, e.g., Commodity Futures Trading Commission, Regulation Automated Trading; Proposed Rule, 80 Fed. Reg. 78824, 78829-30 (December 17, 2015), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2015-30533a.pdf (noting that "advances in trading speeds are partly due to the development of dedicated fiber-optic and microwave communications networks that have dramatically reduced transmission times across large distances").

> The proposed requirement that error trades be resolved in a timely manner would reduce the costs associated with error trades, including associated hedging costs. A counterparty may hedge an executed trade: (i) Before it learns that the trade may be erroneous, (ii) after it learns the trade may be erroneous, but before the SEF has determined whether the trade is an error trade, (iii) after an error has been identified but before it has been resolved, or (iv) after the SEF has resolved the error. **The potential cost of each case likely depends on how quickly the SEF resolves the error because the longer a SEF takes to do so, then the greater the chance the market price of the trade and related hedge trade will move.** For example, if a trader on a SEF enters into a hedge trade and the SEF determines that the initial trade is different from what the trader believed, then the trader may have to execute a new trade that hedges the correct trade and unwind the initial hedge trade. Doing so will be costly if the market has moved and the price of entering into the new hedge and unwinding the old hedge has increased. Similarly, a trader that waits to execute a hedge trade until after the SEF has resolved the error will likely face higher costs the longer the SEF takes to resolve the error.[292]

Strict void ab initio rules within SEF error trade policies actually limit re-execution costs, because rejected trades are made known to market participants as quickly as the SEF routes trades to the DCO (which we argue above must remain subject to the AQATP Standard) and the DCO rejects the trade within the AQATP Standard. That is far more certain than unknown latency inextricably tied to an error trade process that does not treat rejected trades as void ab initio.

The opportunities to expand the liquidity providers in the derivatives markets are already limited. The natural and regulatory barriers to entry and necessary sophistication required to responsibly make markets realistically limits the number of firms that would consider such entry. The CFTC—rather than re-examining practices that already have improved market quality—should be focused on revisions intended to further facilitate entry and diversity in the marketplace. It is only with the streamlined E2C workflow and strict, known, and persistent processing and acceptance standards that the SEF regulatory framework can encourage participation in the derivatives markets and improve pricing for end-users through multilateral trading venues with pre-trade transparency, stated purposes of the SEF regulatory framework.[293]

IV. The CFTC's proposed repeal of the made-available-to-trade process advances CEA section 5h(e)'s statutory objectives.

CEA section 2(h)(8)(A) requires counterparties to execute all swaps required to be cleared pursuant to CEA section 2(h)(1)-(2) ("Clearing Requirement")[294] on a SEF, a SEF that is exempt from registration,[295] or DCM ("Trade Execution Requirement").[296] CEA section 2(h)(8)(B) provides an exception to the Trade

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292 See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62069 (proposed November 30, 2018).

293 7 U.S.C. § 7b–3(e) (stating that "[t]he goal of this [SEF] section is to promote the trading of swaps on swap execution facilities and to promote pre-trade transparency in the swaps market").

294 7 U.S.C. § 2(h)(1)-(2).

295 We agree with the CFTC's interpretation that the exemption referenced in this section refers to facilities operated for the trading or processing of swaps that would be required to register as SEFs if not exempted from such registration pursuant to CEA section 5h(g). 7 U.S.C. § 7b-3(g).

296 7 U.S.C. § 2(h)(8)(A).

Execution Requirement, however, if no such trading venues "make the swap available to trade" or the swap is subject to a clearing exception in CEA section 2(h)(7).[297] Thus, swaps in agricultural commodities, if not listed on at least one DCM, would not be subject to the Trade Execution Requirement, because the CEA section 5h(b)(2) prohibits SEFs from listing such swaps or otherwise "making such swaps available to trade" on SEFs. That would similarly be the case if the CFTC determined that a particular category of swaps is not within "the universe of swaps that can be executed on a SEF" and no DCM lists such Non-SEF Swaps.[298]

The CFTC implemented a process for SEFs and DCMs to submit filings that have the effect of requiring swaps to be subject to the Trade Execution Requirement in 2013.[299] That process for determining whether a swap has been "made available to trade" for purposes of CEA section 2(h)(8) has proven severely flawed. First, the CFTC's CEA section 2(h)(8)(B) interpretation is based on an impermissibly strained reading of the statute, ignoring a far more reasonable and intuitive reading of the Trade Execution Requirement that is closely moored to the plain meaning of the text and regulated market practices. In addition, the proposed interpretation of CEA section 2(h)(8)(B) better accounts for its statutory context and structure. Finally, the CFTC's assessment that a Trade Execution Requirement based on the listing of swaps subject to the Clearing Requirement is "better aligned with the intent of CEA section 2(h)(8)" is correct, although one legislator's statement has been used by the industry to introduce ambiguities into the otherwise plain meaning of the phrase.[300]

The proposed interpretation of CEA section 2(h)(8)(B) also is consistent with the rule of construction and explicit statutory objectives for the SEF statutory framework in CEA section 5h(e).[301] Indeed, from an outcomes-based perspective, Better Markets notes that no additional swaps have been subjected to the Trade Execution Requirement in more than five years, though (1) a large segment of the market continues to be executed outside of the SEF regulatory framework, and (2) industry filings and CFTC divisional actions have provided numerous opportunities to meaningfully expand the interest rate and index credit derivatives mandates. The existing MAT Process, on the other hand, is not only inconsistent with section 5h(e)'s statutory objectives to promote trading on SEFs and pre-trade transparency in the swaps markets; it directly contravenes them.

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[297] 7 U.S.C. § 2(h)(8)(B).

[298] 7 U.S.C. § 7b–3(d).

[299] 7 U.S.C. § 2(h)(8)(B). CFTC Regulations § 37.10 and § 38.12 establish the "MAT determination" process pursuant to which SEFs and DCMs make filings under part 40 rule filings procedures that swaps are "available to trade" and therefore, subject to the trade execution requirement. 17 C.F.R. § 37.10; 17 C.F.R. § 38.12. These provisions provide liquidity factors to guide the market-driven MAT determination: (1) Whether there are ready and willing buyers and sellers for the swap; (2) the frequency or size of transactions in the swap; (3) the swap's trading volume; (4) the number and types of market participants trading the swap; (5) the swap's bid/ ask spread; and (6) the usual number of resting firm or indicative bids and offers in the swap. 17 C.F.R. § 37.10(b), 38.12(b).

[300] Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61975 (proposed November 30, 2018).

[301] 7 U.S.C. § 7b–3(e) (stating that "[t]he goal of this [SEF] section is to promote the trading of swaps on swap execution facilities and to promote pre-trade transparency in the swaps market").

For these reasons, we support the CFTC's reasonable revision to its CEA section 2(h)(8)(B) interpretation and abandonment of the MAT Process for establishing the Trade Execution Requirement.[302] However, we cannot support the CFTC's proposal to tie that interpretation to independently proposed provisions relating to SEF trading protocols.[303] Those further changes—including elimination of minimum trading functionality requirements[304] (i.e., establishment and maintenance of an Order Book[305]) and methods of execution for Required Transactions[306]—are in no way inextricably bound or necessarily even relevant to the proposed CEA section 2(h)(8)(B) interpretation. They are also inconsistent with CEA section 1a(50) and the statutory objectives in CEA section 5h(e).

A. The CFTC's proposed interpretation of CEA section 2(h)(8)(B) is a long overdue improvement to the SEF regulatory framework that would promote swaps trading on SEFs and pre-trade transparency in the swaps markets.

The CFTC proposes to give proper effect to the most intuitive, logical, and plain meaning interpretation of the phrase "makes the swap available to trade" in CEA section 2(h)(8)(B) by subjecting all *listed* swaps subject to the Clearing Requirement also to the Trade Execution Requirement. Congress uses the term "listing" and variations of the phrase "make available to trade" or "permit trading" interchangeably throughout the SEF statutory framework to describe the same concept: the contracts in which DCMs and SEFs provide a marketplace or facilitate trading. For example, CEA section 5h(b) provides that SEFs "may ***make available for trading*** any swap,"[307] provided they do not "***list for trading*** or confirm the execution of any swaps in an agricultural commodity."[308] Thus, within a single statutory provision, CEA section 5h(b), Congress interchangeably uses the phrase "make available for trading" and the term "listing" to describe a limitation on facilitating trading. In cognate provisions on "[c]ontracts not readily susceptible to manipulation," moreover, Congress provides that DCMs "shall **list** on the contract market only contracts that are not readily susceptible to manipulation."[309] That provision in the SEF context, though otherwise identical, provides that SEFs "shall **permit trading** only in swaps that are not readily susceptible to manipulation."[310] Despite such textual differences, the CFTC reasonably has applied Part 40's provisions relating to the "listing" of products "for trading" by certification to both DCMs and

[302] Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61952 (proposed November 30, 2018).

[303] The CFTC emphasized that "[t]he proposed expansion of the trade execution requirement is expected to capture a greater number of swaps with different liquidity profiles, thereby reinforcing the need to establish a more flexible regulatory approach to swaps trading and execution that would help foster customer choice, promote competition between and innovation by SEFs, and better account for fundamental swaps market characteristics." Id at 61952. In that sentence, as well as more than 130 others, the CFTC uses the term "flexible" as a euphemism for its deregulatory proposals.

[304] 17 C.F.R. § 37.3(a)(2).

[305] 17 C.F.R. § 37.3(a)(3).

[306] 17 C.F.R. § 37.9(a)(2). Required Transactions are transactions involving a swaps subject to the Trade Execution Requirement in CEA section 2(h)(8). 17 C.F.R. § 37.9(a)(1).

[307] 7 U.S.C. § 7b–3(b)(1)(A).

[308] 7 U.S.C. § 7b–3(b)(2).

[309] 7 U.S.C. § 7(d)(3).

[310] 7 U.S.C. § 7b-3(f)(3).

SEFs since 2011, which acknowledges that "permitting trading" or "making swaps available" on SEFs is tantamount to listing.[311]

In addition, CEA section 5h(c) provides that DCMs that operate SEFs using an electronic trade execution system "**for listing and executing trades on swaps**" must identify whether such trading occurs on the DCM or SEF.[312] Thus, Congress again references *listing* and trading of swaps on DCM-operated SEFs. That mirrors the CFTC's uncontroversial use of the term, "listing," in several provisions of the SEF regulatory framework (e.g., CFTC Regulation § 37.4, which provides SEF applicants "may submit a swap's terms and conditions ***prior to listing the product*** as part of its application,"[313] and CFTC Regulation § 37.403(b)-(c), which provides that SEFs must demonstrate that they monitor reference pricing for "cash-settled swaps ***listed*** on the SEF"[314]). In short, the CFTC's proposed CEA section 2(h)(8)(B) interpretation is merely an extension of its existing recognition that permitting trading, facilitating trading, listing, and making products available to trade on regulated facilities—while describing the same concept at times in linguistically distinct manners—describe conceptually identical processes and therefore do not compel differences in regulatory treatment.

Having considered the above, we agree with the CFTC's irrefutable proposed view of CEA section 2(h)(8)(B)'s statutory text as follows:

> [T]he most straightforward reading of CEA section 2(h)(8) would specify that once the clearing requirement applies to a swap, then the trade execution requirement also applies to that swap unless no SEF or DCM "makes the swap available to trade." Accordingly, once any single DCM or SEF "makes available," i.e., lists, a swap that is subject to the clearing requirement for trading on its facility, then the trade execution requirement would apply to that swap, such that market participants may only execute the swap on a SEF, a DCM, or an Exempt SEF.[315]

Of course, the industry has performed all sorts of legal contortions to erect artificial procedural hurdles that limit the scope of the Trade Execution Requirement. That is understandable, because the dealers have considerable market power and profits to lose from the Trade Execution Requirement. But the legal arguments simply do not stand up to scrutiny and a common sense, plain meaning reading of the statute. Indeed, if anything, the phrase "available to trade" captures the conception of SEFs as venues that facilitate cleared trading activities in broader set of derivatives instruments, with more permutations, than the standardized, listed futures markets.

Moreover, industry advocacy for the proliferation of non-SEF, OTC trading activities ignores the statutory structure in which the Trade Execution Requirement is found. The language giving rise to the Trade Execution Requirement is included CEA section 2(h),[316] a section added to the CEA by the Dodd-Frank Act and containing provisions relating to imposition of the Clearing Requirement. The header to the

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311 17 C.F.R. § 40.2.

312 7 U.S.C. § 7(c).

313 17 C.F.R. § 37.4(a) (emphasis added).

314 17 C.F.R. § 37.403(b) (emphasis added).

315 Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61979 (proposed November 30, 2018).

316 7 U.S.C. § 2(h).

section logically is entitled, "Clearing requirement,"[317] and CEA section 2(h)(8)'s trade execution provisions are preceded by seven statutory provisions addressing clearing-related requirements and restrictions, including standards for clearing,[318] open access to DCOs,[319] review of clearing determinations,[320] stays of the clearing requirement,[321] evasion of the clearing requirement,[322] exceptions to the clearing requirement,[323] and exemptions relating to the transition to mandatory clearing.[324] It not surprising, therefore, that CEA section 2(h)(8)'s Trade Execution Requirement commences with a requirement that counterparties must execute all "transactions involving swaps" subject to the clearing requirement on a SEF, a SEF that is exempt from registration ("Exempt SEF"),[325] or a DCM.[326] The CFTC's proposal to look, first, to the clearing mandate in setting forth the scope of the Trade Execution Requirement is supported by this statutory context.[327]

In addition, there are other statutory factors that clarify the meaning of CEA section 2(h)(8)(B). Congress prescribed a detailed clearing determination process in CEA section 2(h)(2), setting forth timeframes,[328] procedural requirements,[329] and specific factors to govern the CFTC's determinations, including outstanding notional exposures, trading liquidity, and adequate pricing data in subject markets.[330]

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317 7 U.S.C. § 2(h) (prefacing the substantive provisions of the statutory section with the header, "Clearing requirement").

318 7 U.S.C. § 2(h)(1)(A).

319 7 U.S.C. § 2(h)(1)(B).

320 7 U.S.C. § 2(h)(2).

321 7 U.S.C. § 2(h)(3).

322 7 U.S.C. § 2(h)(4).

323 7 U.S.C. § 2(h)(7).

324 7 U.S.C. § 2(h)(6).

325 We agree with the CFTC's interpretation that the exemption referenced in this section refers to facilities operated for the trading or processing of swaps that would be required to register as SEFs, if not exempted from such registration pursuant to CEA section 5h(g). 7 U.S.C. § 7b-3(g).

326 7 U.S.C. § 2(h)(8)(A) (stating solely "[w]ith respect to transactions involving swaps subject to the clearing requirement of [CEA section 2(h)(1), counterparties shall (i) execute the transaction on a board of trade designated as a [DCM] . . . or (ii) execute the transaction on a [SEF] registered under [CEA section] 7b-3 . . . or a [SEF] that is exempt from registration under [CEA] section 7b-3(f) (sic)").

327 Section 723(a)(3) of the Dodd-Frank Act added a new CEA section 2(h) to establish the clearing requirement for swaps. 7 U.S.C. § 2(h). CEA section 2(h)(1)(A) provides that it is unlawful for any person to engage in a swap unless that person submits such swap for clearing to a derivatives clearing organization that is registered under the Act or a derivatives clearing organization that is exempt from registration under this Act if the swap is required to be cleared. 7 U.S.C. § 2(h)(1)(A). CEA section 2(h)(2) specifies the process for the Commission to review and determine whether a swap, group, category, type or class of swap should be subject to the clearing requirement. 7 U.S.C. 2(h)(2). The Commission further implemented the clearing determination process under part 50, which also specifies the swaps that are currently subject to the requirement. 17 C.F.R. Part 50.

328 See, e.g., 7 U.S.C. § 2(h)(2)(B)-(C).

329 See, e.g., 7 U.S.C. § 2(h)(2)(A).

330 See 7 U.S.C. § 2(h)(2)(D)(ii). See also Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61979 (proposed November 30, 2018) (noting that "CEA section 2(h)(2) delineates a structured process that outlines a specific set of factors that the Commission must consider in its clearing requirement determination and includes a provision for public comment").

In contrast, the CEA provides no such processes or requirements with respect to the Trade Execution Requirement; it is literally silent in that regard. The CFTC therefore rightly acknowledges that "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 . . . ."[331] In other words, extra-textual hurdles to limit the scope of the Trade Execution Requirement (1) ignore the reality that Congress established an explicit process for the Clearing Requirement and could and would have explicitly established a similar process for the Trade Execution Requirement if it determined one was necessary; and (2) fail to account for Congress' explicit consideration in CEA section 2(h)(D) of the very market quality factors recommended by the industry to limit the Trade Execution Requirement—the existence of outstanding notional exposures, trading liquidity, and adequate pricing data.[332]

In any event, the MAT Process cannot be squared with a rule of construction directing the CFTC to construe ambiguities in CEA section 2(h)(8)(B), if any, in a manner that promotes trading on SEFs and pre-trade transparency.[333] The MAT Process—quite literally—erects a procedural *hurdle* to trading on SEFs, and all but sanctions continued OTC trading with dealers. It cannot be said, therefore, to "promote" SEF trading, much less pre-trade transparency. The CFTC's new proposed interpretation of CEA section 2(h)(8)(B), in contrast, recognizes the complementarities between the Trade Execution Requirement and the Clearing Requirement. Broad mandatory clearing of swaps with sufficient outstanding notional exposures, trading liquidity, and pricing data provides the foundation for a multilateral SEF framework. The Trade Execution Requirement—when built upon that Clearing Requirement and a market infrastructure that embraces STP throughout the E2C workflow—promises to expand the available counterparties on SEFs, bring outstanding OTC notional exposures into the regulated SEF trading environment, and better ensure the reliability and integrity of markets and pricing information. The resulting market quality improvements, in turn, further promote trading on SEFs through protocols that enhance pre-trade transparency. In short, the CFTC's proposed CEA section 2(h)(8)(B) interpretation advances statutory objectives; the MAT Process does not.

The industry has made much of a single statement placed into the congressional record by Senator Lincoln, which provides that the CFTC should "take a practical rather than a formal or legalistic approach" to interpreting the phrase "makes available to trade"[334] and should "evaluate not just whether the [SEF]

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331 Id at 61979.

332 In the release adopting the part 50 regulations, the CFTC "noted that this required analysis of a swap's trading liquidity is intended for risk management purposes, i.e., pricing and margining of cleared swaps. In this connection, the Commission has noted that higher trading liquidity in swaps would assist DCOs in end-of-day settlement procedures, as well as in managing the risk of CDS portfolios, particularly in mitigating the liquidity risk associated with unwinding a portfolio of a defaulting clearing member." Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 61979, fn. 278 (proposed November 30, 2018).

333 7 U.S.C. § 7b-3(e).

334 See Statement of Sen. Lincoln, Congressional Record—Senate, S5923 (July 15, 2010), available at https://www.congress.gov/crec/2010/07/15/CREC-2010-07-15.pdf (emphasis added) ("Section 723 creates a 'Trade Execution Requirement' in new section 2(h)(8) of the Commodity Exchange Act (CEA). Section 2(h)(8)(A) requires that swaps that are subject to the mandatory clearing requirement under new CEA Section 2(h)(1) must be executed on either a [DCM] or a [SEF]. Section 2(h)(8)(B) provides an exception to the Trade Execution Requirement if the swap is subject to the commercial end-user exception to the clearing requirement in CEA Section 2(h)(7), or if no [DCM] or [SEF] 'makes the swap available to trade.' This provision was included in the bill as reported by the Senate Agriculture Committee and then in the bill that was passed by the Senate. 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 [SEF] "makes the swap available to trade," the CFTC should evaluate not just whether the [SEF] 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.

permits the swap to be traded on the facility . . . but also **whether, as a practical matter, it is in fact *possible* to trade the swap on the facility**."[335] However, there is tension and perhaps even a conflict in Senator Lincoln's views of the phrase "makes available to trade" and the plain language of CEA section 5h(b)(1). That provision, again, provides that a SEF may "**make available for trading any swap**,"[336] subject to a narrow exception for swaps on agricultural commodities,[337] and contains no limiting language relating to liquidity or any other factor. Moreover, the explicit exception for swaps on agricultural commodities suggests that Congress could and would have provided additional limitations on SEFs making swaps available to trade if it determined any such limitations were necessary. Between the plain language of statutory text and one particular legislator's views on the meaning of a provision, the plain language of the statute must control: CEA section 5h(b)(1)'s unequivocal command is that SEFs may "make available for trading" any swap.

However, even under Senator Lincoln's non-binding reading of CEA section 2(h)(8)(B), the Trade Execution Requirement would turn on whether swaps trading is "possible," a very minimal but "practical" standard. Senator Lincoln states, for example, that the Trade Execution Requirement should turn on whether there is sufficient trading liquidity to ensure "the swap can actually be traded," which she reiterates would be "a ***minimum amount of liquidity*** to make trading ***possible***."[338] Thus, it is clear from a reasonably careful reading of the Senator's statement that CEA section 2(h)(8)(B) cannot be read to significantly limit the scope of the Trade Execution Requirement. Indeed, the Clearing Requirement was imposed only after the CFTC took into account "[t]he existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data"[339] and therefore was limited in the first instance to those swaps having more than a "minimum amount of liquidity."

In fact, the CFTC found that there is far more than "a minimum amount of liquidity" in the interest rate and index credit default swaps subject to the current Clearing Requirement. In the most recent expansion of the Clearing Requirement, for example, the CFTC concluded as follows with respect to a number of interest rate markets:[340]

> In assessing the extent of outstanding notional exposures and trading liquidity for a particular swap, **the Commission reviews various data series to ascertain whether there is an active market for the swap, including whether the swap is traded on a regular basis as reflected by trade count and whether there is a measurable amount of notional exposures**, such that a DCO can adequately risk manage the swap. In particular, the Commission reviewed the aggregate notional exposure and the trade count data from a number of sources for each swap subject to this determination. While there is no defined

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The mere "listing" of the swap by a [SEF], in and of itself, without a minimum amount of liquidity to make trading possible, should not be sufficient to trigger the Trade Execution Requirement.").

335 Id.

336 7 U.S.C. § 7b-3(b)(1).

337 7 U.S.C. § 7b-3(b)(2).

338 Statement of Sen. Lincoln, Congressional Record—Senate, S5923 (July 15, 2010).

339 7 U.S.C. § 2(h)(2)(D)(ii)(I).

340 Commodity Futures Trading Commission, Clearing Requirement Determination under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps, 81 Fed. Reg. 71292, 71211 (October 14, 2016), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2016-23983a.pdf.

> standard for an active market, **the Commission believes the data indicates that there are sufficient outstanding notional exposures and trading liquidity for fixed-to-floating interest rate swaps denominated in the nine additional currencies to support a clearing requirement determination**.[341]

The CFTC also affirmed an earlier "finding that there is **regular trading activity** in these markets, as well as a measurable amount of data, such that there are **significant outstanding notional exposures and trading liquidity in the swaps subject to this determination**."[342] The release provides extensive trading liquidity and outstanding notional measures across multiple data sources that support the imposition of the Clearing Requirement for each of the categories now subject to the Clearing Requirement. With respect to trade counts, for example, the Clearing Requirement categories range from a several hundred trades over the course of a quarter to 15,492 trades over that same period totaling more than $403 billion MXN.[343] But in each case, they are more than adequate to meet the standard of a "minimum amount of liquidity to make trading possible." Similar analyses were conducted with respect to USD interest rate and index credit default swaps subject to the 2012 Clearing Requirement.[344]

One industry contention undoubtedly will be that the necessary outstanding notional amounts, trading liquidity, and reliable pricing information for DCO risk management purposes are distinct from that necessary for economically sound swap execution purposes. There are differences in those two purposes, to be sure. But the sufficiency of outstanding notional amounts, trading liquidity, and pricing information is actually more critical for DCO risk management purposes than it is for trade execution purposes. The former relates to the ability of DCOs to reliably mark positions to market, collect adequate margin based on mark-to-market changes, and manage and allocate close-out, default, and other risks relating to such positions. That which is sufficient for more critical clearing risk management purpose very often would be sufficient to make trading "possible" as well, in particular because some amount of trading liquidity is requisite or at least beneficial to reliably pricing and marking transactions to market for clearing purposes.

For all of these reasons, the CFTC rightly proposes to codify CEA section 2(h)(8)(A)-(B)'s language effecting the Trade Execution Requirement.[345] The CFTC's interpretation of the statutory phrase "makes the swaps available to trade" as meaning, in essence, listing on a CFTC-regulated or CFTC-exempted trading venue is consistent with the plain, intuitive meaning of the phrase as it appears in CEA section 2(h)(8)(B), the statutory context of the Trade Execution Requirement, related statutory provisions in the Clearing Requirement, and indications of congressional intent, including the rule of construction and statutory objectives in CEA section 5h(e). We also agree with the CFTC's intended outcome from the proposal, which is to "expand[] the scope of swaps that must be traded and executed on SEFs or DCMs" and "directly promote more SEF trading, which is one of the Dodd-Frank Act's statutory goals."[346] In doing so, the CFTC also faithfully abides by the G20 commitment to require trading of all standardized OTC

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341 Id.

342 Id at 71210, fn. 74.

343 Id at 71211.

344 Commodity Futures Trading Commission, Clearing Requirement Determination under Section 2(h) of the CEA; Final Rule, 77 Fed. Reg. 74284, 74285 (December 13, 2012), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2012-29211a.pdf.

345 Proposed § 36.1.

346 Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62058 (proposed November 30, 2018).

derivatives "on exchanges or electronic trading platforms, where appropriate," and to require "clear[ing] through central counterparties."[347]

B. The CFTC's proposed registry of registered entities listing swaps subject to the Trade Execution Requirement promotes transparency and competition between trading venues and should be implemented.

Better Markets supports Proposed § 36.2 requiring the CFTC to "publish and maintain on its website a list that specifies the swaps that are subject to the trade execution requirement under [CEA] section 2(h)(8) of . . . and the [DCMs] and [SEFs] where such swaps are listed for trading."[348] In this regard, Better Markets also supports the CFTC's implementation of the Form TER filing requirement in Proposed § 36.2.[349] These measures increase transparency into the Trade Execution Requirement and promote competition by publishing for the public's benefit all regulated trading venues in which swaps subject to the Trade Execution can be executed.[350] We recommend, however, that the CFTC further promote competition in the derivatives markets by providing the DCOs facilitating clearing of each category of swaps subject to the Clearing Requirement. In each case, we also recommend that the CFTC provide summary information with and hyperlinks to contract, margin, and other specifications that permit the public to compare economic factors relevant to the trading and clearing on the available regulated markets.

V. Conclusion

In a 723-page release fundamentally re-envisioning the Dodd-Frank Act's derivatives market structure, revising longstanding CFTC and CFTC staff guidance on critical issues, amending dozens of SEF regulatory provisions, and requesting public comment on 106 enumerated questions, along with a closely related request for comment, even a 68-page, single-spaced comment letter cannot do justice to the public policy issues at stake.[351] Better Markets has been judicious in addressing elements of the SEF Proposal

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347 See G20 Declaration of the Summit on Financial Markets and the World Economy, The White House President George W. Bush, (November 15, 2008), available at http://www.fsb.org/wp-content/uploads/pr_151108.pdf (stating that prudential regulators must "insist that market participants support exchange traded or electronic trading platforms for CDS contracts; expand derivatives market transparency; and ensure that the infrastructure for OTC derivatives can support growing volumes"); See also G20 Leaders' Statement, the Pittsburgh Summit (September 24-25, 2009), available at http://www.fsb.org/wp-content/uploads/g20_leaders_declaration_pittsburgh_2009.pdf (stating that "[a]ll standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest"). These commitments have been affirmed numerous times since 2009. Yet, as of November 2018, there were platform trading frameworks in only 14 of the G20 jurisdictions, with varying measures of success in bringing regulated trading and pre-trade transparency to the derivatives markets. Financial Stability Board, Implementation and Effects of the G20 Financial Regulatory Reforms: 28 November 2018 Annual Report 1, 13 (Nov. 28, 2018), available at http://www.fsb.org/wp-content/uploads/P281118-1.pdf. See also Department of the Treasury, Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation, 48, available at https://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf ("Market efficiency and price transparency should be improved in derivatives markets by requiring the clearing of standardized contracts through regulated CCPs . . . and by moving the standardized part of these markets onto regulated exchanges and regulated transparent electronic trade execution systems . . . .").

348 17 C.F.R. § 36.2(a).

349 17 C.F.R. § 36.2(b).

350 For this reason, we also support the CFTC's proposed requirement that SEFs and DCMs submit a Form TER concurrently with any § 40.2 or § 40.3 product filing that consists of a swap that is subject to the clearing requirement. See Commodity Futures Trading Commission, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946, 62041(proposed November 30, 2018).

351 Based on our conversations with many market participants, including personnel at or representing banks, exchanges, trading firms, SEFs, and clearing organizations, we continue to believe that the length of the SEF Proposal's public comment period

that, we suspect, may escape notice or receive less attention in the administrative record or may receive one-sided attention demanding a public interest response. However, we emphasize that at least a dozen additional issues demand fulsome public attention and would have received it in a public comment period commensurate with the length, complexity, and importance of the proposed rulemaking. These include, for example, the following:

- The SEF Proposal's elimination of required trading protocols and minimum SEF trading functionalities (e.g., establishment and maintenance of an Order Book), each of which violates the SEF definition in CEA section 1a(50), CEA section 5h, and CEA section 5h(e)'s command that the SEF regulatory framework promote pre-trade transparency and trading on SEFs;

- The SEF Proposal's substantial revision of impartial access requirements, which would permit enablement mechanisms, fragment the markets, reverse longstanding guidance and regulations, and all but ensure continued dealer hegemony in violation of SEF Core Principle 2 and CEA section 5h(e)'s command that the SEF regulatory framework promote trading on SEFs;

- The SEF Proposal's passive acceptance of the practice of post-trade name give-up, which does not support any legitimate risk management objective in connection with cleared, anonymously executed swaps; promotes continued access to privileged liquidity by a very small number of dominant swap dealers, contrary to the statutory purposes and core principles of the SEF regulatory framework; and deters SEF participation on account of trading advantages provided to dealers that collect and analyze counterparty trading information; and

- The SEF Proposal's limitations on prearranged trading and pre-execution communications, which present important and complex execution issues that may violate CEA section 1a(50), CEA section 5h, and CEA section 5h(e) but whose appropriateness ultimately depends on policy judgments made in any final rule adopted as logical outgrowth of the SEF Proposal.

There are some good elements in the SEF Proposal, as noted above. But too many elements would have the effect, in essence, of reinstating an OTC derivatives market structure, which proved remarkably inadequate in the lead-up to the 2008 financial crisis. That is a clear violation of the CEA's statutory directives. Moreover, the proposal risks creating a false confidence in the Dodd-Frank Act and the transformative reforms intended by Congress.

The SEF Proposal would (1) increase, rather than eliminate, the general opacity of the derivatives markets; (2) increase, rather than mitigate, unnecessary operational and credit risks attendant to bilateral derivatives exposures; (3) facilitate, rather than resolve, inconsistencies in and abuses relating to risk-management and sales practices; (4) impede, rather than promote, responsible innovation and fair competition by and between markets and market participants; and (5) increase, rather than reduce, systemic

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denied the public a meaningful opportunity to provide fulsome comment. For a full discussion of the length, complexity, and importance of the SEF Proposal, see Letter from Better Markets to Commodity Futures Trading Commission Re: Swap Execution Facilities and Trade Execution Requirement RIN (3038-AE25); Request for Extension of Public Comment Period (November 8, 2018), available at https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61889&SearchText=.

risk arising from procyclical, correlated, and sudden deteriorations of liquidity and credit quality relating to the lack of transparency and competition in the derivatives markets. In contrast, the SEF framework—properly conceived—would broadly enhance the efficiency, competitiveness, transparency, and liquidity of the swap markets.

As emphasized in the bi-partisan Financial Crisis Inquiry Commission's ("FCIC") report, in the very recent past, U.S. regulators too often have been accepting of unsupported industry assertions and sometimes, a philosophy that markets are best left to self-regulate, which as we have seen, too frequently and repeatedly comes with devastating consequences:

> We conclude widespread failures in financial regulation and supervision proved devastating to the stability of the nation's financial markets. **The sentries were not at their posts, in no small part due to the widely accepted faith in the self-correcting nature of the markets and the ability of financial institutions to effectively police themselves.** More than 30 years of deregulation and reliance on self-regulation by financial institutions, championed by former Federal Reserve chairman Alan Greenspan and others, supported by successive administrations and Congresses, and actively pushed by the powerful financial industry at every turn, had stripped away key safeguards, which could have helped avoid catastrophe. **This approach had opened up gaps in oversight of critical areas with trillions of dollars at risk, such as the shadow banking system and over-the-counter derivatives markets** . . .
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> . . . Yet we do not accept the view that regulators lacked the power to protect the financial system. **They had ample power in many arenas and they chose not to use it** . . . In case after case after case, regulators continued to rate the institutions they oversaw as safe and sound even in the face of mounting troubles, often downgrading them just before their collapse. And where regulators lacked authority, they could have sought it. **Too often, they lacked the political will—in a political and ideological environment that constrained it—as well as the fortitude to critically challenge the institutions and the entire system they were entrusted to oversee.**
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> Changes in the regulatory system occurred in many instances as financial markets evolved. But as the report will show, the financial industry itself played a key role in weakening regulatory constraints on institutions, markets, and products. It did not surprise the Commission that an industry of such wealth and power would exert pressure on policy makers and regulators. From 1998 to 2008, the financial sector expended $2.7 billion in reported federal lobbying expenses; individuals and political action committees in the sector made more than $1 billion in campaign contributions. **What troubled us was the extent to which the nation was deprived of the necessary strength and independence of the oversight necessary to safeguard financial stability** . . .
>
> . . . we clearly believe the crisis was a result of human mistakes, misjudgments, and misdeeds that resulted in systemic failures for which our nation has paid dearly. As you read this report, you will see that specific firms and individuals acted irresponsibly. Yet a crisis of this magnitude cannot be the work of a few bad actors, and such was not the case here. At the same time, the breadth of this crisis does not mean that "everyone is at fault"; many firms and individuals did not participate in the excesses that spawned disaster.
>
> **We do place special responsibility with the public leaders charged with protecting our financial system, those entrusted to run our regulatory agencies, and the chief executives of companies whose failures drove us to crisis. These individuals sought**

and accepted positions of significant responsibility and obligation. Tone at the top does matter and, in this instance, we were let down.

No one said "no."[352]

Thus, as the CFTC seeks to revise the Dodd-Frank Act's market structure reforms, we are hopeful that it will view industry's "public" comments and claims in connection with its proposals with the usual due skepticism. Although industry's self-interested commentary on the SEF regulations is important to receive and consider, it should be taken for what it is—and weighted accordingly. Importantly, the volume of such commentary, reflecting vast industry resources, must not overwhelm or drown out the non-industry comments that will not win a page-count contest but should win a merits-based analysis that prioritizes the public interest.

We cite the FCIC report at length because it is an important reminder of the recent past and the critical issues at stake in this proposal. **The sentries at the CFTC remain at their post.** But all of us must remain mindful of our assumptions about the operations of the markets and the motives and incentives of those requesting changes to regulations that, by and large, have managed to advance—though perhaps not fully achieve at this stage—the CEA's statutory objectives.

Sincerely,

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[352] National Commission on the Causes of the Financial and Economic Crisis in the United States, Financial Crisis Inquiry Report XVIII-XXIII (January 2011), available at https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf. See also A. Tooze, Crashed: How a Decade of Financial Crises Changed the World (2018).