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COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 9, 36, 37, 38, 39, and 43

RIN 3038-AE25

Swap Execution Facilities and Trade Execution Requirement

AGENCY: Commodity Futures Trading Commission.

ACTION: Proposed rule.

SUMMARY: The Commodity Futures Trading Commission ("Commission" or "CFTC") is proposing amendments to regulations relating to the trade execution requirement under the Commodity Exchange Act ("CEA" or "Act") and amendments to existing regulations relating to swap execution facilities ("SEFs") and designated contract markets ("DCMs"). Among other amendments, the proposed rules apply the SEF registration requirement to certain swaps broking entities and aggregators of single-dealer platforms; broaden the scope of the trade execution requirement to include all swaps subject to the clearing requirement under the Act that a SEF or a DCM lists for trading; allow SEFs to offer flexible execution methods for all swaps that they list for trading; amend straight-through processing requirements; and amend the block trade definition. The proposed rules, which also include non-substantive amendments and various conforming changes to other Commission regulations, reflect the Commission's enhanced knowledge and experience with swaps trading characteristics and would further the Dodd-Frank Act's statutory goals for SEFs, *i.e.*, promote more SEF trading and pre-trade price transparency in the swaps market. Further, the proposed rules are intended to

strengthen the existing swaps regulatory framework by reducing unnecessary complexity, costs, and other burdens that impede SEF development, innovation, and growth.

DATES: Comments must be received on or before [INSERT DATE 75 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments, identified by "Swap Execution Facilities and Trade Execution Requirement" and RIN 3038-AE25, by any of the following methods:

- CFTC Comments Portal: *https://comments.cftc.gov*. Select the "Submit Comments" link for this rulemaking and follow the instructions on the Public Comment Form.
- Mail: Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.
- Hand Delivery/Courier: Follow the same instructions as for Mail, above.

Please submit your comments using only one of these methods. To avoid possible delays with mail or in-person deliveries, submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, be accompanied by an English translation. Comments will be posted as received to *https://comments.cftc.gov*. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act ("FOIA"), a petition for confidential treatment of

the exempt information may be submitted according to the procedures established under § 145.9 of the Commission's regulations.[1]

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all submissions from *https://comments.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the FOIA.

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[1] 17 CFR 145.9.

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I. Background and Introduction

A. Statutory Background: The Dodd-Frank Act

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[2] amended the Commodity Exchange Act ("CEA" or "Act")[3] to establish a comprehensive new swaps regulatory framework that includes the registration and the oversight of swap execution facilities ("SEFs").[4] As amended, CEA section 1a(50) defines a SEF as a trading system or platform that allows multiple participants to execute or trade swaps with multiple participants through any means of interstate

[2] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, tit. VII, 124 Stat. 1376 (2010) (codified as amended in various sections of 7 U.S.C.), *available at* https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2013-12242a.pdf.
[3] 7 U.S.C. 1 *et seq*.
[4] 7 U.S.C. 7b-3 (adding a new CEA section 5h to establish a registration requirement and regulatory regime for SEFs).

commerce .[5] CEA section 5h(a)(1) establishes the SEF registration requirement, which requires an entity to register as a SEF prior to operating a facility for the trading or processing of swaps.[6] CEA section 5h(f) requires registered SEFs to comply with fifteen core principles.[7] Further, the trade execution requirement in CEA section 2(h)(8) provides that swap transactions that are subject to the clearing requirement in CEA section 2(h)(1)(A)[8] must be executed on a DCM, SEF, or a SEF that is exempt from registration pursuant to CEA section 5h(g) ("Exempt SEF"),[9] unless no DCM or SEF[10] "makes the swap available to trade" or the related transaction is subject to a clearing requirement exception pursuant to CEA section 2(h)(7).

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[5] As amended by the Dodd-Frank Act, CEA section 1a(50) specifically defines a "swap execution facility" 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 facilitates the execution of swaps between persons; and is not a designated contract market. 7 U.S.C. 1a(50).

[6] CEA section 5h(a)(1) states that 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 under section 5h. 7 U.S.C. 7b-3(a)(1).

[7] 7 U.S.C. 7b-3(f).

[8] 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 CFR part 50.

[9] The Commission notes that CEA section 2(h)(8)(A)(ii) contains a typographical error that specifies CEA section 5h(f), rather than CEA section 5h(g), as the provision that allows the Commission to exempt a SEF from registration. Where appropriate, the Commission corrects this reference in the discussion herein.

[10] CEA sections 2(h)(8)(A)(i)-(ii) provide that with respect to transactions involving swaps subject to the clearing requirement, counterparties shall execute the transaction on a board of trade designated as a contract market under section 5; or execute the transaction on a swap execution facility registered under 5h or a swap execution facility that is exempt from registration under section 5h(g) of the Act. Given this reference in CEA section 2(h)(8)(A)(ii), the Commission accordingly interprets "swap execution facility" in CEA section 2(h)(8)(B) to include a swap execution facility that is exempt from registration pursuant to CEA section 5h(g).

B. Regulatory History: The Part 37 Rules

Pursuant to its discretionary rulemaking authority in CEA sections 5h(f)(1) and 8a(5), the Commission identified the relevant areas in which the statutory SEF framework would benefit from additional rules or regulations.[11] Accordingly, the Commission adopted the part 37 rules to implement a regulatory framework for SEFs and for the trading and execution of swaps[12] on such facilities.[13] Among other provisions, subpart A to part 37 applies the SEF registration requirement to facilities that meet the statutory SEF definition; specifies a minimum trading functionality that a SEF must offer to participants for all listed swaps, *i.e.*, an "Order Book";[14] and specifies the process for a SEF to make a swap "available to trade" ("MAT"), *i.e.*, required to be executed on a SEF or DCM pursuant to the trade execution requirement.[15] Subpart A also defines swaps subject to the trade execution requirement as "Required Transactions" and requires a SEF to offer either (i) an Order Book or (ii) a request-for-quote system that sends a request-for-quote to no less than three unaffiliated market participants and operates in conjunction with an Order Book ("RFQ System") for the execution of these

[11] To implement the SEF core principles, Core Principle 1 provides that the Commission may, in its discretion, determine by rule or regulation the manner in which SEFs comply with the core principles. 7 U.S.C. 7b-3(f)(1)(B).

[12] The Commission notes that, unless otherwise stated, the terms "trades," "transactions," and "swaps" are used interchangeably in the discussion herein.

[13] Core Principles and Other Requirements for Swap Execution Facilities, 78 FR 33476 (Jun. 4, 2013) ("SEF Core Principles Final Rule"); Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available to Trade, Swap Transaction Compliance and Implementation Schedule, and Trade Execution Requirement Under the Commodity Exchange Act, 78 FR 33606 (Jun. 4, 2013) ("MAT Final Rule").

[14] 17 CFR 37.3(a)(2). An Order Book is defined as (i) an "electronic trading facility," as that term is defined in CEA section 1a(16); (ii) a "trading facility," as that term is defined in CEA section 1a(51); or (iii) a trading system or platform in which all market participants have the ability to enter multiple bids and offers, observe or receive bids and offers entered by other market participants, and transact on such bids and offers. 17 CFR 37.3(a)(3).

[15] 17 CFR 37.10. Given that swaps subject to the trade execution requirement may also be executed on a DCM, the Commission adopted the same process for a registered DCM to make a swap "available to trade" in part 38. 17 CFR 38.12. Accordingly, discussion in this notice with respect to the application of the trade execution requirement or the MAT process to SEFs should be interpreted to also apply to DCMs.

transactions.[16] Swaps that are not subject to the trade execution requirement are defined as "Permitted Transactions," for which a SEF may offer any execution method and for which market participants may voluntarily trade on a SEF.[17] The Commission's regulations specify additional requirements that correspond to the use of an Order Book or RFQ System to execute Required Transactions.[18] Subparts B though O set forth regulations that further implement each of the fifteen SEF core principles in CEA section 5h(f). Appendix B provides further guidance and acceptable practices associated with the SEF core principles.[19]

These rules reflect a more limited and prescriptive regulatory approach to implementing the statutory provisions and promoting the statutory goals of section 5h of the Act, *i.e.*, promoting the trading of swaps on SEFs and promoting pre-trade price transparency in the swaps market.[20] In particular, the Commission focused on achieving pre-trade price transparency by mandating a minimum trading functionality requirement for all swaps listed on a SEF and two specific, limited execution methods for Required Transactions. The Commission adopted the Order Book requirement both as a minimum trading functionality for SEF registration and as an execution method for Required Transactions.[21] To provide some execution flexibility for Required Transactions,[22] the

[16] 17 CFR 37.9(a). With the exception of block trades, as defined under § 43.2, Required Transactions must be executed on a SEF's Order Book or RFQ System. 17 CFR 37.9(a)(2)(i).
[17] 17 CFR 37.9(c).
[18] *See infra* notes 85 (15-second time delay for the entry of pre-arranged or pre-negotiated transactions to an Order Book) and 242 (additional requirements for RFQ Systems) and accompanying discussion.
[19] 17 CFR part 37 app. B.
[20] 7 U.S.C. 7b-3(e) (specifying the rule of construction for CEA section 5h).
[21] 17 CFR 37.3(a)(2) (minimum trading functionality requirement); 17 CFR 37.9(a)(2)(i)(A) (Required Transactions requirement).
[22] SEF Core Principles Final Rule at 33564-65.

Commission also allowed SEFs to offer an RFQ System, as described above.[23] To further the goal of pre-trade price transparency with respect to trading via an RFQ System, however, the Commission required that an RFQ must be submitted to three unaffiliated market participants and that a requester receive applicable firm bids and offers from the Order Book in addition to any RFQ responses.[24] Recognizing that only certain swaps are well-suited to be traded and executed through an Order Book or RFQ System, the Commission interpreted the trade execution requirement in CEA section 2(h)(8), in particular the phrase "makes the swap available to trade," to have a scope of application that is consistent with the use of these methods. Accordingly, the Commission interpreted the phrase, which the Act does not otherwise define, to implement a voluntary MAT process for determining the swaps that must be executed on a SEF; this process primarily focuses on whether a swap has "sufficient trading liquidity" to be executed via an Order Book or RFQ System.[25]

The Commission noted that the prescribed trading methods, such as the Order Book, are consistent with the SEF definition in CEA section 1a(50) of the Act as they allow multiple market participants to post bids or offers and accept bids and offers that are transparent to multiple market participants.[26] The Commission stated that the RFQ System is consistent with the SEF definition because it requires market participants to be able to access multiple market participants, but not necessarily the entire market.[27] Further, in response to commenters' feedback that the Commission's approach is

[23] 17 CFR 37.9(a)(3).
[24] SEF Core Principles Final Rule at 33497, 33499.
[25] MAT Final Rule at 33609 (noting that a MAT determination may focus on whether a swap is sufficiently liquid to be subject to the trade execution requirement).
[26] SEF Core Principles Final Rule at 33501.
[27] *Id*. at 33496.

inconsistent with the Act, the Commission stated that the limited execution methods for Required Transactions are consistent with the phrase "through any means of interstate commerce" in the SEF definition because a SEF "may for purposes of execution and communication use 'any means of interstate commerce,' including, but not limited to, the mail, internet, email, and telephone, provided that the chosen execution method satisfies the requirements … for Order Books or … for [RFQ Systems]."[28] The Commission also noted that a SEF may provide any method of execution for Permitted Transactions as further justification for its approach under the Act.[29]

In adopting a regulatory framework that would effectuate the statutory SEF provisions and goals, the Commission relied in part upon its experience with the futures market, including DCM oversight and DCM core principles implementation.[30] While the Commission did provide flexibility for certain swap requirements relative to the DCM rules,[31] the Commission sought, where possible, to harmonize SEF regulations with DCM regulations based on the similarities in the statutory core principles between SEFs and DCMs, and the ability of both types of entities to offer swaps for trading and execution.[32]

1. Challenges of Existing Regulatory Approach

The Commission's existing regulatory approach has transitioned some degree of swaps trading and market participants to SEFs, but has also created several challenges for swaps trading on SEFs, as described below.

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[28] *Id*. at 33501.
[29] *Id*. at 33484.
[30] *Id*. at 33477.
[31] For example, the RFQ System requirement for Required Transactions on SEFs is less restrictive than the RFQ-to-all approach that is used by some DCMs. The Commission decided that the former approach was more appropriate for SEFs due to the less standardized nature of the swaps market. SEF Core Principles Final Rule at 33497 n.270.
[32] *Id*. at 33478, 33553 (noting the similarities between the statutory requirements for SEFs and DCMs).

a. Lack of MAT Determinations

The voluntary, SEF-driven MAT determination process has resulted in a limited set of products that are required to be executed on SEFs. Since 2014, SEFs have submitted a limited number of swaps, relative to the scope of swaps subject to the clearing requirement, as "available to trade" to the Commission.[33] The swaps that SEFs have submitted—"on-the-run" index credit default swaps ("CDS") and fixed-to-floating interest rate swaps ("IRS") in benchmark tenors—are generally the most standardized and liquid swaps contracts.[34] Beyond this initial set of MAT determinations, the Commission has not received any filings for additional swaps despite the subsequent expansion of the clearing requirement.[35] The lack of additional determinations is partly

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[33] For a list of MAT determinations that have been submitted to the Commission, *see* CFTC, Industry Oversight, Industry Filings, Swaps Made Available to Trade Determination, https://sirt.cftc.gov/sirt/sirt.aspx?Topic=%20SwapsMadeAvailableToTradeDetermination. For a current list of swaps that have been made "available to trade" and are subject to the trade execution requirement, *see* CFTC, Industry Oversight, Industry Filings, Swaps Made Available to Trade, https://www.cftc.gov/sites/default/files/idc/groups/public/@otherif/documents/file/swapsmadeavailablechart.pdf. For a list of swaps subject to the clearing requirement, *see* 17 CFR 50.4; *see also* CFTC, Industry Oversight, Industry Filings, Swaps Subject to Clearing Requirement, https://www.cftc.gov/sites/default/files/idc/groups/public/@otherif/documents/ifdocs/clearingrequirementcharts9-16.pdf.

[34] *See, e.g.*, Bloomberg SEF, Submission No. 2013-R-9, Bloomberg SEF LLC – Made Available to Trade ("MAT") Submission of Certain Credit Default Swaps ("CDS") and Interest Rate Swaps ("IRS") pursuant to [CFTC] Regulation 40.6 at 3 (Dec. 5, 2013) (stating that its MAT determination consists of only the most standardized and liquid swaps, which represent a majority of market traded volume), https://www.cftc.gov/sites/default/files/stellent/groups/public/@otherif/documents/ifdocs/bsefmatdetermltr120513.pdf; TW SEF,TW SEF LLC – Clarification and Amendment to Self-Certification for Swaps to be Made Available to Trade" at 8 (Nov. 29, 2013) (stating that its MAT determinations with respect to IRS represent the "standard benchmarks, which are the most standard, liquid, and transparent of the IRS market, and trade with market-accepted, standard, plain vanilla dates), https://www.cftc.gov/sites/default/files/stellent/groups/public/@otherif/documents/ifdocs/twsefamendmatltr112913.pdf.

[35] In 2016, the Commission expanded the clearing requirement for IRS in the four classes (fixed-to-floating swaps, basis swaps, forward rate agreements, overnight index swaps) to additional currencies. CFTC, Press Releases, Release No. 7457-16, CFTC Expands Interest Rate Swap Clearing Requirement, https://www.cftc.gov/PressRoom/PressReleases/pr7457-16 (Sept. 28, 2016). *See also* Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps, 81 FR 71202 (Oct. 14, 2016) ("Second Clearing Determination Final Rule").

attributable to market participants' concerns over the Commission's required methods of execution for Required Transactions.[36] Based on those concerns, SEFs have not pursued making additional swaps subject to the trade execution requirement. This lack of additional submissions has effectively limited the number of swaps that must be executed on SEFs which has limited the amount of trading and liquidity formation occurring on SEFs.

b. Swaps Market Characteristics

Over the course of the part 37 implementation process, the Commission has gained greater familiarity with the swaps markets, in particular the nature of the products and how market participants trade and execute those products. Based on what it has learned, the Commission believes that the existing regulatory framework has contributed to the limited amount of swaps that are subject to the trade execution requirement, and therefore, the limited scope of swaps trading that occurs on SEFs.

Swaps consist of many highly variable terms and conditions beyond price and size that can be negotiated and tailored to suit a market participant's specific and unique needs. While some swaps are relatively standardized, others are customized and consist of innumerable permutations, making them generally less standardized and more bespoke than futures contracts. Given the ability to customize swaps to address specific and often large risks that cannot be offset through more standardized instruments, the swaps market is generally comprised of a relatively concentrated number of sophisticated market participants in contrast to the futures market. In this regard, the Commission notes that

[36] *See* CFTC Public Roundtable: The Made Available to Trade Process, 151-152, 192-193 (July 15, 2015), https://www.cftc.gov/idc/groups/public/%40newsroom/documents/file/transcript071515.pdf ("2015 MAT Roundtable") (discussing the prescriptive nature of the required methods of execution and noting the relationship to the MAT determination process).

CEA section 2(e) limits swaps trading on SEFs to "eligible contract participants" ("ECPs"), as defined by CEA section 1a(18).[37] These swaps market characteristics contribute to varying liquidity profiles for swaps that range from relatively illiquid to episodic to relatively liquid.

Historically, these particular characteristics have contributed to the use of a variety of execution methods—electronic, voice-based, or a hybrid of both ("voice-assisted")—by market participants. Utilizing one execution method or another depends on considerations such as the type of swap, transaction size, complexity, the swap's liquidity at a given time, the number of potential liquidity providers, and the associated desire to minimize potential information leakage and front-running risks. For swaps with standard tenors that are relatively liquid, market participants may utilize a method of trading and execution, such as an electronic order book platform, that disseminates trading interests to all other market participants on the platform. Trading and execution in less standardized products, however, generally occur on systems or platforms that are more discreet in disseminating trading interests, such as auction platforms. The Commission's existing approach to required execution methods, as described above, creates a tension with swaps market characteristics that necessitate flexible execution methods. This tension has otherwise hindered the expansion of the trade execution requirement.

c. Operational Complexities and Costs

The Commission has learned that its approach to other part 37 rules may have imposed certain burdens on SEFs, including operating complexities and costs that have

[37] 7 U.S.C. 2(e); 7 U.S.C. 1a(18).

impeded development, innovation, and growth in the swaps market. SEFs have indicated that they are unable to comply with some of these requirements because they are impractical or unachievable due to technology limitations or incompatible with existing market practices. For example, as discussed further below, SEFs have informed the Commission that the confirmation requirement for uncleared swaps under § 37.6(b) and the electronic analysis capability requirements with respect to audit trail data for voice orders under § 37.205 have been operationally difficult and impractical to implement.[38] Even where SEFs have been able to comply with some of the requirements, they have asserted that the compliance costs are high and compliance is unnecessary in helping them satisfy their self-regulatory obligations and the SEF core principles. For example, SEFs have noted the high costs of the financial resources requirements imposed by the Core Principle 13 regulations.[39] SEFs and market participants have attributed the limited development, innovation, and growth of SEFs to these ongoing burdens.

As a result of these burdens, the Commission believes that a significant amount of swaps liquidity formation activity occurs away from registered SEFs in a manner similar to the pre-Dodd-Frank Act swaps trading environment. These examples include (i) entities that aggregate single-dealer platforms to allow market participants to obtain indicative or firm pricing and execute swaps with multiple single-dealer liquidity providers away from SEFs; and (ii) swaps broking entities, including interdealer

[38] *See infra* Section IV.F.—§ 37.6—Enforceability (discussion of SEF confirmation requirements); Section VII.D.—§ 37.205—Audit Trail (discussion of SEF audit trail requirements).
[39] *See* Letter from Wholesale Markets Brokers' Association, Americas ("WMBAA"), Swap Execution Facility Regulations, Made Available to Trade Determinations, and Swap Trading Requirements at 5 (Mar. 11, 2016) ("2016 WMBAA Letter"); *see also* CFTC Letter No. 17-25, Division of Market Oversight Guidance on Calculating Projected Operating Costs By Designated Contract Markets and Swap Execution Facilities (Apr. 28, 2017) ("CFTC Letter No. 17-25").

brokers[40] that facilitate swaps trading between multiple market participants through non-registered voice or electronic platforms. While some of these interdealer brokers are affiliated with registered SEFs, the Commission understands that they have nevertheless maintained a bifurcated operating structure under which a SEF primarily executes and processes orders that have already been negotiated or arranged on an affiliated broker platform, in effect limiting a SEF's role to a swaps transaction booking and processing engine.[41] By operating in this manner, the Commission believes that many entities have been able to avoid the burdens arising from SEF registration and compliance under part 37.

When necessary or appropriate to mitigate these burdens in the course of implementing part 37, Commission staff has issued various guidance and time-limited no-action relief to SEFs and market participants. The no-action relief has afforded additional time for compliance with certain part 37 regulations and related procedures or has provided an opportunity to determine whether a longer-term regulatory solution—such as those proposed in this notice—is warranted.[42] Where compliance could not be achieved or impractical compliance burdens arose from the existing part 37 rules, SEFs may have been impeded from pursuing beneficial market initiatives, such as developing

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[40] The Commission believes that most of these swaps broking entities are currently registered with the Commission as introducing brokers ("IBs"). *See infra* note 340 and accompanying discussion.

[41] The Commission notes that these swaps broking entities and their affiliated SEFs primarily operate as part the "dealer-to-dealer" segment of the swaps market, which primarily facilitates swaps trading between swap dealers. *See infra* Section VII.A.1.a.(1)(i).—Eligibility and Onboarding Criteria (discussion of impartial access requirements).

[42] *See infra* notes 223 (no-action relief from existing § 37.6(b) confirmation requirements for uncleared swap transactions executed on a SEF), 433 (no-action relief from existing § 37.9 and § 37.203(a) with respect to the correction of error trades on SEFs), 474 (no-action relief from existing § 37.205(a) with respect to capturing of trade allocation information in a SEF transaction history database), 822 (no-action relief from existing § 37.1501(f) with respect to SEF annual compliance report filing requirements), 898 (no-action relief from certain "block trade" definitional requirements under existing § 43.2) and accompanying discussion.

new trading systems and protocols to attract greater swaps liquidity. The Commission believes that it is appropriate to address these issues as part of the changes to the existing regulations proposed in this notice.

C. Proposed Approach

Given the challenges described above and the Commission's enhanced knowledge and experience from implementing part 37, the Commission is proposing to strengthen its swaps trading regulatory framework, while still effectuating the statutory SEF provisions and better promoting the statutory SEF goals. The Commission's proposed approach also more appropriately accounts for swaps market characteristics and should reduce certain complexities and costs that have contributed to a significant amount of swaps liquidity formation occurring away from SEFs; limited the scope of swaps that are subject to the trade execution requirement; and impeded SEF development, innovation, and growth. In this regard, the Commission proposes a simple but comprehensive approach that provides SEFs with flexibility, where appropriate, to calibrate their trading and compliance functions based on their respective trading operations and markets. The Commission believes that this proposed approach will attract greater liquidity formation on SEFs.

First, the Commission aims to effectuate the SEF registration requirement to ensure that multiple-to-multiple *trading* of swaps occurs on a SEF by requiring that swaps broking entities and certain single-dealer aggregator platforms register as SEFs (emphasis added). In particular, consistent with the statutory SEF provisions and goals, this proposed rulemaking would apply the SEF registration requirement in CEA section 5h(a)(1) and § 37.3(a) to swaps broking entities, including interdealer brokers, that are currently registered with the Commission as IBs, and their personnel currently facilitating

swaps trading away from SEFs. Based on its experience and observation of market developments since the adoption of part 37, the Commission has witnessed the various ways in which swaps broking entities, including interdealer brokers, have structured themselves to facilitate swaps trading, and therefore liquidity formation, outside of the existing SEF regulatory framework.

Second, the Commission aims to facilitate increased trading and liquidity on SEFs by proposing a revised interpretation of the trade execution requirement that is consistent with CEA section 2(h)(8). The Commission's proposed interpretation would apply the trade execution requirement to all swaps that are both subject to the clearing requirement under section 2(h)(1) of the Act and listed for trading on a SEF. As a result of this approach, the Commission would also withdraw the existing voluntary MAT process.

The 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. Accordingly, the Commission also proposes to allow a SEF to offer any method of execution for all swaps trading and execution, rather than only an Order Book or RFQ System.

Rather than dictating certain execution methods for Required Transactions, the Commission's proposed flexible approach would enable SEFs to provide, and ultimately allow market participants to choose, execution methods that are appropriate for the liquidity and other characteristics of particular swaps. The Commission's approach should also promote pre-trade price transparency in the swaps market by allowing

execution methods that maximize participation and concentrate liquidity during times of episodic liquidity. The Commission believes that providing flexibility in execution methods will allow the swaps market to continue to naturally evolve and allow SEFs to innovate and provide more efficient, transparent, and cost-effective means of trading and execution. The Commission also proposes to eliminate the minimum trading functionality requirement, which should reduce the costs incurred by SEFs to operate and maintain order books that have not attracted significant volumes. In lieu of specific execution method requirements, the Commission is proposing general disclosure-based trading and execution rules that would apply to any execution method offered by a SEF.

In conjunction with allowing SEFs to offer more flexible execution methods, the Commission is proposing new rules for certain SEF personnel—"SEF trading specialists"—that constitute part of a SEF's trading system or platform. The proposed rules require SEFs to adopt minimum proficiency testing and ethics training requirements to ensure that their trading specialists possess and maintain an adequate level of technical knowledge and understand their ethical responsibilities in customer trading or execution and fostering liquidity formation. The proposed rules would also require SEFs to adopt trading conduct standards and a duty of supervision. With the ability to offer more flexible execution methods for all swaps, in particular those that involve discretion by trading specialists in handling trading or execution, the Commission believes that these proposed requirements are necessary to enhance professionalism in the swaps market and to promote market integrity and fairness. Further, the proposed requirements would mandate requisite levels of knowledge and competence that are commensurate to other

similar requirements established for personnel in major trading markets, such as futures and equities.[43]

The Commission is also proposing a series of amendments to additional part 37 regulations that implement the SEF core principles. These proposed amendments would allow a SEF to better tailor its compliance and regulatory oversight programs to its trading operations and markets. The Commission believes that these proposed revisions are critical to the ability of SEFs to offer the diverse types of execution methods that would be available to them under this proposal. Further, the proposed rules would streamline and refine some of the existing prescriptive requirements applicable to SEFs to better reflect technological capabilities and existing market practices in the swaps market. The proposed rules would also seek to reduce unnecessary compliance costs while still maintaining robust compliance programs and consistency with the SEF core principles. The ability to tailor compliance and oversight programs is consistent with the "reasonable discretion" that Core Principle 1 provides SEFs to comply with the core principles and mitigates compliance challenges that SEFs have encountered in implementing part 37.[44]

With respect to existing staff guidance and staff no-action relief, the Commission would adopt or codify such guidance or relief where appropriate. Providing a simple, but more comprehensive regulatory approach would help mitigate barriers for market participants to trade and execute further on SEFs, which would in turn better promote the statutory SEF goals.

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[43] *See infra* note 355.

[44] Core Principle 1 states that, unless otherwise determined by the Commission by rule or regulation, a SEF shall have reasonable discretion in establishing the manner in which it complies with the SEF core principles." 7 U.S.C. 7b-3(f)(1)(B).

Finally, the proposed rules include non-substantive amendments and various conforming changes to relevant provisions in the Commission's regulations.

The Commission believes that the proposed revisions to the part 37 framework are consistent with the statutory SEF provisions and should serve to advance swaps trading on SEFs. The proposed rules are designed to more appropriately account for swaps market characteristics, especially with respect to the use of a wider array of different execution methods to trade and execute a broad scope of swaps with varying liquidity characteristics. Accordingly, the proposed rules are expected to better promote the development, innovation, and growth of the swaps market, with the intent of attracting liquidity formation onto SEFs.

D. Summary of Proposed Revisions

As a general overview of the major changes described in this notice, the Commission is proposing:

- Registration: A proposed interpretation to apply the statutory SEF registration requirement and the definition of "swap execution facility" in CEA sections 5h(a)(1) and 1a(50), respectively, to certain swaps broking entities, including interdealer brokers, as well as aggregators of single-dealer platforms. The proposed rules also include revisions to simplify the registration process by streamlining Form SEF.
- Trade Execution Requirement: A revised interpretation of the trade execution requirement in CEA section 2(h)(8) and new rules based upon that interpretation that (i) broaden the scope of the trade execution requirement; (ii) create a compliance schedule for the expanded requirement; and (iii) provide exemptions from the requirement for certain types of swap transactions pursuant to CEA section 4(c).

Further, the Commission is proposing to require each SEF to submit a Form TER that specifies those swaps that it lists for trading that are subject to the clearing requirement.

- Execution Methods: New general, disclosure-based trading and execution rules under Core Principle 2 that apply to any execution method offered by a SEF. These 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. Further, the Commission is also proposing to limit the scope of trading-related communications that SEF participants may conduct away from a SEF's trading system or platform.
- Proficiency: In conjunction with allowing SEFs to offer more flexible methods of execution for swaps subject to the trade execution requirement, the Commission is also proposing new rules under Core Principle 2 for SEF trading specialists. The proposed rules would benefit SEF participants by strengthening market integrity and fairness through requirements for SEFs to establish proficiency testing and ethics training, trading conduct standards, and a duty of supervision.
- Swap Documentation: Amendments to the existing § 37.6(b) confirmation requirement that would allow a SEF to provide a "trade evidence" record for an uncleared swap that serves as evidence of a legally binding swap transaction, but may be supplemented by counterparties with additional terms based on previously negotiated underlying agreements.

- Impartial Access: Modifications to the existing impartial access rules under § 37.202 that would allow a SEF to structure participation criteria and trading practices in a manner that aligns with the current swaps market structure.
- Self-Regulatory Oversight: Amendments to §§ 37.203-206 under Core Principle 2 that provide a SEF with the ability to, among other things, (i) tailor its rule enforcement program and disciplinary procedures and sanctions to the characteristics of its trading operations and market; (ii) develop an audit trail surveillance system that is appropriate to the types of available execution methods it offers; and (iii) choose other additional types of regulatory service providers to assist with fulfilling its oversight duties.
- Product Guidance: Additional guidance, pursuant to Core Principle 3, for a SEF to demonstrate that the swaps that it lists for trading are not readily susceptible to manipulation.
- Straight-Through Processing: Amendments and clarifications to the SEF straight-through processing requirements that better reflect existing swaps market practices.
- Financial Resources: Amendments to apply the existing Core Principle 13 financial resource requirements in a more practical manner to SEF operations. The proposed rule changes include amendments to the existing six-month liquidity requirement and the addition of new acceptable practices that provide further guidelines to SEFs for making a reasonable calculation of their projected operating costs.
- Chief Compliance Officer: Amendments to Core Principle 15 regulations that streamline existing requirements for the chief compliance officer ("CCO") position;

allow SEF management to exercise discretion in CCO oversight; and simplify the preparation and submission of the required annual compliance report.

E. Consultation with Other U.S. Financial Regulators

In developing these rules, the Commission has consulted with the Securities and Exchange Commission, pursuant to section 712(a)(1) of the Dodd-Frank Act.[45]

II. Part 9—Rules Relating to Review of Exchange Disciplinary, Access Denial or Other Adverse Actions

The Commission is proposing non-substantive amendments to part 9 of the Commission's regulations that conform to proposed amendments to § 37.206—Disciplinary procedures and sanctions. Accordingly, the Commission discusses those proposed amendments to part 9 in Section VII.F. of this notice in conjunction with its discussion of the proposed amendments to § 37.206.

III. Part 36—Trade Execution Requirement

The Commission is proposing new rules under part 36 of the Commission's regulations to implement a proposed revised interpretation of the trade execution requirement in CEA section 2(h)(8), which would broaden the scope of the requirement to include additional swaps. The Commission discusses the proposed implementing rules in Section IV.I.4.a. of this notice in conjunction with its discussion of (i) the proposed adoption of flexible means of execution and elimination of the minimum trading functionality under § 37.3(a)(2); (ii) the prescribed execution methods under § 37.9; and (iii) the MAT process (and corresponding trade execution compliance schedule) under § 37.10, § 37.12, and §§ 38.11-12.[46] Further, the Commission discusses the proposed Form

[45] Dodd-Frank Act, Pub. L. 111-203, tit. VII, § 712(a)(1), 124 Stat. 1376 (2010).
[46] *See infra* Section IV.I.4.a.—§ 36.1(a)—Trade Execution Requirement.

TER submission, the proposed compliance schedule for the expanded requirement, and proposed exemptions from the requirement in Section XXI. of this notice.

IV. Part 37—Subpart A: General Provisions

A. § 37.1—Scope

Section 37.1 currently clarifies that part 37 applies to every SEF that is registered or is applying to become registered as a SEF with the Commission. Section 37.1 also clarifies that part 37's applicability does not affect the eligibility of a registered SEF or a SEF applicant to operate as either a DCM under part 38 of the Commission regulations or a swap data repository ("SDR") under part 49 of the Commission's regulations.

The Commission proposes a non-substantive amendment to § 37.1. The Commission has not identified any provisions in part 37 that would preclude a registered SEF from being eligible to operate as a DCM or an SDR; accordingly, the clarifying language may create unnecessary ambiguity. Therefore, the Commission proposes a non-substantive amendment to eliminate the existing language to avoid any potential confusion.

B. § 37.2—Applicable Provisions and Definitions[47]

1. § 37.2(a)—Applicable Provisions

Section 37.2 states that a SEF must comply with part 37 and all other applicable Commission regulations, including any related definitions and cross-referenced sections. Section 37.2 also identifies certain specific pre-Dodd-Frank Act provisions whose applicability to SEFs may otherwise not be apparent—in particular, § 1.60 and part 9 of

[47] The Commission proposes to retitle § 37.2 to "Applicable provisions and definitions" from "Applicable provisions" based on the proposed addition of § 37.2(b) described below.

the Commission's regulations.[48] The Commission proposes to adopt a non-substantive amendment to eliminate the reference to part 9; the Commission notes that it has since adopted amendments to part 9 to conform to the relevant part 37 regulations.[49]

2. § 37.2(b)—Definition of "Market Participant"

The Commission proposes a new provision under § 37.2(b) to define "market participant," as the term is currently used in part 37, to clarify a SEF's jurisdiction over the various participants that may be involved in trading or executing swaps on its facility. In the preamble to the SEF Core Principles Final Rule, the Commission specified that a "market participant" includes any "person that directly or indirectly effects transactions on the SEF. [The definition] includes persons with trading privileges on the SEF and persons whose trades are intermediated."[50] This term applies to several part 37 rules and triggers certain obligations under the Core Principle 2 regulations, which set forth a SEF's self-regulatory responsibilities. For example, § 37.206 requires a SEF to establish participation rules that broadly impose a SEF's disciplinary authority across different categories of participants, including market participants.[51]

In practice, SEFs have created various participation categories, including "direct access," "direct market access," and "sponsored access" to describe how persons connect

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[48] Section 1.60 sets forth requirements for futures commission merchants ("FCMs") and DCMs to submit documents requested by the Commission that have been filed in any material legal proceeding in which the FCM or DCM is a party. 17 CFR 1.60. For a description of the Commission's part 9 regulations, *see infra* Section VII.F.—Part 9—Rules Relating to Review of Exchange Disciplinary, Access Denial or Other Adverse Actions.

[49] Technical Amendments to Rules on Registration and Review of Exchange Disciplinary, Access Denial, or Other Adverse Actions, 83 FR 1538 (Jan. 12, 2018). The Commission notes that it is also proposing additional amendments to part 9 in this notice that conform to the proposed amendments to the Core Principle 2 regulations discussed herein. The Commission also proposes to renumber this provision to subsection (a) based on the proposed addition of § 37.2(b) described below.

[50] SEF Core Principles Final Rule at 33506. *See also* Division of Market Oversight Guidance on Swap Execution Facility Jurisdiction (Feb. 10, 2014) ("2014 Staff Jurisdiction Guidance").

[51] 17 CFR 37.206.

to their trading systems or platforms. For example, the Commission understands that "direct access" generally refers to participants who have been granted trading privileges by a SEF and utilize their own proprietary means, *e.g.*, trading credentials and/or front-end interface, to participate directly on the SEF.[52] In contrast, "direct market access" or "sponsored access" generally describe arrangements in which a person uses a SEF participant's means, including trading credentials and/or front-end systems, to participate directly on the SEF. For example, many SEFs allow persons to access their systems or platforms by using the credentials and/or front-end functionality provided by a SEF participant, such as a futures commission merchant ("FCM") serving as a clearing member on the SEF or an IB.[53] Finally, some persons may participate on a SEF via an agency execution model by directing an intermediary, *e.g.*, an FCM or an IB, to submit orders or request quotes on their behalf.

Notwithstanding these categories, SEFs have generally relied on the existing description of "market participant" in the SEF Core Principles Final Rule preamble to establish jurisdiction over all of these participants that access the SEF and trade swaps on a direct or indirect basis. Given this established reliance and the continued use of this term under the proposed rules, the Commission seeks to codify the definition of "market participant" in part 37. The Commission proposes to define "market participant" as any person who accesses a SEF (i) through direct access provided by a SEF; (ii) through access or functionality provided by a third-party; or (iii) through directing an intermediary that accesses a SEF on behalf of such person to trade on its behalf. As a

[52] The Commission notes that "direct access" also refers to participants who may onboard and utilize a SEF's own front-end application to trade swaps on the SEF's systems or platforms.
[53] The Commission notes that some SEFs refer to such persons as "customers" of a SEF trading participant.

threshold matter, the Commission notes that since these persons are currently considered "market participants," they are already subject to a SEF's jurisdiction. The Commission believes that persons accessing a SEF through the various means described above interact with other market participants on the SEF and have the ability to engage in abusive trading practices. Therefore, they should continue to be subject to a SEF's jurisdiction, including disciplinary procedures and recordkeeping obligations.[54]

a. Applicability of § 37.404(b) to Market Participants

The Commission notes in particular that this proposed definition of "market participant" would apply to the recordkeeping requirements under § 37.404(b). Section 37.404(b) requires a SEF to adopt rules that require its market participants to keep records of their trading, including records of their activity in any index or instrument used as a reference price, the underlying commodity, and related derivatives markets.[55] Participants who trade on a SEF via direct access and participants who use the access or functionality of another participant to trade on a SEF have primary access to these types of records of their own trading. Further, the Commission believes persons who direct an intermediary to trade on their behalf are best situated to maintain the records required by § 37.404(b). The Commission understands that such intermediaries would likely only

[54] Although a person who directs an intermediary to trade on its behalf does not interact with other market participants in the same manner, the Commission believes that such a person could engage in abusive trading activity by using more than one intermediary to place orders that result in an abusive trading practice. For example, a person seeking to achieve a wash result could structure a transaction or a series of transactions through separate intermediaries, which may give the appearance of bona fide purchases and sales, but where the trades have been entered into without the intent to take a bona fide market position. While persons do not typically access a SEF in this manner, the Commission is mindful that the part 37 rules do not preclude this access method and notes that some SEFs currently facilitate agency-based trading. Accordingly, the Commission believes that a SEF must continue to have jurisdiction and disciplinary authority over these persons in order to effectively investigate misconduct and prosecute rule violations that occur on the SEF.

[55] 17 CFR 37.404(b).

have access to records of swaps activity occurring on the SEF, not necessarily activity by their customers in the index or instruments used as a reference price, the underlying commodity, and related derivatives markets. Consequently, the Commission believes that as "market participants" under the proposed definition, they should be subject to the recordkeeping requirements under § 37.404(b).[56]

b. SEF Jurisdiction over Clients of Market Participants

The proposed "market participant" definition would not capture clients of asset managers who, as market participants of a SEF, trade on a SEF on their clients' behalf.[57] The Commission recognizes that based on general industry practice, these clients have given their respective asset managers broad discretion to execute transactions in various financial products in different markets, including swaps. When asset managers trade on a client's behalf based on that discretion, such trading typically occurs without specific knowledge by the client as to whether such transactions are occurring on a SEF or the identity of the SEFs involved. While the clients themselves ultimately are the named counterparties to any transactions executed on their behalf, the asset managers are the participants accessing the SEF, and as such, are subject to the "market participant" definition and the obligations thereunder, including the SEF's jurisdiction. The Commission notes that asset managers—not their clients—access the SEF and sign onboarding documentation subjecting them to the SEF's jurisdiction. Since clients of asset managers would not be captured under the proposed market participant definition, a

[56] The Commission notes that the proposed "market participant" definition, or the discussion herein, does not alter any person's obligations under § 1.35. 17 CFR 1.35.

[57] The Commission notes that in the SEF Core Principles Final Rule, one commenter expressed concern that the vague use of the term "market participant" could potentially subject dealers' customers, and thus asset managers and their clients, to onerous requirements. SEF Core Principles Final Rule at 33506.

SEF would not be required to subject these clients to jurisdiction under proposed § 37.202(d).

Given that these clients give broad trading discretion to their asset managers, the Commission believes that requiring an asset manager who accesses and conducts actual trading on a SEF to submit to the SEF's jurisdiction is sufficient. This approach ensures that SEFs have the ability to take disciplinary action against the individual or entity—the asset manager—that could actually engage in potentially abusive trading practices on the SEF. The Commission notes that this logic would apply in other circumstances where a client gives broad trading discretion to another person to trade and execute swap transactions on the client's behalf. Therefore, these situations would not fall within the third prong of the "market participant" definition as described above because the client is not "directing" the intermediary to trade on its behalf.

With respect to recordkeeping, the Commission understands that asset managers typically maintain records of swap transactions on SEFs to which their clients are named counterparties. Although asset managers would likely not have complete records of their clients' trading activity in the index or instruments used as a reference price, the underlying commodity, and related derivatives markets under § 37.404(b), the Commission does not believe that SEFs would need these client records for regulatory purposes to the extent that the client is not directing the asset manager to trade on its behalf, but rather allowing the asset manager to exercise discretion in trading swaps. Therefore, the potential risks of manipulation, price distortion, and disruptions of the delivery or cash settlement process, which a SEF is required to prevent through trade monitoring under Core Principle 4, may be less attributable to such clients. To the extent

that such risks may exist, however, the Commission believes it is sufficient for SEFs to have access to records that relate to the asset manager, who is conducting the actual swaps trading activity.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.2(b). The Commission is particularly interested in the impact of the scope of the proposed "market participant" definition on various constituencies and, therefore, requests comment on the following questions:

(1) Is the Commission's proposed definition of "market participant" clear and complete? Please comment on any aspect of the definition that you believe is not clear or adequately addressed.

(2) Should the proposed definition of "market participant" distinguish between clients that give up complete trading discretion to an asset manager or another SEF participant and clients that do not so give up discretion or only give up partial discretion? If so, on what basis should the definition establish such a distinction?

(3) Do customers currently access a SEF through an intermediary, *e.g.*, an FCM or IB, and direct that intermediary to trade on their behalf through an agency-based approach? If this is not common, could this method of accessing a SEF become more common in the future? If so, under what circumstances would this occur? Is the third prong of the proposed "market participant" definition appropriate, which would include a person who directs an intermediary that accesses a SEF to trade on its behalf? If not, then why?

(4) Are there any other methods that are either currently being used or could be used to access a SEF? Are there any other examples of how a person could access a SEF

through access or functionality provided by a third party? What type of abusive trading practices, if any, could a customer attempt to conduct if the customer directs its trading through an intermediary such as an FCM or an IB? Please provide examples.

(5) What type of abusive trading practices, if any, could a client of an asset manager conduct if the client gives up complete trading discretion to the asset manager? Please provide examples. If the client allows an asset manager to exercise discretion in trading swaps, what are the risks of manipulation, price distortion, and disruptions of the delivery or cash settlement process that may be attributable to the client?

(6) Does a SEF's ability to monitor trading to prevent such risks require it to have access to client trading records that include activity in the index or instrument used as a reference price, the underlying commodity, and related derivatives markets? Are there any trading records that are currently created and maintained by clients of asset managers that would not also be retained by the asset managers? If so, please describe such records. Should SEFs receive such records for regulatory purposes?

C. § 37.3—Requirements and Procedures for Registration

1. § 37.3(a)—Requirements for Registration[58]

CEA section 5h(a)(1) establishes the SEF registration requirement and specifies that 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.[59] In adopting the SEF Core Principles Final Rule, the Commission affirmed its view under existing § 37.3(a)(1) that the broad

[58] The Commission proposes to renumber paragraph (a)(1) to subsection (a) based on the proposed elimination of the minimum trading functionality requirement under § 37.3(a)(2) and the Order Book definition under § 37.3(a)(3) described below.

[59] CEA section 5h(a)(1) states that 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. 7 U.S.C. 7b–3(a)(1).

registration requirement in CEA section 5h(a)(1) applies only to facilities that meet the SEF definition in CEA section 1a(50).[60] In furtherance of CEA section 5h(a)(1), existing § 37.3(a)(1) states that 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 shall register the facility as a SEF or as a DCM.[61] The Commission believed that this interpretation of the statutory SEF registration requirement would help further the statutory SEF goals of promoting swaps trading on SEFs and promoting pre-trade price transparency in the swaps market.[62]

As discussed further below, the Commission is proposing to apply the SEF registration requirement to several types of entities. The Commission does not intend for the discussion in this notice to exhaustively address which entities must register as a SEF. Rather, a determination of whether an entity must register as a SEF pursuant to CEA section 5h(a)(1) would depend on an evaluation of the operations of the entity, in particular whether it meets the SEF definition under CEA section 1a(50).[63]

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[60] SEF Core Principles Final Rule at 33481. The statutory SEF definition in CEA section 1a(50) provides that a SEF is 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 facilitates the execution of swaps between persons; and is not a designated contract market. 7 U.S.C. 1a(50).

[61] 17 CFR 37.3(a)(1). In addition to SEFs, existing § 37.3(a)(1) also references registration as a DCM. While the trading of swaps may occur through either a SEF or a DCM, CEA section 2(e) limits the trading of swaps on SEFs to ECPs. Both ECPs and non-ECPs may trade swaps through a DCM. 7 U.S.C. 2(e).

[62] SEF Core Principles Final Rule at 33481.

[63] The Commission notes that the preamble to the SEF Core Principles Final Rule addresses the applicability of the SEF registration requirement in CEA section 5h(a)(1) to several types of entities that facilitate swaps activity. SEF Core Principles Final Rule at 33479-84. The Commission maintains its approach to these types of entities with respect to the registration requirement, except as discussed herein. *See infra* Section IV.C.1.b.—Single-Dealer Aggregator Platforms (addressing the SEF registration requirement with respect to single-dealer aggregator platforms).

a. Footnote 88

As noted above, the Commission has stated that the SEF registration requirement in CEA section 5h(a)(1)[64] only applies to facilities that meet the statutory SEF definition in CEA section 1a(50).[65] In footnote 88 of the preamble to the SEF Core Principles Final Rule, the Commission specifically stated that the SEF registration requirement is not limited by the trade execution requirement in CEA section 2(h)(8), "such that only facilities trading swaps subject to the trade execution requirement would be required to register as a SEF.[66] Therefore, a facility is required to register as a SEF if it operates in a manner that meets the statutory SEF definition even though it only executes or trades swaps that are not subject to the trade execution [requirement]."[67] The Commission adopted this approach despite several comments to the proposed part 37 regulations, stating that registration as a SEF should only be required if an entity both met the SEF definition and offered swaps subject to the trade execution requirement.[68] The Commission stated that its approach to this issue is consistent with the statutory SEF registration requirement, the statutory SEF definition, and the trade execution requirement; the Commission also held that its approach promotes the statutory SEF goals.[69]

The Commission proposes to codify this existing approach to the SEF registration requirement by amending § 37.3(a)(1) to state that a person operating a facility that meets the statutory SEF definition must register as a SEF without regard to whether the swaps

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[64] 7 U.S.C. 5h(a)(1).
[65] 7 U.S.C. 1a(50).
[66] SEF Core Principles Final Rule at 33481 n.88.
[67] *Id*.
[68] *Id*. at 33479–80.
[69] *Id*. at 33481–82.

that it lists for trading are subject to the trade execution requirement. This proposed amendment is intended to clarify that the trade execution requirement is not a determinant of whether an entity must register as a SEF by codifying the requirement that an entity must register as a SEF if it permits trading or execution of any swap, including swaps that are not subject to the trade execution requirement, in a manner consistent with the statutory SEF definition, *i.e.*, trading or execution on a "multiple-to-multiple" basis among market participants.

Request for Comment

The Commission requests comment on all aspects of the proposed amendment to § 37.3(a).

b. Single-Dealer Aggregator Platforms

In the preamble to the SEF Core Principles Final Rule, the Commission evaluated the application of the statutory SEF registration requirement to various swaps market entities, including "aggregation services or portals" ("SEF Aggregator Portals") and "one-to-many systems or platforms" ("Single-Dealer Platforms").[70] The Commission generally determined that SEF Aggregator Portals and Single-Dealer Platforms do not meet the statutory SEF definition and therefore are not required to register as SEFs.[71]

As the Commission has gained greater knowledge and experience with the swaps market, however, it has become aware of a different type of a trading system or platform that implicates the SEF registration requirement—trading systems or platforms that aggregate Single-Dealer Platforms ("Single-Dealer Aggregator Platforms"). Specifically, a Single-Dealer Aggregator Platform typically operates a trading system or platform that

[70] SEF Core Principles Final Rule at 33481-83.
[71] *See id*.

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. Those non-dealer participants are thus able to view, execute, or trade swaps posted to the Single-Dealer Aggregator Platform's system or platform from multiple dealer participants. These types of systems or platforms, however, have not registered their operations as SEFs.

The Commission believes that the type of trading system or platform provided by Single-Dealer Aggregator Platforms should be subject to the SEF registration requirement because it meets the SEF definition in CEA section 1a(50) by allowing multiple participants to trade swaps by accepting bids and offers made by multiple participants in the facility or system.[72]

While a Single-Dealer Aggregator Platform has elements that resemble a Single-Dealer Platform, which is a type of entity that does not trigger the SEF registration requirement,[73] the Commission believes that both types of platforms are distinguishable from one another. In the preamble to the SEF Core Principles Final Rule, the Commission characterized Single-Dealer Platforms as systems or platforms in which a single dealer serves as a single liquidity provider by exclusively providing all bids and offers against which its customers, *i.e.*, participants, trade or execute swaps.[74] Accordingly, the dealer serves as the counterparty to all swaps executed on its trading system or platform.[75] Unlike the "one-to-many" nature of a Single-Dealer Platform, however, a Single-Dealer Aggregator Platform comports with the SEF definition in CEA

[72] 7 U.S.C. 1a(50).
[73] SEF Core Principles Final Rule at 33482.
[74] *Id*.
[75] *See id*.

section 1a(50) by providing a trading system or platform where multiple dealers send or stream bids and offers to multiple participants, thereby subjecting them to SEF registration.

The Commission also believes that Single-Dealer Aggregator Platforms are distinguishable from SEF Aggregator Portals. SEF Aggregator Portals are 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. In the preamble to the SEF Core Principles Final Rule, the Commission stated 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, rather than providing a venue for the trading or execution of swaps.[76] A SEF Aggregator Portal does not provide a trading system or platform where multiple participants have the ability to execute or trade swaps with multiple participants within its facility; rather, the multiple-to-multiple participant execution or trading occurs on the SEF and not the SEF Aggregator Portal. 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, thereby subjecting it to the SEF registration requirement.

Request for Comment

The Commission requests comment on all aspects of the proposed application of the SEF registration requirement to Single-Dealer Aggregator Platforms. The

[76] Although the Commission maintains that a SEF Aggregator Portal is generally not required to register as a SEF, such a system or platform may be subject to the Act and Commission regulations as an IB, as defined in CEA section 1a(31), given that its activity may constitute soliciting or accepting orders to be routed to SEFs. 7 U.S.C. 1a(31).

Commission may consider alternatives to the proposed application of the registration requirement to Single-Dealer Aggregator Platforms and requests comment on the following questions:

(7) Is the Commission's position that Single-Dealer Aggregator Platforms meet the SEF definition appropriate? Please explain.

(8) Should the Commission apply the SEF registration requirement to any other type of entity or activity? If so, please describe the type of entity and/or activity at issue.

(9) What factors, if any, would prevent a Single-Dealer Aggregator Platform from complying with the SEF registration requirement?

(10) Is the Commission's existing position that SEF Aggregator Portals and Single-Dealer Platforms do not satisfy the statutory SEF definition appropriate? Please explain.

c. Swaps Broking Entities, Including Interdealer Brokers

In the preamble to SEF Core Principles Final Rule, the Commission specified whether the SEF registration requirement would apply to several specific types of entities,[77] but did not address whether the requirement would apply to swaps broking entities, *i.e.*, interdealer brokers, most of whom are registered with the Commission as

[77] As noted in the preamble to the SEF Core Principles Final Rule, the Commission received comments characterizing the SEF registration requirement as ambiguous and requesting that the Commission provide clarification with respect to certain entities. SEF Core Principles Final Rule at 33479-81. In response, the Commission provided examples of how the SEF registration requirement would or would not apply to "certain categories of better understood facilities." *Id.* at 33482–84. These categories included (i) one-to-many systems or platforms; (ii) blind auction systems or platforms; (iii) aggregation services or portals; (iv) services facilitating portfolio compression and risk mitigation transactions; and (v) swap processing services. The Commission, however, emphasized that these examples do not "comprehensively" address all entities that are subject to SEF registration and urged participants to seek clarification from the Commission as to how the registration requirement applied to their particular operations. *Id.* at 33482.

IBs and traditionally facilitate swaps trading in the over-the-counter ("OTC") markets.[78] As discussed below, the Commission believes that the activities of these 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) (emphasis added). In light of existing market practices, the Commission believes that it is necessary to apply the SEF registration requirement to ensure that the multiple-to-multiple "trading" that occurs on such trading systems or platforms is subject to the Act and Commission's regulations as regulated SEFs. This application is consistent with Congressional intent, as evidenced by the statutory SEF registration requirement and SEF definition, and is further consistent with the statutory SEF goals.

The Commission understands that the proposed interpretation may require certain non-domestic operations—in particular, foreign swaps broking entities, such as foreign interdealer broker operations—to seek SEF registration or an exemption from SEF registration pursuant to CEA section 5h(g), provided that they fall within the Commission's jurisdiction.[79] Given the potentially complex issues that may arise for these entities from the Commission's proposed application of the SEF registration

[78] "Interdealer broker," as used in this notice, refers to an interdealer broker entity or operation in the aggregate and not to a particular individual, *i.e.*, an associated person, who works as a broker within the entity or operation. The Commission, however, considers such individuals to constitute part of the interdealer broker's trading system or platform. *See infra* Section VI.A.1.—§ 37.201(a)—Required Swap Execution Facility Rules (specifying proposed rules for SEF execution methods that apply to activities of SEF trading specialists who facilitate swaps trading or execution by, among other things, conducting broking-like functions).

[79] Pursuant to CEA section 5h(g), the Commission may exempt a facility from SEF registration upon a finding that it is subject to "comparable, comprehensive supervision and regulation" under the rules and regulations of the facility's home country. 7 U.S.C. 7b–3(g). *See infra* Section IV.C.1.d.—Foreign Swaps Broking Entities and Other Foreign Multilateral Swaps Trading Facilities.

requirement, the Commission proposes below to delay the compliance date of the requirement with respect to such entities and their operations. This proposed delay would allow the Commission to further develop its cross-border regulatory regime, including the achievement of additional comparability determinations with foreign regulators regarding their respective regulatory frameworks for swap trading venues located within their respective jurisdictions, *i.e.*, foreign multilateral swaps trading facilities, which would include foreign swaps broking entities as described below. Such a determination would allow such operations to seek an exemption from SEF registration. A delay would also provide time to foreign swaps broking entities to determine an appropriate course of action for their respective operations.[80]

(1) Structure and Operations of Swaps Broking Entities, Including Interdealer Brokers

Since adopting part 37, the Commission has developed a deeper understanding of the swaps market and has observed how swaps broking entities, including interdealer brokers, have structured themselves in relation to the current SEF regulatory framework. Interdealer broker trading systems or platforms facilitate swaps trading between multiple customers by negotiating or arranging swaps through voice-based or voice-assisted systems that combine voice functionalities with electronic systems such as order books. Swap dealers currently use these trading systems or platforms for several purposes, including obtaining market color or maintaining pre-trade anonymity in the course of trading. Specifically, an interdealer broker typically "works" customer orders by issuing RFQs-to-all among other customers and negotiating or arranging any resultant bids or

[80] The Commission notes that potential courses of action for such entities may include seeking SEF or DCM registration; reorganizing into an existing affiliated SEF; working with the appropriate regulator within their home country to seek an exemption from registration pursuant to CEA section 5h(g); or adjusting their activity to avoid the Commission's jurisdiction.

offers. Once the interdealer broker arranges a reciprocating bid and reciprocating offer, it sets a price for a specific swap transaction for a particular product, which in many cases enables a subsequent "trade work-up" session.[81] Finally, the interdealer broker will either facilitate the execution of the transaction(s) if the broker is part of a SEF's trading system or platform[82] or will otherwise route the pre-arranged transaction(s) to a SEF for execution if the broker is not a part of the registered SEF.

The Commission notes that interdealer brokers have adopted varying approaches to structuring themselves in relation to the SEF regulatory framework. 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.[83] As SEF participants, they submit transactions, which have already been arranged on those trading systems or platforms, to the SEF for execution. 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.

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[81] For a description of a "trade work-up" session, *see infra* note 269.

[82] As discussed below, persons operating within these SEFs that facilitate swaps trading are commonly referred to as "trading specialists" or "execution specialists." *See infra* Section VI.A.3.—§ 37.201(c)—SEF Trading Specialists.

[83] In becoming participants on a SEF, interdealer brokers typically meet the SEF's access criteria prior to onboarding, which provides them with trading privileges on the SEF. As SEF participants, they are subject to the SEF's jurisdiction, including all applicable disciplinary rules, similar to any other SEF participant. Where the SEF offers its participants the ability to submit pre-arranged or pre-negotiated transactions for execution, an interdealer broker SEF participant will route transactions it has arranged between its customers or clients, who are also SEF participants, for execution on the SEF.

This bifurcated approach has existed despite the close similarities among interdealer broker trading systems or platforms, whether they are registered or not as SEFs—they offer trading systems or platforms that facilitate the trading of swaps between multiple participants. This approach, however, has been justified by the execution of the swap on a SEF; as noted, the interdealer brokers that conduct activity on non-SEF platforms ultimately route the pre-arranged transactions to a SEF where they are executed. This approach seems premised on the view that because the execution occurs on a registered SEF, the facilitating interdealer broker does not need to register as a SEF, notwithstanding its role in negotiating or arranging the transaction(s).

To facilitate trading in Required Transactions outside the SEF, these interdealer broker trading systems or platforms typically operate outside of SEFs pursuant to the time delay requirement for Required Transactions under § 37.9(b).[84] Under § 37.9(b), the Commission implemented a fifteen-second time-delay requirement for Required Transactions that are pre-arranged or pre-negotiated by a broker and submitted as cross trades for execution through the SEF's Order Book. This requirement allows a broker or dealer to execute a Required Transaction by trading against a customer's order or executing two customers' orders against each other through pre-negotiation or pre-arrangement, provided that one side of the transaction is exposed to the Order Book for fifteen seconds before the other side of the transaction is submitted for execution. The time delay is intended to provide other market participants with an opportunity to execute against the first order.[85] In practice, however, the time delay requirement has enabled

[84] 17 CFR 37.9(b).
[85] SEF Core Principles Final Rule at 33503. *See infra* note 322 and accompanying discussion (describing the policy reason for the § 37.9(b) time delay requirement).

interdealer brokers to facilitate "trading" of swaps *i.e.*, the negotiating or arranging of swaps transactions outside the SEF, through the interdealer brokers' multiple-to-multiple trading systems or platforms. Negotiating or arranging consists of facilitating the interaction of bids and offers.[86] Once the transaction is pre-negotiated or pre-arranged through the interdealer broker's multiple-to-multiple trading system or platform, the interdealer broker routes the pre-arranged transaction to the SEF, where one side of the transaction is exposed for fifteen seconds on the Order Book prior to the entry of the other side for execution.

For swaps that are not subject to the trade execution requirement, *i.e.*, Permitted Transactions, SEFs have allowed their market participants to conduct trading via pre-execution communications away from their respective facilities and then submit the resulting transaction, with the price, terms, and conditions already agreed upon between the participants, to the SEF's trade capture functionality for execution.[87] The Commission notes that several SEFs affiliated with interdealer brokers offer this type of functionality based in part on the execution flexibility allowed under § 37.9(c)(2) for Permitted Transactions, *i.e.*, a SEF may offer any method of execution for such swaps. Accordingly, interdealer brokers submit Permitted Transactions that have been negotiated or arranged through their trading systems or platforms to an affiliated SEF without being subject to any corresponding order exposure (*e.g.*, a fifteen-second time-delay).[88]

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[86] *See infra* Section VI.A.2.a.—§ 37.201(b)—Pre-Execution Communications (discussion of how pre-execution communications between market participants constitute "trading").

[87] For further discussion of this execution method, *see infra* Section VI.A.2.—§ 37.203(a)—Pre-Arranged Trading Prohibition; § 37.9—Time Delay Requirement.

[88] The Commission has also observed that other swaps broking entities that are not affiliated with a SEF similarly negotiate or arrange transactions away from a registered SEF and subsequently submit those transactions to a registered SEF for execution. These types of transactions, however, are less common and constitute a smaller portion of the overall volume of relevant transactions discussed herein.

Coupled with the ability to submit Required Transactions in accordance with the time delay requirement, these arrangements essentially enable the operation of multiple-to-multiple trading systems or platforms for a broad range of swaps outside of the SEF regulatory framework.

(2) SEF Registration Requirement for Swaps Broking Entities, Including Interdealer Brokers

Based on the statutory SEF registration requirement and SEF definition, the associated SEF goals, the Commission's experience and knowledge from implementing part 37, and its evaluation of trading practices that have developed under the current SEF regulatory framework with respect to swaps broking entities that include interdealer brokers, the Commission proposes that a trading system or platform operated by such an entity must register as a SEF pursuant to CEA section 5h(a)(1) and § 37.3(a).[89] The Commission believes that such trading systems or platforms conform to the statutory SEF definition because they allow multiple participants to *trade* swaps by accepting bids and offers made by multiple participants in that facility or system (emphasis added). As described above, these trading systems or platforms facilitate the negotiation or arrangement of swap transactions through the interaction of bids and offers. The Commission believes that this "trading" activity should occur within a SEF, regardless of whether the product is subject to the trade execution requirement.[90] Accordingly, entities

[89] Although the Commission's description of swaps broking entities above focuses on the dealer-to-dealer market, the Commission clarifies that any person operating a system or platform for multiple-to-multiple participant swaps *trading* as described herein must register as a SEF consistent with CEA section 5h(a)(1) and § 37.3(a) (emphasis added).

[90] The Commission notes that this view is consistent with the proposed amendment to § 37.3(a) to clarify that a person operating a facility that meets the statutory SEF definition must register as a SEF without regard to whether the swaps that it lists for trading are subject to the trade execution requirement. *See supra* Section IV.C.1.a.—Footnote 88. As part of the proposed elimination of the prescriptive execution methods under § 37.9 for Required Transactions, the Commission is proposing to eliminate the time delay

operating these types of trading systems or platforms should be subject to the SEF registration requirement.[91]

In addition to the statutory basis for this application, the Commission's proposed approach would advance the Dodd-Frank goals of promoting swaps trading on SEFs and pre-trade price transparency.[92] The Commission believes that the operation of multiple-to-multiple swaps trading systems or platforms by swaps broking entities, including interdealer brokers outside of SEFs has frustrated these statutory goals and moved liquidity formation away from SEFs. To promote both trading on SEFs and pre-trade price transparency, the Commission believes that the activities associated with swaps trading should occur on SEFs consistent with the SEF registration requirement. Allowing such 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 post-trade processing engine, which is inconsistent with the statutory language and goals of the CEA related to SEFs.

The Commission also believes that requiring these types of swaps broking entities to register as SEFs would help to consistently apply the SEF regulatory framework over a segment of swaps trading activity that is very similar to registered SEF activity.

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requirement under § 37.9(b). *See infra* Section VI.A.2.—§ 37.203(a)—Pre-Arranged Trading Prohibition; § 37.9(b)—Time Delay Requirement. Based on this proposed elimination and the adoption of a flexible approach to SEF execution methods, the Commission notes that rules permitting the pre-arrangement or pre-negotiation of a swap transaction subject to a time delay requirement would no longer be needed or allowed.

[91] In addition to negotiation or arrangement that occurs through a swaps broking entity, the Commission believes that negotiation or arrangement that occurs directly between participants should also occur within a SEF. The Commission is proposing to require SEFs to have rules that prohibit market participants from engaging in pre-execution communications, *i.e.*, negotiation or arrangement of swaps, away from a SEF's trading system or platform, subject to certain exceptions. *See infra* Section VI.A.2.a.—§ 37.201(b)—Pre-Execution Communications.

[92] 7 U.S.C. 7b-3(e).

Interdealer 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 Commission and the general marketplace. Although many interdealer brokers are registered as IBs pursuant to CEA section 4f and are subject to the Commission's rules and regulations,[93] 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. The Commission believes that Congress would not have created SEFs and added the word "trading" in the statutory SEF registration requirement and SEF definition if it intended that an IB framework would be sufficient for swaps "trading." 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,[94] the Commission believes such activity would be more appropriately subject to a SEF-specific regulatory framework. This approach would achieve the policy goal of applying more consistent regulatory treatment to very similar swaps market activity.

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[93] 7 U.S.C. 6f(a). Part 3 sets forth the registration and regulatory requirements for IBs, among other registered entities. 17 CFR part 3. Among those requirements, IBs are required to register with the National Futures Association ("NFA") and therefore are also subject to the NFA rules and regulations. 17 CFR 3.2. The Commission further notes that § 155.4 sets forth trading standards for IBs. 17 CFR 155.4. For a description of additional IB-related Commission requirements, *see infra* note 341.

[94] The Commission emphasizes that an interdealer broker that solely solicits or accepts individual or single bids or offers and introduces them to an exchange, such as a SEF, would not be required to register as a SEF because it would not be facilitating the "trading," *i.e.*, negotiating or arranging of swaps between multiple market participants consistent with the SEF registration requirement. Such brokers would be able to continue to engage in such solicitation or acceptance in conformance with the IB definition. 7 U.S.C. 1a(31).

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 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").[95] 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.[96] These requirements enable SEFs to more comprehensively monitor for, among other things, potential abusive trading practices such as fraud and manipulation.[97] The Commission notes that establishing SEF monitoring and surveillance requirements over activity in the interdealer broker market is 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 London Interbank Offered Rate ("LIBOR"), an average benchmark for short-term interest rates used to determine floating rates for IRS.[98]

Accordingly, the Commission proposes that swaps broking entities, including interdealer brokers, that offer a trading system or platform in which more than one market participant has the ability to *trade* any swap with more than one other market

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[95] 17 CFR 1.3 (definition of "self-regulatory organization").
[96] 7 U.S.C. 7b-3(f)(2)(B).
[97] Given that the interdealer brokers are participants of the SEFs to which they submit negotiated or arranged transactions for execution, the Commission notes that SEFs still have jurisdiction over that activity and could investigate suspected prohibited activity and issue sanctions where appropriate, pursuant to the SEF's self-regulatory obligations.
[98] *See, e.g.*, Enforcement Order re: Société Générale S.A. Attempted Manipulation and False Reporting of LIBOR and Euribor, CFTC Docket No. 18-14 (June 4, 2018); *see also* 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).

participant on the system or platform, shall register as a SEF or seek an exemption from registration pursuant to CEA section 5h(g) (emphasis added). Where an entity operates both a registered SEF and an affiliated swaps broking entity—such as an interdealer broker—that negotiates or arranges trades via a non-SEF trading system or platform and participates on the affiliated SEF as a market participant, the swaps broking entity could also comply with the SEF registration requirement by integrating its non-SEF trading system or platform into its affiliated SEF. The Commission believes that this proposed application of the SEF registration provision in CEA section 5h(a)(1), which the Commission continues to interpret in conjunction with the SEF definition in CEA section 1a(50), is consistent with the statute and helps further the statutory SEF goals provided in CEA section 5h.

The Commission proposes to delay the application of the SEF registration requirement with respect to swaps broking entities, including interdealer brokers, for a period of six months, subject to certain conditions and starting from the compliance date of any final rule adopted from this proposed rulemaking. Swaps broking entities, including interdealer brokers, that meet the conditions set forth below would be able to continue to maintain their current practice of facilitating the negotiating or arranging of swaps transactions between multiple participants and routing those swaps transactions to SEFs for execution.[99] Without the six-month delay period, the Commission believes that

[99] As discussed below, the Commission is proposing § 37.201(b) to prohibit the use of pre-execution communications by market participants away from a SEF's trading system or platform. *See infra* Section VI.A.2.a.—§ 37.201(b)—Pre-Execution Communications. The Commission notes that to the extent swaps broking entities, including interdealer brokers, engage in such communications in the course of negotiating or arranging transactions and submitting them to a SEF for execution, the prohibition—if adopted via a final rule—would not apply during the six-month period.

applying the SEF registration requirement to these entities would disrupt their operations and further fragment swaps liquidity.

As applied to swaps broking entities, including interdealer brokers—most of whom are registered with the Commission as IBs—the Commission proposes that the six-month delay from the SEF registration requirement would be subject to the following conditions:

(i) All swap transactions that are traded on a swaps broking entity, including an interdealer broker, must be routed for execution to a SEF; and

(ii) The swaps broking entity, including an interdealer broker, must provide electronically the following information with respect to itself to the Secretary of the Commission at *submissions@cftc.gov* and the Commission's Division of Market Oversight ("Division" or "DMO") at *DMOSubmissions@cftc.gov*: (i) entity name as it appears in the entity's charter; (ii) name and address of the entity's ultimate parent company; (iii) any names under which the entity does business; (iv) address of principal executive office; (v) a contact person's name, address, phone number, and email address; (vi) asset classes and swap products for which the entity facilitates trading; and (vii) any registrations, authorizations, or licenses held.[100]

Upon a DMO determination that a swaps broking entity's notice is complete, the Commission proposes to post these notices on the Commission's website under the

[100] The Commission anticipates that the effective date of any final rule would be established ninety days from the publication of the rule in the *Federal Register*. The Commission believes that the proposed ninety-day period would provide swaps broking entities, including interdealer brokers seeking to avail themselves of the six-month compliance date delay with a sufficient opportunity to compile and submit this information to the Commission.

"Industry Filings" page. This proposed approach would effectively maintain the status quo for these swaps broking entities for the proposed six-month delay period.

The Commission notes that the proposed six-month delay for swaps broking entities, including interdealer brokers, does not affect any other requirements under the CEA or the Commission's regulations. In particular, this delayed compliance date would not affect the application of CEA section 2(e) and its requirement that only ECPs be permitted to trade swaps on SEFs.[101]

As part of this proposed transition period, swaps broking entities, including interdealer brokers, would be able to route their transactions to a SEF for execution. Furthermore, during this period, counterparties subject to the trade execution requirement would be able to satisfy that requirement by trading via a swaps broking entity, including an interdealer broker, that routes the transactions to a SEF for execution.

Request for Comment

The Commission requests comment on all aspects of the proposed application of the SEF registration requirement to swaps broking entities. The Commission may consider alternatives to the proposed application of the requirement and requests comment on the following questions:

(11) Is the Commission's view that swap broking entities, including interdealer brokers, meet the SEF definition appropriate? Please explain why or why not. Is it clear what activity falls within the SEF registration requirement and SEF definition, including the meaning of "trading"? If not, please explain.

[101] 7 U.S.C. 2(e). *See supra* note 61.

(12) Should the Commission apply the SEF registration requirement to any other type of entity or activity?

(13) What factors, if any, would prevent a swaps broking entity, including an interdealer broker, from complying with the SEF registration requirement or from seeking an exemption from registration pursuant to CEA section 5h(g)?

(14) Is the proposed six-month delay period sufficient to allow swaps broking entities, including interdealer brokers, time to seek registration or alter their operations in compliance with the SEF registration requirements? Why or why not?

(15) Should the Commission allow swaps broking entities, including interdealer brokers, to route swap transactions to exempt SEFs during this six-month delay period? Why or why not?

d. Foreign Swaps Broking Entities and Other Foreign Multilateral Swaps Trading Facilities

As discussed above, the Commission has observed that swaps broking entities, including interdealer brokers, have utilized various business structures to operate in a bifurcated manner, *i.e.,* a SEF and a non-SEF trading system or platform. One common structure consists of an entity that serves as a parent to a registered SEF entity and several affiliated broker entities that negotiate or arrange trades and participate exclusively on the affiliated SEF as market participants. While many of those broker entities are domestically domiciled, a significant number of them are also located in numerous foreign jurisdictions.[102] Similar to domestic swaps broking entities, these foreign swaps

[102] Based on discussions with market participants, the Commission is aware of foreign swaps broking entities that are interdealer brokers located in numerous foreign jurisdictions, including Australia, Brazil, Canada, Chile, Colombia, Hong Kong, Japan, Mexico, Singapore, and South Korea, that participate on SEFs. The Commission is also aware that interdealer brokers domiciled in the European Union ("EU")

broking entities are not currently registered as SEFs, but are typically registered with the Commission as IBs.[103] These entities often serve as hubs for liquidity within their particular jurisdiction during non-U.S. trading hours—operating trading systems or platforms that facilitate the negotiating or arranging of transactions for multiple U.S. persons with local customers and the routing of those transactions to an affiliated SEF for execution.[104] These foreign swaps broking entities' trading systems or platforms are very similar to those operated by swaps broking entities within in the U.S., such that they provide more than one market participant with the ability to *trade* swaps with more than one other market participant (emphasis added). Therefore, the Commission proposes that these foreign swaps broking entities are "foreign multilateral swaps trading facilities," which are foreign facilities that operate a trading system or platform where multiple participants have the ability to execute or trade swaps with multiple market participants.

Consistent with the proposal regarding the SEF registration requirement above, such foreign multilateral swaps trading facilities, including foreign swaps broking entities, would be required to register as a SEF or seek an exemption from SEF registration if their activity falls within the jurisdictional reach of the Commission pursuant to CEA section 2(i). Pursuant to CEA section 2(i), activities outside of the U.S. are not subject to the swap provisions of the CEA, including any rules prescribed or

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operate as investment firms that operate Multilateral Trading Facilities ("MTFs") and Organized Trading Facilities ("OTFs"). The Commission notes that it has exempted certain MTFs and OTFs located in the EU from registration as SEFs pursuant to CEA section 5h(g). *See infra* note 109 (describing December 2017 exemptive order issued by the Commission to certain MTFs and OTFs based on comparability determination).

[103] *See supra* note 93 (general description of Commission requirements with respect to IBs).

[104] For purposes of this discussion, the term "U.S. person" identifies those persons who, under the Commission's interpretation, could be expected to satisfy the jurisdictional nexus set forth in CEA section 2(i) based on their swap activities, either on an individual or aggregate basis. *See* Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations; Rule, 78 FR 45292, 45301 (Jul. 26, 2013) ("2013 Cross-Border Guidance").

regulations promulgated thereof, unless those activities either have a "direct and significant connection" with activities in, or effect on, commerce of the United States; or contravene any rule or regulation established to prevent evasion of a Dodd-Frank Act-enacted provision of the CEA.[105] The Commission expects that it will clarify the cross-border jurisdictional reach of the SEF registration requirement in the future for foreign multilateral swaps trading facilities, including foreign swaps broking entities, pursuant to CEA section 2(i).[106] To the extent that a foreign multilateral swaps trading facility's activities are determined to fall within the Commission's jurisdictional reach, the facility would be required to register as a SEF or seek an exemption from SEF registration.[107]

Such facilities that do not wish to register as a SEF and prefer to comply with the regulatory requirements of their home country may seek an exemption from SEF

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[105] 7 U.S.C. 2(i).

[106] In November 2013, DMO issued guidance regarding the application of the SEF registration requirement to foreign multilateral swaps trading facilities. Division of Market Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities (Nov. 15, 2013). The guidance specified that a foreign multilateral swaps trading platform that provides U.S. persons or persons located in the United States (including personnel and agents of non-U.S. persons located in the United States) ("U.S.-located persons") with the ability to trade or execute swaps on or pursuant to the rules of the platform, either directly or indirectly through an intermediary, would be expected to register as a SEF or DCM. *Id.* at 2. The guidance listed two non-exhaustive factors to determine whether a foreign platform met this registration requirement: (i) whether a foreign multilateral swaps trading facility directly solicits or markets its services to U.S. persons or U.S.-located persons; or (ii) whether a significant portion of the market participants who a foreign multilateral swaps trading facility permits to effect transactions are U.S. persons or U.S.-located persons. *Id.* at 2 n.8. The guidance further specified DMO's belief that U.S. persons and U.S.-located persons generally comprise those persons whose activities have the requisite "direct and significant" connection with activities in, or effect on, commerce of the United States within the meaning of CEA section 2(i). *Id.* at 2. The guidance also stated DMO's view that a multilateral swaps trading facility's provision of the ability to trade or execute swaps on or through the platform to U.S. persons or U.S.-located persons may create the requisite connection under CEA section 2(i) for purposes of the SEF/DCM registration requirement. *Id.* Subsequently, the Commission learned that many foreign multilateral swaps trading facilities prohibited U.S. persons and U.S-located persons from accessing their facilities due to the uncertainty that the guidance created with respect to SEF registration. The Commission understands that these prohibitions reflect concerns that U.S. persons and U.S.-located persons accessing their facilities would trigger the SEF registration requirement. As noted above, the Commission expects to address the application of CEA section 2(i) to foreign multilateral swaps trading facilities, including foreign swaps broking entities, in the future.

[107] The Commission discusses further below the potential implications for foreign multilateral swaps trading facilities offering swaps that are subject to the trade execution requirement to applicable counterparties.

registration pursuant to CEA section 5h(g) either directly or via the auspices of their home country regulator. Pursuant to CEA section 5h(g), the Commission may exempt facilities from SEF registration if the 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.[108] Based on this provision, the Commission issued an order in December 2017 that exempts certain MTFs and OTFs authorized within the EU from the SEF registration requirement based on a finding that their respective regulatory frameworks satisfy the standard for granting an exemption from the SEF registration requirement pursuant to CEA section 5h(g).[109] At this time, the Commission has neither adopted a formal regulatory framework for granting an exemption pursuant to this provision nor has it granted exemptive relief to facilities in other jurisdictions beyond the 2017 order to EU-based MTFs and OTFs.

(1) Proposed Delay of SEF Registration Requirement

Given that the Commission intends to address the cross-border jurisdictional reach of the Commission's SEF registration requirement in the future, the Commission 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

[108] 7 U.S.C. 7b-3(g).

[109] Order Exempting MTFs and OTFs Authorized Within the EU from SEF Registration Requirement (Dec. 8, 2017) ("2017 MTF and OTF Exemptive Order"). The order established this finding with respect to EU-wide legal requirements—including, in particular, requirements under the EU's new Markets in Financial Instruments Regulation ("MiFIR"), the EU's amended Markets in Financial Instruments Directive ("MiFID II"), and the EU's Market Abuse Regulation—that establish regulatory frameworks for MTFs and OTFs. Pursuant to this finding, the Commission provided specific exemptions to several MTFs and OTFs. *Id.* at app. A.

("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.

The proposed delay period would not apply to foreign swaps broking entities that do not currently facilitate trading, *i.e.*, negotiation or arrangement, of swaps transactions for U.S. persons, given that their operations would not be materially affected by the proposed application of the SEF registration requirement to swaps broking entities. Further, the proposed delay period would not apply to foreign multilateral swaps trading facilities, as described above, that are not foreign swaps broking entities. Such facilities are not subject to the Commission's proposed application of the SEF registration requirement, and therefore, are already required to register as a SEF pursuant to the SEF registration requirement or seek an exemption pursuant to CEA section 5h(g). Similarly, the Commission notes that MTFs and OTFs located in the EU may not rely on this delay and instead must seek an exemption from SEF registration pursuant to the terms of the Commission's 2017 exemptive order.[110]

Eligible Foreign Swaps Broking Entities that meet the conditions set forth below would be able to continue to maintain the current practice of facilitating the negotiation or arrangement of swaps transactions between multiple participants and routing those swaps transactions to SEFs or Exempt SEFs for execution.[111] Without the two-year period, the Commission believes that applying the SEF registration requirement to these entities would disrupt their operations and fragment swaps liquidity.

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[110] 2017 MTF and OTF Exemptive Order.

[111] As discussed below, the Commission is proposing § 37.201(b) to prohibit the use of pre-execution communications by market participants away from a SEF's trading system or platform. *See infra* Section VI.A.2.a.—§ 37.201(b)—Pre-Execution Communications. The Commission notes that to the extent Eligible Foreign Swaps Broking Entities engage in such communications in the course of negotiating or arranging transactions and submitting them to a SEF for execution, the prohibition—if adopted via a final rule—would not apply during the two-year period.

During this period, the Commission anticipates that it will address what constitutes a "direct and significant connection with activities in, or effect on, commerce of the United States" for foreign multilateral swaps trading facilities, including foreign swaps broking entities, under CEA section 2(i).[112] The proposed delay would also provide the Commission with time to develop any threshold standards for the application of CEA section 2(i) to the SEF registration requirement in CEA section 5h(a)(1). While the Commission has yet to determine standards in this area, the Commission notes that any such standard could include a *de minimis* component, whereby the activity of U.S. persons below some defined quantitative threshold on a particular foreign multilateral swaps trading facility would not trigger a need for SEF registration.

The Commission notes that counterparties that are required to comply with the trade execution requirement may only satisfy the requirement by executing a swap on a SEF, a DCM, or an Exempt SEF.[113] Accordingly, any foreign multilateral swaps trading facility that seeks to offer such swaps to such counterparties for trading must be registered as a SEF or DCM or obtain an exemption from SEF registration pursuant to CEA section 5h(g), regardless of whether that trading system or platform meets the standards (or any future standards the Commission may develop) for CEA section 2(i), *i.e.*, a "direct and significant connection," to trigger SEF registration. As noted above, the proposed delay would not apply to these foreign multilateral swaps trading facilities. Similarly, upon the expiration of the proposed two-year delay, any Eligible Foreign Swaps Broking Entity that seeks to offer such swaps to such counterparties for trading on

[112] 7 U.S.C. 2(i).

[113] For a discussion of which counterparties must comply with the Category A Transaction-Level Requirements, including the trade execution requirement, *see* 2013 Cross-Border Guidance at 45350-59 app. D.

its trading system or platform must be registered as a SEF or DCM or obtain an exemption from SEF registration pursuant to CEA section 5h(g).

During this time, the Commission could formalize a regulatory framework for providing exemptions from the SEF registration requirement for foreign multilateral swaps trading facilities, including foreign swaps broking entities, that meet that CEA section 2(i) standard. The proposed two-year delay not only could provide the Commission with sufficient time to formalize this framework, which would require standards and processes for evaluating exemption requests, but also give Eligible Foreign Swaps Broking Entities more time to determine their best course of action, *i.e.*, seek SEF registration with the Commission or obtain a CEA section 5h(g) exemption from registration. Accordingly, the proposed delay would further provide the Commission and regulators in foreign jurisdictions with additional time to evaluate such registration applications or requests for exemption received from Eligible Foreign Swaps Broking Entities.

With respect to exemptions, the Commission anticipates that most foreign swaps broking entities and other foreign multilateral swaps trading facilities would seek to comply with the rules and regulations of their home countries, and thus, seek an exemption from SEF registration. The Commission further anticipates that the issuance of such exemptions may take some time based upon the large number of jurisdictions in which these operations are currently located.[114] Thus, the Commission believes that it would be beneficial to provide more time for evaluation of exemption requests because exempting such comparably-regulated foreign entities from SEF registration, similar to

[114] *See supra* note 102 (listing the foreign jurisdictions where swaps broking entities operate).

other deference initiatives, should generally reduce market fragmentation, regulatory arbitrage, and duplicative or conflicting regulatory requirements, while increasing the potential for harmonized regulatory standards on a global level. Further, the Commission anticipates that any future determination process for granting exemptions from SEF registration would ensure that foreign and domestic multilateral swaps trading facilities, which operate in a similar fashion to one another, are all held to comparable regulatory standards.

The Commission further believes that this proposal should create strong incentives for foreign jurisdictions to establish or bolster their own robust regulatory regimes for swaps trading. Such measures would also be consistent with the commitment made among the G-20 countries in 2009 "to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage."[115] To the extent that foreign swaps broking entities and other foreign multilateral swaps trading facilities operate in foreign jurisdictions that currently do not have or are not expected to have comparable and comprehensive supervision and regulation, such facilities would be subject to the proposed SEF registration requirement if their operations create a "direct and significant" connection to activities in, or effect on, commerce of the United States under CEA section 2(i).

(2) Proposed Conditions for Delay of SEF Registration Requirement

[115] Group of Twenty, "G-20 Leaders' Statement: The Pittsburgh Summit 7 (Sept. 24-25, 2009), https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf.

As applied to Eligible Foreign Swaps Broking Entities—most of whom are registered with the Commission as IBs—the Commission proposes that the two-year delay from the SEF registration requirement be subject to the following conditions:

(i) All swap transactions involving U.S. persons that are traded on an Eligible Foreign Swaps Broking Entity must be routed for execution to a SEF or an Exempt SEF;[116] and

(ii) The Eligible Foreign Swaps Broking Entities must provide the following information electronically to the Secretary of the Commission at *submissions@cftc.gov* and DMO at *DMOSubmissions@cftc.gov*: (i) entity name as it appears in the entity's charter; (ii) name and address of the entity's ultimate parent company; (iii) any names under which the entity does business; (iv) address of principal executive office; (v) a contact person's name, address, phone number, and email address; (vi) asset classes and swap products for which the entity facilitates trading; (vii) certification that the entity currently arranges or negotiates swap transactions for U.S. persons; (viii) the entity's home country regulator or regulators; and (ix) any registrations, authorizations, or licenses held by the entity in its home country.[117]

Upon a DMO determination that an Eligible Foreign Swaps Broking Entity's notice is complete, the Commission would post these notices on the Commission's website under the "Industry Filings" page. This proposed approach would effectively maintain the status quo for these Eligible Foreign Swaps Broking Entities during the two-

[116] For a current list of Exempt SEFs, *see* 2017 MTF and OTF Exemptive Order at app. A.

[117] The Commission anticipates that the effective date of any final rule would be established ninety days from the publication of the rule in the *Federal Register*. The Commission believes that a ninety-day effective date would provide Eligible Foreign Swaps Broking Entities seeking a two-year compliance date delay with sufficient opportunity to compile and submit the requisite information to the Commission.

year compliance date delay period. The Commission notes that the proposed two-year delay for Eligible Foreign Swaps Broking Entities does not affect any other requirements under the CEA or the Commission's regulations. In particular, this delayed compliance date would not affect the application of CEA section 2(e) and its limitation of SEF and Exempt SEF trading to ECPs.[118]

As part of this proposed transition period, Eligible Foreign Swaps Broking Entities would be able to route their transactions to either a SEF or an Exempt SEF for execution. Furthermore, during this two-year delay, counterparties subject to the trade execution requirement would be able to satisfy that requirement by trading via an Eligible Foreign Swaps Broking Entity that routes the transactions to either a SEF or an Exempt SEF for execution.

In light of these considerations, the Commission notes that the issue of whether an Eligible Foreign Swaps Broking Entity routes a transaction to a SEF or an Exempt SEF during the proposed two-year time delay period would have practical implications for the counterparties involved in the transaction with respect to complying with Commission reporting and clearing requirements. For swap transactions that are routed to a SEF for execution, the SEF would be responsible for compliance with (i) the real-time reporting requirements under part 43 of the Commission's regulations and (ii) the regulatory reporting requirements under part 45 of the Commission's regulations.[119] Counterparties to a swap transaction that is routed to an Exempt SEF for execution would be responsible for the reporting requirements set forth in both part 43 and part 45, unless there is a

[118] 7 U.S.C. 2(e). *See supra* note 61.

[119] In connection with swap transactions executed on a SEF, the Commission notes that the part 45 regulations continue to apply to counterparties that are subject to such reporting requirements. 17 CFR part 45.

substituted compliance determination by the Commission with respect to those requirements.[120]

Further, for swap transactions routed to a SEF that are intended to be cleared or subject to the clearing requirement, the SEF would be responsible for routing the swap transaction to a Commission-registered derivatives clearing organization ("DCO") or a clearing organization that has been exempted from DCO registration by the Commission pursuant to CEA section 5b(h), *i.e.*, Exempt DCO, for clearing.[121] For swap transactions routed to an Exempt SEF for execution that are intended to be cleared or are subject to the clearing requirement, the Commission notes that the following clearing-related requirements would to apply to such swap transactions:

(i) When a swap transaction executed by a U.S. person on such an Exempt SEF is a "customer" position subject to CEA section 4d, the transaction, if intended to be cleared, must be cleared through a Commission-registered FCM at a Commission-registered DCO;

(ii) When a swap transaction executed by a U.S. person on such an Exempt SEF is a "proprietary" position under Commission regulation 1.3(y), the transaction, if intended to be cleared, must be cleared either through a Commission-registered DCO or an Exempt DCO; and

(iii) When a swap transaction is subject to the Commission's clearing requirement, the transaction must be cleared either through a Commission-registered DCO or an Exempt DCO, provided that consistent with (i) above, the transaction must be cleared

[120] Exempt SEFs may report transactions on behalf of counterparties as a service provider; the counterparties, however, retain ultimate responsibility for reporting.
[121] *See* 17 CFR 37.700-702.

through a Commission-registered FCM at a Commission-registered DCO and cannot be cleared through an Exempt DCO if the transaction is a "customer" position subject to CEA section 4d.

Request for Comment

The Commission requests comment on all aspects of its proposed approach to SEF registration for Eligible Foreign Swaps Broking Entities, in particular the proposed two-year delay in the compliance date of any final rule. The Commission may consider alternatives to the proposed two-year delay and requests comment on the following questions:

(16) Is the delay of two years for Eligible Foreign Swaps Broking Entities an adequate delay? If not, then how long of a delay should the Commission consider and why?

(17) Are there additional considerations that the Commission should take into account in establishing this delay?

(18) Are there additional conditions that the Commission should consider imposing on Eligible Foreign Swaps Broking Entities during this delay period?

2. §§ 37.3(a)(2)-(3)—Minimum Trading Functionality and Order Book Definition

In developing the regulatory framework for SEFs, the Commission adopted a "minimum trading functionality" requirement under § 37.3(a)(2) that requires a SEF to maintain and offer an Order Book for all of the swaps that it lists for trading.[122] An Order Book is defined under § 37.3(a)(3) as (i) an electronic trading facility;[123] (ii) a trading

[122] 17 CFR 37.3(a)(2).

[123] CEA section 1a(16) defines "electronic trading facility" as a trading facility that (i) operates by means of an electronic or telecommunications network; and (ii) maintains an automated audit trail of bids, offers, and the matching of orders or the execution of transactions on the facility. 7 U.S.C. 1a(16).

facility;[124] or (iii) a trading system or platform in which all market participants in the trading system or platform have the ability to enter multiple bids and offers, observe or receive bids and offers entered by other market participants, and transact on such bids and offers.[125] In the preamble to the SEF Core Principles Final Rule, the Commission acknowledged that the Order Book functionality does not have the requisite flexibility to serve as the ideal method of execution for a variety of swaps, in particular those that feature lower levels of liquidity.[126] The Commission nevertheless believed that an Order Book could establish a base level of pre-trade price transparency to all market participants and, therefore, required that each SEF offer an Order Book for all swaps that it lists for trading, including both swaps subject to the trade execution requirement and swaps not subject to the trade execution requirement.[127]

The Commission has observed that market participants have rarely used Order Books to trade swaps on SEFs despite their availability for all swaps listed by SEFs. Depending on the product involved, for example, order book trading typically ranges between "less than [one percent] to less than [three percent] of total CDS transactions" on SEFs, while order book trading constitutes between "less than [one percent] to

[124] CEA section 1a(51) defines "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 by accepting bids or offers made by other participants that are open to multiple participants in the facility or system; or through the interaction of multiple bids or multiple offers within a system with a pre-determined non-discretionary automated trade matching and execution algorithm. 7 U.S.C. 1a(51)(A).
[125] 17 CFR 37.3(a)(3).
[126] SEF Core Principles Final Rule at 33564-65. In the preamble to the SEF Core Principles Final Rule, the Commission stated its anticipation that an Order Book would typically work well for liquid Required Transactions, *i.e.*, transactions involving swaps that are subject to the trade execution requirement. For less liquid Required Transactions, however, it anticipated that RFQ systems would help facilitate trading." *Id.*
[127] SEF Core Principles Final Rule at 33564.

approximately [twenty percent] of total IRS transactions…."[128] The Commission believes that this low level of swaps trading on Order Books is attributable[129] to an Order Book's inability to support the broad and diverse range of products traded in the swaps market that trade episodically, rather than on a continuous basis.[130] Given the broad array of liquid and illiquid swaps listed on SEFs, mandating that a SEF offer an Order Book for all of these products has imposed significant operational and financial costs and burdens, particularly from a technological standpoint, with little benefit to most market participants who choose not to utilize them.[131]

Therefore, based in part on its experience, the Commission proposes to eliminate the minimum trading functionality requirement and the regulatory Order Book definition. The Commission believes that eliminating the minimum trading functionality would help reduce operating costs for SEFs, as they would no longer be required to operate and maintain order book systems that are poorly suited for trading in less liquid swaps, and

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[128] J. Christopher Giancarlo and Bruce Tuckman, Swaps Regulation Version 2.0: An Assessment of the Current Implementation of Reform and Proposals for Next Steps 49-50 (Apr. 26, 2018), *available at* https://www.cftc.gov/ sites/default/files/2018-05/oce_chairman_swapregversion2whitepaper_042618.pdf.

[129] In addition to reasons stated above, the Commission acknowledges that the lack of swaps trading on SEF Order Books may also be attributed to other factors, such as concerns over "name give-up" practices and the current lack of certain trading features, such as the ability to calculate volume-weighted average pricing.

[130] In their study of the index CDS market, Pierre Collin-Dufresne, Benjamin Junge, and Anders B. Trolle state that "[p]roponents of bringing all market participants onto one limit order book typically argue that it would (i) increase quote competition among dealers and (ii) allow clients to occasionally supply liquidity via limit orders thereby lowering overall transaction costs (although at the cost of execution risk). However, a limit order book arguably works best when trading is continuous and it is not necessarily optimal when trading is more episodic as is the case for index CDSs. For instance, Barclay, Hendershott, and Kotz (2006) document a precipitous drop in electronic trading (via limit order books) when Treasuries go off-the-run and trading volumes decline." Pierre Collin-Dufresne, Benjamin Junge, & Anders B. Trolle, *Market Structure and Transaction Costs of Index CDSs* 6 n.10 (Swiss Fin. Inst. Res. Paper No. 18-40, 2017) ("2017 Collin-Dufresne Research Paper"), citing Michael J. Barclay, Terrence Hendershott, & Kenneth Kotz, *Automation Versus Intermediation: Evidence from Treasuries Going Off the Run*, 61 J. Fin. 2395, 2395–2414 (2006).

[131] The Commission understands that these costs include regularly occurring software updates to electronic order book systems and other ongoing technology-related maintenance.

therefore, do not attract significant trading activity. Instead of employing resources to build and support a seldom-utilized trading system or platform, the proposed elimination provides a SEF with the flexibility to determine how to allocate its resources, particularly as it relates to developing methods of execution that are better suited to trading the products that it lists. As discussed below, other execution methods may be better suited to maximizing participation and concentrating liquidity formation on SEFs in episodically liquid swaps markets.[132] Therefore, removing this requirement may spur development and innovation in execution methods. The Commission also believes that eliminating this requirement may encourage SEFs to list new and different types of swaps, given that they would no longer have to incur the costs of operating and supporting Order Books. The Commission notes, however, that a SEF would be free to continue to offer an order book if it so chooses.

The Commission adopted the minimum trading functionality requirement based in part on the goal of promoting pre-trade price transparency,[133] but acknowledges that the CEA does not explicitly prescribe the Order Book as a SEF minimum trading functionality. Accordingly, with the elimination of this requirement under § 37.3(a)(2), the only trading functionality obligation that a SEF must comply with on an ongoing basis is based upon the CEA section 1a(50) definition of SEF.[134] Therefore, the SEF must operate 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

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[132] *See infra* Section IV.I.4.b.—Elimination of Required Execution Methods.
[133] 7 U.S.C.7b-3(e).
[134] The Commission emphasizes that while the SEF definition in CEA section 1a(50) would serve as the baseline requirement for the type of trading systems or platforms that a SEF must maintain, it also provides the basic criterion to determine which types of trading systems or platforms are subject to the SEF registration requirement.

the facility or system, through any means of interstate commerce.[135] To meet the SEF definition, a trading system or platform must provide multiple participants with the ability to accept bids and offers from other multiple participants within the facility or system. As long as multiple participants have the ability to accept bids and offers from other multiple participants within the facility or system, the facility or system will meet the SEF definition, regardless of how the multiple participants choose to interact with one another. Based on this more straightforward approach, the Commission expects that determining whether a particular system or platform meets the SEF definition would generally be self-evident. Nevertheless, the Commission will continue to work with entities that seek interpretive guidance on the parameters of that definition.[136]

3. § 37.3(b)—Procedures for Registration[137]

a. Elimination of Temporary Registration

To implement the SEF regulatory framework, the Commission established a temporary SEF registration regime to help minimize disruptions to incumbent platforms that had been operating prior to the adoption of part 37 and to allow new entities to

[135] 7 U.S.C. 1a(50).

[136] Based on the Commission's proposed elimination of the Order Book as a minimum trading functionality requirement, the Commission clarifies one particular issue regarding the scope of the CEA section 1a(50) SEF definition. In the preamble to the SEF Core Principles Final Rule, the Commission expressed doubt as to whether an RFQ-to-one system met the multiple participant aspect of the SEF definition. SEF Core Principles Final Rule at 33498, 33561, and 33563. This view, articulated in the context of the Commission's discussion of RFQ Systems as a required method of execution, would suggest that an "RFQ-to-one" trading system or platform may, on its face, not meet the SEF definition. The Commission notes, however, that this view does not appropriately give meaning to the 'ability' factor of the SEF definition. Therefore, the Commission seeks to clarify the application of the 'ability' factor as it applies to RFQ-to-one transactions. The Commission believes that an entity that permits its market participants to use its RFQ-to-one functionality to issue concurrent or serial RFQs to multiple, different recipients would fit within the SEF definition, as it provides participants the "ability" to accept bids and offers from multiple participants within the trading system or platform.

[137] Based on the elimination of the temporary registration requirements, the Commission proposes to retitle § 37.3(b) to "Procedures for registration" from "Procedures for full registration." The Commission also proposes to add a title to § 37.3(b)(1)—"Application for registration."

compete with those incumbent platforms.[138] Section 37.3(c) sets forth the process for SEF applicants to apply for temporary SEF registration prior to the Commission's review of an application for full SEF registration. The temporary registration process, however, has expired pursuant to a two-year sunset provision established under § 37.3(c)(5).[139] Since the expiration of this process, the Commission has reviewed SEF applications pursuant to a 180-day Commission review period.[140]

Based on the expiration of the temporary registration regime, the Commission proposes to eliminate the provisions under existing § 37.3(c) and adopt various conforming changes to other provisions in proposed § 37.3(b) and proposed § 37.3(h), as discussed below.

b. § 37.3(b)(1)—Application for Registration

To request registration as a SEF, § 37.3(b)(1)(i) requires an applicant to electronically file a complete Form SEF, as set forth in Appendix A to part 37, with the Commission.[141] The Commission uses Form SEF, which is comprised of a series of different exhibits that require an applicant to provide details of its operations, to determine whether the applicant demonstrates compliance with the Act and applicable Commission's regulations.[142] Applicants must also use Form SEF to amend a pending application or to seek an amended registration order.[143] As part of the SEF registration process, an applicant must also request from the Commission a unique, extensible,

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[138] SEF Core Principles Final Rule at 33487.
[139] The Commission notes that the part 37 regulations became effective on August 5, 2013. Accordingly, the temporary registration provisions expired on August 5, 2015, subject to certain exceptions.
[140] 17 CFR 37.3(b)(5).
[141] 17 CFR 37.3(b)(1)(i).
[142] The exhibits that comprise Form SEF concern the applicant's business organization (Exhibits A-H); financial information (Exhibits I-K); compliance (Exhibits L-U); and operational capability (Exhibit V). 17 CFR part 37 app. A.
[143] 17 CFR 37.3(b)(3); 17 CFR part 37 app. A.

alphanumeric identifier code for the purpose of identifying the SEF in connection with swap reporting requirements pursuant to part 45 of the Commission's regulations.[144]

Based on its experience with the SEF registration process, the Commission believes that some of the information requested under Form SEF has proven to be unnecessary to determine an applicant's compliance with the Act and applicable Commission regulations. The Commission also recognizes that some of the exhibit requirements are unclear in the amount of information required to be provided, thereby causing inconsistency across applications in the information received to evaluate compliance. The proposed changes to the part 37 framework, as discussed further herein, would also necessitate certain Form SEF revisions. Therefore, the Commission is proposing several amendments to Form SEF that would consolidate or eliminate several of the existing exhibits and also request some additional information. Further, the Commission is proposing several amendments to the Form SEF instructions. The Commission intends for these proposed changes to establish a clearer and more streamlined application process that would still provide the Commission with sufficient and appropriate information to determine compliance with the Act and Commission regulations.

(1) Form SEF Exhibits—Business Organization

The Commission proposes several amendments to the "Business Organization" exhibits—existing Exhibits A through H—of Form SEF.[145]

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[144] 17 CFR 37.3(b)(1)(iii).

[145] The Commission is not proposing any substantive changes to Exhibit A, which requires an applicant to specify persons who own ten percent or more of the applicant's stock or otherwise may control or direct the applicant's management or policies; and Exhibit B, which requires an applicant to provide a list of present officers, directors and governors, or their equivalents. The Commission is proposing non-substantive

First, the Commission proposes to consolidate certain existing exhibits, in particular (i) existing Exhibit G, which requires an applicant to submit various governance documents, into existing Exhibit C, which requires information regarding the applicant's board of directors;[146] and (ii) existing Exhibit F, which requires an analysis of the applicant's staffing, into existing Exhibit E, which requires a description of the personnel qualifications for each category of the applicant's professional employees.[147] Under the consolidated new Exhibit E, the Commission proposes to require more specific detail about the applicant's personnel structure, including personnel seconded to the applicant. As proposed, Exhibit E would require information about the reporting lines among the applicant's personnel; estimates of the number of non-management and non-supervisory employees; and a description of the duties, background, skills, and other qualifications for each officer, manager/supervisor, and any other category of non-management and non-supervisory employees. The Commission believes that amending Exhibit E to provide greater specificity would promote consistency among applications

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amendments to Exhibit A to reorganize the existing requirements to paragraphs (a)-(b) and to revise the existing language accordingly.

[146] Existing Exhibit C requires a narrative that describes the composition and fitness standards for the applicant's board of directors. Existing Exhibit G requires a copy of the applicant's constitution, articles of incorporation, articles of formation, or articles of association with all amendments thereto; partnership or limited liability agreements; existing by-laws, operating agreement, rules or instruments corresponding thereto; any governance fitness information not included in existing Exhibit C; and a certificate of good standing. As proposed, the existing Exhibit G requirements would be re-designated as paragraphs (a) and (c) of a consolidated new Exhibit C; existing Exhibit C would be re-designated as paragraph (b) within new Exhibit C.

[147] Existing Exhibit E requires a description of such employees employed by the applicant or a division, subdivision, or other separate entity within the applicant. Existing Exhibit F requires the analysis of staffing requirements that are necessary to operate the applicant as a SEF, including the staff names and qualifications.

and further assist in evaluating the applicant's compliance with the Act and the Commission's regulations, particularly with respect to self-regulatory requirements.[148]

The Commission also proposes to narrow the scope of information required by existing Exhibit D, which requires a description of the applicant's organizational structure that includes a list and description of affiliates and relevant divisions, subdivisions, or other separate entities related to the applicant. As proposed, Exhibit D would require an applicant to describe the nature of the business of any affiliated entities which engage in financial services or market activities, including but not limited to, the trading, clearing, or reporting of swaps. The Commission believes that this amendment would more appropriately focus the required information on entities related to the applicant's swaps-trading business and minimize the submission of information that is not related. Further, the Commission proposes non-substantive amendments to the existing exhibit.

(2) Form SEF Exhibits—Financial Information

The Commission proposes several amendments to the "Financial Information" exhibits—existing Exhibits I through K—of Form SEF.

The Commission proposes to adopt several changes to existing Exhibit I.[149] This exhibit requires applicants to submit financial information to demonstrate compliance with the financial resources requirements under Core Principle 13. Among other required information, paragraph (a) requires applicants to submit their most recent fiscal-year

[148] Based on the proposed consolidation of existing Exhibit F and existing Exhibit G, existing Exhibit H would be re-designated as a new Exhibit F with no additional substantive changes. This exhibit requires a brief description of any material pending legal proceeding(s), other than ordinary and routine litigation incidental to the business, to which the applicant or any of its affiliates is a party or to which any of its or their property is the subject.

[149] The Commission also proposes to re-designate existing Exhibit I as a new Exhibit G based on the proposed changes described above.

financial statements[150] and paragraph (b) requires a narrative of how the value of the applicant's financial resources is sufficient to cover operating costs of at least one year, on a rolling basis, of which six months' value of those resources are unencumbered and liquid. Paragraph (c) requires an applicant to submit copies of any agreements (i) establishing or amending a credit facility, (ii) insurance coverage, or (iii) other arrangement that demonstrate compliance with the liquidity requirement. Paragraph (d) requires an applicant to submit representations regarding sources and estimates for future ongoing operational resources.

The Commission proposes to amend the requirements of paragraphs (a) through (c) to conform to the proposed amendments to the SEF financial resources requirements under Core Principle 13. In particular, the proposed required documentation would demonstrate an applicant's ability to maintain resources that exceed one year of operating costs and the existence of resources to meet the liquidity requirement.[151] The Commission also proposes to eliminate paragraph (d) because the representation of an applicant's future ongoing operational resources is not necessary to determine compliance with Core Principle 13. Additionally, the Commission proposes to amend paragraph (a) to incorporate the existing Form SEF instruction for newly-formed applicants who cannot submit the requisite financial statements, but who alternatively seek to provide *pro forma* financial statements for a six-month period.

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[150] The financial information currently required under paragraph (a) includes an applicant's balance sheet; income and expense statement; cash flow statement; and statement of sources and application revenues and all notes or schedules thereto.

[151] *See infra* Section XVIII.—Part 37—Subpart N: Core Principle 13 (Financial Resources) for a description of the Commission's proposed changes to the Core Principle 13 regulations upon which new Exhibit G is based.

The Commission also proposes to adopt several changes to Exhibit K.[152] This exhibit requires an applicant to provide disclosures related to fees that it would impose upon participants. Paragraph (a) requires a complete list of all of the facility's dues, fees, and other charges for its services; paragraph (b) requires a description of the basis or methods used to determine those amounts; and paragraph (c) requires a description of any differences in charges between different customers or groups of customers for similar services. The Commission proposes to amend paragraph (a) to require applicants to identify any market maker programs, other incentive programs, or other discounts on dues, fees, or other charges to be imposed. Based on the Commission's experience, this information is beneficial in evaluating compliance with access requirements pursuant to Core Principle 2.[153] Given the Commission's proposed revisions to the existing impartial access requirements—in particular, the elimination of the "comparable fees" requirement under existing § 37.202(a)(3)—the Commission further proposes to eliminate the requirement for a description of fee differentials under paragraph (c). The Commission also proposes several streamlining changes to the existing language.

In addition to the amendments to new Exhibit G (existing Exhibit I) and new Exhibit H (existing Exhibit K), the Commission proposes to eliminate existing Exhibit J, which requires an applicant to disclose the financial resources information for any SEF, DCM, or other swap trading platform affiliates. Based on its experience with Exhibit J, the Commission recognizes that this information related to an applicant's affiliates is not

[152] The Commission also proposes to re-designate existing Exhibit K as a new Exhibit H based on the proposed changes described above.

[153] The Commission notes that proposed § 37.202(a)(2) would require a SEF to establish and apply fee structures and fee practices to its market participants in a fair and non-discriminatory manner. *See infra* Section VII.A.1.b.—§ 37.202(a)(2)—Fees.

particularly useful in demonstrating an applicant's compliance with Core Principle 13 or the conflicts of interest requirements under Core Principle 12.

(3) Form SEF Exhibits—Compliance

The Commission proposes several amendments to the "Compliance" exhibits—existing Exhibits L through U—of Form SEF.

First, the Commission proposes to eliminate several exhibits including (i) existing Exhibit P, which requires the applicant to provide information on disciplinary and enforcement protocols, tools, and procedures that is generally duplicative to the details contained in an applicant's rulebook and compliance manual;[154] (ii) existing Exhibit R, which requires a list of the applicant's prohibited trade practice violations that is duplicative to the rules that an applicant must include in its rulebook pursuant to Core Principle 2 requirements;[155] and (iii) existing Exhibit U, which requires a list of items subject to a request for confidential treatment under § 145.9 of the Commission's regulations—as described further below, the Commission proposes to instead require SEFs to identify these documents within the Table of Contents to Form SEF.

Second, the Commission proposes to streamline the requirements of existing Exhibit L.[156] This exhibit currently requires a narrative and documentation that describe the manner in which the applicant complies with each SEF core principle. This documentation includes a regulatory compliance chart that sets forth each core principle

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[154] An applicant is currently required to submit a copy of its rules under existing Exhibit M and a copy of its compliance manual under existing Exhibit O, as currently designated. The Commission is maintaining those requirements under the proposed revisions to Form SEF as a new Exhibit J and a new Exhibit K, respectively. The Commission notes that it proposes to move "arrangements for alternative dispute resolution" under existing Exhibit P to a new Exhibit L described below. *See infra* note 159.

[155] Section 37.203 requires a SEF to establish and enforce trading rules that will deter abuses, including prohibitions on abusive trading practices in its markets. 17 CFR 37.203.

[156] The Commission also proposes to re-designate existing Exhibit L as a new Exhibit I based on the proposed changes described above.

and cites the relevant rules, policies, and procedures that describe the manner in which the applicant is able to comply with each core principle. For issues that are novel or for which compliance with a core principle is not evident, this exhibit also requires an applicant to explain how that item and the application satisfy the SEF core principles. The Commission proposes to streamline this exhibit to require that the applicant only submit the regulatory compliance chart and an explanation of novel issues, as is currently required. Based on its experience, the Commission believes that the regulatory compliance chart with citations to relevant rules, policies, and procedures is sufficient to determine an applicant's compliance with the Act and the Commission's regulations. The Commission has found that the additional narrative and documentation that describe the manner in which the applicant complies with each SEF core principle creates unnecessary paperwork and does not further the Commission's review of an application in this regard. The Commission further proposes certain non-substantive amendments to the existing language of Exhibit L.

Third, the Commission proposes to simplify the requirements of existing Exhibit M.[157] This exhibit currently requires a copy of the applicant's rules, and any technical manuals, other guides, or instruction for SEF users, including minimum financial standards for members or market participants. The Commission proposes to eliminate the existing requirement to cite position limits and aggregation standards in part 151 of the Commission's regulations and any position limit rules set by the facility. As discussed below with respect to Core Principle 6, the Commission intends to address the

[157] The Commission also proposes to re-designate existing Exhibit M as a new Exhibit J based on the proposed changes described above.

position limit issue in a separate rulemaking;[158] the Commission also notes that this requirement is redundant to the applicant's requirement to submit a copy of its rules. Further, the Commission proposes several non-substantive amendments to streamline Exhibit M's existing language.

Fourth, the Commission proposes to eliminate the requirements under existing Exhibit N. The exhibit currently requires an applicant to provide executed or executable copies of any agreements or contracts that facilitate the applicant's compliance with the SEF core principles, including third-party regulatory service provider or member or user agreements. To streamline Form SEF, the Commission would require instead that applicants submit these documents pursuant to other relevant exhibits, as described below.

Fifth, the Commission proposes a new Exhibit L, which would continue to require an applicant to submit user agreements. As proposed, the new exhibit would specify that the required agreements would include, but not be limited to, on-boarding documentation, regulatory data use consent agreements, intermediary documentation, and arrangements for alternative dispute resolution.[159] The new Exhibit L would also require a narrative of the legal, operational, and technical requirements for users to directly or indirectly access the SEF. This requirement reflects some documents that applicants have previously submitted under existing Exhibit N. The additional specificity, however, reflects the Commission's experience with different participant-related agreements that implicate (i) a SEF participant's ability to access the facility's trading system or platform pursuant to

[158] *See infra* Section XI.—Part 37—Subpart G: Core Principle 6 (Position Limits or Accountability).
[159] The Commission notes that "arrangements for alternative dispute resolution" are included based on the requirements of existing Exhibit P, which the Commission proposes to eliminate from Form SEF. *See supra* note 154.

Core Principle 2; and (ii) the facility's use of a SEF participant's proprietary data or personal information under existing § 37.7.[160]

Sixth, the Commission proposes a new Exhibit M to establish requirements related to an applicant's swaps reporting capabilities. The new Exhibit M would require the applicant to submit (i) a list of the SDRs to which the applicant will report swaps data, including the respective asset classes;[161] (ii) an executed copy of all agreements between the applicant and those SDRs; and (iii) a representation from each of those SDRs stating that the applicant has satisfactorily completed all requirements, including all necessary testing, that enables the SDR to reliably accept data from the applicant. These requirements reflect some of the documents that the Commission has required applicants to submit under existing Exhibit N and would enable the Commission to determine the applicant's ability to comply with § 37.901, which requires a SEF to report swap data pursuant to parts 43 and 45 of the Commission's regulations.[162]

Seventh, the Commission proposes a new Exhibit N to incorporate the requirements in existing Exhibit T related to an applicant's ability to submit swaps to a DCO for clearing. New Exhibit N would require the applicant to submit (i) a list of DCOs and exempt DCOs to which the applicant will submit swaps for clearing, including the respective asset classes; (ii) a representation that the clearing members of those DCOs and exempt DCOs will guarantee all trades submitted by the swap execution facility for clearing; (iii) an executed copy of the clearing agreement and any related documentation

[160] The Commission notes that it proposes to move the language of existing § 37.7, which generally prohibits a SEF from using a participant's proprietary data or personal information that it collects or receives for regulatory purposes for business or marketing purposes, to a new § 37.504. *See infra* Section X.D.—§ 37.504—Prohibited Use of Data Collected for Regulatory Purposes.
[161] The Commission notes that the reference to a Commission-registered SDR in Exhibit M also includes a provisionally-registered SDR.
[162] 17 CFR 37.901.

for each of those DCOs or exempt DCOs; and (iv) a representation from each of those DCOs or exempt DCOs stating that the applicant has satisfactorily completed all requirements, including all necessary testing, that enable its acceptance of swap transactions submitted by the applicant for clearing. These requirements reflect some of the documents that the Commission has required applicants to submit under existing Exhibit N and would enable the Commission to determine an applicant's ability to comply with proposed § 37.702(b)(1) under Core Principle 7, which requires a SEF to coordinate with each DCO to facilitate "prompt, efficient, and accurate" processing and routing of transactions to the DCO for clearing.[163]

Eighth, the Commission proposes a new Exhibit O to require an applicant to submit all other agreements or contracts that enable the applicant to comply with the applicable SEF core principles and are not already required to be submitted under new Exhibits L, M, N, or Q.[164] In conjunction with these other exhibits, new Exhibit O matches the scope of documents that an applicant is currently required to submit under existing Exhibit N.[165]

Ninth, the Commission proposes to adopt several changes to existing Exhibit Q.[166] This exhibit currently requires an applicant to provide an explanation of how its

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[163] For a discussion of the relevant proposed amendments to the Core Principle 7 regulations, *see infra* Section XII.B.—§ 37.702—General Financial Integrity.

[164] Exhibit Q requires an applicant to complete and submit the Program of Risk Analysis and Oversight Technology Questionnaire. Among other things, the questionnaire requires an applicant to provide any agreements with third-party IT providers. *See infra* Section XIX.B.—§ 37.1401(g)—Program of Risk Analysis and Oversight Technology Questionnaire.

[165] Given this new proposed exhibit, the Commission proposes to re-designate existing Exhibit O as a new Exhibit K. The content of the exhibit would remain the same and require an applicant to submit a copy of a compliance manual and documents that describe how the applicant will conduct trade practice, market, and financial surveillance.

[166] The Commission also proposes to re-designate existing Exhibit Q as a new Exhibit P based on the proposed changes described above.

trading system(s) or platform(s) satisfy the Commission's rules, interpretations, and guidelines concerning SEF execution methods. Where applicable, paragraphs (a) and (b) of Exhibit Q specify that the explanation should include various details related to the minimum trade functionality requirement under § 37.3(a)(2), *i.e.*, an Order Book, and the prescribed execution methods for Required Transactions under § 37.9, *i.e.*, an Order Book or an RFQ System. As discussed below, the Commission is proposing to eliminate these requirements and to allow SEFs to offer flexible means of execution,[167] subject to certain trading-related rules under proposed § 37.201(a).[168] Accordingly, the Commission proposes conforming changes to Exhibit Q. In addition to the explanation of the applicant's trading system(s) or platform(s), the Commission also proposes to require an applicant to provide screenshots of any of its trading system(s) or platform(s). Based on the Commission's experience, these screenshots provide a useful supplement to evaluate any explanation provided under this exhibit.

Finally, the Commission proposes to consolidate existing Exhibit S, which currently requires a discussion of how the applicant will maintain trading data, into new Exhibit K (re-designated from existing Exhibit O). Exhibit K would require an applicant to submit a copy of its compliance manual and documents that describe how the applicant will conduct trade practice, market, and financial surveillance.

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[167] *See infra* Section IV.I.—§ 37.9—Methods of Execution for Required and Permitted Transactions; § 37.10—Process for a Swap Execution Facility to Make a Swap Available to Trade; § 37.12—Trade Execution Compliance Schedule; § 38.11—Trade Execution Compliance Schedule; § 38.12—Process for a Designated Contract Market to Make a Swap Available to Trade.

[168] Proposed § 37.201(a) would require a SEF to establish rules that govern the operation of the SEF, including rules that specify (i) the protocols and procedures for trading and execution; (ii) the use of discretion in facilitating trading and execution; and (iii) the sources and methodology for generating any market pricing information. *See infra* Section VI.A.1.—§ 37.201(a)—Required Swap Execution Facility Rules.

(4) Form SEF Exhibits—Operational Capability

The Commission proposes to re-designate existing Exhibit V, which requires the applicant to provide information pertaining to its program of risk analysis and oversight via the Technology Questionnaire, as a new Exhibit Q and to adopt non-substantive amendments to the exhibit's existing language.[169] Additionally, the Commission is making certain amendments to update the questionnaire, as described below.[170]

(5) Other Form SEF Amendments

In addition to the proposed amendments to the existing exhibits, the Commission is proposing several changes to the Form SEF instructions. Form SEF currently requires applicants to include a Table of Contents that lists each exhibit submitted as part of the application. In lieu of a separate list provided via existing Exhibit U, the Commission proposes to require that applicants designate, in the Table of Contents, the exhibits that are subject to a request for confidential treatment. The Commission also proposes to require that any such confidential treatment be reflected by some type of identifying number and code on the appropriate exhibit(s), similar to the approach followed for DCO applications and Form DCO.[171] Further, the Commission proposes to eliminate the existing instruction for newly-formed applicants regarding *pro forma* financial statements, which the Commission proposes to incorporate in paragraph (a) of new Exhibit G.

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[169] As discussed below, the Commission is proposing § 37.1401(g) to require a SEF to annually prepare and submit an up-to-date Technology Questionnaire to Commission staff. *See infra* Section XIX.B.—§ 37.1401(g)—Program of Risk Analysis and Oversight Technology Questionnaire.

[170] *See infra* Section XIX.B.—§ 37.1401(g)—Program of Risk Analysis and Oversight Technology Questionnaire.

[171] The Commission also proposes to specify in the Form SEF instructions that an applicant must file a confidentiality request in accordance with § 145.9 of the Commission's regulations..

The Commission also proposes two minor amendments related to the Form SEF cover sheet. First, to enable the Commission to evaluate a SEF's compliance with ongoing filing requirements more readily, the Commission proposes to require an applicant to specify its fiscal year-end date.[172] Second, the Commission proposes to eliminate the reference to the use of Form SEF to amend an existing order or registration, in conformance with the proposed amendment to § 37.3(b)(3) discussed further below.[173]

(6) Request for Legal Entity Identifier

The Commission proposes to eliminate the requirement that an applicant request a "unique, extensible, alphanumeric code" from the Commission under § 37.3(b)(1)(iii) and to require instead that the applicant obtain a legal entity identifier ("LEI"). The Commission adopted part 37 prior to the establishment of the technical specification and governance mechanism for a global entity identifier. Since that adoption, a 20-digit alphanumeric LEI has been developed and adopted by many regulatory authorities in other jurisdictions, as well as the Commission, for use in identifying counterparties and other entities pursuant to various regulatory reporting requirements, including part 45 of the Commission's regulations.[174]

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[172] The Commission notes that these ongoing filing requirements include (i) a fiscal year-end financial report that a SEF would be required to file within ninety days after the end of its fourth fiscal quarter under proposed § 37.1306(d), *see infra* Section XVIII.F.4.—§ 37.1306(d); (ii) proposed Exhibit Q of Form SEF, *i.e.*, the Program of Risk Analysis and Oversight Technology Questionnaire that a SEF would be required to file within ninety days after the end of its fiscal year under proposed § 37.1401(g), *see infra* Section XIX.B.—§ 37.1401(g)—Program of Risk Analysis and Oversight Technology Questionnaire; and (iii) an annual compliance report that a SEF would be required to file within ninety days after the end of its fiscal year under proposed § 37.1501(e)(2), *see infra* Section XX.A.5.—§ 37.1501(e)—Submission of Annual Compliance Report and Related Matters.

[173] *See infra* Section IV.C.3.d.—§ 37.3(b)(3)—Amendment of Application for Registration.

[174] The Commission notes that applicants may obtain an LEI from an LEI-issuing organization that has been accredited by the Global Legal Entity Identifier Foundation ("GLEIF"). GLEIF, About LEI—Get an LEI: Find LEI Issuing Organizations, https://www.gleif.org/en/about-lei/get-an-lei-find-lei-issuing-organizations.

Request for Comment

The Commission requests comments on all aspects of the proposed amendments to § 37.3(b)(1) and Appendix A to part 37.

c. § 37.3(b)(2)—Request for Confidential Treatment

The Commission is not proposing any amendments to § 37.3(b)(2).

d. § 37.3(b)(3)—Amendment of Application for Registration[175]

Section 37.3(b)(3) specifies that an applicant amending a pending application or requesting an amendment to a registration order must file an amended application with the Secretary of the Commission in the manner specified by the Commission. The Form SEF instructions correspond to this requirement and currently specify that requests for amending a registration order and any associated exhibits must be submitted via Form SEF. Section 37.3(b)(3) otherwise specifies that a SEF must file any amendment to its application subsequent to registration as a submission under part 40 of the Commission's regulations, or as specified by the Commission.[176] In the preamble to SEF Core Principles Final Rule, the Commission also stated that if any information provided in a Form SEF is or becomes inaccurate for any reason, even after registration, the SEF "must promptly make the appropriate corrections with the Commission."[177]

The Commission proposes to clarify and amend the requirements regarding post-registration amendments to both Form SEF exhibits and registration orders. First, the Commission proposes to amend § 37.3(b)(3) and Form SEF to eliminate the required use

[175] The Commission proposes to retitle § 37.3(b)(3) to "Amendment of application for registration" from "Amendment of application prior or subsequent to full registration" based on the proposed changes described below.

[176] 17 CFR 37.3(b)(3). Part 40 governs the submission of new products, rules and rule amendments for registered entities, including a process for the voluntary submission of rules for Commission review and approval under § 40.5 and a process for the self-certification of rules under § 40.6. 17 CFR 40.5-6.

[177] SEF Core Principles Final Rule at 33485.

of Form SEF to request an amended order of registration from the Commission.[178] Under current practice, SEFs file a request for an amended order with the Commission rather than submitting Form SEF. Commission staff typically will review the request, obtain additional information from the SEF where necessary, and subsequently recommend to the Commission whether to grant or deny the amended order. Given current practice, the Commission believes that an updated Form SEF is not needed to request an amended order of registration.

Second, the Commission proposes to eliminate the existing language that specifies the use of part 40 to file application amendments subsequent to registration. The Commission emphasizes that not all of the information from the Form SEF exhibits need to be updated pursuant to part 40 subsequent to registration; certain part 37 provisions already require SEFs to update their information on an ongoing basis. For example, under § 37.1306, a SEF is required to file updated financial reports, including fiscal year-end reports, which precludes the need to amend and file new Exhibit G (existing Exhibit I) through part 40. The Commission clarifies that part 40 only applies to information from application exhibits that constitute a "rule," as defined under § 40.1(i).[179] Therefore, registered SEFs have already been submitting changes to these

[178] *See infra* Section IV.C.4.—§ 37.3(c)—Amendment to an Order of Registration.

[179] "Rule" is defined under § 40.1(i) as any constitutional provision, article of incorporation, bylaw, rule, regulation, resolution, interpretation, stated policy, advisory, terms and conditions, trading protocol, agreement or instrument corresponding thereto, including those that authorize a response or establish standards for responding to a specific emergency, and any amendment or addition thereto or repeal thereof, made or issued by a registered entity or by the governing board thereof or any committee thereof, in whatever form adopted. 17 CFR 40.1(i). The Commission generally interprets the § 40.1(i) rule definition broadly to encompass governance documentation (proposed Exhibit C); fees (proposed Exhibit H); rulebooks (proposed Exhibit J); compliance manuals (proposed Exhibit K); participant agreements (proposed Exhibit L); SDR-related agreements (proposed Exhibit M); clearing-related agreements (proposed Exhibit N); other third-party agreements (proposed Exhibit O); and information related to execution methods (proposed Exhibit P).

types of documentation pursuant to the part 40 rule filing procedures. Given that part 40 defines "rule," the existing language is not required to be included under proposed § 37.3(b)(3). If certain information from the Form SEF exhibits are not required to be updated through other part 37 provisions or part 40, then a SEF does not have to file those amendments subsequent to registration. The Commission notes, however, that it may otherwise request information related to a SEF's business pursuant to § 37.5(a).[180]

Request for Comment

The Commission requests comments on all aspects of the proposed amendments to § 37.3(b)(3).

e. § 37.3(b)(4)—Effect of Incomplete Application

The Commission is not proposing any amendments to § 37.3(b)(4).

f. § 37.3(b)(5)—Commission Review Period

Based on the elimination of the temporary registration regime under existing § 37.3(c), the Commission proposes to amend the existing provision to eliminate related language and specify that the Commission reviews a SEF registration application pursuant to a 180-day timeframe and the procedures specified in CEA section 6(a).

g. § 37.3(b)(6)—Commission Determination

The Commission is not proposing any amendments to § 37.3(b)(6).

4. § 37.3(c)—Amendment to an Order of Registration

Consistent with existing Commission practice and the proposal to eliminate the use of Form SEF to request an amended registration order, the Commission proposes a new § 37.3(c)—"Amendment to an order of registration"—to establish a separate process

[180] 17 CFR 37.5(a).

for such requests.[181] A SEF would be required to submit its request electronically in the form and manner specified by the Commission.[182] Similar to the procedures set forth for the registration application process, a SEF would be required to provide the Commission with any additional information and documentation necessary to review a request. The Commission would issue an amended order if the SEF would continue to maintain compliance with the Act and the Commission's regulations after such amendment. Further, the Commission may also issue an amended order subject to conditions. The Commission also proposes to specify that it may decline to issue an amended order based upon a determination that the SEF would not continue to maintain compliance with the Act and the Commission's regulations upon such amendment.

Request for Comment

The Commission requests comments on all aspects of proposed § 37.3(c).

5. § 37.3(d)—Reinstatement of Dormant Registration

The Commission is not proposing any amendments to § 37.3(d).

6. § 37.3(e)—Request for Transfer of Registration

Section 37.3(e) establishes requirements that a SEF must follow when seeking to transfer its registration from its current legal entity to a new legal entity as a result of a corporate change.[183] Among these requirements, § 37.3(e)(2) requires a SEF to file a transfer request no later than three months prior to the anticipated corporate change, or if not possible, as soon as it knows of the change.[184] Section 37.3(e)(3) requires a transfer

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[181] *See supra* Section IV.C.3.d.—§ 37.3(b)(3)—Amendment of Application for Registration.
[182] The Commission proposes to eliminate existing § 37.3(c), which establishes the temporary SEF registration process that is no longer available to applicants, as described above. *See supra* Section IV.C.3.a.—Elimination of Temporary Registration.
[183] 17 CFR 37.3(e).
[184] 17 CFR 37.3(e)(2).

request to include certain information, such as the transferee's governing documents under § 37.3(e)(3)(iv).[185] Under § 37.3(e)(3)(vi), the request must also include certain representations from a transferee, including representations that it will (i) retain and assume, without limitation, all of the assets and liabilities of the transferor; (ii) assume responsibility for complying with the Act and the Commission's regulations; (iii) assume, maintain, and enforce all of the transferor's rules that are applicable to SEFs, including the transferor's rulebook and any amendments; (iv) comply with all self-regulatory responsibilities, including maintaining and enforcing all self-regulatory programs; and (v) notify market participants of all changes to the rulebook prior to the transfer, as well as the transfer and issuance of a corresponding order by the Commission.[186] Under § 37.3(e)(3)(vii), the transfer request must also include a representation from the transferee that upon the transfer, it will assume responsibility for and maintain compliance with the SEF core principles for all swaps previously made available for trading through the transferor; and that none of the proposed rule changes will affect the rights and obligations of any market participant.[187]

The Commission proposes several non-substantive amendments to streamline the existing requirements under § 37.3(e) for filing a transfer request. First, the Commission proposes to simplify the timeline for filing a request by requiring that a SEF file the request "as soon as practicable," rather than no later than three months prior to the

[185] 17 CFR 37.3(e)(3).
[186] 17 CFR 37.3(e)(3)(vi).
[187] 17 CFR 37.3(e)(3)(vii).

anticipated corporate change or as soon as it knows of such a change, if less than three months prior to the change.[188]

Second, with respect to the required information in a transfer request, the Commission also proposes to specifically reference other types of governing documents that would be adopted by transferees, such as a limited liability agreement or an operating agreement.[189] This proposed change acknowledges that a transferee of a SEF's registration may be a non-corporate entity, such as a limited liability company or partnership.

Third, the Commission proposes to simplify a transferee's compliance-related representations under § 37.3(e)(3)(vi). The Commission proposes to consolidate and eliminate unnecessary language;[190] and eliminate the existing requirement that the transferee attest that it will assume, maintain, and enforce compliance with the SEF core principles, as well as maintain and enforce self-regulatory programs.[191] The Commission notes that the language that it proposes to delete is otherwise duplicative to § 37.3(e)(3)(vi)(B), which generally requires the transferee to represent that it will assume responsibility for compliance with all applicable provisions of the Act and the Commission's regulations. Further, the Commission proposes to eliminate the existing requirement under § 37.3(e)(3)(vii)(A) that a transferee represent that it will continue to

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[188] The Commission proposes to adopt this amendment under § 37.3(e)(2).

[189] The Commission proposes to adopt this amendment under § 37.3(e)(3)(iv). The Commission recognizes that different types of entities are established and governed by different types of documentation. For example, a corporation is formed based on articles of incorporation and operates pursuant to bylaws; a limited liability company is generally established pursuant to articles of organization and operates pursuant to an operating agreement; and a limited partnership is generally formed based on a limited partnership agreement. Based on the proposed amendments to § 37.3(e)(iv), the Commission also proposes to amend § 37.3(e)(3)(i) by changing the word "agreement" to "documentation."

[190] The Commission proposes to consolidate existing clauses (B) and (D) into a new proposed clause (B).

[191] The Commission proposes to eliminate this requirement under existing clause (C) and renumber existing clause (E) as clause (C).

comply with the SEF core principles for all swaps made available for trading through the transferor. The Commission notes that all SEFs, whether or not a transferee, must comply with the Act and Commission regulations, including all requirements applicable to a SEF's listed swaps.

Fourth, the Commission proposes to amend § 37.3(e) to better reflect the practical realities of the transfer process. Rather than require a transferee to represent that it will retain and assume all the assets and liabilities of the transferor without limitation, the Commission proposes to instead require that the transferee state in the request when it would not do so.[192] In addition, rather than require a transferee to represent that none of a transferee's proposed rule changes will affect the rights and obligations of any market participant, the Commission proposes instead to require that the transferee represent that it will notify market participants of changes that may affect their rights and obligations.[193] These amendments would eliminate certain pre-emptive restrictions upon business-related changes associated with the transfer, but also allow the Commission to continue reviewing whether such changes may be inconsistent with the Act or the Commission's regulations.

7. § 37.3(f)—Request for Withdrawal of Application for Registration

The Commission is not proposing any amendments to § 37.3(f).

8. § 37.3(g)—Request for Vacation of Registration

The Commission is not proposing any amendments to § 37.3(g).

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[192] The Commission proposes to adopt this amendment under subparagraph (3)(vi)(A).

[193] The Commission proposes to amend the language of existing subparagraph (3)(vii)(B) and renumber the provision to subparagraph (3)(vii)(C) based on the proposed changes described above. The Commission notes that the transferee's notification obligations would not be limited to those that may affect a market participant's rights and obligations; the proposed rule would maintain the existing requirement that a transferee represent that it will notify market participants of all changes to the transferor's rulebook prior to the transfer.

9. § 37.3(h)—Delegation of Authority

Given the deletion of the phrase relating to temporary registration in the existing paragraph, the Commission proposes a conforming non-substantive amendment.

D. § 37.4—Procedures for Implementing Rules[194]

Section 37.4 currently sets forth rules related to the listing of swap products and the submission of rules on a pre- and post-registration basis. Section 37.4(a) specifies that a SEF applicant may submit the terms and conditions of swaps that it intends to list for trading as part of its registration application.[195] Section 37.4(b) specifies that any swap terms and conditions or rules submitted as part of the SEF's application shall be considered for approval by the Commission at the time it issues the SEF's registration order.[196] Section 37.4(c) specifies that after the Commission issues a registration order, the SEF shall submit any proposed swap terms and conditions, including amendments to such terms and conditions, proposed new rules, or proposed rule amendments, pursuant to part 40 of the Commission's regulations.[197] Section 37.4(d) specifies that any swap terms and conditions or rules submitted as part of an application to reinstate a dormant SEF shall be considered for approval at the time that the Commission approves the dormant SEF's reinstatement of registration.[198]

The Commission proposes to eliminate § 37.4(a) and to adopt conforming amendments to § 37.4(b) to establish that the Commission's process of reviewing the terms and conditions of a swap product that the applicant intends to list for trading upon

[194] The Commission proposes to retitle § 37.4 to "Procedures for implementing rules" from "Procedures for listing products and implementing rules" based on the proposed changes described below.
[195] 17 CFR 37.4(a).
[196] 17 CFR 37.4(b).
[197] 17 CFR 37.4(c).
[198] 17 CFR 37.4(d).

registration is separate from the review process of a SEF's application for registration.[199] As amended, § 37.4(b) would specify that rules, except swap product terms and conditions, submitted by the SEF applicant as part of a registration application would be considered for approval at the time the Commission issues an order of registration. Upon obtaining an order of registration, a registered SEF may formally submit product terms and conditions under § 40.2 or § 40.3, which controls the submission of new product terms and conditions by registered entities.[200] Given that the submission procedures for rules, including product terms and conditions, are established under part 40, the Commission also proposes to eliminate unnecessary language by deleting § 37.4(c). The Commission believes that separating these two processes would promote efficiency for both Commission staff and SEF applicants. For example, a SEF applicant's registration order could otherwise be unnecessarily delayed or stayed if the SEF applicant submits for Commission approval, along with its application for registration, a novel or complex product that would require additional consideration or analysis by Commission staff.

To conform to the proposed approach for reviewing swap product terms and conditions from SEF applicants described above, the Commission also proposes to amend § 37.4(d) to delete the reference to any "swap terms and conditions" submitted by a dormant SEF that is applying for reinstatement of registration.[201] Accordingly, dormant SEFs would not be able to provide proposed swap product terms and conditions for approval as part of the dormant SEF registration reinstatement process. Upon obtaining a

[199] The Commission proposes to renumber subsection (b) to subsection (a) based on the proposed amendment as described above.
[200] 17 CFR part 40. Although an applicant may not submit swap product terms and conditions for approval as part of the registration process, the Commission notes that SEF applicants may informally discuss any proposed products with Commission staff for informal feedback as part of the registration process.
[201] The Commission proposes to renumber subsection (d) to subsection (b) based on the proposed amendments as described above.

reinstatement of registration, a SEF may formally submit product terms and conditions under § 40.2 or § 40.3, which controls the submission of new product terms and conditions by registered entities.

Request for Comment

The Commission requests comments on all aspects of the proposed amendments to § 37.4.

E. § 37.5—Provision of Information Relating to a Swap Execution Facility[202]

1. § 37.5(a)—Request for Information

The Commission is not proposing any amendments to § 37.5(a).

2. § 37.5(b)—Demonstration of Compliance

The Commission is proposing certain non-substantive amendments to § 37.5(b).

3. § 37.5(c)—Equity Interest Transfer

Section 37.5(c) sets forth notification requirements related to transfers of equity interest in a SEF. Section 37.5(c)(1) requires a SEF to notify the Commission if the SEF enters into a transaction involving the transfer of fifty percent or more of the equity interest in the SEF.[203] Section 37.5(c)(2) requires the SEF to file the notice at the earliest possible time, but no later than the open of business ten business days following the date upon which the SEF enters into a firm obligation to transfer the equity interest.[204] Upon such a notification, the Commission may request supporting documentation of the

[202] The Commission proposes to retitle § 37.5 to "Provision of information relating to a swap execution facility" from "Information relating to swap execution facility compliance" based on the proposed changes described below.
[203] 17 CFR 37.5(c)(1).
[204] 17 CFR 37.5(c)(2).

transaction.[205] Where any aspect of the transfer constitutes a rule as defined under part 40, § 37.5(c)(3) requires a SEF to comply with the requirements of CEA section 5c(c) and part 40.[206]

The Commission has previously stated that in situations where such an equity transfer occurs, the Commission has an interest in reviewing and considering the implications of the changes in ownership.[207] In particular, the Commission seeks to determine whether the change in ownership will adversely impact the operations of the SEF or the SEF's ability to comply with the core principles and the Commission's regulations thereunder.[208] Further, the Commission intended for § 37.5(c) to enable Commission staff to consider whether any term or condition contained in an equity transfer agreement(s) is inconsistent with the self-regulatory responsibilities of a SEF or with any of the core principles.[209]

The Commission proposes to amend § 37.5(c)(1) to require a SEF to file a notice with the Commission in the event of any transaction that results in the transfer of direct or indirect ownership of fifty percent or more of the equity interest in the SEF. The Commission notes that indirect ownership may transpire, for example, through a

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[205] 17 CFR 37.5(c)(1). In the SEF Core Principles Final Rule, the Commission specified the types of documentation to include, but not be limited to, (i) relevant agreement(s); (ii) associated changes to relevant corporate documents; (iii) a chart outlining any new ownership or corporate or organization structure, if available; and (iv) a brief description of the purpose and any impact of the equity interest transfer. SEF Core Principles Final Rule at 33490. The final rule also stated that a SEF must file a certification regarding its compliance with CEA section 5h and the Commission's regulations thereunder, as set forth in existing § 37.5(c)(4). *Id*.

[206] 17 CFR 37.5(c)(3).

[207] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR 1214, 1217 (Jan. 7, 2011) ("SEF Core Principles Proposed Rule").

[208] *Id*.

[209] *Id*. In the SEF Core Principles Final Rule, the Commission raised the provision to 50 percent from 10 percent and maintained a similar policy rationale, SEF Core Principles Final Rule at 33490, *i.e.*, to "ensure that SEFs remain mindful of their self-regulatory responsibilities when negotiating the terms of significant equity interest transfers." SEF Core Principles Proposed Rule at 1217.

transaction involving a direct or indirect parent company of the SEF. Section 37.5(c), however, only requires a SEF to file a notice where the SEF is a party to a transaction involving a transfer of direct ownership of fifty percent or more of the equity interest in the SEF, but not where the SEF is not a party to the transaction, or where the transaction results in a transfer of indirect ownership of the SEF. The Commission believes that such transfers implicate the same regulatory policies underlying the existing rule and therefore proposes amendments to broaden the requirement. Based on the proposed changes described above, the Commission further proposes conforming non-substantive amendments to § 37.5(c)(2)—"Timing of notification"—and § 37.5(c)(4)—"Certification."[210]

The Commission further proposes to streamline § 37.5(c) by deleting § 37.5(c)(3)—the Commission notes that part 40 already applies to SEFs with respect to rule filings, and therefore, a separate provision is not necessary to apply part 40 to SEFs.

Request for Comment

The Commission requests comments on all aspects of the proposed amendments to § 37.5(c).

4. § 37.5(d)—Delegation of Authority

The Commission is not proposing any amendments to § 37.5(d).

F. § 37.6—Enforceability

1. § 37.6(a)—Enforceability of Transactions

Section 37.6(a) is intended to provide market participants with legal certainty with respect to swap transactions on a SEF and generally clarifies that a swap transaction

[210] The Commission also proposes to renumber paragraph (c)(4) to paragraph (c)(3) based on the proposed elimination of the existing language in paragraph (c)(3) described below.

entered into on or pursuant to the rules of a SEF cannot be void, voidable, subject to recession, otherwise invalidated, or rendered unenforceable due to a violation by the SEF of the Act or applicable Commission regulations or any proceeding that alters or supplements a rule, term or condition that governs such swap or swap transaction.[211]

The Commission proposes non-substantive amendments to § 37.6(a).[212] These amendments include (i) amending the phrase "entered into" to "executed" to provide greater clarity; and (ii) eliminating the reference to swaps executed "pursuant to the rules of" a SEF, which conforms to the proposed amendment to the "block trade" definition under § 43.2, discussed further below.[213]

2. § 37.6(b)—Swap Documentation

Section 37.6(b) requires a SEF to provide each counterparty to a transaction with a written "confirmation" that contains all of the terms of a swap transaction at the time of the swap's execution for both cleared and uncleared swap transactions, including (i) "economic terms" that are specific to a transaction, *e.g.*, swap product, price, and notional amount; and (ii) non-specific "relationship terms" that generally govern all transactions between two counterparties, *e.g.*, default provisions, margin requirements, and governing law.[214] "Confirmation" is defined under parts 43 and 45 of the Commission's regulations as the consummation (electronically or otherwise) of legally binding documentation that memorializes the agreement of the counterparties to *all terms* of the swap (emphasis

[211] 17 CFR 37.6(a).
[212] The Commission also proposes to add a new title to § 37.6(a)—"Enforceability of transactions."
[213] *See infra* Section XXII.—Part 43—§ 43.2—Definition of "Block Trade."
[214] 17 CFR 37.6(b).

added).[215] The definition also states that a confirmation shall be in writing (electronic or otherwise) and legally supersede any previous agreement (electronic or otherwise) relating to the swap.[216] The Commission adopted § 37.6(b), in part, to facilitate this process for swaps transactions—both cleared and uncleared—executed on or pursuant to the rules of a SEF.[217]

For uncleared swap transactions, the Commission is aware that many relationship terms that may govern certain aspects of an uncleared swap transaction are often negotiated and executed between potential counterparties prior to execution.[218] The Commission previously provided that SEFs may satisfy § 37.6(b) for uncleared swap transactions by incorporating by reference the relevant terms set forth in such agreements, as long as those agreements have been submitted to the SEF prior to execution.[219] As applied, § 37.6(b) requires that the SEF obtain and incorporate this documentation into the issued confirmation, which is intended in part to provide SEF participants with legal certainty with respect to uncleared swap transactions.[220]

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[215] 17 CFR 43.2; 17 CFR 45.1. *See also* 17 CFR 23.500 (similar definition of "confirmation" that applies to swap dealers ("SDs") and major swap participants ("MSPs")).
[216] 17 CFR 43.2; 17 CFR 45.1.
[217] SEF Core Principles Final Rule at 33491.
[218] SEF Core Principles Final Rule at 33491 n.195. Swap 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. *See* 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). For uncleared swap transactions, § 23.504(b) requires written documentation of all the terms governing the trading relationship between an SD or MSP and its counterparty. 17 CFR 23.504(b).
[219] SEF Core Principles Final Rule at 33491 n.195.
[220] To ensure that the SEF confirmation provides legal certainty, the Commission stated that counterparties choosing to execute a swap transaction on or pursuant to the rules of a SEF must have all terms, including possible long-term credit support arrangements, agreed to no later than execution, such that the SEF can provide a written confirmation inclusive of those terms at the time of execution. SEF Core Principles Final Rule at 33491.

This requirement, however, has created impractical burdens for SEFs. Based upon feedback from SEFs, the Commission understands that SEFs have encountered many issues in trying to comply with the requirement for uncleared swaps, including high financial, administrative, and logistical burdens to collect and maintain bilateral transaction agreements from many individual counterparties. SEFs have stated that they are unable to develop a cost-effective method to request, accept, and maintain a library of every previous agreement between counterparties.[221] SEFs have also noted that the potential number of previous agreements is considerable, given that SEF counterparties enter into agreements with many other parties and have multiple agreements for different asset classes.[222]

Commission staff has acknowledged these technological and operational challenges and has accordingly granted time-limited no-action relief.[223] Based on this relief, SEFs have incorporated applicable relationship terms from previous agreements by reference in the confirmation without obtaining copies of these agreements prior to the

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[221] Many of these agreements are maintained in paper form or scanned PDF files that are difficult to quickly digitize in a cost-effective manner. *See* WMBAA, Request for Extended Relief from Certain Requirements under Parts 37 and 45 Related to Confirmations and Recordkeeping for Swaps Not Required or Intended to be Cleared at 3 (Mar. 1, 2016). Further, some SEFs have cited the considerable resource cost of obtaining the number of different agreements that exist to accommodate the different parties and different asset classes. *Id.*

[222] *Id.*

[223] Commission staff provided initial no-action relief in 2014. CFTC Letter No. 14-108, Re: Staff No-Action Position Regarding SEF Confirmations and Recordkeeping Requirements under Certain Provisions Included in Regulations 37.6(b) and 45.2 (Aug. 18, 2014). Commission staff has since extended this no-action relief on several occasions. *See* CFTC Letter No. 17-17, Re: Extension of No-Action Relief for Swap Execution Facility Confirmation and Recordkeeping Requirements under Commodity Futures Trading Commission Regulations 37.6(b), 37.1000, 37.1001, 45.2, and 45.3(a) (Mar. 24, 2017); CFTC Letter No. 16-25, Re: Extension of No-Action Relief for Swap Execution Facility Confirmation and Recordkeeping Requirements under Commodity Futures Trading Commission Regulations 37.6(b), 37.1000, 37.1001, 45.2, and 45.3(a) (Mar. 14, 2016); CFTC Letter 15-25, Re: Extension of No-Action Relief for SEF Confirmation and Recordkeeping Requirements under Commission Regulations 37.6(b), 37.1000, 37.1001, and 45.2, and Additional Relief for Confirmation Data Reporting Requirements under Commission Regulation 45.3(a) (Apr. 22, 2015).

execution of a swap.[224] SEFs, however, still must memorialize the relationship terms contained in separate, previously-negotiated agreements that the SEF has not reviewed at the time of incorporation, and would likely not review post-execution. One industry participant, however, noted that a SEF would not be familiar with the terms of the agreements that it is required to incorporate by reference into a confirmation.[225]

Based on its experience with the part 37 implementation, the Commission acknowledges that cleared and uncleared swaps raise different issues with respect to confirmation requirements and the current SEF requirements create difficulties for the latter type of swap transaction. Therefore, the Commission is proposing a revised approach to § 37.6(b) as described below.

a. § 37.6(b)(1)—Legally Binding Documentation

The Commission proposes §§ 37.6(b)(1)(i)-(ii) to establish separate swap transaction documentation requirements for cleared and uncleared swaps. Proposed § 37.6(b)(1)(i)(A) would apply the existing confirmation requirement—that a SEF must issue a written confirmation that includes all of the terms of the transaction—to cleared swap transactions. The Commission further proposes to define "confirmation document" under § 37.6(b)(1)(i)(B) as a legally binding written documentation that memorializes the agreement to all terms of a swap transaction and legally supersedes any previous agreement that relates to the swap transaction between the counterparties.

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[224] *Id*.

[225] *See* SIFMA Asset Management Group, Re: Straight-Through Processing, Swap Execution Facility Implementation and Relief Relating to the Aggregation Provision in Final Block Trade Rule at 6 n.14 (Oct. 25, 2013) (stating that "it is highly impractical for a SEF to familiarize itself with the often complex, bespoke master agreement and trade terms (and the various documents that may be incorporated by reference) in order to produce a customized, potentially complex confirmation on a trade by trade basis.").

With respect to uncleared swap transactions the Commission proposes a revised approach under § 37.6(b)(1)(ii) that would require a SEF to provide the counterparties to an uncleared swap transaction with a "trade evidence record" that memorializes the terms of the swap transaction agreed upon between the counterparties on the SEF. In contrast to a cleared swap confirmation, the trade evidence record would not be required to include all of the terms of the swap transaction, including relationship terms contained in underlying documentation between the counterparties. As defined under proposed § 37.6(b)(1)(ii)(B), a trade evidence record means a legally binding written documentation that memorializes the terms of a swap transaction agreed upon by the counterparties and legally supersedes any conflicting term in any previous agreement that relates to the swap transaction between the counterparties. The Commission anticipates that these terms would include, at a minimum, the "economic terms" that are agreed upon between the counterparties to a specific SEF transaction, *e.g.*, trade date, notional amount, settlement date, and price.

The Commission believes that the proposed rule would provide SEFs with a simplified approach to comply with the legal documentation requirement, but also continue to promote the policy objective of § 37.6(b) by providing SEF participants with legal certainty with respect to both cleared and uncleared swap transactions. Further, the proposed approach accommodates existing counterparty trading practices for uncleared swaps, particularly the use of separate, previously-negotiated underlying agreements to establish relationship terms that generally govern the trading relationship, as opposed to a specific transaction, between two counterparties. To the extent that such terms either are agreed upon between the counterparties in underlying documentation established away

from the SEF and continue to govern the transaction post-execution or are not required to establish legal certainty for a specific transaction, a SEF would not be required to incorporate those terms into a trade evidence record. The proposed approach should address the challenges that have prevented SEFs from fully complying with § 37.6(b) by reducing the administrative burdens for SEFs, who would not be required to obtain, incorporate, or reference those previous agreements, and for counterparties, who would not be required to submit all of their relevant documentation with other potential counterparties to the SEF.[226]

Request for Comment

The Commission requests comments on all aspects of proposed § 37.6(b)(1). In particular, the Commission is particularly interested in the prescribed contents and legal import of a trade evidence record and requests comment on the following questions:

(19) Should the Commission allow a SEF to issue a trade evidence record that does not include all the terms of a swap transaction agreed to on the SEF?

(20) Should the Commission require a SEF to include a minimum set of terms in a trade evidence record, *e.g.*, material economic terms? Should the Commission specify those terms in the proposed regulation?

(21) Should the Commission require a SEF to include any of the "primary economic terms," as defined under § 45.1, in a trade evidence record? If so, which terms should be included?

[226] The Commission acknowledges that the issuance of a trade evidence record would not alter the other obligations of a SEF or the counterparties under the CEA and the Commission's regulations. For example, a SEF would still be required to report all required swap creation data under § 45.3(a), as applicable. 17 CFR 45.3(a). Further, a counterparty that is a swap dealer or major swap participant would also still be required to transmit a confirmation pursuant to § 23.501, as applicable. 17 CFR 23.501.

(22) Should the Commission specify that a trade evidence record (i) serves as evidence of a legally binding agreement upon the counterparties; and (ii) legally supersedes any previous agreement, rather than any conflicting term in any previous agreement, as proposed? With respect to (i), are there terms that are generally contained within previously-negotiated, underlying agreements between the counterparties that are necessary to make a transaction legally binding, and therefore must be submitted to the SEF?

(23) Should the Commission specify in its regulations that notwithstanding the trade evidence record requirement, a SEF is allowed to incorporate by reference underlying, previous agreements containing terms governing a swap transaction into any trade evidence record associated with the transaction?

(24) Do proposed §§ 37.6(b)(1)(i)-(ii) provide sufficient legal certainty with respect to any contradictory terms that may be contained within the previous agreements?

b. § 37.6(b)(2)—Requirements for Swap Documentation

Section 37.6(b) requires that the confirmation take place at the same time as execution, except for a limited exception for certain information for bunched orders.[227] The Commission proposes § 37.6(b)(2)(i) to amend this requirement and instead require a SEF to provide a confirmation document or trade evidence record to the counterparties to a transaction "as soon as technologically practicable" after the execution of the swap transaction on the SEF.[228]

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[227] 17 CFR 37.6(b).

[228] The Commission notes that in the context of real-time public reporting, it has defined "as soon as technologically practicable" to mean as soon as possible, taking into consideration the prevalence, implementation and use of technology by comparable market participants. 17 CFR 43.2. The meaning of this term, as proposed in § 37.6(b)(2)(i) herein, would be consistent with this definition.

The Commission recognizes that a strict implementation of the existing requirement is not practical from a temporal standpoint, given that a SEF's issuance of a written confirmation document or trade evidence record would only occur upon execution by counterparties.[229] Further, the required issuance of a written confirmation document or trade evidence record simultaneous with execution may become further impracticable for some SEFs from an operational and technological standpoint based on the different trading systems or platforms that SEFs may offer under a more flexible approach to execution methods proposed by the Commission.[230] Therefore, proposed § 37.6(b)(2)(i) is intended to establish a more practical approach that accommodates different types of SEF operations. The Commission believes that the proposed standard—"as soon as technologically practicable"—would also continue to promote the Commission's goals of providing the swap counterparties with legal certainty in a prompt manner. Based on this proposed amendment to the existing language of § 37.6(b), the Commission also proposes to renumber the existing requirement regarding bunched orders to proposed § 37.6(b)(2)(ii) and adopt non-substantive amendments.

As noted, § 37.6(b) requires a SEF to provide the written confirmation of a transaction executed on or pursuant to the SEF's rules to "each counterparty to [the] transaction." The Commission proposes to add § 37.6(b)(2)(iii) to provide that a SEF may issue a confirmation document or trade evidence record to the intermediary trading

[229] The Commission notes that a public commenter previously cited execution and confirmation as two separate processes in the swap transaction process. SEF Core Principles Final Rule at 33491 (comment from the Energy Working Group that execution and confirmation are "distinct steps" in the swap transaction process).

[230] *See infra* Section IV.I.—§ 37.9—Methods of Execution for Required and Permitted Transactions; § 37.10—Process for a Swap Execution Facility to Make a Swap Available to Trade; § 37.12—Trade Execution Compliance Schedule; § 38.11—Trade Execution Compliance Schedule; § 38.12—Process for a Designated Contract Market to Make a Swap Available to Trade.

on behalf of a counterparty, provided that the SEF establish and enforce rules to require any intermediary to transmit any such document or record to the counterparty as soon as technologically practicable. Based on industry practice, the Commission notes that to the extent that intermediaries, acting on behalf of swap participants, facilitate swap execution on a SEF, the SEF transmits the written confirmation to the intermediary and then requires the intermediary to forward the confirmation to its customer. The Commission understands that participants using intermediaries to trade on a SEF may not establish the appropriate connectivity necessary to receive written confirmations directly from the SEF. Requiring the intermediary to transmit the document or record as soon as technologically practicable would further accommodate current market practices, as discussed above.

Request for Comment

The Commission requests comments on all aspects of proposed § 37.6(b)(2). In particular, the Commission requests comment on the following questions:

(25) Is the Commission's proposal, to require a SEF to transmit confirmation documents or trade evidence records to counterparties "as soon as technologically practicable" after the execution of the swap transaction on the SEF an appropriate time frame? Should the Commission require that the SEF issue the confirmation document or trade evidence record within a specified time limit?

(26) Is the Commission's proposal to require a SEF to establish and enforce rules that require an intermediary acting on behalf of a counterparty to transmit a confirmation document or trade evidence record to such counterparty "as soon as technologically practicable" an appropriate time frame? Should the Commission require that the SEF issue the confirmation document or trade evidence record within a specified time limit?

(27) Should the Commission define "as soon as technologically practicable" in a similar manner to the definition in part 43?

G. § 37.7—Prohibited Use of Data Collected for Regulatory Purposes

The Commission proposes to move and amend § 37.7, which prohibits a SEF from using proprietary or personal information that it collects or receives to fulfill regulatory obligations for business or marketing purposes, as a new § 37.504 under the Core Principle 5 (Ability to Obtain Information) regulations. The Commission discusses the proposed amendments to the existing requirements further below.[231]

H. § 37.8—Boards of Trade Operating Both a Designated Contract Market and a Swap Execution Facility[232]

Section 37.8(a) requires an entity that operates as both a DCM and a SEF to separately register with the Commission in accordance with the procedures set forth under part 38 and part 37 of the Commission's regulations, respectively. Section 37.8(a) further requires that a dually-registered entity comply with the respective DCM and SEF core principles and regulations on an ongoing basis.

The Commission notes that the language is superfluous to the similar requirements that already exist under § 38.2 and § 37.2 for DCMs and SEFs, respectively, and therefore proposes to delete this latter requirement. The Commission notes, however, that this is not a substantive change and DCMs and SEFs must otherwise comply with the Act and applicable regulations.

[231] *See infra* Section X.D.—§ 37.504—Prohibited Use of Data Collected for Regulatory Purposes.
[232] The Commission proposes to renumber § 37.8 to § 37.7 based on the proposed changes described above.

I. § 37.9—Methods of Execution for Required and Permitted Transactions; § 37.10—Process for a Swap Execution Facility to Make a Swap Available to Trade; § 37.12—Trade Execution Compliance Schedule; § 38.11—Trade Execution Compliance Schedule; § 38.12—Process for a Designated Contract Market to Make a Swap Available to Trade

The CEA, as amended by the Dodd-Frank Act, requires the Commission to develop and implement a regulatory framework for trading swaps on registered SEFs and establishes a corresponding trade execution requirement that requires certain swaps to be executed on DCMs, SEFs, or Exempt SEFs.[233] The regulatory framework that the Commission developed to implement these provisions prescribes, among other things, (i) a process that allows SEFs and DCMs to initiate determinations of which swaps should be subject to the CEA section 2(h)(8) trade execution requirement, *i.e.*, the MAT process; and (ii) the methods of execution that must be used for swaps that are subject to the trade execution requirement. In addition, the framework permits SEFs to offer any method of execution for swaps that are not subject to the trade execution requirement.

The Commission adopted this framework in part to achieve the SEF statutory goals in CEA section 5h(e) of promoting trading on SEFs and promoting pre-trade transparency in the swaps market. The Commission acknowledges that the existing framework has transitioned some swaps trading and market participants to SEFs. Since 2013, however, the Commission has gained considerable knowledge and experience with swaps trading dynamics through implementing part 37, particularly with respect to the required use of certain execution methods. Based on that knowledge and experience, the Commission believes that certain aspects of the current SEF regulatory framework should

[233] 7 U.S.C. 2(h)(8). Although the trade execution requirement may be satisfied through DCMs, the Commission's discussion of the trade execution requirement in this proposed rulemaking will generally pertain to SEFs, unless otherwise noted.

be enhanced to further promote the statutory SEF goals and better maximize the role of SEFs as vibrant and liquid marketplaces for swaps trading.

Accordingly, the Commission is proposing two revisions to the current framework. First, the Commission proposes to adopt a revised interpretation of CEA section 2(h)(8) to set the applicability of the trade execution requirement, *i.e.*, swaps subject to the clearing requirement and listed for trading by a SEF or DCM would be subject to the requirement. Instead of maintaining the current MAT determination process, the Commission believes that this proposed approach would be better aligned with the intent of CEA section 2(h)(8) and further the statutory goal of promoting swaps trading on SEFs. As applied to the current scope of swaps that are subject to the clearing requirement and listed for trading by SEFs and DCMs, the Commission anticipates that this approach would significantly expand the scope of swaps that are subject to the trade execution requirement. Second, based on its understanding of swaps trading dynamics and the increased scope of swaps that would become subject to the trade execution requirement, the Commission also proposes to allow greater flexibility in the trading of such swaps by eliminating the prescribed execution methods for swaps subject to the requirement.

1. Trade Execution Requirement and MAT Process

The trade execution requirement mandates counterparties to execute swap transactions subject to the clearing requirement on a SEF or DCM, unless no SEF or DCM "makes the swap available to trade."[234] The Commission adopted § 37.10 and §

[234] 7 U.S.C. 2(h)(8). CEA section 2(h)(8) also specifies that swaps that are subject to a clearing exception under section 2(h)(7) are not subject to the trade execution requirement. *See infra* Section XXI.A.3.—§ 36.1(c)—Exemption for Swap Transactions Excepted or Exempted from the Clearing Requirement under

38.12 to establish a "MAT determination" process that allows SEFs and DCMs, respectively, to make swaps "available to trade," and therefore, subject to the trade execution requirement.[235] These processes enable a SEF or DCM to make a swap "available to trade" by submitting a determination to the Commission pursuant to the part 40 rule filing procedures.[236] A SEF or DCM that submits a MAT determination must include an assessment of whether the subject swap has "sufficient trading liquidity" and must address at least one of six factors that serve as indicia of the swap's trading liquidity.[237] Swaps that become subject to the trade execution requirement pursuant to the approval or certification of a MAT determination must, with the limited exception of block transactions, be executed by counterparties on a SEF or DCM.[238]

2. Execution Method Requirements

Section 37.9 defines swaps that are subject to the trade execution requirement, *i.e.*, those swaps that must be executed on a SEF or DCM, as "Required Transactions"[239] and specifies that a SEF may only offer two methods for executing such swaps. Specifically, Required Transactions must be executed on (i) an Order Book, as defined

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Part 50. The Commission interprets "swap execution facility" in CEA section 2(h)(8)(B) to include a swap execution facility that is exempt from registration pursuant to CEA section 5h(g). *See supra* note 10.

[235] 17 CFR 37.10; 17 CFR 38.12.

[236] The Commission notes that a SEF or DCM may submit a MAT determination pursuant to the rule approval process under § 40.5 or through the rule certification process under § 40.6. 17 CFR 37.10(a)(1) and 38.12(a)(1).

[237] 17 CFR 37.10(b), 38.12(b). Parts 37 and 38 respectively specify the same six factors: (i) whether there are ready and willing buyers and sellers for the swap; (ii) the frequency or size of transactions in the swap; (iii) the swap's trading volume; (iv) the number and types of market participants trading the swap; (v) the swap's bid/ask spread; and (vi) the usual number of resting firm or indicative bids and offers in the swap. 17 CFR 37.10(b), 38.12(b). The Commission explained in the preamble to the MAT Final Rule that with respect to factors (ii)-(iii), the submitting DCM or SEF could look to DCM, SEF, or bilateral transactions. MAT Final Rule at 3360.

[238] Based on part 40, a MAT determination filing applies the trade execution requirement to a particular swap either upon Commission approval (in the case of a filing submitted for approval under § 40.5) or upon the lack of Commission objection (in the case of a filing submitted on a self-certified basis under § 40.6).

[239] 17 CFR 37.9(a)(1).

under § 37.3(a)(3) and discussed above;[240] or (ii) an RFQ System, as defined under § 37.9(a)(3).[241] An RFQ System is defined, among other requirements, as a trading system or platform where a market participant transmits a request for a bid or offer to no less than three market participants who are not affiliates of, or controlled by, the requester or each other ("RFQ-to-3 requirement").[242] To the extent that a SEF offers an RFQ System for Required Transactions, that system must operate in conjunction with an Order Book, which a SEF is currently required to establish and maintain as a minimum trading functionality.[243] Pursuant to the statutory SEF definition, SEFs have been able to offer these methods through "any means of interstate commerce,"[244] which the Commission has interpreted to mean "a variety of means of execution or communication, including, but not limited to, telephones, internet communications, and electronic transmissions."[245] Accordingly, SEFs have been able to develop and offer an Order Book or RFQ System through various forms, including voice-based systems.

In establishing the Order Book and RFQ System requirements, the Commission sought in part to transition swaps trading onto SEFs and achieve the statutory SEF goal of promoting pre-trade price transparency in the swaps market. In addition to establishing

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[240] *See supra* notes 123-125 and accompanying discussion (definition of "Order Book" under § 37.3(a)(3)).
[241] 17 CFR 37.9(a)(2).
[242] 17 CFR 37.9(a)(3). The RFQ System definition additionally specifies that the three requesters may not be affiliates or controlled by one another; and the system must provide each of its market participants with equal priority in receiving RFQs and transmitting and displaying for execution responsive orders. 17 CFR 37.9(a)(3); 17 CFR 37.9(a)(3)(iii).
[243] 17 CFR 37.9(a)(2)(i)(B). In operating an RFQ System in conjunction with an Order Book, a SEF must communicate to a requester any firm bid or offer pertaining to the same instrument resting on any of the SEF's Order Books; and provide the requester with the ability to execute against such firm resting bids or offers along with any responsive RFQ orders. 17 CFR 37.9(a)(3)(i)-(ii). As discussed above, the Commission is proposing to eliminate the minimum trading functionality under § 37.3(a)(2) and the Order Book definition under § 37.3(a)(3). *See supra* Section IV.C.2.—§§ 37.3(a)(2)-(3)—Minimum Trading Functionality and Order Book Definition.
[244] 7 U.S.C. 1a(50).
[245] SEF Core Principles Final Rule at 33501 n.328.

the Order Book as a minimum trading functionality for all swaps listed for trading by a SEF, the Commission intended for the Order Book requirement to promote such transparency for swaps subject to the trade execution requirement. The Commission did acknowledge, however, that an Order Book lacks the appropriate flexibility to be suitable for trading many types of swaps, in particular those lacking liquidity.[246] The lack of liquidity is a characteristic of broad segments of the swaps market, which trade episodically among a limited number of market participants in large average notional amounts.

To address this lack of suitability even within the scope of Required Transactions, the Commission prescribed the RFQ System as an alternative execution method for these transactions.[247] At the time, the Commission observed that RFQ systems provide market participants with a certain level of trading flexibility, in particular by allowing them to balance the risks of information leakage and front-running associated with disclosing trading interests against the price competition benefits derived by disseminating a request to a larger number of participants.[248] The Commission recognizes that most SEFs currently offer an RFQ System for most of the respective products that they list for trading; when trading swaps subject to the trade execution requirement, market

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[246] SEF Core Principles Final Rule at 33564-65. In the preamble to the SEF Core Principles Final Rule, the Commission expressed its anticipation that "the order book method will typically work well for liquid Required Transactions (*i.e.*, transactions involving swaps that are subject to the trade execution requirement in CEA section 2(h)(8)), but for less liquid Required Transactions, RFQ systems are expected to help facilitate trading." *Id.*

[247] 17 CFR 37.9(a)(2). The Commission adopted the RFQ System requirement based upon its prevalence in the OTC swaps market. *Id.* at 33564. The Commission stated that "RFQ systems are currently used by market participants in the OTC swap market, many in conjunction with order book functionality." In adopting the requirement, the Commission also stated it was "leveraging best practices from current swaps trading platforms." *Id.* at 33565.

[248] SEF Core Principles Final Rule at 33476.

participants have mostly utilized an RFQ System, transmitting RFQs to more than three unaffiliated market participants in many instances.[249]

3. Implementation of Existing Requirements

While the Commission acknowledges that the existing approach has transitioned some swaps trading to SEFs, this transition has stagnated and will not likely increase further without changes to the existing regulatory framework. This stagnation, as discussed further below, is reflected by the limited set of swaps that have become subject to the trade execution requirement, and therefore subject to mandatory trading on SEFs, through the Commission's MAT process. The lack of additional swaps becoming subject to the requirement over the last several years has been attributable to market participants' concerns over the Commission's Order Book and RFQ System requirements for Required Transactions under § 37.9; this concern, in turn, has dissuaded SEFs from submitting additional MAT determinations.

Since the Commission's adoption of the MAT determination process, a small number of swaps that are subject to the clearing requirement have become subject to the trade execution requirement. In the fall of 2013, four SEFs and one DCM submitted a limited number of swaps to the Commission as "available to trade" via the Commission's § 40.6 self-certification process.[250] The swaps submitted consist of the current "on-the-

[249] In discussing trading of CDX and iTraxx indices, Lynn Riggs, Esen Onur, David Reiffen, and Haoxiang Zhu found that "[c]ustomers most frequently request quotes from three dealers, which happens in about 45% of the RFQ sessions, followed by five dealers, which happens in just below 30% of the RFQ sessions. In about 18% of the sessions the customer selects four dealers." Lynn Riggs, Esen Onur, David Reiffen, & Haoxiang Zhu, Mechanism Selection and Trade Formation on Swap Execution Facilities: Evidence from Index CDS 10 (2017), https://www.cftc.gov/idc/groups/public/@economicanalysis/documents/file/oce_mechanism_selection.pdf ("2017 Riggs Study").

[250] TW SEF LLC – Amendment to Self-Certification for Swaps to be Made Available to Trade (Jan. 26, 2014) (third amended filing from initial submission on October 28, 2013); Javelin SEF, LLC, No. 13-

run" and most recent "off-the-run" index CDS with a five-year tenor and fixed-to-floating IRS with benchmark tenors denominated in U.S. dollars, euros, and pound sterling.[251] The IRS and CDS that are currently subject to the trade execution requirement represent the most standardized and highly liquid swaps contracts offered by SEFs,[252] but also represent a very limited segment of the potential universe of swaps eligible to become subject to the trade execution requirement, *i.e.*, those swaps that are both subject to the clearing requirement and currently listed for trading on a SEF.[253] Based on data evaluated by the International Swaps and Derivatives Association ("ISDA"), approximately 85 percent of total reported IRS traded notional volume ("traded

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06R(3), Javelin Determination of Made Available to Trade of Certain Interest Rate Swaps made Pursuant to Parts 37 of the Rules of the Commodity Futures Trading Commission (Jan. 8, 2014) (third amended filing from initial submission on October 18, 2013) ("Javelin SEF MAT Determination"); Bloomberg SEF LLC, No. 2013-R-9, Bloomberg SEF LLC – Made Available to Trade ("MAT") Submission of Certain Credit Default Swaps ("CDS") and Interest Rate Swaps ("IRS") pursuant to Commodity Futures Trading Commission (the "Commission") Regulation 40.6 (submission #2013-R-9) (Dec. 5, 2013) ("Bloomberg SEF MAT Determination"); MarketAxess SEF Corporation, Made Available to Trade ("MAT") Submission of Certain Credit Default Swaps (Oct. 30, 2013) ("MarketAxess SEF MAT Determination"); trueEX, LLC, Submission 2013-14, Made Available to Trade ("MAT") Submission of Certain Interest Rate Swaps ("IRS") pursuant to CFTC Regulation 40.6 (Oct. 21, 2013) ("trueEX MAT Determination").

[251] CFTC, Industry Filings—Swaps Made Available to Trade, https://www.cftc.gov/idc/groups/public/@otherif/documents/file/swapsmadeavailablechart.pdf.

[252] *See, e.g.*, TW SEF LLC – Self-Certification for Swaps to be Made Available to Trade at 8 (Oct. 28, 2013) (describing the IRS submitted as benchmark swaps with the most liquidity and the CDS submitted as the most actively traded); Javelin SEF MAT Determination at 11 (noting that the bid-offer spreads for the IRS submitted is tight and characteristic of considerable liquidity); Bloomberg SEF MAT Determination at 3 (stating that the scope of the MAT determination represents IRS and CDS that are the most standardized and liquid); MarketAxess SEF MAT Determination at 1 (stating that the MAT determination consists of the most liquid CDS listed); trueEX MAT Determination at 4 (specifying that the trade frequency of IRS with whole-year tenors is sufficient to support a MAT determination).

[253] The clearing requirement currently applies to various categories of IRS, including fixed-to floating swaps denominated in U.S. dollars, pound sterling, and euros with whole- and partial-year tenors that range from 28 days to 50 years; fixed-to-floating swaps in additional currency denominations with whole and partial tenors that range from 28 days up to 30 years; basis swaps, overnight index swaps, and forward rate agreements in varying denominations and tenors; and various CDX and iTraxx index CDS in the current on-the-run series and a broad range of older series (prior to the most recent off-the-run series) with whole-year benchmark tenors. 17 CFR 50.4.

notional") in 2017 consisted of swaps subject to the clearing requirement.[254] This represents an increase from the approximately 73 to 77 percent of total reported IRS traded notional during 2015 to 2016 that was subject to the clearing requirement.[255] Data analysis conducted by Commission staff found that the percentage of trading volume in IRS subject to the trade execution requirement is far lower than the percentage subject to the clearing requirement and has actually declined, from approximately 10 to 12 percent of total reported IRS traded notional in 2015 to approximately 7 to 9 percent of the total reported IRS traded notional in 2017 and the first half of 2018.[256]

Beyond this limited initial set of self-certified MAT determinations, however, the Commission has not received any additional MAT determinations for the significantly large number of IRS and CDS that are subject to the clearing requirement. This discrepancy has grown even larger as a result of a subsequent expansion of the clearing requirement.[257] The Commission believes that the lack of further MAT determinations from SEFs or DCMs is largely attributed to the influence of market participants who believe that applying the trade execution requirement, and therefore the required use of an Order Book or RFQ System, would adversely impact their ability to utilize execution

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[254] ISDA, ISDA Research Note: Actual Cleared Volumes vs. Mandated Cleared Volumes: Analyzing the US Derivatives Market 3 (July 2018), https://www.isda.org/a/6yYEE/Actual-Cleared-Volumes-vs-Mandated-Cleared-Volumes.pdf ("2018 ISDA Research Note").

[255] *Id*.

[256] Commission staff conducted data analysis based on publicly available data accessed via Clarus Financial Technology ("Clarus"). In a separate analysis, ISDA found that only 5 percent of trading volume in IRS during 2015 and the first three quarters of 2016 consisted of IRS subject to the trade execution requirement. ISDA, ISDA Research Note: Trends in IRD Clearing and SEF Trading 1, 3, 11 (December 2016), https://www.isda.org/a/xVDDE/trends-in-ird-clearing-and-sef-trading1.pdf ("2016 ISDA Research Note").

[257] The Commission expanded the list of swaps subject to the clearing requirement in 2016 by adding several new classes of IRS denominated in nine different currencies. *See supra* note 35. The Commission believes that the expansion likely contributed to the increase noted above in the percentage of total reported IRS traded notional subject to the clearing requirement in 2017 relative to prior years.

methods that are best suited for the swap they are trading and their individual trading needs.[258]

To establish which swaps would be sufficiently liquid to be traded via an Order Book or RFQ System, the Commission relied upon the expertise and experience of SEFs and DCMs in the MAT determination process.[259] The limited number of MAT determinations that has resulted reflects these execution methods' lack of suitability in facilitating a broad range of swaps trading. Market participants have stated that the prescriptive requirements under § 37.9 limit their ability to otherwise utilize other execution methods that they believe may be better suited to address their business needs, adapt to quickly-changing market conditions, or achieve some combination thereof.[260] Given that many of the swaps that are subject to the clearing requirement are highly customizable and less liquid, continuing to mandate the use of an Order Book and RFQ System is inconsistent with transitioning a broader segment of the swaps market to the SEF regulatory framework. Therefore, the Commission recognizes the need for greater

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[258] SIFMA AMG noted that these limited methods of execution meant that a MAT determination "could force the entire swap market to change its practice, disrupting trading and upending the natural evolution of market dynamics." *See* Letter from the Asset Management Group of the Securities Industry and Financial Markets Association ("SIFMA AMG"), In re Concerns Regarding the SEF Framework 3 (May 11, 2015) ("2015 SIFMA AMG Letter"). Further, SIFMA AMG argued that the "artificial limitation" on execution methods for required transactions "has resulted in reduced liquidity and fewer options for asset managers working to reduce portfolio risk in a cost-effective manner…." *Id*. At a Commission roundtable discussion on the MAT process, one participant noted that market participant aversion to a broad MAT determination by Javelin SEF discouraged other SEFs from submitting determinations, based on the fear that market participants would cease trading or avoid their respective platforms altogether. 2015 MAT Roundtable at 65-67. *See also* Joe Rennison, Experts split on MAT determinations, Risk.net (Nov. 8, 2013), https://www.risk.net/infrastructure/trading-platforms/2305790/experts-split-mat-determinations (noting market participant resistance to Javelin SEF's initial MAT submission).

[259] MAT Final Rule at 33609.

[260] *See* 2015 SIFMA AMG Letter at 8 (In re the current approach to required methods of execution: "this prescriptive approach has negatively impacted market conditions and has caused fragmentation of the U.S. swap market. The unnecessary restriction on modes of execution…limits a SEF's ability to foster liquidity and diminishes the venues that asset managers may access for liquid, competitive pricing.").

flexibility in execution methods to broaden the scope of the trade execution requirement over additional swaps trading.[261]

The Commission acknowledges that the Order Book and RFQ System requirements are too prescriptive and limiting to be applied over a broader segment of the swaps market. Specifically, these methods do not account for the swaps products that are highly customized and episodically liquid by nature. The Commission previously acknowledged that market participants take into account factors such as swap product complexity, trade size, and liquidity in deciding how to trade swaps, including the number of market participants to whom a request for quote will be sent.[262] Thus, even the RFQ-to-3 requirement, which the Commission adopted to provide more execution flexibility, may hinder market participants from determining the appropriate number of market participants to disseminate an RFQ for the additional swaps that would be subject to the trade execution requirement. Mandating the use of limited methods of execution for swaps subject to the requirement imposes the Commission's judgment regarding how best to execute different swaps and ultimately inhibits market participants from tailoring their own trading strategies and decisions based on the swaps involved, their individual business needs, the desired transaction size, and existing market conditions, among other factors.

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[261] The Commission notes that the current SEF regulatory framework allows a SEF to offer flexible methods of execution for swaps that are not subject to the trade execution requirement, *i.e.*, Permitted Transactions; this approach would facilitate trading in bespoke or less liquid swaps on a SEF. 17 CFR 37.9(c). As noted above, only 7 to 9 percent of total reported IRS traded notional has consisted of swaps subject to the trade execution requirement in recent months; however, approximately 57 percent of total reported IRS traded notional has occurred on SEFs in 2018. ISDA, ISDA SwapsInfo Weekly Analysis: Week Ending October 19, 2018, http://analysis.swapsinfo.org/2018/10/interest-rate-and-credit-derivatives-weekly-trading-volume-week-ending-october-19-2018/ ("2018 ISDA SwapsInfo Weekly Analysis"). Accordingly, the Commission believes that adopting a more flexible approach to execution methods in the SEF regulatory framework would better reflect the current swaps market environment.

[262] SEF Core Principles Final Rule at 33562.

The required methods of execution has also limited SEFs from developing more efficient, transparent, and cost-effective methods of trading, as well as impeded their ability to compete with one another using innovative and different methods of execution.[263] For example, a SEF may develop a new trading functionality that does not qualify as an Order Book or RFQ System, but is effective and efficient in trading both IRS that are and are not subject to the trade execution requirement. Under the current regulatory framework, participants could not use that new method for IRS that are subject to the trade execution requirement or IRS that would become subject to the requirement in the future. This scenario deprives market participants of a useful execution method and deprives the SEF that developed the method of benefitting from its innovative efforts.

The Commission notes that this scenario could occur with respect to forward rate agreements ("FRAs"), many of which are economically similar to IRS that are currently subject to the trade execution requirement. In spite of this economic similarity, FRAs in several different types of currency denominations and tenor ranges that are currently subject to the clearing requirement, but have not been submitted to the Commission as "available to trade."[264] Based on an ISDA analysis, over 97 percent of total reported FRA traded notional during the third quarter of 2016 was cleared and approximately 81 percent of which was traded on SEF and accounted for slightly less than 54 percent of total reported IRS traded notional occurring on SEFs.[265] The Commission has observed

[263] At the Commission's 2015 MAT Roundtable, one participant expressed concern that a MAT determination would "cut[]off potential modes of execution," rather than promoting new innovative execution methods. *See* 2015 MAT Roundtable at 165.
[264] 17 CFR 50.4 (specifying the FRAs that are subject to mandatory clearing).
[265] 2016 ISDA Research Note at 5. The Commission notes that these statistics include both swaps subject to the clearing requirement and swaps that are voluntarily cleared. In a subsequent analysis, however, ISDA determined that 92 to 98 percent of total reported FRA traded notional from 2014 to 2017 consisted of FRAs subject to the clearing requirement. 2018 ISDA Research Note at 9. Commission staff replicated

that FRA trading on SEFs occurs through "permitted" execution methods, such as risk mitigation services,[266] that assist market participants with managing their exposures to market, credit, and other sources of risk.[267] Despite their utility, risk mitigation services do not constitute an Order Book or RFQ System, and therefore, are not available as an execution method for swaps subject to the trade execution requirement under the current regulatory framework. Given that many FRAs would become subject to the trade execution requirement under the Commission's proposed regulatory framework, as discussed further below, allowing SEF participants to continue executing these types of swaps would require more flexible execution methods that are appropriate for conducting risk mitigation exercises.

Further, the Commission believes that the current approach to required methods of execution may have imposed barriers to entry for entities that seek to offer swaps trading. As noted above, limiting the execution methods that a SEF can provide limits their ability to offer new and innovative trading solutions. As a result, new entrant SEFs have been unable to differentiate themselves from incumbent SEFs on the basis of innovation and development, given that both incumbent platforms and newly-registered entities are otherwise limited to offering an Order Book and an RFQ System.

ISDA's results and also found that in 2018, the share of total reported FRA traded notional that is cleared has increased to 99 percent, with approximately 81 percent of cleared FRAs continuing to trade on SEF. Commission staff also found that during the first half of 2018, cleared FRAs accounted for approximately 48 percent of IRS volume on SEFs, a somewhat smaller share than the amount that ISDA found during its own review period.

[266] The Commission notes that market participants have contended that the required methods of execution are unsuitable for allowing SEFs to conduct risk mitigation services for swaps that are subject to the trade execution requirement. *See* CFTC Letter No. 13-81, Time-Limited No-Action Relief from Required Transaction Execution Methods for Transactions that Result from Basis Risk Mitigation Services (Dec. 23, 2013). *See also* 2016 WMBAA Letter at app. A (stating that "[a]dditional methods of execution for Required Transactions should include risk mitigation [platforms]").

[267] The Commission previously determined that risk mitigation services that facilitate swap execution are subject to the SEF registration requirement. SEF Core Principles Final Rule at 33482-83.

Accordingly, SEFs have been forced to compete with one another on a more ancillary basis, rather than on fundamental operating aspects that provide value to market participants, in particular the available trading system and platform.

The Commission's current approach to required methods of execution has also compelled SEFs to make unintended adjustments and alterations to their execution methods, including auction platforms[268] and work-up trading protocols.[269] Given the prescriptive requirements that a SEF execution method must comply with to qualify as an Order Book under § 37.3(a)(3) or as an RFQ System under § 37.9(a)(3), some SEFs have expended time and effort to amend certain aspects of their trading systems or platforms, including trading protocols, prior to allowing participants to use those methods to execute swaps subject to the trade execution requirement. The Commission acknowledges that SEFs have not been able to employ and operate execution methods that are fully developed to facilitate price discovery and more robust participation on the SEF in periods of episodic liquidity. Rather, requiring SEFs to adjust various aspects of their respective systems or platforms to comply with the required methods of execution has likely introduced operating inefficiencies that have not provided corresponding benefits to SEF participants. Therefore, the Commission believes that the prescriptive execution

[268] For a description of auction-based platforms, *see infra* note 313 and accompanying discussion.

[269] In a trade work-up session associated with a SEF's trading system or platform, two participants that execute a particular swap transaction at a particular price have the opportunity to execute additional volume of that swap at that price within a given time period established by the SEF. When that period has lapsed, multiple other buyers and sellers may then seek to execute that particular swap at the established price set by the initial transaction. Interested participants may continue to seek to execute that swap at the established price until the buying and selling interest is exhausted or the work-up session has expired, as set forth by the SEF. The Commission has observed that SEFs offer these sessions within a particular execution method, *e.g.*, an electronic order book, to encourage participants to provide liquidity to the market.

methods have inhibited the effectiveness of execution methods designed and developed by SEFs to promote trading.

4. Proposed Approach

To further promote the SEF statutory goals, the Commission proposes a SEF regulatory framework that would facilitate a more robust application of the trade execution requirement and allow more flexibility in the execution methods that may be offered and used for trading swaps that are subject to the requirement. The Commission believes that this approach would better establish SEFs as vibrant and liquid marketplaces for swaps trading that foster price discovery and liquidity formation. The Commission believes that its proposed approach is consistent with the statutory SEF provisions and would also further the statutory SEF goals, while helping to alleviate the challenges of the existing approach described above.

The Commission proposes to adopt a new interpretation of the trade execution requirement that would greatly expand the scope of swaps that are subject to the requirement. Considering the market characteristics and episodic liquidity profiles of these additional swaps, the Commission's proposed approach would provide needed flexibility to SEFs and market participants to support more trading through SEF trading systems or platforms. In conjunction with an expansion of the trade execution requirement, the Commission also proposes to eliminate the prescriptive execution methods for swaps subject to the requirement. Rather than impose execution method requirements that are limited to an Order Book or RFQ System, the Commission's proposed approach would allow SEFs to develop and offer—and therefore enable—market participants to choose execution methods that are appropriate to their trading.

Providing market participants with greater choice in execution methods allows them to utilize trading systems or platforms that are not constrained by prescriptive regulatory requirements and suit their trading circumstances and the market conditions for those swaps at a given time. This flexibility is necessary to facilitate trading in the broad scope of swaps that would become subject to the trade execution requirement. This flexibility should also allow the swaps market and SEFs to continue to naturally evolve and innovate to more efficient, transparent, and cost effective means of trading, even for swaps currently subject to the trade execution requirement. The Commission believes that this flexibility, in concert with the concentration of trading activity in episodically liquid swaps on SEFs, should help foster price discovery and allow market participants to pursue more appropriate, counterparty and swap-specific levels of pre-trade price transparency through additional methods of execution.[270] Accordingly, the Commission believes that more execution flexibility also reduces certain complexity, costs, and burdens that have impeded SEF development and innovation, particularly with more swaps that would be subject to mandatory trading on SEFs. Ultimately, this approach is intended to attract greater liquidity that would promote more trading on SEFs.

a. § 36.1(a)—Trade Execution Requirement

The Commission has interpreted the trade execution requirement in CEA Section 2(h)(8)—in particular, the phrase "makes the swap available to trade"—in a manner that

[270] As discussed above, the Commission acknowledges that market participants take into account factors such as swap product complexity, trade size, liquidity, and the associated desire to minimize potential information leakage and front-running risks in deciding how to trade swaps, including the number of market participants to whom a request for quote will be sent. In selecting that number of market participants to whom a request for quote will be sent, the market participant is determining the appropriate level of pre-trade transparency necessary to efficiently and effectively execute that swap transaction based on the above factors and its individual trading needs. *See supra* Section I.B.1.b.—Swaps Market Characteristics.

has limited the scope of swaps that must be traded on a SEF.[271] Initially designed to ensure that the Order Book and RFQ System requirements could support swaps that are sufficiently liquid for trading, the MAT determination process has resulted in a small number of swaps that are currently subject to the trade execution requirement. As noted above, Commission staff has determined that only a small and declining percentage of total reported IRS traded notional over a recent time period is subject to the trade execution requirement, with only part of overall IRS trading volume occurring on SEFs.[272]

Given the current regulatory framework's limited ability in promoting swaps trading on SEFs, which limits the statutory SEF goals, the Commission is proposing to adopt a revised interpretation of CEA section 2(h)(8). The Commission believes that the phrase "makes the swap available to trade" should be interpreted to mean that once the clearing requirement applies to a swap, then the trade execution requirement applies to that swap upon any single SEF or DCM listing the swap for trading.[273] As previously noted by some commenters to the proposed MAT rule, CEA section 2(h)(8) does not mandate the MAT process adopted by the Commission to implement the trade execution requirement.[274] The Commission believes that the most straightforward reading of CEA

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[271] MAT Final Rule at 33606.

[272] *See supra* notes 256 and 261 and accompanying discussion.

[273] In addition to DCMs and SEFs, CEA section 2(h)(8) contemplates the ability of Exempt SEFs to list swaps subject to the clearing requirement. As discussed below, the Commission proposes to use its exemptive authority pursuant to CEA section 4(c) to exclude swaps that are exclusively listed by Exempt SEFs from being subject to the trade execution requirement. Accordingly, only a CFTC-registered DCM or SEF would be able to trigger the CEA section 2(h)(8) trade execution requirement by listing a clearing requirement swap. *See infra* Section XXI.A.2.—§ 36.1(b)—Exemption For Certain Swaps Listed Only By Exempt SEFs.

[274] MAT Final Rule at 33607. These commenters believed that use of the clearing determination process in CEA section 2(h)(2) "as the exclusive basis for finding that a swap is available to trade would subject more swaps to the trade execution requirement and further the objectives of the Dodd-Frank Act." SEF Core Principles Final Rule at 33607-08. Some commenters pointed out that the procedure for determining

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.

The Commission notes 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 when amending the CEA via the Dodd-Frank Act.[275] In contrast, the clearing requirement, established by Congress concurrently with the trade execution requirement under the Dodd-Frank Act, sets forth a formal statutory process for the Commission to follow in determining which swaps must be submitted to a DCO for clearing.[276] The Commission notes that the statutory process in CEA section 2(h)(2) establishes that submissions from a DCO for each swap, or any group, category, type, or class of swap that it plans to accept for clearing is automatically subject to a clearing determination by the Commission.[277] As part of a clearing requirement determination, the CEA requires the Commission to evaluate submitted swaps based on a prescribed set

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whether a swap was made available to trade was "duplicative of the mandatory clearing determination process [in CEA section 2(h)(2)] and accordingly stated that the Commission should rely on the clearing determination process to also determine whether a swap is available to trade." MAT Final Rule at 33607.

[275] The Commission also observes that Congress specifically placed the trade execution requirement within the CEA section 2(h) heading of "clearing requirement." The Commission believes that this placement of the trade execution requirement within the clearing requirement further supports the view that no additional framework was intended by Congress beyond the processes already enumerated within this section. 7 U.S.C. 2(h).

[276] Specifically, 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. Among other things, the Commission must consider outstanding notional exposures; trading liquidity; adequate pricing data; adequate clearing infrastructure; mitigation of systematic risk; effects on competition; and legal certainty surrounding solvency concerns. 7 U.S.C. 2(h)(2).

[277] CEA section 2(h)(2)(B)(iii)(II).

of factors that includes trading liquidity.[278] Given the absence of analogous CEA provisions governing the trade execution requirement and based on its experience since implementing the swaps trading framework, the Commission believes that the proposed interpretation of CEA section 2(h)(8) is consistent both with that statutory provision and with the statutory goal of promoting the trading of swaps on SEFs.

As support for its view that the proposed interpretation of CEA section 2(h)(8) would promote the trading of swaps on SEFs, the Commission notes that more than 85 percent of IRS and index CDS trading volume is currently subject to the clearing requirement;[279] many, but not all, of those swaps are currently listed for trading by SEFs. Therefore, the proposed reading would both promote the statutory SEF goal of swaps trading on SEFs and help to further swaps liquidity on SEFs by requiring all counterparties to trade these swaps on a SEF, which may promote increased pre-trade price transparency.[280] A more robust trade execution requirement would help migrate

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[278] As adopted under part 50 of the Commission's regulations, the Commission has 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. 77 FR 47176.

[279] 2018 ISDA Research Note at 3, 15-16.

[280] The Commission believes that further achieving both SEF statutory goals—promoting trading on SEFs and promoting pre-trade price transparency—requires both (i) increasing the number of swaps that are subject to the trade execution requirement, thereby increasing the amount of trading that must occur on SEF; and (ii) concurrently providing flexible execution methods. The Commission believes that requiring market participants to conduct a larger portion of their swaps trading on SEFs would centralize liquidity, foster additional competition among a more concentrated number of market participants, and reduce information asymmetries that would increase market efficiency and decrease transaction costs. While offering flexible methods of execution alone could transition additional swaps trading to SEFs, the Commission believes that maximizing the potential benefits of the proposed approach necessitates an approach that would also lessen fragmentation in trading of swaps on SEFs versus the OTC environment.

Accordingly, the Commission's proposed approach would have a profound impact on the amount of swaps trading that occurs on SEFs. As noted above, Commission staff found that a small and declining percentage of the reported IRS volume in recent months has consisted of swaps subject to the trade execution requirement (currently less than 10 percent). ISDA determined, however, that more than 55 percent of total reported IRS traded notional has been occurring on SEFs since 2015. *See supra* note 261

and concentrate additional trading interests to available trading systems or platforms on SEFs.[281] The Commission believes that all of these factors can increase activity on SEFs, as well as help improve their efficiency and effectiveness.

Given the Commission's proposed approach to the trade execution requirement, as described above, the Commission proposes to eliminate (i) the MAT process for SEFs under § 37.10; (ii) the associated trade execution compliance schedule under § 37.12; (iii) the MAT process for DCMs under § 38.12; and (iv) the associated trade execution compliance schedule under § 38.11.

The Commission further proposes to codify under § 36.1(a) the statutory language of the trade execution requirement in CEA section 2(h)(8), which requires counterparties to execute a swap that is subject to the clearing requirement on a DCM, a SEF, or an exempt SEF unless no such entity "makes the swap available to trade" or the swap is subject to a clearing exception in CEA section 2(h)(7).[282] As proposed, § 36.1(a) would specify that counterparties must execute a transaction subject to the clearing requirement

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(noting that SEFs have facilitated trading of Permitted Transactions). Based on these determinations, the Commission's proposed interpretation of the trade execution requirement may result in a significantly larger amount of additional IRS trading volume on SEFs, given that the Commission believes that many, but not all, of that 85 percent of IRS that is subject to clearing requirement is currently listed on SEFs. Moreover, it is plausible that adopting this proposed interpretation would induce SEFs to list additional swaps subject to the clearing requirement, which would expand the amount of swaps trading that is subject to the trade execution requirement.

[281] As noted above, the Commission expects that the proposal would greatly expand the scope of the trade execution requirement. In particular, the Commission expects that the following swaps would become subject to the trade execution requirement based on the fact they are currently subject to the clearing requirement and also listed by at least one SEF or DCM: (i) various swaps in the interest rate asset class including fixed-to floating swaps denominated in U.S. dollars, pound sterling, and euros with non-benchmark tenors (whole and partial) that range from 28 days to 50 years; fixed-to-floating swaps in additional denominations with whole and partial tenors ranging from 28 days up to 30 years; basis swaps, overnight index swaps ("OIS"), and FRAs with different denominations and tenors; and (ii) various CDX and iTraxx index CDSs in older series (prior to the most recent off-the-run series) and additional tenors, as well as new CDS indices.

[282] 7 U.S.C. 2(h)(8)(B). The Commission interprets "swap execution facility" in CEA section 2(h)(8)(B) to include a swap execution facility that is exempt from registration pursuant to CEA section 5h(g). *See supra* note 10.

on a DCM, a SEF, or an Exempt SEF that lists the swap for trading. As discussed above, the Commission believes that the statutory phrase "makes the swap available to trade" specifies the listing of a swap by a DCM, a SEF, or an exempt SEF on its facility for trading. Accordingly, the trade execution requirement would apply to a swap that is subject to the clearing requirement upon the listing of that swap by any DCM or SEF.[283]

As discussed further below, the Commission is also proposing (i) exemptions of various transactions from the trade execution requirement under § 36.1 pursuant to its exemptive authority in CEA section 4(c); (ii) a compliance schedule for market participants with respect to the expanded application of the trade execution requirement to additional swaps; (iii) a public registry with information as to which swaps are subject to the trade execution requirement and the SEFs or DCMs that list them for trading; and (iv) a standardized form to assist the Commission in populating the public registry with relevant information regarding the trade execution requirement.[284]

Request for Comment

The Commission requests comment on all aspects of its proposed approach to the trade execution requirement, including § 36.1(a) as well as any alternative approaches to implementation of the trade execution requirement.

b. Elimination of Required Execution Methods

To better foster trading on SEFs—particularly with respect to the many episodically liquid swaps that will become subject to the trade execution requirement—the Commission proposes to eliminate the existing execution method requirements under

[283] As discussed below, the Commission is proposing an exemption from the requirement for swap transactions involving swaps that are listed for trading only by an Exempt SEF. *See infra* Section XXI.A.2.—§ 36.1(b)—Exemption For Certain Swaps Listed Only By Exempt SEFs.
[284] *See infra* Section XXI.A.—§ 36.1—Trade Execution Requirement.

§ 37.9. These requirements include the (i) definition of and associated requirements for Required Transactions under § 37.9(a), including the RFQ System definition under § 37.9(a)(3);[285] and (ii) the definition and associated provision for Permitted Transactions under § 37.9(c). Therefore, a SEF would be permitted to offer any method of execution that meets the SEF definition for any swap that it lists for trading, irrespective of whether the particular swap is or is not subject to the trade execution requirement. The Commission believes that this approach is consistent with the statutory SEF definition in CEA section 1a(50), which establishes that a SEF operates a trading system or platform whereby multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants also using the trading system or platform.[286]

The Commission's proposed elimination of § 37.9(a) also includes the elimination of subparagraph (a)(2)(ii), which currently specifies that with respect to offering an Order Book or RFQ System for Required Transactions, a SEF may utilize "any means of interstate commerce" for purposes of execution and communication, including, but not limited to, the mail, internet, email and telephone.[287] Given the elimination of the Order Book and RFQ System requirements, the Commission notes that this provision is no longer necessary.

As noted above, implementing the proposed interpretation of the trade execution requirement would increase the number of swaps that are required to trade on a SEF. Many of these swaps, which are all currently subject to the clearing requirement would

[285] As discussed above, the Commission is also proposing to eliminate the Order Book definition set forth under § 37.3(a)(3). *See supra* Section IV.C.2.—§§ 37.3(a)(2)-(3)—Minimum Trading Functionality and Order Book Definition. As discussed below, the Commission is also proposing to eliminate the time delay requirement under § 37.9(b), which applies to Required Transactions executed on an Order Book. *See infra* Section VI.A.2.—§ 37.203(a)—Pre-Arranged Trading Prohibition; § 37.9(b)—Time Delay Requirement.
[286] 7 U.S.C. 1a(50).
[287] 17 CFR 37.9(a)(2)(ii).

have terms and conditions, *e.g.*, partial-year tenors and varying payment terms, that counterparties customize to address idiosyncratic risks, such as larger and longer duration risk exposures.[288] Given their variable and complex nature, trading in these types of swaps can be punctuated by alternating periods of liquidity and illiquidity.[289] The markets for many of these swaps may consist of only a few trades per day or, in some cases, a few trades per month.[290] Historically, market participants have had discretion to utilize execution methods tailored to their particular trading motives and needs, the

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[288] Additionally, market participants may execute such swaps as part of different transaction structures, including package transactions composed of multiple risk-assuming or risk-hedging swap and non-swap components that are priced together. In their review of three months of OTC IRS trading, Federal Reserve Bank of New York ("FRBNY") staff found that the swaps traded were "broad in scope with a wide range of products, currencies, and maturities traded. . . [including] transactions in eight different product types, 28 currencies and maturities ranging from less than one month to 55 years." Michael Fleming, John Jackson, Ada Li, Asani Sarkar, & Patricia Zobel, Federal Reserve Bank of New York Staff Report No. 557, *An Analysis of OTC Interest Rate Derivatives Transactions: Implications for Public Reporting* 2 (2012) ("2012 FRBNY Analysis"). The analysis further identified "a meaningful degree of customization in contract terms, particularly in payment frequencies and floating rate tenors." *Id.* at 3. The Commission acknowledges that while some of the swaps that were included in the FRBNY's analysis would not be subject to the clearing requirement, *e.g.*, any IRS with a 55-year tenor, the Commission nevertheless believes that this analysis captures many of the swaps that are subject to the clearing requirement.

[289] In a 2011 Senate hearing related to SEFs, one participant testified that "[t]rading in [swaps] markets is characterized by variable or non[-]continuous liquidity. Such liquidity can be episodic, with liquidity peaks and troughs that can be seasonal … or more volatile and tied to external market and economic conditions (*e.g.*, many credit, energy and interest rate products)." *Emergence of Swap Execution Facilities: A Progress Report: Hearing Before the S. Subcomm. on Sec., Ins., and Investment of the S. Comm. on Banking, Hous., and Urban Affairs*, 112th Cong. 15 (2011) (statement of Stephen Merkel, Executive Vice President and General Counsel, BGC Partners, Inc.).

[290] In their review of three months of OTC IRS swaps, FRBNY staff also "found over 10,500 combinations of product, currency, tenor and forward tenor traded during [their] three-month sample, with roughly 4,300 combinations traded only once." 2012 FRBNY Analysis at 3. Further, their analysis found that within the data set, even the most commonly traded instruments were not frequently traded. No single instrument in the data set traded more than 150 times per day, on average, and the most frequently traded instruments in OIS and FRA only traded an average of 25 and 4 times per day, respectively. *Id.* Collin-Dufresne, Junge, and Trolle also made similar observations with respect to index CDS trading on SEFs, noting that the market is generally characterized by relatively few trades in very large sizes. Based on their analysis, the CDX.IG swaps market consists of 114 dealer-to-client trades and 24 dealer-to-dealer trades per day, on average, with a median trade size of USD $50 million in both segments. The average number of trades in the CDX.HY market are greater—164 dealer-to-client trades and 27 dealer-to-dealer trades per day, on average—but the median trade size is smaller—USD $10 million in both segments—which they attributed to the significantly higher volatility of high-yield contracts. 2017 Collin-Dufresne Research Paper at 16.

liquidity profile and characteristics of the swap being traded, and current market conditions, among other considerations.[291]

The existing execution methods for Required Transactions under the current framework, however, has precluded the full use of such discretion and forces participants to trade certain swaps in accordance with an Order Book or an RFQ System. As noted above, the Commission believes that these limited execution methods would not be suitable for the broad swath of the swaps market that would become newly subject to the trade execution requirement. Instead, prescribing those execution methods for this expanded group of swaps would likely impose greater trading risks on market participants, including execution and liquidity risks that negate any benefits associated with the centralized exchange trading of such swaps.[292] The Commission also notes that the current execution methods could exacerbate the current information leakage and front running risks as described above.[293]

The existing framework was designed to promote the SEF statutory goals, in particular to promote pre-trade price transparency, but based on its implementation experience, the Commission believes that a SEF regulatory framework that requires a greater number of swaps to be traded through flexible execution methods on a SEF will better promote both SEF statutory goals. The Commission believes that requiring more

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[291] Those means include, for example, voice-based trading systems or platforms that utilize human trading specialists who exercise discretion and judgment in managing the degree to which trading interests are exposed and how orders are filled. Where pre-trade market information from bids and offers may be limited due to market participants' caution in displaying trading interests, SEFs often offer session-based execution methods, such as auctions, to generate trading interest.

[292] *See supra* note 130 (explaining that requiring all market participants to use a central limit order book will not necessarily promote price competition among dealers in markets that lack continuous trading or have episodic liquidity).

[293] SEF Core Principles Final Rule at 33562. *See generally* 2017 Riggs Study (discussing the "winner's curse," which is similar to information leakage in context, in the dealer-to-client CDS market).

swaps to be traded on SEFs would help foster vibrant and liquid SEF markets as liquidity formation and price discovery is centralized on these markets. With more swaps trading activity occurring in a concentrated SEF environment, the Commission anticipates that a greater number of observable transactions—for example, IRS of varying tenors along a single price curve—would allow for a richer price curve that provides participants with more accurate pricing for economically similar swaps along other points of the curve.

For example, auction platforms and work-up sessions—both of which SEFs currently offer under the existing framework—help to maximize participation and trading on the SEF at specific points of time and serve as effective tools for price discovery for market participants in periods of episodic liquidity. By allowing SEFs the flexibility to develop and tailor these types of functionalities to facilitate trading across a wide range of market liquidity conditions, a SEF can effectively promote appropriate counterparty and swap-specific levels of pre-trade price transparency[294] across a broader range of swaps. Further, as discussed above, affording SEFs with greater flexibility with execution methods would avoid forcing them to alter these types of functionalities in a sub-optimal manner simply to conform to certain limited execution methods that are not suitable for trading a broad range of swaps with varying liquidity profiles.

By eliminating the existing approach to required methods of execution, the Commission's proposed regulatory framework is also expected to foster customer choice in a manner that would benefit the swaps markets. The Commission believes that its proposed approach appropriately allows market participants, each of whom is a sophisticated entity trading in a professional market, to determine the execution method

[294] *See supra* note 270 (discussing appropriate counterparty and swap-specific levels of pre-trade price transparency).

that best suits the swap being traded and their trading needs and strategies.[295] As noted above, the Commission believes that market participants in a professional market, in part because of sophistication and self-interest, will seek the most efficient and cost-effective method of execution to achieve their business and trading objectives. The Commission believes that providing for customer choice, while also concentrating liquidity and price discovery onto SEFs, may help create an environment for swaps trading that is better able to promote appropriate counterparty and swap-specific levels of pre-trade price transparency than the existing framework and will also do so for a significantly broader segment of the swaps markets than the existing framework. As noted above, execution methods such as auction platforms and work-up sessions may do a better job of maximizing participation and concentrating liquidity than Order Books or RFQ Systems in episodically liquid markets.

The proposed approach would allow SEFs to offer varied and innovative execution methods that are best suited to the products they list, as well as the trading needs of their market participants. Rather than being confined to limited execution methods, SEFs would be able to develop more efficient, transparent, and cost-effective means for participants to trade swaps. In turn, the Commission believes that this innovation may serve to promote more competition between SEFs to attract participation through novel trading systems or platforms. The Commission further believes greater execution flexibility may also potentially incentivize new entrant trading venues to enter

[295] The Commission notes that other markets—such as bonds, U.S. treasuries, and FX—do not prescribe methods of execution, but rather permit their market participants to determine the best method of execution for the transaction. Swaps markets have historically followed this model. In this respect, the Commission believes that its proposal realigns the swaps market trading characteristics with other fixed income markets.

the SEF marketplace, as they would be able to utilize new and different execution methods than are currently employed by incumbent platforms.

Request for Comment

The Commission requests comment on all aspects of its proposed approach to execution methods as well as any alternative approaches.

V. Part 37—Subpart B: Core Principle 1 (Compliance With Core Principles)

The Commission is not proposing any amendments to § 37.100, which codifies the language of Core Principle 1.[296]

VI. Part 37 Regulations Related to SEF Execution Methods—Subpart C: Core Principle 2 (Compliance With Rules)

Core Principle 2 requires a SEF to establish and enforce rules that govern its facility, including trading procedures to be followed when entering and executing orders, among other requirements.[297]

To support the proposed approach of allowing more flexible execution methods on SEFs, which is intended to foster more liquidity formation through trading activity on SEF trading systems and platforms, the Commission is proposing to amend certain rules and adopt new rules under Core Principle 2, as described below. These proposed rules

[296] Core Principle 1 requires a SEF to comply with the core principles set forth in CEA section 5h(f) and any requirement that the Commission may impose by rule or regulation pursuant to CEA section 8a(5) as a condition of obtaining and maintain registration as a SEF. 7 U.S.C. 7b-3(f)(1). Core Principle 1 also provides a SEF with reasonable discretion in establishing the manner in which it complies with the core principles, unless the Commission determines otherwise by rule or regulation. 7 U.S.C. 7b-3(f)(1)(B).

[297] Core Principle 2 also requires a SEF to (i) establish and enforce compliance with rules, including terms and conditions of swaps traded or processed on or through the SEF and any limitation on access to the SEF; (ii) 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 provide market participants with impartial access to the market and to capture information that may be used in establishing whether rule violations have occurred; and (iii) provide by its rules that when a SD or MSP enters into or facilitates a swap that is subject to the clearing requirement, the SD or MSP will be responsible for compliance with the trade execution requirement. 7 U.S.C. 7b-3(f)(2). The Commission codified Core Principle 2 under § 37.200. 17 CFR 37.200.

would, among other things, help foster open and transparent markets as well as promote market efficiency and integrity. In particular, the Commission proposes to establish general rules that would apply to any execution method that a SEF offers on its facility. The Commission also proposes to limit the ability of market participants to conduct pre-execution communications and submit resulting pre-negotiated or pre-arranged trades to a SEF for execution; and eliminate exceptions to the pre-arranged trading prohibition under § 37.203(a), including the time delay requirement under § 37.9(b).

Additionally, the Commission proposes to amend certain existing rules and adopt new rules under Core Principle 2, as described below, that correspond to the Commission's application of the SEF registration requirement to swap broking entities, including interdealer brokers. Among other goals, these 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. Specifically, the Commission proposes rules under § 37.201(c) that would require SEFs to ensure minimum proficiency and conduct standards for SEF trading specialists.

A. § 37.201—Requirements for Swap Execution Facility Execution Methods[298]

Section 37.201 implements the Core Principle 2 requirement that a SEF establish and enforce rules that govern its facility. Section 37.201(a) specifies that these requirements include trading procedures to be followed when entering and executing

[298] The Commission proposes to retitle § 37.201 to "Requirements for swap execution facility execution methods" from "Operation of swap execution facility and compliance with rules" based on the proposed changes described below.

orders traded or posted on the SEF.[299] Section 37.201(b) additionally requires a SEF to establish and impartially enforce rules related to (i) the terms and conditions of swaps traded or processed on the SEF; (ii) access to the SEF; (iii) trade practice requirements; (iv) audit trail requirements; (v) disciplinary requirements; and (vi) mandatory trading requirements.[300] The Commission proposes to eliminate these rules, which are largely duplicative of the Core Principle 2 requirements, and adopt the new rules described below.

1. § 37.201(a)—Required Swap Execution Facility Rules

Proposed § 37.201(a) would require a SEF to establish rules that govern the operation of the SEF, including rules that specify (i) the protocols and procedures for trading and execution; (ii) the permissible uses of "discretion" in facilitating trading and execution; and (iii) the sources and methodology for generating any market pricing information.

Pursuant to a SEF regulatory framework that would allow SEFs to offer flexible execution methods, the Commission believes that such rules would benefit market participants by providing a baseline level of transparency in SEF trading. As the Commission previously noted, one of the central goals of the Dodd-Frank Act is to bring transparency to the opaque OTC swaps market.[301] The Commission has further observed that when markets are open and transparent, prices are more competitive and markets are more efficient.[302] In this regard, the Commission notes that rather than imposing detailed, prescriptive SEF execution method requirements that do not comport with

[299] 17 CFR 37.201(a).
[300] 17 CFR 37.201(b).
[301] SEF Core Principles Final Rule at 33553.
[302] *Id*.

swaps market characteristics, this proposed rule represents a more balanced approach—a SEF would have the flexibility to develop and offer execution methods designed to foster trading based on the dynamics of the applicable swaps market (*e.g.*, liquidity and product characteristics) and on its market participants' needs, but also would be required to disclose how these execution methods operate. This disclosure would help to foster open and transparent markets, and promote market efficiency and integrity by establishing a consistent level of disclosure and information across all SEFs, which would allow market participants to make informed decisions regarding whether to onboard to a particular SEF and whether to use a particular execution method offered by a SEF.[303] In making such decisions, market participants would be able to understand more fully any differences among those flexible methods across SEFs.

Based on the definition of "rule" under § 40.1(a), which encompasses any SEF "trading protocol," the proposed rule clarifies those features of a SEF's execution methods that constitute SEF "rules" and must be submitted to the Commission pursuant to part 40 and disclosed to SEF market participants.[304] Accordingly, SEFs would be required to disclose such information in their rulebooks. After reviewing SEF rulebooks, the Commission believes that this proposed disclosure requirement is consistent with current market practice and the general level of information already disclosed by many

[303] The Commission notes that this view is analogous to the principles set forth in the FX Global Code. The FX Global Code was developed by a partnership between central banks and participants from 16 jurisdictions. The code does not impose legal or regulatory obligations on participants nor does it act as a substitute for regulation, but rather serves as a supplement to local laws by setting forth guidelines for good practices in the FX markets. The code specifies, among other recommendations, that "Market Participants," which include operators of trading systems or platforms, should provide all relevant disclosures and information to participants to help them make informed decisions about whether to transact or not. *See* FX Global Code at 13-14 (updated Aug. 2018) ("FX Global Code"), *available at* https://www.globalfxc.org/docs/fx_global.pdf.

[304] *See supra* note 179 (definition of "rule" in the Commission's regulations).

SEFs. Accordingly, the Commission does not anticipate that this proposed rule would require material changes to most SEF rulebooks; rather, the proposed rule would ensure that currently-registered and new SEFs provide a consistent, minimum level of transparency and disclosure to the marketplace. The Commission further notes that SEFs are free to provide additional levels of disclosure beyond that required under proposed § 37.201(a).

a. § 37.201(a)(1)—Trading and Execution Protocols and Procedures

Proposed § 37.201(a)(1) would require a SEF to establish rules governing the protocols and procedures for trading and execution, including entering, amending, cancelling, or executing orders for each execution method offered by the SEF. The Commission believes that requiring SEFs to provide this level of detail and transparency for each of their execution methods is particularly important given the Commission's proposal to permit SEFs to offer flexible execution methods for all of their listed swaps.

The Commission believes that proposed § 37.201(a)(1) clarifies a SEF's existing obligations and is consistent with current market practice, in particular the general level of disclosure and information that many SEFs already provide in their rulebooks. This proposed rule is also better aligned with other proposed Core Principle 2 regulations that relate to SEF trading protocols and procedures, such as proposed § 37.203(e), which would require SEFs to promulgate rules and procedures to resolve error trades, including trade amendments or cancellations, as discussed below.[305]

To comply with this rule, for example, a SEF that offers an RFQ protocol could specify various operational aspects of that protocol in its rulebook. Those aspects could

[305] *See infra* Section VII.B.5.—§ 37.203(e)—Error Trade Policy.

include, among other things, how a requestor could initiate an RFQ; whether the RFQ requestor's identity is disclosed or anonymous; whether an RFQ request could be made visible to the entire market; whether a responder could offer either indicative or firm bids or offers; the length of time that an RFQ response with a firm bid or firm offer would have to remain executable by the RFQ requestor; or whether RFQ responses are disclosed to the whole market or just the requestor. By specifically requiring a SEF to disclose information regarding how each offered execution method operates, a market participant would have the ability to (i) make an informed decision about whether to trade and execute on that SEF; (ii) determine the type of trading system or platform that best suits its needs; and (iii) conform its trading and execution practices to the SEF's protocols and procedures.[306]

b. § 37.201(a)(2)—Discretion

Proposed § 37.201(a)(2) would require a SEF, where applicable, to establish rules specifying the manner or circumstances in which the SEF may exercise "discretion" in facilitating trading and execution for each of its execution methods. Many SEFs, in particular those that resemble or are based upon operations of swaps broking entities, including interdealer brokers, feature execution methods that involve the use of discretion.[307] SEF trading specialists,[308] who have traditionally served as interdealer

[306] *See* FX Global Code at 13-14 (recommending that trading systems or platforms have rules that are transparent, including how orders are handled and transacted).

[307] As noted above, upon the adoption of part 37, some interdealer brokers have registered their operations or components of their operations, *i.e.*, trading systems or platforms, as SEFs. *See supra* Section IV.C.1.c.(1)— Structure and Operations of Swaps Broking Entities, Including Interdealer Brokers.

[308] "SEF trading specialist" refers to a natural person employed by a SEF (or acting in a similar capacity as a SEF employee) to perform various core functions that facilitate trading and execution, including discussing market color with market participants, negotiating trade terms, issuing RFQs, and arranging bids and offers. For the Commission's proposed definition of "SEF trading specialist," *see infra* Section VI.A.3.—§ 37.201(c)—SEF Trading Specialists.

brokers in the wholesale swaps market, exercise discretion on behalf of market participants in a variety of ways. This discretion includes determining how, when, and with whom to disseminate, arrange, and execute bids and offers; and determining whether and when to amend or cancel those bids and offers in response to market developments. Exercising this type of trading and execution judgment involves taking different factors into account, such as the characteristics and needs of the client, size and nature of the order, likelihood and speed of execution, price and costs of execution, and current market conditions. The use of discretion in trading reflects the market characteristics of the wholesale swaps market, where the wide range of different swaps and transaction sizes results, in some instances, in low liquidity markets with episodic, non-continuous trading activity.

Given the established role of swaps broking entities, including interdealer brokers, in fostering market liquidity through identifying and arranging multiple trading interests—both liquid and illiquid—amidst changing market conditions, the Commission recognizes that the use of discretion is an important element in fostering an efficient market. Therefore, the Commission's proposed regulatory framework would further accommodate the use of discretion by SEFs. As described above, SEFs would be allowed to offer flexible execution methods, thereby allowing methods that involve the exercise of discretion by SEF trading specialists.[309] Further, the proposed expansion of the trade execution requirement would lead to a greater number of swaps being traded on SEFs.

[309] The Commission's clarification of the SEF registration requirement, as discussed above, would require swaps broking entities, including interdealer brokers, to register as SEFs. *Id*. The Commission notes that as a result, a significant number of personnel at these entities would likely meet the definition of "SEF trading specialist."

The Commission believes that the proposed broadening of both the SEF registration requirement and the trade execution requirement would increase the level of discretion that SEFs (and their trading specialists) exercise in connection with swaps trading. To address this situation, proposed § 37.201(a)(2) would require SEFs to disclose the manner or circumstances in which they may exercise discretion. The Commission believes that such a disclosure requirement is important to inform market participants, facilitate an orderly SEF trading environment, foster open and transparent markets, and promote market integrity while remaining consistent with Core Principle 2.[310] Such information would help a market participant have important awareness of how a trading system or platform is designed, thereby allowing them to make informed decisions with respect to swaps trading on a particular SEF. For example, such information would help market participants determine appropriate parameters or instructions in submitting their bids and offers to a particular SEF, as well as inform their expectations about possible trading outcomes or objectives on that SEF. The Commission believes that more informed market participants would promote fairer and more efficient trading on SEFs and, ultimately, make SEFs more robust price discovery mechanisms.

Pursuant to proposed § 37.201(a)(2), the Commission intends to require each SEF to generally disclose the possible areas in which it may use discretion for each execution method, rather than establish exact, pre-determined trading protocols and procedures. In identifying those general areas, a SEF's rules should disclose sufficient information that a

[310] *See* FX Global Code at 13-14 (recommending that trading systems or platforms should make participants aware of where discretion may exist or may be expected, and how it may be exercised, as a way to promote fairness and transparency in trading).

reasonable market participant would consider important in deciding whether to onboard onto the SEF and, once participating on the SEF, in understanding how discretion may affect trading. The proposed rule, however, does not necessarily require a SEF to disclose any proprietary or confidential information in its public rulebook.[311] Based on its experience with reviewing SEF rulebooks, the Commission believes that proposed § 37.201(a)(2) is consistent with current market practice and the general level of information that many SEFs already provide in their rulebooks.[312] Accordingly, the Commission does not anticipate that existing SEFs will be required to adopt material changes to their rulebooks; rather, the proposed rule would ensure that both currently-registered and new SEFs continue to provide sufficient transparency and disclosure.

c. § 37.201(a)(3)—Market Pricing Information

Proposed § 37.201(a)(3) would require each SEF to adopt rules that disclose the general sources and methodology for generating any market pricing information that the SEF provides to market participants to facilitate trading and execution. The term "sources" would include any general inputs that the SEF may consider when forming a price, such as swaps pricing data, *e.g.*, the last traded price; historical, executable, or indicative bids and offers on the SEF or other trading platforms; or the views of market participants, who the SEF may contact to ascertain interest. The term "methodology"

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[311] The Commission notes, however, that if a SEF believes that any such information should be kept confidential, such that it should be provided to market participants but not in a public filing, the SEF may submit a request for confidential treatment with its respective rule submission. 17 CFR 40.8. The Commission's treatment of such information would be governed by § 145.9, 17 CFR 145.9, and the Freedom of Information Act. 5 U.S.C. 552.

[312] The Commission notes, for example, that SEF rules have generally specified several areas where discretion may be exercised in facilitating trading, such as determining when to enter orders on behalf of participants; determining when and with which participants to gauge possible trading interest; and determining how to calculate mid-market prices for use in a session-based execution method, *i.e.*, determining the number of factors to consider in the calculation of a mid-market price or the weight of each factor.

means that a SEF should generally identify the extent to which it may formulate a price on its trading systems or platforms, whether prices generated by SEFs are based on discretion or some type of pre-set approach, and how the information or data sources are generally applied or weighted within the SEF's methodology.

The Commission recognizes that some SEFs provide participants either an indicative or executable "market price" to encourage price discovery and liquidity or otherwise inform trading interest. The use of market prices is particularly prevalent in connection with certain execution methods, such as auctions and similar matching sessions.[313] SEFs often generate these prices by considering various sources of data, including prices from executed transactions, prices from executable or indicative bids and offers, publicly reported swaps data, active market participant views, or prices from related instruments in other markets. Based on the availability of this information at a given time, a SEF may take one or more of these factors into account differently in formulating a single price. These pricing mechanisms help to initiate the price discovery process and allow market participants to formulate views about the current state of the market. By relying upon an established price, a market participant may make trading decisions without being exposed to information leakage that might otherwise cause widened bid-offer spreads and impose higher transaction costs.[314] Given this unique feature of the swaps market due to its episodic liquidity, the Commission recognizes that

[313] In a typical SEF auction or matching session-based trading functionality, a SEF establishes a price for a listed swap that is determined through a variety of different factors. Participants may submit their trading interest in the swap at the established price, either within an established time session or on a continuous basis, and subsequently execute that swap at the established price, often on a time-priority basis.

[314] The Commission understands that participants often avoid acting as a "first-mover" for relatively less liquid swaps by exercising caution in displaying their trading interests, *i.e.*, price and size; accordingly, SEFs—similar to historical OTC trading environments—utilize these types of methods to promote trading for particular swaps and pre-trade price transparency.

SEF pricing practices are an important element in fostering liquidity on SEFs and, therefore, in promoting the Act's statutory goals of encouraging SEF trading and pre-trade price transparency.

Where pricing generated by a SEF in lieu of pricing based on market participant bids and offers helps to foster liquidity and price discovery, the Commission believes that requiring SEFs to inform market participants as to their price formation sources and methodology would foster open and transparent markets and promote market integrity and efficiency. Requiring a SEF to disclose the sources of information used to generate a price and the methodology for calculating that price, for example, would allow market participants to be aware of prevailing liquidity and market conditions, thereby helping them to form views as to whether that price is an appropriate indicator of a particular market. Accordingly, market participants would be able to make informed trading decisions, such as whether to participate in an available trading session, and if so, the level of participation, *e.g.*, whether they would contribute their own information to help establish a trading price in a particular execution method.[315] The Commission believes that this information should build confidence among participants in the integrity, fairness, and effectiveness of the SEF as a regulated trading venue. In turn, a greater level of confidence in SEFs should lead to increased swaps trading volume and, ultimately, an increased potential for higher levels of pre-trade price transparency through increased participation.

Similar to proposed § 37.201(a)(2), the Commission emphasizes that proposed § 37.201(a)(3) would establish a general approach as to the scope of information that a SEF

[315] *See supra* note 313 (describing mechanics of a SEF auction or matching session-based trading functionality).

must disclose and does not require the SEF to specify detailed calculations or algorithms used to generate pricing information. The Commission also notes that the proposed rule would not require SEFs to disclose the identities of market participants who provide data used to formulate prices or to disclose proprietary aspects of their pricing methodology.[316] Rather, a SEF's rules should disclose sufficient information that a reasonable market participant would consider important to determine whether to join the SEF and to generally understand the nature of the market pricing information provided by the SEF. In addition, proposed § 37.201(a)(3) would not require a SEF to provide any proprietary or confidential information in its public rulebook. Based on its experience with reviewing SEF rulebooks submitted via the part 40 rule filing process, the Commission believes that proposed § 37.201(a)(3) is consistent with current market practice and the general level of information that many SEFs already include in their rulebooks.[317]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.201(a). In particular, the Commission requests comment on the following question:

(28) Do the requirements under proposed §§ 37.201(a)(1)-(3) set an appropriate level of disclosure by SEFs to market participants? Are the requirements too broad? Should

[316] The Commission further notes, however, that regardless of whether market participants participate in the price-formation process or whether their identities remain anonymous, all market participants remain subject to section 9(a)(2) of the Act. That provision prohibits any attempt to provide false, misleading, or knowingly inaccurate reports concerning market information or conditions that affect or tend to affect the price of any swap. 7 U.S.C 13(a)(2).

[317] In disclosing the general sources and methodologies for generating market pricing information, the Commission notes that such SEF rules have generally specified (i) the SEF's ability to consider either a single or multiple number of established factors in determining a price; (ii) the various types of factors that it may take into account to determine a price; or (iii) other additional analytical methods that may be used to supplement a price calculated from existing bids and offers on the platform.

the Commission require additional disclosures that would be material for market participants to make an informed decision to participate on the SEF? If so, what additional disclosures should be required? Please provide specific examples in your responses.

2. § 37.203(a)—Pre-Arranged Trading Prohibition; § 37.9(b) Time Delay Requirement

Part 37 has permitted market participants to communicate with one another away from a SEF in connection with the eventual execution of swap transactions via the SEF's trading systems or platforms.[318] The Commission has observed that such communications, which commonly occur on a direct basis between swap dealers and their clients in the dealer-to-client market, vary in nature and scope. Such communication may, for example, include communications to discern trading interest prior to trading on the SEF, *e.g.*, obtaining market color, identifying potential trades, and locating interested counterparties. Such communications, however, may also consist of the actual negotiation or arrangement of a swap transaction's terms and conditions prior to execution on a SEF. Such communications are permitted through several provisions in the current regulatory framework, as described below, based in part on whether the transaction qualifies for an exception to the prohibition on pre-arranged trading under § 37.203(a); or whether the swap is otherwise not subject to the trade execution requirement.

The Commission notes that "pre-arranged trading" is prohibited as an abusive trading practice under § 37.203(a). This prohibition generally applies to market participants who communicate with one another to pre-negotiate the terms of a trade

[318] SEF Core Principles Final Rule at 33503.

away from a SEF's trading system or platform, but then execute the trade on such system or platform in a manner that appears competitive and subject to market risk. The Commission has intended for this prohibition to maintain the integrity of price competition and market risk that is incident to trading in the market.[319] Notwithstanding this prohibition, SEFs have permitted pre-arranged trading on their facilities in certain instances.

For Required Transactions executed via an Order Book, a SEF may permit market participants to communicate with one another and pre-arrange or pre-negotiate a swap transaction away from its trading system or platform, subject to a time delay requirement and facility rules on pre-execution communications. Section 37.9(b)(1) currently permits a broker or dealer to engage in pre-execution communications to pre-arrange or pre-negotiate a swap, as long as one side of the resulting transaction is entered into the Order Book for a 15-second delay before the second side is entered for execution against the first side (the "time delay requirement"). The Commission defined "pre-execution communications" as communications between market participants to discern interest in the execution of a transaction prior to the exposure of the market participants' orders (*e.g.*, price, size, and other terms) to the market; such communications include discussion

[319] The Commission generally considers pre-arranged trading to be a form of "fictitious" trading that is prohibited pursuant to CEA section 4c(a)(1), which makes it unlawful for any person to offer to enter into, enter into, or confirm the execution of a fictitious sale. 7 U.S.C. 6c(a)(1), 6c(a)(2)(A)(ii). Specifically, pre-arranged trading involves "the use of trading techniques that give the appearance of submitting trades to the open market while negating the risk of price competition incident to such a market." Harold Collins, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) 22982, 31902 (CFTC Apr. 4, 1986). Generally, pre-arranged trading creates a false impression to the market that an executed transaction is indicative of a competitive trading environment. *Id.* at 31903 ("By determining trade information such as price and quantity outside the pit, then using the market mechanism to shield the private nature of the bargain from public scrutiny, both price competition and market risk are eliminated.").

of the size, side of market, or price of an order, or a potentially forthcoming order.[320] To the extent that SEFs would allow their market participants to engage in such pre-execution communications, the Commission required SEFs to adopt associated rules.[321]

The Commission implemented § 37.9(b) to ensure a minimum level of pre-trade price transparency for orders based on pre-execution communications that occur away from the SEF, and to incentivize price competition between market participants for orders entered into an Order Book.[322] The Commission anticipated that disclosing one side of a pre-arranged transaction in the Order Book first would provide other market participants with an opportunity to execute against that side prior to entry of the second side in the Order Book.[323] A similar requirement, however, was not applied to Required Transactions executed through a SEF's RFQ System. The Commission noted that the

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[320] SEF Core Principles Final Rule at 33503. In light of the Commission's general prohibition on pre-arranged trading under § 37.203(a), the Commission defined this term to clarify the permissible types of communications in which market participants can pre-arrange or pre-negotiate a transaction consistent with § 37.9(b)(1). The Commission currently requires that SEFs that choose to allow their market participants to engage in pre-execution communications prior to executing such transactions must do so pursuant to their rules. 17 CFR 37.203(a). Such communications may constitute an element of pre-arranged trading, which is an abusive trading practice prohibited under existing § 37.203(a).

[321] SEF Core Principles Final Rule at 33509.

[322] *Id*. at 33503. The Commission modeled the time delay requirement after similar DCM rules that have imposed time delays on cross trades involving futures and options on futures. Pursuant to these rules, market participants are permitted to conduct pre-execution communications with respect to orders that are later exposed to the market for a certain period of time prior to execution on the DCM's trading system or platform. As DCM Core Principle 9 requires DCMs to provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the DCM, 7 U.S.C. 7(d)(9)(A), DCMs have implemented certain time delay procedures that establish a "safe harbor" for orders resulting from pre-execution communications that would otherwise be considered pre-arranged trading. To protect price discovery, such orders must be exposed to the market for a minimum amount of time prior to allowing such orders to match against one another on a DCM. This time delay generally provides other participants with an opportunity to execute against the initial order. *See, e.g.*, CME Group, Rule 539.C (rules on pre-execution communications regarding Globex trades).

[323] 17 CFR 37.9(b)(1).

requirement to send an RFQ to three other market participants already provides pre-trade price transparency, thereby obviating the need for a corresponding time delay.[324]

In addition to the time delay requirement, § 37.203(a) also specifies that a SEF may choose to permit pre-arranged trading in other instances. First, a SEF may permit a swap that it lists to be executed as a block trade away from a SEF pursuant to part 43. This exception allows such large-sized transactions to be privately negotiated to avoid potentially significant and adverse price impacts that would occur if traded on trading systems or platforms with pre-trade price transparency.[325] Second, a SEF may permit pre-arranged trading for "other types of transactions" through rules that are filed with the Commission pursuant to part 40. These rules permit pre-arranged trading with respect to Required Transactions that are intended to resolve error trades[326] or are executed as a component of certain categories of package transactions.[327]

In the preamble to the SEF Core Principles Final Rule, the Commission did not discuss the issue of pre-execution communications regarding swaps that are not subject to the trade execution requirement, *i.e.*, Permitted Transactions, but the Commission has

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[324] SEF Core Principles Final Rule at 33504. The SEF Core Principles Final Rule did not explicitly require a SEF to adopt pre-execution communication rules for swaps executed using its RFQ System. Nevertheless, the Commission has observed that some SEFs have self-certified rules under § 40.6 to allow their market participants to engage in pre-execution communication prior to transmitting an RFQ through the facility's RFQ System.

[325] As defined under § 43.2, a "block trade" involves a SEF-listed swap transaction with a notional amount that meets the corresponding appropriate minimum block size and is executed away from the SEF's trading system or platform, but pursuant to the SEF's rules and procedures. 17 CFR 43.2. The Commission is proposing to amend that definition to specify that block trades must be executed on a SEF. *See infra* Section XXII.—Part 43—§ 43.2—Definition of "Block Trade."

[326] Based on time-limited no-action relief issued by DMO, a SEF may submit pre-arranged Required Transactions for execution on the SEF that resolve error trades, *i.e.*, correct transactions to offset an initial transaction executed on the SEF containing a clerical or operational error, and where necessary, a new transaction that reflects the terms to which the counterparties had originally assented. *See infra* note 433 and accompanying discussion.

[327] Based on time-limited no-action relief issued by DMO, a SEF may submit pre-arranged Required Transactions for execution on SEFs that are components of certain categories of package transactions. *See infra* note 334.

permitted SEFs to adopt a more flexible approach to the use of communications away from the SEF. This approach corresponds to the Commission's approach to Permitted Transactions, which are not required to be executed on a SEF and otherwise may be executed on a SEF through flexible execution methods.[328] Under a more flexible approach, the Commission has observed that SEFs—both those that facilitate trading in the dealer-to-client market and those that facilitate trading in the dealer-to-dealer market—have consequently adopted rules to allow their market participants to engage in a variety of pre-execution communications away from their respective trading systems or platforms prior to executing Permitted Transactions on SEFs. The Commission notes in particular that some methods allow counterparties to submit pre-negotiated terms and conditions of a transaction to a SEF "order entry" system for execution and related post-trade processing.[329]

a. § 37.201(b)—Pre-Execution Communications

The Commission proposes several amendments under the proposed framework that would broadly apply to pre-execution communications that occur away from a SEF. For swaps subject to the trade execution requirement, proposed § 37.201(b) would require a SEF to prohibit its participants from engaging in pre-execution communications away from its facility, including negotiating or arranging the terms and conditions of a swap prior to its execution on the SEF, *i.e.*, via the SEF's methods of execution. This prohibition would be subject to certain proposed exceptions discussed further below.

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[328] SEF Core Principles Final Rule at 33504.

[329] As noted above, several SEFs affiliated with interdealer brokers offer this type of functionality. As participants affiliated with a SEF, interdealer brokers have arranged Permitted Transactions on behalf of dealer clients through "communications" on their trading systems or platforms and submitted those transactions to a SEF for execution without being subject to any corresponding order exposure. *See supra* note 88 and accompanying discussion.

Given this general prohibition, the Commission also proposes to eliminate the existing exceptions to the pre-arranged trading prohibition, including (i) the time delay requirement under § 37.9(b); (ii) the exception for block trades under § 37.203(a) as part of the Commission's proposed amendments to the "block trade" definition under § 43.2;[330] and (iii) the exception for "other types of transactions" under § 37.203(a). Proposed § 37.203(a), as discussed below, would continue to require a SEF to prohibit abusive trading practices, including pre-arranged trading, as appropriate to its trading systems or platforms. Therefore, a SEF would not be allowed to provide rules that allow market participants to pre-negotiate or pre-arrange a transaction and submit the sides of the transaction to an order book pursuant to a time delay.

In eliminating the prescriptive execution methods and allowing more flexible execution for swaps subject to the trade execution requirement, the Commission believes that pre-execution communications, including the negotiation or arrangement of those swaps, would be able to occur entirely within a SEF's trading system or platform. Such negotiation or arrangement, regardless of the method through which they may occur, *i.e.*, among participants themselves or through a swaps broking entity, constitutes "trading" that should occur on a SEF. The Commission notes that "trading," as discussed above, includes the negotiation or arrangement of transactions through the interaction of bids and offers.[331] Based on its experience with implementing part 37, the Commission believes that the broad scope of pre-execution communications that have been allowed to

[330] *See infra* Section XXII.—Part 43—§ 43.2—Definition of "Block Trade."
[331] With respect interdealer brokers, the Commission believes that their trading systems or platforms facilitate "trading" between multiple participants in conformance with the statutory SEF definition and, therefore, are subject to the SEF registration requirement. *See supra* Section IV.C.1.c.(2)—SEF Registration Requirement for Swaps Broking Entities, Including Interdealer Brokers.

occur away from the SEF under the existing framework has undermined a meaningful role of the SEF in facilitating trading activity and liquidity formation.

Accordingly, the Commission believes that these proposed changes are an important element of the proposed SEF regulatory framework and are intended to enhance this framework, such that a broader range of swaps trading activity would be occurring on SEFs and creating a vibrant and liquid marketplace for swaps trading. For example, the Commission notes the likely increase in the number of swaps that would become subject to the trade execution requirement under this proposal. Currently, many of those swaps are Permitted Transactions submitted to a SEF for execution after negotiation or arrangement away from the facility, or are negotiated and executed on an OTC basis. With an expanded scope of swaps subject to the trade execution requirement, the Commission is concerned that allowing a disproportionate amount of SEF transactions to be pre-arranged or pre-negotiated away from the facility under the pretense of trading flexibility would undercut the import of the expansion of the requirement. Without a limitation on pre-execution communications that occur away from the SEF, the SEF's role in facilitating swaps trading is also diminished and would undermine the statutory goals of promoting greater swaps trading on SEFs and promoting pre-trade price transparency.

The Commission also notes that its proposed approach to pre-execution communications, as applied to SEFs in the dealer-to-dealer market, is consistent with the application of the SEF registration requirement to swaps broking entities, *e.g.*, interdealer brokers that facilitate swaps trading activity between market participants. As discussed above, the Commission believes that brokers, who facilitate trading communications

between market participants away from a SEF and subsequently submit pre-negotiated or pre-arranged trades to the SEF for execution, relegate the SEF to a de facto post-trade processing venue. Requiring these entities to register as SEFs would ensure that this type of liquidity formation occurs on a SEF.[332] Similarly, the submission of trade terms negotiated or arranged via direct communications between participants, *e.g.*, a swap dealer and a client, away from a SEF allows liquidity formation to occur outside of the SEF regulatory framework, which undermines the statutory SEF goals. Limiting the scope of these communications would also help ensure that this activity occurs on a registered SEF via flexible means of execution, which promotes the statutory goals of promoting trading on SEFs and promoting pre-trade price transparency.

(1) Exception for Swaps Not Subject to the Trade Execution Requirement

The Commission proposes an exception to the proposed prohibition on pre-execution communications under § 37.201(b) for swaps that are not subject to the trade execution requirement. The Commission's proposed exception recognizes that market participants do not have to execute such swaps on SEFs. The Commission also acknowledges that two counterparties may initially discuss or negotiate a potential swap transaction on a bilateral basis away from a SEF with the intent to execute the transaction away from the SEF, but subsequently determine to submit the resulting arranged

[332] As noted above, the Commission recognizes that domestic swaps broking entities and foreign swaps broking entities would be subject to a six-month and two-year delayed application of the SEF registration requirement, respectively. These delays would allow them to continue to negotiate or arrange swaps transactions between multiple participants and route them to SEFs or Exempt SEFs for execution. Accordingly, the compliance date of any final rule with respect to the prohibition on pre-execution communication under proposed § 37.201(b) and the pre-arranged trading prohibition under § 37.203(a) for these entities would also be subject to a delay of six months or two years, depending on the entity's domicile and starting from the effective date of the final rule. *See supra* Section IV.C.1.c.—Swaps Broking Entities, Including Interdealer Brokers and Section IV.C.1.d.—Foreign Swaps Broking Entities and Other Foreign Multilateral Swaps Trading Facilities.

transaction to be executed on a SEF. The Commission believes that applying the proposed § 37.201(b) prohibition to swaps not subject to the trade execution requirement would not be practical, given that counterparties do not have to execute these swaps on a SEF. The Commission emphasizes, however, that this proposed exception does not affect the SEF registration requirement under proposed § 37.3(a), which would specify that a person operating a facility that meets the statutory SEF definition must register as a SEF without regard to whether the swaps that it lists for trading are subject to the trade execution requirement.[333]

(2) § 37.201(b)(1)—Exception for Package Transactions

The Commission also proposes an exception under § 37.201(b)(1) to the proposed prohibition on pre-execution communications for swaps subject to the trade execution requirement that are components of "package transactions" that also include components that are not subject to the trade execution requirement.[334] For purposes of this exception,

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[333] *See supra* Section IV.C.1.a.—Footnote 88. For example, the exception would inherently not apply to a swaps broking entity that conducts pre-execution communications to facilitate trading activity on behalf of multiple participants in swaps that are not subject to the trade execution requirement. As noted above, such an entity would be subject to the SEF registration requirement and personnel facilitating those communications would likely be designated as SEF trading specialists that constitute part of a SEF's trading system or platform. *See supra* notes 308-309.

[334] The Commission notes that the swap components of different categories of package transactions have been subject to time-limited no-action relief provided by Commission staff from the trade execution requirement and required methods of execution. These categories of package transactions include those where (i) each of the components is a swap subject to the trade execution requirement ("MAT/MAT"); (ii) at least one of the components is subject to the trade execution requirement and each of the other components is subject to the clearing requirement ("MAT/Non-MAT (Cleared)"); (iii) each of the swap components is subject to the trade execution requirement and all other components are U.S. Treasury securities ("U.S. Dollar Swap Spreads"); (iv) each of the swap components is subject to the trade execution requirement and all other components are agency mortgage-backed securities ("MAT/Agency MBS"); (v) at least one individual swap component is subject to the trade execution requirement and at least one individual component is a bond issued and sold in the primary market ("MAT/New Issuance Bond"); (vi) at least one individual swap component is subject to the trade execution requirement and all other components are futures contracts ("MAT/Futures"); (vii) at least one of the swap components is subject to the trade execution requirement and at least one of the components is a CFTC swap that is not subject to the clearing requirement ("MAT/Non-MAT (Uncleared)"); (viii) at least one of the swap components is subject to the trade execution requirement and at least one of the components is not a swap (excluding aforementioned

a "package transaction" involves two or more counterparties and consist of two or more component transactions whose executions are (i) contingent upon one another, (ii) priced or quoted together as one economic transaction, and (iii) executed simultaneous or near simultaneous to each other.[335]

The Commission recognizes that some package transactions contain both a swap that is subject to the trade execution requirement and other swap or non-swap components that are not subject to the requirement. Components not subject to the requirement include, for example, swaps not subject to the clearing requirement, *e.g.*,

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categories) ("MAT/Non-Swap Instruments"); and (ix) at least one of the swap components is subject to the trade execution requirement and at least one of the components is a swap over which the CFTC does not have exclusive jurisdiction, *e.g.*, a mixed swap ("MAT/Non-CFTC Swap"). *See* CFTC Letter No. 14-12, No-Action Relief from the Commodity Exchange Act Sections 2(h)(8) and 5(d)(9) and from Commission Regulation § 37.9 for Swaps Executed as Part of a Package Transaction (Feb. 10, 2014) ("NAL No. 14-12"); CFTC Letter No. 14-62, No-Action Relief from the Commodity Exchange Act Sections 2(h)(8) and 5(d)(9) and from Commission Regulation § 37.9 for Swaps Executed as Part of Certain Package Transactions and No-Action Relief for Swap Execution Facilities from Compliance with Certain Requirements of Commission Regulations § 37.9(a)(2), § 37.203(a) and § 38.152 for Package Transactions (May 1, 2014) ("NAL No. 14-62"); CFTC Letter No. 14-121, Extension of No-Action Relief for Swap Execution Facilities and Designated Contract Markets from Compliance with Certain Requirements of Commission Regulations § 37.9(a)(2), § 37.203(a) and § 38.152 for Package Transactions (Sept. 30, 2014) ("NAL No. 14-121"); CFTC Letter No. 14-137, Extension of No-Action Relief from the Commodity Exchange Act Sections 2(h)(8) and 5(d)(9) and from Commission Regulation § 37.9 and Additional No-Action Relief for Swap Execution Facilities from Commission Regulation § 37.3(a)(2) for Swaps Executed as Part of Certain Package Transactions (Nov. 10, 2014) ("NAL No. 14-137"); CFTC Letter No. 15-55, Extension of No-Action Relief from the Commodity Exchange Act Sections 2(h)(8) and 5(d)(9) and from Commission Regulation § 37.9 and No-Action Relief for Swap Execution Facilities from Commission Regulation § 37.3(a)(2) for Swaps Executed as Part of Certain Package Transactions (Oct. 15, 2014) ("NAL No. 15-55"); CFTC Letter No. 16-76, Re: Extension of No-Action Relief from the Commodity Exchange Act Sections 2(h)(8) and 5(d)(9) and from Commission Regulation § 37.9 and No-Action Relief for Swap Execution Facilities from Commission Regulation § 37.3(a)(2) for Swaps Executed as Part of Certain Package Transactions (Nov. 1, 2016) ("NAL No. 16-76"); CFTC Letter No. 17-55, Re: Extension of No-Action Relief from Sections 2(h)(8) and 5(d)(9) of the Commodity Exchange Act and from Commission Regulations 37.3(a)(2) and 37.9 for Swaps Executed as Part of Certain Package Transactions (Oct. 31, 2017) ("NAL No. 17-55"). To the extent that counterparties may be facilitating package transactions that involve a "security," as defined in section 2(a)(1) of the Securities Act of 1933 or section 3(a)(10) of the Securities Exchange Act of 1934, or any component agreement, contract, or transaction over which the Commission does not have exclusive jurisdiction, the Commission does not opine on whether such activity complies with other applicable law and regulations.

[335] The Commission notes that it similarly defines "package transaction" under proposed § 36.1(d)(1) for purposes of providing an exemption to the trade execution requirement for swaps that are executed as part of package that includes a bond issued in a primary market. *See infra* Section XXI.A.4.—§ 36.1(d)—Exemption for Swaps Executed with Bond Issuance.

swaptions, and various types of securities.[336] The negotiation or arrangement of each of these components generally occurs concurrently or on a singular basis; in particular, negotiations for the pricing of such package transactions may be primarily based on the components that are not subject to the requirement. Further, the swap components in those types of transactions that are subject to the requirement often serve as hedging tools to other components. For those components not subject to the requirement, market participants may negotiate the terms away from a SEF.

The Commission believes that imposing a prohibition on swaps subject to the trade execution requirement that are part of a package transaction that includes components not subject to the requirement would inhibit the ability of counterparties to negotiate or arrange the latter components away from the SEF.[337] Given that components of package transactions are each priced or quoted together as part of one economic transaction, the Commission recognizes the impracticality of requiring communications related to the negotiation or the arrangement of the swap component that is subject to the trade execution requirement to occur on the SEF. Accordingly, an exception from the prohibition on pre-execution communications away from the SEF for swap components subject to the requirement would be appropriate in such circumstances.[338] Consistent with its intent to incorporate existing staff no-action relief into the Commission's

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[336] Based on time-limited no-action relief issued by DMO, the categories of package transactions that consist of components not subject to the requirement include (i) U.S. Dollar Swap Spreads; (ii) MAT/Agency MBS; (iii) MAT/New Issuance Bond; (iv) MAT/Futures; (v) MAT/Non-MAT (Uncleared); (vi) MAT/Non-Swap Instruments; and (vii) MAT/Non-CFTC Swaps. *See supra* note 334.

[337] Package transactions composed entirely of swaps that are subject to the trade execution requirement would be subject to the prohibition of pre-execution communications under proposed § 37.201(b) and are not eligible for this proposed exception.

[338] The Commission notes that a swaps broking entity that facilitates trading in any swap component on behalf of multiple participants, regardless of whether the swap is subject to the trade execution requirement, would be subject to the SEF registration requirement. *See supra* note 333.

regulations, the Commission notes that the proposed exception would codify some of the relief that currently applies to certain types of package transactions.[339]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.201(b). In particular, the Commission seeks insights regarding market participants' use of pre-execution communications and requests comment on the following questions:

(29) What are market participants' current pre-execution communication practices? How often do market participants currently engage in pre-execution communication? What level of trade detail is discussed during such pre-execution communications? What role, if any, should pre-execution communications continue to have in the SEF market structure?

(30) Is the Commission's proposal to require a SEF to prohibit market participants from conducting pre-execution communications away from a SEF with respect to swaps that are subject to the trade execution requirement appropriate? In light of the Commission's proposal to allow SEFs to offer flexible execution methods, are there any impediments for market participants to execute those swaps, in particular those that would become subject to the Commission's proposed approach to the trade execution requirement?

[339] Swap components in the following categories of package transactions are currently subject to relief from the required methods of execution under existing § 37.9: (i) MAT/Non-MAT (Uncleared); (ii) MAT/Non-Swap Instruments; and (iii) MAT/Non-CFTC Swap. NAL No. 17-55 at app. A. Pursuant to this relief, the Commission notes that SEFs have allowed market participants to negotiate or arrange the swap components away from the SEF and submit them for execution.

(31) With respect to swaps that are not subject to the trade execution requirement, is the Commission's proposal to allow SEFs to permit market participants to conduct pre-execution communications away from a SEF appropriate?

(32) Are there any technical limitations that a SEF would face to accommodate pre-execution communications that would otherwise impede the ability of market participants to trade and execute swaps on a SEF?

(33) Should the Commission allow an exception to the proposed prohibition against pre-execution communications for communications involving "market color"? If so, how should the Commission define "market color"? For example, should such a definition consist of views shared by market participants on the general state of the market or trading information provided on an anonymized and aggregated basis? Should such a definition exclude (i) an express or implied arrangement to execute a specified trade; (ii) non-public information regarding an order; and (iii) information about an individual trading position? Are these elements appropriate and should the Commission consider additional elements?

(34) Should the Commission allow an exception to the proposed prohibition against pre-execution communications for communications intended to discern the type of transaction—which may or may not be a swap—that a market participant may ultimately execute on a SEF? The Commission understands that these types of communications are common in the dealer-to-client market and allow a dealer to assist a client with determining which financial instruments may be best suited to manage the client's risks or to establish certain market positions. If so, please describe the nature and scope of these communications that would support an exception to the proposed prohibition.

(35) Should the Commission allow an exception to the proposed prohibition against pre-execution communications for all corrective trades intended to resolve error trades pursuant to the proposed error trade policy rules under § 37.203(e), as discussed further below? Please explain why or why not.

(36) The Commission is proposing to allow market participants to engage in pre-execution communications away from a SEF for package transactions in which at least one component is not subject to the trade execution requirement. For the swap components of some of these package transactions that are currently traded and executed on SEFs—for example, those where all other components are U.S. Treasury securities—should they not be subject to this exception? Are there other types of package transactions for which the Commission should provide an exception to the proposed prohibition on pre-execution communications?

3. § 37.201(c)—SEF Trading Specialists

The Commission notes that a number of registered SEFs—in particular, those that operate in the dealer-to-dealer market—offer voice-based or voice-assisted execution platforms that utilize natural persons to facilitate trading in varying degrees. These persons, commonly referred to as "trading specialists" or "execution specialists," perform core functions that facilitate swaps trading and execution in a multiple-to-multiple participant environment, including disseminating trading interests to the market, *e.g.*, transmitting RFQs provided by participants; matching bids and offers; and negotiating or arranging transaction terms and conditions on behalf of participants.

Many individuals currently carry out the same functions away from a SEF as part of a swaps broking entity, such as an interdealer broker, prior to execution of the

transaction on the SEF.[340] These swaps broking entities are often registered with the Commission as IBs[341] and these individuals are registered as associated persons of IBs.[342] As associated persons of IBs, these persons are subject to various regulatory requirements for intermediaries aimed at protecting customers.[343] As noted above, the Commission has proposed that these swaps broking entities be registered as a SEF, given that they facilitate trading.[344]

The Commission recognizes, however, that the current regulatory requirements for swaps broking entities do not necessarily fully address the unique functions of trading specialists on a SEF, which are broader in scope than the traditional IB functions of solicitation or acceptance of orders. SEF trading specialists serve an intermediary-type

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[340] *See supra* Section IV.C.1.c.(1)—Structure and Operations of Swaps Broking Entities, Including Interdealer Brokers.

[341] The Commission notes above that IBs are registered with the Commission pursuant to CEA section 4f. *See supra* note 93 and accompanying discussion. IBs and their associated persons are required to register pursuant to registration procedures set forth by the NFA. 17 CFR 3.10, 3.12. Section 170.17 requires that each IB becomes and remains a member of at least one registered futures association, *e.g.*, the NFA. 17 CFR 170.17. Pursuant to CEA sections 4p and 17(p), such entities are subject to, among other requirements administered by the registered futures association, training standards and proficiency testing. 7 U.S.C. 6p, 21(p). Depending on the category of intermediary, registrants may be subject to various financial and reporting requirements, *e.g.*, 17 CFR 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 CFR part 155 (trading standards for floor brokers, FCMs, and IBs). Pursuant to CEA section 6c and part 180, all registrants are subject to prohibitions against fraud and manipulation. 7 U.S.C. 9; 17 CFR part 180. Applicants for registration are subject to statutory disqualifications from registration 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).

[342] Section 1.3 defines an "associated person" of an IB 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 CFR 1.3.

[343] *See supra* note 341. *See also* NFA Registration Rules part 400 (proficiency requirements established by the NFA for various registered entities and associated person).

[344] Upon adoption of the SEF Core Principles Final Rule, some swaps broking entities, in particular interdealer brokers, registered their operations or components of their operations, *i.e.*, trading systems or platforms, as SEFs. *See supra* Section IV.C.1.c.(1)—Structure and Operations of Swaps Broking Entities, Including Interdealer Brokers. As part of this process, the Commission understands that some specialists have transitioned to the SEF from affiliated broker entities, in either a permanent capacity or pursuant to a secondment arrangement.

role for each market participant that accesses their SEF by facilitating fair, orderly, and efficient trading and overall market integrity. From a regulatory perspective, the Commission believes that 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.

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.

By allowing SEFs to offer flexible methods of execution and broadening the trade execution requirement to swaps with more episodic liquidity, the Commission believes that the proposed rulemaking would lead to greater volumes of trading on voice-based trading systems or platforms that utilize discretion and judgment. The use of these methods should increase and enhance the utility of SEFs in a manner consistent with the SEF statutory intent and goals, but the Commission also believes that the expected increased role of discretion in SEF trading operations should be accompanied with a regulatory approach that aims to enhance professionalism among trading specialists and enhance market integrity. The Commission believes in particular that such a regulatory

approach should address in particular the integral role that trading specialists play in exercising that discretion in a SEF's multiple-to-multiple trading environment.

Therefore, the Commission proposes to adopt a definition under § 37.201(c) that would categorize certain persons employed by a SEF as a "SEF trading specialist" and require a SEF to ensure that any such person (i) is not subject to a statutory disqualification under CEA sections 8a(2) or 8a(3); (ii) has met certain proficiency requirements; and (iii) undergoes ethics training on a periodic basis. The proposed regulations would further require a SEF to establish and enforce a code of conduct for its SEF trading specialists, as well as diligently supervise their activities. These proposed rules are intended to enhance professionalism in the swaps market and promote market integrity.

a. § 37.201(c)(1)—Definition of "SEF Trading Specialist"

The Commission 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 (other than in a ministerial or clerical capacity), or who is responsible for direct supervision of such persons. This proposed definition would include both persons directly employed by the SEF and persons who are not directly employed, such as independent contractors and persons who are serving as SEF personnel pursuant to an arrangement with an affiliated broker employer, *i.e.*, "seconded" persons. Based on the Commission's proposed application of the SEF registration requirement, as described above, the Commission notes that this definition would also apply to those persons who facilitate swaps trading through swaps broking entities, including interdealer brokers, who would be subject to

SEF registration.[345] As noted above, facilitating the "trading" of swaps means the negotiating or arranging swaps transactions;[346] negotiating or arranging consists of facilitating the interaction of bids and offers.[347] The proposed definition, however, would exclude SEF personnel who facilitate trading solely in a ministerial or clerical capacity because the activities of such employees do not involve the level of discretion and judgement as the activities of SEF trading specialists and, thus, do not implicate the same regulatory concerns.[348]

b. § 37.201(c)(2)—Fitness

In light of the activities of SEF trading specialists and the regulatory considerations discussed above, the Commission proposes § 37.201(c)(2)(i) to prohibit a SEF from permitting any person who is subject to a statutory disqualification under CEA sections 8a(2) or 8a(3) to serve as a SEF trading specialist if the SEF knows, or in the exercise of reasonable care should know, of the person's statutory disqualification.[349] CEA sections 8a(2) and 8a(3) set forth numerous bases upon which the Commission may refuse to register a person, including, without limitation, felony convictions, commodities

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[345] *See supra* Section IV.C.1.c.(2)—SEF Registration Requirement for Swaps Broking Entities, Including Interdealer Brokers and Section IV.C.1.d.—Foreign Swaps Broking Entities and Other Foreign Multilateral Swaps Trading Facilities.

[346] *See supra* Section IV.C.1.c.(2)—SEF Registration Requirement for Swaps Broking Entities, Including Interdealer Brokers.

[347] *Id.*

[348] The Commission notes that persons acting in a ministerial or clerical capacity are subject to exceptions from other Commission requirements. For example, the definition of "associated person" under § 1.3 excludes a person who solicits or accepts customer orders in a clerical capacity on behalf of an FCM or IB, or who solicits or accepts swaps in a clerical or ministerial capacity on behalf of an SD or MSP. 17 CFR 1.3.

[349] The Commission notes that CEA section 4s(b)(6) makes it unlawful for an SD or MSP to permit any person associated with the SD or MSP who is subject to a statutory disqualification to effect or be involved in effecting swaps on behalf of the SD or MSP, if the SD or MSP knew, or in the exercise of reasonable care should have known, of the statutory disqualification. 7 U.S.C. 6s(b)(6). This prohibition applies with respect to an AP of an SD or MSP, but does not include an individual employed in a clerical or ministerial capacity. 17 CFR 23.22(a) (definition of "person" applicable to the prohibition).

or securities law violations, and bars or other adverse actions taken by financial regulators.[350] While SEF trading specialists would not be required to register with the Commission, the Commission believes that given the nature of their interaction with market participants in facilitating swaps trading and execution, as well as the central role they play in maintaining market integrity and orderly trading, a SEF should not be permitted to employ those who are subject to such a statutory disqualification.

The Commission, however, also proposes two exceptions to the proposed prohibition. Under proposed § 37.201(c)(2)(ii)(A), the prohibition would not apply where a person is listed as a principal[351] or is registered with the Commission as an AP of a Commission registrant or as a floor trader or floor broker, notwithstanding that the person is subject to a disqualification from registration under sections 8a(2) or 8a(3) of the Act. Pursuant to authority delegated to it by the Commission,[352] the NFA has permitted a person to be listed as a principal or registered with the Commission where, in its discretion, the NFA has determined that the incident giving rise to a statutory disqualification is insufficiently serious, recent, or otherwise relevant to evaluating the person's fitness. Under proposed § 37.201(c)(2)(ii)(B), the prohibition also would not apply where a person subject to a statutory disqualification is not registered with the Commission, but provides a written notice from a registered futures association ("RFA") stating that if the person were to apply for registration as an AP, then the RFA would not deny the application on the basis of the statutory disqualification. The Commission

[350] 7 U.S.C. 12a(2)-(3).
[351] 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 CFR 3.10(a)(2).
[352] CEA section 8a(10) enables the Commission to authorize any person to perform any portion of the registration functions under the Act. 7 U.S.C. 12(a)(10). The Commission has delegated to the NFA the authority to perform the full range of registration functions, including vetting of applicants for statutory disqualifications. *See, e.g.*, 50 FR 34885 (Aug. 28, 1985); 57 FR 23136 (Jun. 2, 1992).

believes that a statutory disqualification that has not or would not prevent a person from being listed as a principal or from registering with the Commission because it is insufficiently serious, recent, or otherwise relevant to evaluating the person's fitness for registration with the Commission, as determined by an RFA, should not be a basis for prohibiting a SEF from employing the person as a SEF trading specialist.

c. § 37.201(c)(3)—Proficiency Requirements

The Commission proposes to require a SEF to maintain proficiency standards for SEF trading specialists. Proposed § 37.201(c)(3)(i) would require a SEF to establish and enforce standards and procedures to ensure that its SEF trading specialists have the proficiency and knowledge necessary to fulfill their responsibilities to the SEF and to comply with the Act, applicable Commission regulations, and the SEF's rules. Further, the Commission proposes under proposed § 37.201(c)(3)(ii) to mandate that a SEF require any person employed as a SEF trading specialist to have taken and passed a swaps proficiency examination as administered by an RFA.[353] Accordingly, SEFs would not have to comply with the examination requirement until an RFA, such as the NFA, completes development of the exam and establishes an administration process. Pursuant to proposed § 37.201(c)(3)(iii), a SEF's compliance with the proficiency examination

[353] As proposed, the swaps proficiency examination would have to be developed and administered by an RFA. The NFA currently requires persons seeking to become members or associate members of the NFA, or persons seeking to register with the Commission as an AP to take and pass the National Commodity Futures Examination ("Series 3 Exam"), which is administered by FINRA, subject to certain exceptions. The Series 3 Exam does not test for swaps proficiency. As a result, NFA Registration Rule 401(e) currently provides an exception to the NFA's qualification testing requirement for a person applying for registration with the Commission as an AP, if the applicant's sole activities subject to regulation by the Commission are swaps-related. NFA Registration Rule 401(e). The Commission is aware that the NFA recently announced that it would develop a swaps proficiency requirements program for all APs engaging in swaps activities, including those of FCMs, IBs, commodity pool operators ("CPOs"), commodity trading advisors ("CTAs"), and individuals who act as APs at SDs. NFA, NFA to Develop Swaps Proficiency Requirements Program," https://www.nfa.futures.org/news/newsRel.asp?ArticleID=5014 (Jun. 5, 2018).

requirement would constitute compliance with the general proficiency requirements upon establishment of an exam and administration process by the RFA.[354] Additionally, a SEF would satisfy the examination requirement if a SEF trading specialist took and passed the examination once without any further testing, unless the person has not served in such a capacity for a continuous two-year period. In that case, the SEF trading specialist would have to retake and pass the examination.

Given the level of discretion and judgement that SEF trading specialists exercise in facilitating swaps trading and execution, as well as the size and complexity of the transactions often executed on a SEF, the Commission believes that it is essential that a SEF ensure that its SEF trading specialists possess appropriate skills and knowledge. Accordingly, the Commission believes that demonstrating such skills and knowledge would be best achieved through a swaps proficiency examination regime. The Commission notes that persons who intermediate transactions in the futures markets and securities markets are already subject to proficiency requirements that include examinations.[355] The Commission believes that requiring SEFs to ensure that their SEF trading specialists have the necessary skills and proficiency to perform the key functions of a SEF would similarly enhance the level of professionalism and market integrity in the swaps market.[356]

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[354] The Commission clarifies, however, that in the absence of an available examination that meets the Commission's requirements, SEFs would still be required to ensure that their SEF trading specialists meet the general proficiency requirements set forth under proposed § 37.201(c)(3)(i).

[355] In addition to the Series 3 Exam, which applies to persons seeking membership with the NFA as an AP of a registered entity with respect to futures and options on futures, *see supra* note 353, persons who seek registration as a securities professional must also pass various qualification exams to demonstrate competency in particular securities-related areas. *See generally* FINRA, Registrations and Qualifications, www.finra.org/industry/registration-qualification.

[356] The Commission notes that this proposed requirement is analogous to the principles set forth in the FX Global Code regarding ethics. The code specifies, among other recommendations, that operators of trading

d. § 37.201(c)(4)—Ethics Training

The Commission proposes § 37.201(c)(4) to require a SEF to establish and enforce policies and procedures to ensure that its SEF trading specialists receive ethics training on a periodic basis. Given each trading specialist's obligation to promote a fair and orderly market in facilitating trading and execution while also using discretion in handling orders on behalf of individual market participants, a SEF must maintain a training program to ensure that its trading specialists are aware of and understand the relevant professional and ethical standards established by the SEF.[357] Proposed § 37.201(c)(4) is consistent with and would further a SEF's existing obligation under Core Principle 12 to establish and enforce rules that minimize conflicts of interest.[358] Additionally, the proposed rule corresponds to the existing requirement under § 37.1501 that a SEF CCO establish and administer a written code of ethics for the SEF that is designed to prevent ethical violations and promote honesty and ethical conduct by the SEF's personnel.[359] The Commission also views ethics training as a necessary element of a SEF's adequate supervision of its trading specialists and, accordingly, proposes to require such supervision under § 37.201(c)(6), as described below.[360] The Commission believes that the proposed requirement would enhance professionalism in the overall swaps market and promote swaps market integrity.

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systems or platforms and their personnel, have sufficient knowledge of, and comply with, applicable law and have sufficient relevant experience, technical knowledge, and qualifications. FX Global Code at 6-7.

[357] As discussed above, this proposed requirement is similar to one of the leading principles set forth in the Global FX Code regarding ethical standards. The Global FX Code states, in part, that firms should promote ethical values and behavior, support efforts to promote such ethical standards in the wider FX market, and encourage involvement by personnel in such efforts. FX Global Code at 6-7.

[358] 7 U.S.C. 7b-3(f)(12).

[359] *See infra* Section XX.A.3.—§ 37.1501(c)—Duties of Chief Compliance Officer (requirement under proposed § 37.1501(c)(6)).

[360] *See infra* Section VI.A.3.f.—§ 37.201(c)(6)—Duty to Supervise.

(1) Guidance to Core Principle 2 in Appendix B—Ethics Training

The Commission also proposes new guidance to Core Principle 2 in Appendix B that would provide the general objectives for an ethics training program and examples of topics that should be addressed.[361] The guidance provides SEFs with the latitude to determine the appropriate frequency, duration, and format of ethics training for its trading specialists, including the use of qualified third-party providers and various forms of technology and media. The proposed guidance, however, specifies that an ethics training program is essential to enable SEF trading specialists to remain current with respect to the ethical and regulatory implications of evolving technology, trading practices, products, and other relevant changes. For example, if a SEF's trading protocols or operations continue to develop, *e.g.*, the 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. This approach is generally consistent with the Commission's implementation of the training requirements applicable to Commission registrants under CEA section 4p(b), as set forth in acceptable practices established by the Commission for ethics training for registered persons under part 3 of the Commission's regulations.[362]

[361] The Commission proposes to add this guidance as a new paragraph (a)(1) and eliminate existing paragraph (a)(1), which states that a SEF's rules may authorize its compliance staff to issue warning letters or recommend that a disciplinary panel take such action. *See infra* note 456 (discussing proposed changes to the existing SEF warning letter requirements).
[362] 17 CFR part 3 app. B (Statement of Acceptable Practices With Respect to Ethics Training).

e. § 37.201(c)(5)—Standards of Conduct

The Commission proposes to require a SEF to establish and enforce a code of conduct for its SEF trading specialists. Like the proposed ethics training requirement under § 37.201(c)(4), the proposed code of conduct requirement aims to ensure that SEFs foster and maintain a high level of professionalism, integrity, and ethical conduct among their trading specialists when dealing with market participants and facilitating trading and execution. A SEF's code of conduct may provide that, among other things, a SEF trading specialist should (i) act in an honest and ethical manner and observe high standards of professionalism; (ii) handle orders with fairness and transparency; and (iii) not engage in fraudulent, manipulative, or disruptive conduct. The Commission includes these items for SEF consideration, but a SEF may include different or additional standards as well. These proposed standards of conduct are intended to be general and principles-based, given the many unique aspects of a SEF trading specialist's role in facilitating trading and execution as part of the SEF's particular trading system or platform.

f. § 37.201(c)(6)—Duty to Supervise

To help promote compliance with a SEF's professionalism requirements, including ethics requirements and standards of conduct, the Commission also proposes § 37.201(c)(6) to require a SEF to diligently supervise the activities of its trading specialists in facilitating trading and execution on the SEF. While a SEF is generally responsible for the actions of its agents pursuant to CEA section 2(a)(1)(B) and § 1.2,[363] proposed § 37.201(c)(6) would impose an affirmative duty of supervision on each SEF. Given the

[363] CEA section 2(a)(1)(B) and § 1.2 establish that the act, omission, or failure of any official, agent, or other person acting for a principal within the scope of his employment or office is imputed to the principal. 7 U.S.C. 2(a)(1)(B); 17 CFR 1.2.

dynamic manner in which SEF trading specialists may use discretion to facilitate swaps trading and execution on behalf of market participants, a SEF should have an affirmative obligation to supervise its trading specialists. The Commission notes that a similar customer protection rule currently applies to registered entities, including IBs—§ 166.3 requires each Commission registrant to diligently supervise all the activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.[364] Therefore, to the extent that some of these SEFs were previously registered with the Commission and operated as IBs, the Commission believes that proposed § 37.201(c)(6) would impose certain analogous requirements.

g. § 37.201(c)(7)—Additional Sources for Compliance

The Commission is proposing § 37.201(c)(7) to refer SEFs to the new guidance to Core Principle 2 in Appendix B as discussed above.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.201(c). In particular, the Commission requests comment on the following questions:

(37) Is the proposed definition of the term "SEF trading specialist" overly broad or too narrow? Are there additional activities that SEF trading specialists engage in that should be reflected in the definition? Are there additional natural persons who should be captured by the proposed definition?

(38) Are the exceptions to the fitness requirement for SEF trading specialists under proposed § 37.201(c)(2)(ii) appropriate? Should the Commission prohibit a SEF from

[364] 17 CFR 166.3.

employing persons other than those subject to a statutory disqualification under CEA sections 8a(2) or 8a(3)? If so, what additional disqualification factors should the Commission use? In this connection, should the Commission not rely on any of the disqualification factors in CEA sections 8a(2) or 8a(3)?

(39) Should the qualification testing requirement under proposed § 37.201(c)(3)(ii) be broadened to allow a SEF to employ persons who have taken and passed a swaps proficiency examination developed and administered by parties other than an RFA? If so, should the Commission then adopt standards to ensure that such testing adequately ensures proficiency? How could the Commission ensure that the examination meets appropriate standards and consistency, such that it could be recognized by all SEFs? Should the Commission approve each examination to ensure appropriate standards are met and consistency is achieved across different examinations?

(40) Are the ethics training and standards of conduct requirements under proposed §§ 37.201(c)(4)-(5), respectively, overly prescriptive or too flexible? Should the Commission provide greater specificity regarding the standards of conduct that a SEF must enforce? Are there particular subjects that should be specifically required as part of ethics training?

VII. Additional Part 37 Regulations—Subpart C: Core Principle 2 (Compliance With Rules)

In addition to requiring a SEF to establish and enforce rules that govern its facility, Core Principle 2 requires a SEF to adopt trading, trade processing, and participation rules that provide participants with impartial access to the market and deter abuses; and establish

and enforce compliance with any limitation on access.[365] Further, Core Principle 2 requires a SEF to have the capacity to detect, investigate, and enforce those rules, including the means to capture information that may be used in identifying rule violations.[366] The Commission adopted many detailed regulations in part 37 to further implement these requirements, including impartial access requirements under § 37.202; rule enforcement program requirements under § 37.203; third-party service provider requirements under § 37.204; audit trail requirements under § 37.205; and disciplinary procedures and sanctions requirements under § 37.206.

The Commission is proposing several new rules and rule amendments under Core Principle 2, including clarifications of existing rules where appropriate, to implement its proposed swaps regulatory framework. These proposed amendments would streamline the SEF rules and allow SEFs to account for technological developments, existing market practices, and costs in their trading and market operations. Further, the amendments would codify no-action relief that has been provided under several existing Commission staff no-action letters. Among these changes, the Commission is proposing a modification to the impartial access requirements under § 37.202 and several corresponding amendments, which would provide a SEF with the ability to devise its participation criteria based on its own trading operations and market focus. Further, the Commission is proposing several amendments to §§ 37.203-206 that would allow a SEF to better tailor its own compliance and regulatory oversight rules to its trading operations and markets, while still maintaining a robust compliance program.

[365] 7 U.S.C. 7b-3(f)(2)(B)(i).
[366] 7 U.S.C. 7b-3(f)(2)(B)(ii).

A. § 37.202 Access Requirements

The Commission implemented the statutory impartial access requirement by adopting § 37.202. Existing § 37.202(a)(1) requires a SEF to provide any ECP and any independent software vendor ("ISV") with impartial access to its market(s) and market services, including indicative quote screens or any similar pricing data displays, provided that the facility has, among other things, criteria governing such access that are "impartial, transparent, and applied in a fair and non-discriminatory manner."[367] In the preamble to the SEF Core Principles Final Rule, the Commission stated that "impartial" means "fair, unbiased, and unprejudiced."[368] The Commission further stated that the impartial access requirement allows ECPs to "compete on a level playing field"[369] and does not allow a SEF to "limit access … to certain types of ECPs or ISVs."[370] The Commission also noted that each similarly situated group of ECPs and ISVs must be treated similarly.[371] The Commission believed that this approach would increase the number of market participants on SEFs, which in turn would increase SEF trading, thereby improving liquidity and price discovery in the swaps market.[372]

Core Principle 2, however, also allows a SEF to establish and enforce compliance with any rule of the SEF, including any limitation on access to the SEF.[373] Accordingly, existing § 37.202(c) requires a SEF to establish and impartially enforce rules that govern the SEF's decision to allow, deny, suspend, or permanently bar ECPs' access to the SEF, including when such decisions are made as part of a disciplinary or emergency action by

[367] 17 CFR 37.202(a)(1).
[368] SEF Core Principles Final Rule at 33508.
[369] *Id*.
[370] *Id*.
[371] *Id*.
[372] *Id*.
[373] 7 U.S.C. 7b-3(f)(2)(A)(ii).

the SEF.[374] The Commission further stated that a SEF may establish different access criteria for each of its markets, provided that the criteria are impartial and are not used as a competitive tool against certain ECPs and ISVs.[375] Subject to these requirements, the Commission stated that a SEF may "use its own reasonable discretion to determine its access criteria, provided that the criteria are impartial, transparent and applied in a fair and non-discriminatory manner, and are not anti-competitive."[376]

Existing § 37.202(a)(3) requires a SEF to have a comparable fee structure for ECPs and ISVs receiving comparable access to, or services from, the SEF.[377] The Commission clarified that this requirement neither sets nor limits fees that a SEF may charge.[378] The Commission further clarified that a SEF may establish different categories of ECPs and ISVs seeking access to, or services from, the SEF, but may not discriminate with respect to fees within a particular category.[379] The Commission stated that existing § 37.202(a)(3) is not intended to be a "rigid requirement that fails to take into account legitimate business justifications for offering different fees to different categories of entities seeking access to the SEF."[380]

Finally, existing § 37.202(a)(2) requires SEFs to have procedures for ECPs to provide written or electronic confirmation of their ECP status with the SEF prior to

[374] 17 CFR 37.202(c).
[375] SEF Core Principles Final Rule at 33508.
[376] *Id*.
[377] 17 CFR 37.202(a)(3).
[378] SEF Core Principles Final Rule at 33509.
[379] *Id*.
[380] *Id*.

obtaining access.[381] Under existing § 37.202(b), an ECP must consent to a SEF's jurisdiction prior to obtaining access to the SEF.[382]

1. § 37.202(a)—Impartial Access to Markets, Market Services, and Execution Methods[383]

The Commission has applied the impartial access requirements to various areas of a SEF's operations that concern participant access to the market. These features include (i) eligibility or onboarding criteria; (ii) a participant's ability to access the SEF's functionalities, *i.e.*, trade and execute on a SEF's execution methods; (iii) the manner in which a SEF's execution methods treat market participants' bids and offers, in particular the use of discretion; and (iv) participation fee structures. The Commission's current approach to impartial access in these areas, however, has raised two issues that have led to certain inconsistencies in implementation of the requirement.

First, the existing approach has created uncertainty for SEFs seeking to establish and apply access criteria in a consistent manner. The Commission recognizes that SEF Core Principle 2 requires a SEF to provide impartial access, but also allows a SEF to establish limitations on access. Accordingly, the Commission has allowed SEFs to establish different access criteria for different markets, but has also required each "similarly situated" group of ECPs and ISVs to be treated in the same manner.[384] The preamble to the SEF Core Principles Final Rule also states that SEFs can use their own reasonable discretion to determine their access criteria, provided that they are impartial.

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[381] 17 CFR 37.202(a)(2).
[382] 17 CFR 37.202(b).
[383] The Commission proposes to retitle § 37.202(a) to "Impartial access to markets, market services, and execution methods" from "Impartial access to markets and market services" based on the proposed changes described below.
[384] SEF Core Principles Final Rule at 33508.

In practice, implementation of the rule has led to some uncertainty by SEFs as to whether different access criteria for their markets, market services, and execution methods would be allowed or not allowed under § 37.202.

Second, the manner in which the Commission has implemented the existing approach has often favored the promotion of an "all-to-all" trading environment and has, thus, limited the ability of SEFs to adapt their operations to the characteristics and dynamics of the swaps market.[385] All-to-all trading environments, such as futures markets, are generally marked by smaller-sized products with standardized terms and conditions that appeal to a broad range of market participants, including retail customers. These same characteristics are also more conducive to continuous and liquid trading. By contrast, swaps trading often occurs between a limited number of ECPs in a broad array of unique, larger-sized products with more variable terms that are customized to address specific and unique hedging risks. These characteristics result in episodic market liquidity in many swaps markets, in contrast to the continuous liquidity found in all-to-all trading environments. The Commission believes that the imposition of features found in an "all-to-all" trading environment upon swaps markets is at odds with general market characteristics and dynamics of swaps trading.

a. § 37.202(a)(1)—Impartial Access Criteria

Based on its experience with implementing part 37, the Commission proposes to modify its approach to applying the impartial access requirement. In doing so, the Commission proposes to streamline and consolidate the existing language and relevant preamble discussion from the SEF Core Principles Final Rule, including the

[385] *Id*.

Commission's view of "impartial" and the concept of "similarly situated," to establish a revised impartial access requirement. Under proposed § 37.202(a)(1), a SEF would be required to establish rules that set forth impartial access criteria for accessing its markets, market services, and execution methods, including any indicative quote screens or any similar pricing data displays. Such impartial access criteria must be transparent, fair and non-discriminatory and applied to all or similarly situated market participants.

In proposing this approach, the Commission believes that criteria that are "fair and non-discriminatory" would inherently be "fair, unbiased, and unprejudiced," which the Commission previously defined as "impartial." The Commission also believes that the proposed rule clarifies that this criteria must be applied to market participants in a fair and non-discriminatory manner, as currently required under the existing requirements of § 37.202(a)(1). Finally, proposed § 37.202(a)(1) would continue to allow each SEF to determine which market participants are "similarly situated" in its market and configure appropriate access criteria, provided that such criteria are transparent, fair, and non-discriminatory to participants. Applying access criteria in a "fair and non-discriminatory" manner means that a SEF should permit or deny access to a market participant on a non-arbitrary basis, based on objective, pre-established requirements or limitations. The Commission emphasizes, however, that this streamlined approach does not mean that a SEF must create an "all-to-all" trading environment.

The Commission acknowledges that it has often applied the impartial access requirement to promote an "all-to-all" trading environment, which is neither required under Core Principle 2 nor is consistent with swaps market structure. Under the proposed approach, the Commission would not seek to apply the requirement to mandate that all

participants have access to all SEFs, which may have circumscribed a SEF's ability under Core Principle 2 to set access limitations. Rather, to allow SEFs to serve different types of market participants or have different access criteria for different execution methods, the Commission would allow SEFs to apply access limitations, as long as they are applied in a fair and non-discriminatory manner.

This approach would also align with swaps market characteristics—in particular, the episodic nature of swaps liquidity—that have led to the overall swaps market being made up of both dealer-to-client and dealer-to-dealer markets, as described below. The Commission believes that the structure of the swaps market is a natural outgrowth of certain fundamental features of swaps trading. The Commission further believes that all-to-all markets are inimical to these fundamental swaps trading features; therefore, imposing all-to-all, market-derived requirements on swaps markets ultimately detracts from achieving the statutory SEF goals of promoting swaps trading on SEFs and pre-trade price transparency in the swaps market. Accordingly, the Commission believes that each SEF should be able to use access criteria to develop its business in a manner that is both consistent with the characteristics of swaps markets and accommodating of the types of participants that comprise the SEF's intended market.

The Commission still believes that any access criteria intended to prevent or reduce competition among similarly situated market participants would be unfair and discriminatory and, therefore, inconsistent with proposed § 37.202(a)(1). If a market participant is willing or able to meet the objective, pre-established, and transparent criteria for eligibility to onboard to a SEF or gain additional access to a SEF's trading mechanisms, then the SEF should not preclude that market participant from onboarding

to the SEF or using its functionalities. Accordingly, such a market participant should not be subject to access criteria that are unfair and discriminatory and are intended to prevent or dis-incentivize that market participant's participation on the SEF.[386]

The Commission emphasizes that under proposed § 37.202(a)(1), any access criteria—whether it concerns eligibility or onboarding criteria, prerequisites for using certain trading functionalities, or fee schedules—constitutes a "rule," as that term is defined under § 40.1(i), that would be subject to rule approval or self-certification procedures under part 40.[387] Through the part 40 rule review process, the Commission would continue to evaluate a SEF's compliance with the impartial access requirements as proposed.

The Commission also proposes to eliminate the reference to "ISVs," which the Commission notes is not required under Core Principle 2. Given that a SEF should be able to set its access criteria to develop its business based on its desired market and participant needs, the Commission also believes that a SEF should be able to determine an ISV's level of access to the SEF. The Commission previously applied the impartial access requirement to ISVs on the basis that such types of vendors would provide various benefits to the swaps market and market participants, such as enhanced transparency and trading efficiency through the consolidation of trading data from multiple venues,

[386] The Commission also notes that such criteria may be inconsistent with Core Principle 11. Core Principle 11 prohibits a SEF from adopting measures that result in any unreasonable restraint of trade or impose any material anticompetitive burdens on trading or clearing, unless they are necessary or appropriate to achieve the purposes of the CEA and are otherwise consistent with the CEA and the Commission's regulations. 17 CFR 37.1100.
[387] 17 CFR 40.5-6.

analytics, and best displayed prices.[388] Based on the Commission's experience and notwithstanding the existing impartial access requirement, ISVs have not established a significant level of participation on SEFs, nor have they achieved a broad level of adoption among market participants. Rather, the Commission has observed that most participants access SEFs through means other than ISV services.[389] Therefore, the Commission believes that the impartial access requirement should apply to market participants who are accessing SEF trading systems or platforms to trade swaps, rather than establish requirements for a separate set of entities that are merely providing ancillary market services.

(1) Application of Impartial Access Requirement

Based on the areas in which the Commission has applied the existing impartial access requirement to various aspects of a SEF's operation during the part 37 implementation, the Commission discusses below how the proposed impartial access approach would apply to these areas to provide further clarity, including (i) eligibility and onboarding; (ii) execution methods; and (iii) SEF use of discretion.

(i) Eligibility and Onboarding Criteria

The Commission has applied the impartial access requirement to assess a SEF's eligibility and onboarding criteria. In the preamble to the SEF Core Principles Final Rule, the Commission prospectively identified whether or not certain hypothetical arrangements would comply with the rulemaking's approach to impartial access. Certain criteria were deemed non-compliant, such as platforms whose participants were limited to

[388] The Commission previously cited examples of ISVs that included smart order routers, trading software companies that develop front-end trading applications, and aggregator platforms. SEF Core Principles Final Rule at 33508 n.423.

[389] *See supra* notes 52-54 (describing the various modes of participation on SEFs by market participants).

wholesale liquidity providers;[390] platforms that imposed participation limits based on maintaining financial integrity and operational safety;[391] platforms that established objective minimum capital or credit requirements;[392] and platforms that limited participation to sophisticated market participants.[393] The Commission generally characterized these types of criteria as inconsistent with Core Principle 2 because they would inherently limit access to certain types of ECPs and ISVs.[394] Subsequent Commission staff guidance further identified other eligibility criteria that Commission staff viewed as inconsistent with impartial access, based on the view that limiting access to a SEF's trading systems or platforms to certain types of ECPs or ISVs is inconsistent with Core Principle 2.[395]

The Commission has realized from experience that certain criteria developed by SEFs reflect fundamental swap market segments. In particular, the swaps market consists of both a dealer-to-client market segment and a dealer-to-dealer market segment that are related, but also differ in important respects. In the dealer-to-client segment, corporate end-users and other buy-side participants access and utilize the swaps market to manage risk positions that are unique to their particular circumstances. Swap dealers provide liquidity to the participants within this market segment for a fee, which participants are

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[390] SEF Core Principles Final Rule at 33507-08.
[391] *Id*.
[392] *Id*. at 33507.
[393] *Id*.
[394] *Id*. at 33508.
[395] These criteria included (i) not providing access to an ECP that is both a liquidity provider and taker; (ii) prohibiting individuals from obtaining access despite their meeting the requirements to be an ECP; (iii) limiting access to ECPs that satisfy minimum transaction volume level requirements; and (iv) requiring an ECP to be a clearing member or to have an agreement with a clearing member to access the SEF, even if only for the purpose of trading swaps that are not intended to be cleared. Commission staff also expressed concern that SEFs allowing only either intermediated access or direct access may impede impartial access in certain instances. Division of Clearing and Risk, Division of Market Oversight and Division of Swap Dealer and Intermediary Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities (Nov. 14, 2013) ("2013 Staff Impartial Access Guidance").

willing to pay, that reflects the risks incurred by dealers from the episodic or relative lack of liquidity in the swaps market for many specific swaps. The swap dealers subsequently offset positions established through the dealer-to-client market segment by hedging their swaps inventories on a portfolio basis in the dealer-to-dealer market, which is wholesale in nature. Those dealer-to-dealer markets consist of other primary dealers and sophisticated market-making participants seeking to fulfill similar objectives through competitive execution of large-sized transactions. In pricing a customer trade, dealers base their prices on the cost of hedging those trades in the dealer-to-dealer markets.

The dealer-to-dealer market may provide benefits to the swaps markets, in particular to non-dealer clients, by allowing dealers who provide liquidity to offload risk from clients. Without this market, liquidity in the dealer-to-client market may suffer because the inherent risks of holding swaps inventory could arguably dis-incentivize participation by dealers in the dealer-to-client market or otherwise require dealers to charge their customers higher prices for taking on this risk. Absent the supply of liquidity providers, non-dealers who are liquidity takers would have difficulty executing swaps at competitive pricing. SEFs that serve the wholesale, dealer-to-dealer market have stated that using eligibility or participation criteria to maintain a dealer-to-dealer market is beneficial, given that it allows participants who share similar profiles and trading interests to interact with each another, thereby helping to promote liquid markets with tight pricing.

For the reasons stated above, the Commission believes that SEF eligibility and onboarding criteria that would serve to maintain this market structure would be appropriate and consistent with existing market dynamics and may provide the benefits

discussed above. Accordingly, a SEF could premise these criteria in different ways, such as limiting access upon the type of the market participant or the swap product itself. For example, a SEF would be able to calibrate access to serve market participants within a particular market segment, such as dealers trading in a wholesale swaps market, who may be categorized as "similarly situated."

(ii) Access to Execution Methods

In addition to assessing SEF onboarding and eligibility, the Commission has also applied the current impartial access standard to evaluate various SEF-established prerequisites for trading on certain platforms or interacting with certain participants. Some of those prerequisites reflect the nature of the swap involved, *e.g.*, whether the swap is submitted for clearing or is uncleared, which determines whether certain market participants are eligible to trade with one another.[396] When a SEF lists a swap that is traded as a component of a transaction with other non-swap legs, the SEF might also establish trading eligibility criteria that take account of a participant's ability to trade the non-swap leg components of such swaps.[397] Other prerequisites may be based upon the prior or ongoing level of trading activity generated by a particular participant, *e.g.*, whether the participant has been actively submitting bids and offers. During the implementation of part 37, the Commission has deemed appropriate certain criteria based on business or operational justifications, but also deemed other criteria as inconsistent with impartial access. For example, platform access criteria that require a market

[396] Such a situation might result in a SEF limiting trading access to uncleared swaps to only those market participants who have existing underlying documentation to execute such swaps with other potential counterparties.

[397] For example, a SEF could require market participants (or their clearing members) to have membership in a particular clearing organization, *e.g.*, membership with the Fixed Income Clearing Corporation ("FICC"), in order to access a method of execution in which counterparties execute a package transaction with a non-swap leg that FICC must clear.

participant to contribute a certain amount of liquidity, *e.g.*, provide a minimum number of bids and offers, have been prohibited, despite the business or operational justifications offered by SEFs.

SEFs have also argued that requiring market participants to meet trading prerequisites or participation criteria to access certain platforms or trade certain products can be beneficial to promoting effective trading markets on SEFs. In implementing part 37, the Commission has acknowledged that such criteria may be beneficial toward maintaining and promoting orderly trading for uncleared swaps on SEFs—for example, where participants must have certain trading enablements in place prior to trading uncleared swaps with other participants on the platform.[398] Specifically, the Commission has allowed such types of enablements, *e.g.*, trading relationship documentation with a minimum percentage of trading participants prior to posting bids and offers or trading in certain established minimum sizes, to promote a more dynamic and liquid trading environment for uncleared swaps with active participation.[399]

The Commission's current approach to impartial access, however, has led to confusion as to whether these types of criteria are inappropriate because they do not ensure equal participation by all market participants; or as to whether they are appropriate because they reflect a SEF's ability to impose limitations on access and are consistent

[398] The Commission notes that Commission staff previously used the term "enablement mechanism" in guidance to refer to "any mechanism, scheme, functionality, counterparty filter, or other arrangement that prevents a market participant from interacting or trading with, or viewing the bids and offers (firm or indicative) displayed by any other market participant on that SEF, whether by means of any condition or restriction on its ability or authority to display a quote to any other market participant or to respond to any quote issued by any other market participant on that SEF, or otherwise." 2013 Staff Impartial Access Guidance at 1.

[399] The Commission notes that Commission staff previously viewed a SEF's application or support otherwise for enablement mechanisms with respect to swaps that were intended to be cleared as "prohibited discriminatory treatment," that is inconsistent with the existing impartial access requirement under § 37.202. *Id*. at 1-2.

with the view that SEFs should have the discretion to determine the most suitable way to promote trading on their platforms. Specifically, the Commission recognizes that requiring impartial access for "similarly situated" groups of market participants has currently been interpreted to require that a SEF allow all participants in that group to be able to interact with one another in the same manner and degree.

The Commission clarifies that a SEF must have impartial access criteria, *i.e.*, transparent, fair, and non-discriminatory, for trading prerequisites or participation criteria prior to accessing certain platforms or trading certain products. As long as these access criteria are impartial, such that any market participant who meets the criteria is able to utilize a certain execution method or trade a certain product, then they would be allowed to do so under the proposed approach. For example, if a SEF established a minimum trade size for its order book that applied to a market participant's orders, then such criteria would be allowed if any of its market participants who met these criteria could trade on the order book. As noted above, Core Principle 2 does not require a SEF to create an "all-to-all" marketplace, and the Commission believes that SEFs should be allowed to establish criteria that would facilitate trading based on its products and the intended trading environment. As long as a SEF also applies its impartial access criteria in a fair and non-discriminatory manner, as described above, the Commission believes that such criteria would comply with § 37.202(a)(1).

(iii) Use of Discretion

The Commission has also previously determined whether a SEF complies with the impartial access requirement based on how the SEF's trading systems or platforms handle participant orders. For example, a SEF's voice-based or voice-assisted execution

methods involve the exercise of "discretion" by a SEF trading specialist in managing the interaction of multiple bids and offers from multiple participants. As described above, SEF trading specialists solicit orders on behalf of the SEF and seek to arrange transactions by matching those orders with reciprocal trading interests.[400] Given the variability in how participant orders may be handled through the use of discretion, the Commission has sought to ensure that market participants are receiving "impartial access" in the manner in which their orders are handled while also acknowledging that discretion is inherent to these types of systems or platforms.

The Commission also recognizes that its current approach to impartial access may be in tension with its proposal to allow more flexible execution methods on SEFs, particularly those that involve discretion and are prevalent in the dealer-to-dealer market. While some SEF execution methods facilitate trading and execution on a non-discretionary basis, *e.g.*, electronic trading systems, including Order Books and RFQ Systems, some execution methods rely upon the ability of a SEF trading specialist to ascertain liquidity for particular products and manage multiple competing bids and offers, *e.g.*, voice-based platforms. To facilitate trading and execution in such a trading environment, SEF trading specialists must account for a host of changing market conditions, such as available pricing, product complexity, prevailing trade sizes, and market participant needs. The Commission recognizes that SEF trading specialists may apply these factors differently among different participants during different periods of trading. In contrast to prevailing practices among swaps broking entities, such as

[400] For the Commission's previous description of the role of SEF trading specialists, who function as part of a SEF's voice-based or voice-assisted trading system or platform, and their use of discretion, *see supra* Section VI.A.1.b.—§ 37.201(a)(2)—Discretion and Section VI.A.3.—§ 37.201(c)—SEF Trading Specialists.

interdealer brokers that have operated outside of the SEF regulatory framework,[401] the Commission has scrutinized similar practices on SEF voice-based platforms against the impartial access requirements. The Commission acknowledges that its application of impartial access at times has constrained the ability of SEFs to establish trading systems or platforms that serve particular segments of the swaps marketplace.

The Commission also believes that the trading discretion exercised by SEF trading specialists may affect the manner in which market participants are treated on a facility, but would not necessarily be inconsistent with the Commission's proposed approach to impartial access. The Commission believes that to the extent that the exercise of discretion furthers a SEF's ability to facilitate trading and execution on its system or platform—including identifying trading interest in a discrete manner or managing bids and offers to maintain accurate market pricing—it should be viewed as being consistent with impartial access. The Commission also notes that proposed § 37.201(a)(2) would support the use of discretion in a manner consistent with impartial access; as discussed above, the proposed rule would provide transparency into the use of discretion by requiring each SEF to disclose the general manner and circumstances behind its use within each execution method.[402] Notwithstanding proposed § 37.201(a)(2), however, the Commission emphasizes that a SEF would still be required to ensure that any use of trading discretion occurs in a fair and non-discriminatory manner.

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[401] As discussed above, the Commission is clarifying the application of the SEF registration requirement in this notice to specify that these types of entities are subject to SEF registration based on their activity in facilitating trading and execution in swaps on a multiple-to-multiple basis between market participants. *See supra* Section IV.C.1.c.(2)—SEF Registration Requirement for Swaps Broking Entities, Including Interdealer Brokers.

[402] *See supra* Section VI.A.1.b.—§ 37.201(a)(2)—Discretion and Section VI.A.3.—§ 37.201(c)—SEF Trading Specialists.

b. § 37.202(a)(2)—Fees

Based on its experience in reviewing fee structures for SEFs, the Commission proposes to eliminate the requirement under § 37.202(a)(3) that a SEF must establish "comparable fee structures" for ECPs and ISVs receiving "comparable access" to the SEF or services from the SEF. In practice, this requirement has not fully accounted for the market practices described above. Instead, the Commission proposes § 37.202(a)(2) to require a SEF to establish and apply fee structures and fee practices in a fair and non-discriminatory manner to its market participants.[403]

Currently, SEFs have established different fee levels for different categories of market participants or different types of trading activity, whether imposed directly through a trading fee schedule or indirectly through the use of trading incentive or discount programs.[404] The Commission has observed that SEFs have generally based their fees or discounts on a host of different considerations, such as technological costs attributable to facilitating a particular method of accessing the platform or a listed product's complexity. In particular, fee-setting arrangements for swaps trading in the dealer-to-dealer segment, which includes interdealer broker operations that would become subject to the proposed SEF registration requirement,[405] may differ, even in

[403] To further streamline the other existing impartial access requirements, the Commission proposes to renumber existing paragraph (a)(2), which requires confirmation of a participant's ECP status, to subsection (c); and to renumber existing paragraph (a)(3), which addresses SEF fee requirements, to paragraph (a)(2). The Commission also proposes to renumber subsection (c)—"Limitations on access"—to subsection (b) and to amend that existing language, as described below. Accordingly, the Commission also proposes to renumber existing subsection (b)—"Jurisdiction"—to subsection (d).

[404] With respect to trading incentive or discount programs, the Commission has observed various types of arrangements, such as discounts from trading fees that vary in size and scope based on the method of execution utilized and the relative rank of a SEF participant vis a vis other participants in terms of quoting frequency and number of products quoted.

[405] *See supra* Section IV.C.1.c.(2)—SEF Registration Requirement for Swaps Broking Entities, Including Interdealer Brokers.

instances where market participants are receiving comparable access or services from the SEF. Rather, fee arrangements in the dealer-to-dealer market are often subject to individualized negotiations between a particular market participant and its broker, often involving a combination of different factors and business considerations that can lead to different fees for market participants who could otherwise be characterized as similarly situated.[406] The Commission has observed that these factors or considerations may include discounts based on past or current trading volume attributable to the market participant, market maker participation, or pricing arrangements related to services provided by a SEF-affiliated entity involving other non-swap products. The confluence of such factors, and the varying degrees to which they help inform swap trading fee determinations, have been difficult to distill into fee structures applicable to categories of market participants.

Based on this practical difficulty, the Commission is proposing to allow SEFs and market participants the flexibility to determine fees based on legitimate business negotiations. In this proposal, the Commission does not intend to limit the scope of business-related factors that a SEF may continue to consider in establishing participation fee arrangements. Proposed § 37.202(a)(2) is intended to provide market participants and SEFs with the flexibility to negotiate fee arrangements on an individualized basis based on legitimate business justifications. The Commission emphasizes, however, that consistent with the impartial access requirement under proposed § 37.202(a)(1), a SEF should not use fees to discriminate against certain market participants.

[406] In some instances, swap trading fees comprise part of a larger overall negotiated fee that is agreed upon between a market participant and a broker for broking services in a broad range of other products, including other fixed income instruments and equities.

2. § 37.202(b)—Limitations on Access

The Commission proposes to require a SEF to maintain documentation of any decision to deny, suspend, permanently bar, or otherwise limit a market participant's access to the SEF.[407] The Commission believes that such documentation is important to assisting a SEF's CCO in reviewing the SEF's adherence to its access criteria rules and determining whether the SEF is applying its access criteria in a manner that meets § 37.202. This documentation can further assist the Commission in reviewing any limitation on access determinations for a market participant during rule enforcement reviews or in the event that a market participant or the Commission challenges a SEF's access decision.

The Commission also proposes non-substantive amendments to the existing provision, including amending the existing reference to "eligible contract participant" to "market participant" to provide greater clarity.

3. § 37.202(c)—Eligibility

The Commission proposes under § 37.202(c) to maintain the existing requirement that a SEF must require its market participants to provide a written confirmation (electronic or otherwise) of their ECP status prior to obtaining access to the SEF. The Commission also proposes to make minor non-substantive revisions to the current language.[408]

[407] The Commission proposes to renumber existing subsection (c)—"Limitations on access"—to subsection (b) and amend the requirement as described above.
[408] The Commission proposes to renumber existing paragraph (a)(2) to subsection (c) and adopt a new title—"Eligibility."

4. § 37.202(d)—Jurisdiction

The Commission proposes under § 37.202(d) to maintain the existing requirement that a SEF must require that a market participant consent to its jurisdiction prior to granting any market participant access to its facilities. The Commission also proposes to make minor non-substantive revisions to the current language.[409] In addition, the Commission confirms that consistent with prior Commission staff guidance, a SEF does not need to obtain consent to its jurisdiction through an affirmative writing, and a SEF may obtain consent through a notification in its rulebook.[410]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.202. In particular, the Commission requests comment on the following questions:

(41) Should the Commission specify a basis for how it would determine that a SEF's access criteria are unfair and discriminatory? Should a SEF be limited in the type of justifications that it may provide for its access criteria to demonstrate that they are impartial, *e.g.*, such criteria are intended to promote participation and/or liquidity? If so, what would those justifications be?

(42) What should be the bases or factors for determining whether market participants are "similarly situated"?

(43) Should enablements be allowed as a type of access criteria for cleared swaps, in addition to their usage for uncleared swaps? Is this consistent with the Commission's proposed approach to impartial access? Why or why not? If so, please provide examples

[409] The Commission proposes to renumber existing subsection (b)—"Jurisdiction" to subsection (d).
[410] 2014 Staff Jurisdiction Guidance at 2.

of enablements for cleared swaps that are consistent with the Commission's proposed approach to impartial access.

B. § 37.203—Rule Enforcement Program

Section 37.203 implements certain aspects of Core Principle 2, which requires a SEF to (i) establish and enforce trading, trade processing, and participation rules to deter abuses; and (ii) have the capacity to detect, investigate, and enforce those rules, including the ability to capture information to identify rule violations.[411] The regulation sets forth the requirements of an acceptable SEF rule enforcement program, including requirements related to prohibiting abusive trading practices; detecting and investigating rule violations; maintaining sufficient staffing and resources; maintaining an automated trade surveillance system; conducting real-time market monitoring; and conducting investigations.

During the part 37 implementation process, the Commission has acquired greater experience with the swaps markets, in particular related to SEF compliance and regulatory oversight requirements. The Commission acknowledges that the existing swaps regulatory framework was developed based in part on the futures regulatory framework. As a result, the current part 37 regulations do not sufficiently account for differences between futures and swaps markets, in particular the differences in the complexity and size of transactions, the number and sophistication of market participants,[412] and the variations in the methods of execution offered. Within the swaps

[411] 7 U.S.C. 7b-3(f)(2).
[412] The Commission notes that CEA section 2(e) limits swaps trading to ECPs, as defined by section 1a(18) of the Act. 7 U.S.C. 2(e).

market, the Commission also recognizes that product offerings, execution methods, types of market participants, and liquidity may even vary among SEFs.

Accordingly, the Commission believes that instead of prescribing a limited approach to compliance and regulatory oversight requirements, a SEF should be enabled to tailor its compliance and oversight program to fit its respective operations and market.[413] Further, the Commission seeks to ensure that SEF rule enforcement requirements are consistent with the ability of a SEF to offer flexible execution methods for any of its listed swaps. Therefore, as described below, the Commission proposes to amend § 37.203 to enable a SEF to establish a rule enforcement program that is best suited to its trading systems and platforms, as well as its market participants, while still ensuring the ability to fulfill its self-regulatory obligations. The Commission believes that these proposed amendments would also reduce certain complexities, costs, and burdens, while still continuing to implement the Core Principle 2 requirements and require a robust compliance program.

1. § 37.203(a)—Abusive Trading Practices Prohibited

Section 37.203(a) requires a SEF to generally prohibit abusive trading practices on its markets by members and market participants, but also enumerates specific practices that a SEF must specifically prohibit, including front-running, wash trading, pre-arranged trading (except for block trades or other types of transactions certified or approved by the Commission under part 40), fraudulent trading, money passes, and any

[413] The Commission proposes to eliminate the introductory sentence under § 37.203, which states that a SEF shall establish and enforce trading, trade processing, and participation rules that will deter abuses and it shall have the capacity to detect, investigate, and enforce those rules. This language is duplicative of the existing requirements under Core Principle 2.

other trading practice that the SEF deems to be abusive.[414] Section 37.203(a) further requires a SEF to prohibit any other manipulative or disruptive trading practices prohibited by the Act or Commission regulations. SEFs permitting intermediation must also prohibit customer-related abuses, such as trading ahead of customer orders, trading against customer orders, accommodation trading, and improper cross trading.

The Commission proposes a non-substantive amendment to § 37.203(a) to eliminate the term "members." The Commission notes that its proposed definition of "market participant" under § 37.2(b) would capture the universe of persons and entities that could engage in abusive trading practices, including a SEF's members.[415]

As discussed above in conjunction with the proposed prohibition on pre-execution communications under § 37.201(b), the Commission is also proposing to eliminate exceptions to the pre-arranged trading prohibition under § 37.203(a).[416]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.203(a). In particular, the Commission requests comment on the following questions:

(44) Are there any abusive trading practices enumerated under proposed § 37.203(a) that are not applicable to swaps trading on a SEF, on certain SEF markets, or through certain methods of execution?

(45) Are there other abusive trading practices that could potentially occur in the swaps markets that the Commission should enumerate as a required prohibition under § 37.203(a), *e.g.*, intradesk and intracompany trading; order flashing; a failure to honor

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[414] 17 CFR 37.203(a).
[415] *See supra* Section IV.B.2.—§ 37.2(b)—Definition of "Market Participant."
[416] *See supra* Section VI.A.2.a.—§ 37.201(b)—Pre-Execution Communications.

firm prices; attempting to change the general conditions of a swap transaction after price has been agreed upon; or potential abuses at those points in the day when options are settled against swaps levels?

2. § 37.203(b)—Authority to Collect Information[417]

Section 37.203(b) currently requires a SEF to have arrangements and resources for effective enforcement of its rules, which includes the authority to collect information and examine books and records of SEF members and persons under investigation. A SEF must also facilitate direct supervision of the market and analysis of data collected to determine whether a rule violation has occurred.[418]

The Commission proposes several amendments to the existing requirements. First, the Commission proposes to eliminate the requirement that a SEF's arrangements and resources must facilitate the direct supervision of the market and the analysis of data collected to determine whether a rule violation has occurred. The Commission views the language of this requirement as superfluous because other regulations already set forth these requirements in greater specificity, such as § 37.203(d), which requires a SEF to maintain an automated trade surveillance system that is capable of detecting and reconstructing potential trade practice violations.[419]

Second, the Commission proposes to eliminate the requirements that SEFs have the authority to collect documents on a routine and non-routine basis and examine books

[417] The Commission proposes to retitle § 37.203(b) to "Authority to collect information" from "Capacity to detect and investigate rule violations" based on the proposed changes described below.
[418] 17 CFR 37.203(b).
[419] 17 CFR 37.203(d). The Commission also notes that other part 37 regulations require a SEF to supervise the market and analyze data, including regulations that implement Core Principle 4. As amended, § 37.401(a) would require a SEF to conduct real-time market monitoring of all trading activity on the SEF to identify disorderly trading, any market or system anomalies, and instances or threats of manipulation, price distortion, and disruption. *See infra* Section IX.A.—§ 37.401—General Requirements.

and records kept by members and persons under investigation. Instead, the Commission proposes to require that each SEF have the authority to collect information required to be kept by persons subject to the SEF's recordkeeping rules.[420] The Commission recognizes that the existing requirement does not provide clarity as to the meaning of collecting of documents on a "routine and non-routine" basis and how a SEF can collect information from "persons under investigation."[421] Based on the Commission's experience in implementing part 37, the Commission believes that SEFs are better suited to determine what recordkeeping rules are appropriate based on the products that it offers for trading and the types of participants on its market, among other considerations.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.203(b).

3. § 37.203(c)—Compliance Staff and Resources

Section 37.203(c) currently requires a SEF to establish and maintain sufficient compliance staff and resources to conduct a number of enumerated tasks, such as audit trail reviews, trade practice surveillance, market surveillance, and real-time monitoring. The rule further requires that such staff must be sufficient to address unusual market or trading events and to conduct investigations in a timely manner.[422]

The Commission proposes to eliminate the enumerated tasks and replace them with the phrase "self-regulatory obligations under the Act and Commission regulations." The proposed amendment is intended to apply the requirement to all of the SEF's

[420] A SEF's recordkeeping rules are established by, among other provisions, § 37.404(b), which requires a SEF to have rules that require its market participants to keep records of their trading. 17 CFR 37.404(b).
[421] The Commission notes that this lack of clarity existed during the adoption of part 37. For example, one commenter previously requested clarity regarding the scope of the rule. SEF Core Principles Final Rule at 33511.
[422] 17 CFR 37.203(c).

applicable self-regulatory functions and clarify that the existing requirement is not limited to the enumerated tasks. Similarly, the Commission also proposes to eliminate the language that requires staffing to be sufficient to address unusual market or trading events and to complete investigations in a timely manner, given that these enumerated requirements are an inherent part of a SEF's existing self-regulation obligations. As the Commission noted in the SEF Core Principles Final Rule, a SEF may also take into account the staff and resources of any third-party entities it uses under § 37.204 to provide regulatory services when evaluating the sufficiency of its compliance staff.[423] Further, the Commission reiterates that as stated in the preamble to the SEF Core Principles Final Rule, some SEF compliance staff can be shared among affiliated entities as appropriate.[424]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.203(c).

4. § 37.203(d)—Automated Trade Surveillance System

Section 37.203(d) requires a SEF to maintain an automated trade surveillance system capable of detecting potential trade practice violations.[425] The rule also requires that the system load and process daily orders and trades no later than twenty-four hours after the completion of the trading day. Given that this requirement applies to all orders and trades regardless of the type of execution method, § 37.203(d) requires orders that are not submitted to an electronic trading system, *e.g.*, orders submitted by voice or certain

[423] The Commission notes that a SEF must, at all times, maintain sufficient internal compliance staff to oversee the quality and effectiveness of the regulatory services provided, as required by § 37.204. As discussed below, the Commission proposes to expand § 37.204(a) to allow a SEF to use a non-registered entity approved by the Commission for the provision of regulatory services.
[424] SEF Core Principles Final Rule at 33511.
[425] 17 CFR 37.203(d).

other electronic communications, such as instant messaging and email, also be loaded and processed into an automated trade surveillance system. Such a system, among other requirements, must have the capability to detect and flag specific trade execution patterns and trade anomalies; compute, retain, and compare trading statistics; compute trading gains and losses and swap-equivalent positions; and reconstruct the sequence of trading activity.

The Commission proposes to eliminate the specific automated trade surveillance system capabilities enumerated under § 37.203(d), except for the ability of a SEF to reconstruct the sequence of market activity. Specifically, the Commission proposes to retain this concept by amending the remaining rule language to require that a SEF's automated trade surveillance system be capable of detecting potential trade practice violations and reconstructing the sequence of market activity and trading. The Commission believes that an automated trade surveillance system must be able to reconstruct both the sequence of market activity and trading in order to detect such violations.

The Commission recognizes based on its experience with implementing the existing requirement that a SEF's automated trade surveillance system cannot perform all of the enumerated capabilities under the existing rule, such as computing trade gains, losses, and swap equivalent positions. The Commission also acknowledges that it has not clarified the enumerated capabilities, which has led to some confusion.[426] As amended, the rule would provide each SEF with the ability to tailor its automated trade surveillance system requirements as needed to fulfill its compliance responsibilities, thereby allowing

[426] The Commission notes that some commenters previously expressed concern about the clarity of the enumerated capabilities. SEF Core Principles Final Rule at 33512.

the SEF to account for the nature of its trading systems or platforms. The Commission believes that this proposed approach is consistent with the reasonable discretion given to a SEF under Core Principle 1 to establish the manner in which it complies with the SEF core principles.

The Commission also proposes to amend § 37.203(d) to clarify that all trades executed by voice or by entry into a SEF's electronic trading system or platform, as well as orders that are "entered into an electronic trading system or platform," must be loaded and processed into the automated trade surveillance system. This proposed amendment reflects the Commission's recognition that no cost-effective and efficient means currently exists that would provide a SEF with the capability to load and process orders that are not initially entered into an electronic trading system or platform, *e.g.*, orders entered by voice or certain other electronic communications, such as instant messaging and email, given that those orders are in different formats. The Commission notes that this proposed change is consistent with the proposed amendments to §§ 37.205(b)(2)-(3), as discussed below, that would similarly limit a SEF's electronic transaction history database and electronic analysis capability requirements.[427] The Commission, however, emphasizes that a SEF must continue to have the capability to load and process all executed trades, including those resulting from orders entered by voice or certain other electronic communications, such as instant messaging and email. The Commission also emphasizes that under proposed § 37.205(a), a SEF must continue to capture all orders entered by voice (*i.e.*, oral communications) or certain other electronic communications, such as instant messaging and email.

[427] *See infra* Section VII.D.2.a.—§ 37.205(b)(1)—Original Source Documents; § 37.205(b)(2)—Transaction History Database; § 37.205(b)(3)—Electronic Analysis Capability.

Finally, the Commission proposes to clarify that the term "trading day"—on which such data must be loaded into the automated trade surveillance system—means the day "on which such trade was executed or such order was entered."

Request for Comment

The Commission requests comment on all aspects of proposed § 37.203(d).

5. § 37.203(e)—Error Trade Policy[428]

Section 37.203(e) currently requires a SEF to conduct real-time market monitoring of all trading activity on its system(s) or platform(s) to identify disorderly trading and any market or system anomalies.[429] The regulation further requires a SEF to have the authority to adjust prices and cancel trades when needed to mitigate "market disrupting events" caused by SEF trading system or platform malfunctions or errors in orders submitted by market participants. Further, any trade price adjustments or trade cancellations must be transparent to the market and subject to standards that are clear, fair, and publicly available.

a. Error Trades—Swaps Submitted for Clearing

In 2013, the Division of Clearing and Risk ("DCR") and DMO (together, the "Divisions") issued guidance (the "2013 Staff STP Guidance") to address "straight-through processing" requirements that, among other things, expressed the view that SEFs should have rules stating that trades that are rejected from clearing are "void *ab initio*."[430]

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[428] The Commission also proposes to retitle § 37.203(e) to "Error trade policy" from "Real-time market monitoring" based on the proposed changes described below.

[429] 17 CFR 37.203(e).

[430] Staff Guidance on Swaps Straight-Through Processing at 5 (Sept. 26, 2013) ("2013 Staff STP Guidance"). In addition to discussing the void *ab initio* concept, as discussed below, the 2013 Staff STP Guidance also discussed "straight-through processing" for swap transactions. *See infra* Section XII.B.2.—§ 37.702(b) and § 39.12(b)(7)—Time Frame for Clearing. The Commission notes that to the extent that

According to the Divisions, swap transactions that are executed and subsequently rejected by the DCO from clearing would be considered void, even where the rejection is attributable to an operational or clerical error from the SEF or market participants.[431]

SEFs and market participants raised concerns that considering such transactions to be void *ab initio* under the guidance would impede their ability to correct trades that were rejected from clearing at the DCO on the basis of such errors. For example, some transactions submitted for clearing may fail to match a specified term due to a clerical error, *e.g.*, counterparty names; as a result, the trades would be rejected from clearing and deemed void *ab initio*, even though the error would be readily correctable.[432] The Divisions' view on void *ab initio* would compel counterparties to execute a new trade with the corrected terms, rather than allow a SEF to identify and correct the error through other established protocols and procedures.

For those SEFs that apply the concept of void *ab initio*, however, the Commission's current execution method requirements have inhibited the ability to correct errors through subsequent trades, where a swap has been rejected from clearing due to the error or where a swap containing an error has been accepted for clearing by a DCO. For swaps that are Required Transactions, market participants have been otherwise prohibited

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error trades leading to a rejection from clearing could be corrected without the execution of a new trade, such methods would depart from the void *ab initio* concept articulated by the Divisions.

[431] As previously stated by Commission staff for purposes of granting time-limited no-action relief, an operational or clerical error is any type of error other than a rejection from clearing due to credit reasons. CFTC Letter No. 17-27, Re: 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 (May 30, 2017) at 1 n.2 ("NAL No. 17-27").

[432] The Commission understands that when a swap trade that is intended to be cleared has an operational or clerical error, a DCO will reject that trade, even if it otherwise complies with the risk-based limits established for the respective counterparties. As DCOs do not distinguish clearing rejections for credit reasons from clearing rejections due to clerical or operational errors, error trades are treated as void *ab initio*.

from determining how to resolve the error between themselves by entering into an offsetting trade or a new trade with the correct terms due to (i) the execution method requirements under § 37.9(a)(2), which requires that all Required Transactions be traded via either an Order Book or RFQ System; and (ii) the corresponding prohibition on pre-arranged trading under § 37.203(a). In response to these concerns related to void *ab initio*, Commission staff has provided time-limited no-action relief.[433]

Based on this no-action relief, SEFs have allowed market participants to pre-arrange corrective trades for execution and submission to a DCO for clearing through means not prescribed under § 37.9 for Required Transactions. Such trades include a new trade with the corrected terms, where an error trade has been rejected from clearing. Such trades also include a new trade to offset an error trade accepted for clearing and a second subsequent trade with the corrected terms, as originally intended between the counterparties. This relief has enabled counterparties to address error trades, but has required SEFs to adopt mechanisms to identify these corrective trades and additional related rules and procedures for their respective market participants.

In light of the challenges described above, the Commission proposes clarifications and amendments to address the role of void *ab initio* with respect to error trades for SEFs

[433] CFTC Letter No. 13-66, Time-Limited No-Action Relief for Swap Execution Facilities from Compliance With Certain Requirements of Commission Regulation 37.9(a)(2) and 37.203(a) (Oct. 25, 2013) ("NAL No. 13-66"). In April 2015, staff issued additional no-action relief, which reinstated the previous time-limited no-action relief from NAL No. 13-66 for SEFs from § 37.9(a)(2) and § 37.203(a) for swaps rejected from clearing due to an operational or clerical error. Under the expanded no-action relief, SEF market participants have resolved error trades accepted for clearing at the DCO, among other types of transaction. CFTC Letter No. 15-24, Re: 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 (Apr. 22, 2015) ("NAL No. 15-24"). Commission staff subsequently extended the relief provided in NAL No. 15-24 in June 2016. CFTC Letter No. 16-58, Re: 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 (June 12, 2016). This relief has been most recently extended by NAL No. 17-27 in May 2017.

as described below.[434] The Commission notes that void *ab initio* is a determination made by a SEF, and not by a DCO, which merely accepts or rejects a trade from clearing. Additionally, consistent with the 2013 Staff STP Guidance,[435] the Commission notes that void *ab initio* does not apply to back-loaded trades, *i.e.*, trades originally executed without an intent to clear, which the parties subsequently decided to clear.

b. Current SEF Error Trade Policies

SEFs have adopted rules and protocols to address other general aspects of correcting an error trade. These factors, among the many specified across all SEFs, include a definition of "error trade"; the circumstances to which the SEF's error trade rules would apply; the process for a market participant to report an alleged error trade; the process through which a SEF may review and determine that an error trade has occurred; notification procedures; and the possible courses of action that a SEF may take (or allow its market participants to take) to correct the error trade. The Commission believes that the adoption of such error trade policies by SEFs reflects their understanding that such policies are a beneficial practice that promotes a fair and orderly trading market for their market participants.[436]

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

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[434] The Commission notes that it is also proposing certain clarifications and amendments related to the 2013 Staff STP Guidance with respect to straight-through processing of swaps. *See infra* Section XII.B.2.b.—Proposed Approach to Straight-Through Processing.

[435] 2013 Staff STP Guidance at 5.

[436] The Commission notes that the guidance to Core Principle 4 in Appendix B cites "clear error-trade and order-cancellation" policies as a type of trading risk control that could be part of an acceptable program for preventing market disruptions. 17 CFR part 37 app. B (guidance to Core Principle 4—paragraph (a)(5)—"Risk controls for trading").

number of such examples, including inconsistent approaches to notifying SEFs of alleged error 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. Based on the feedback received and its own observations during the part 37 implementation, the Commission proposes to refine its approach to SEF error trade policies in a manner that would benefit market participants.

c. § 37.203(e)—Error Trade Policy[437]

The Commission proposes to eliminate the real-time market monitoring requirement, which is duplicative of Core Principle 4, and adopt a refined approach to SEF error trade policies under proposed § 37.203(e) that would allow a SEF to implement its own protocols and processes to correct error trades with respect to swaps (i) rejected by a DCO due to an operational or clerical error or (ii) accepted for clearing by a DCO that contains an operational or clerical error.[438] Therefore, the Commission's proposal would explicitly permit a SEF to establish its own rules regarding error trades rejected from clearing, which the Commission believes would facilitate a SEF's ability to establish its own error trade procedures that it believes is best suited to its particular

[437] The Commission proposes to retitle § 37.203(e) to "Error trade policy" from "Real-time market monitoring."

[438] The Commission notes that the real-time market monitoring requirement is duplicative of Core Principle 4, which requires a SEF to conduct real-time monitoring of trading and comprehensive and accurate trade reconstructions. To account for the minor difference between the real-time monitoring requirements under § 37.203(e), which requires a SEF's monitoring to "identify disorderly trading," and § 37.401, which currently does not specify that requirement, the Commission is proposing to amend § 37.401 to incorporate this requirement. *See infra* Section IX.A.—§ 37.401—General Requirements.

market, including whether to maintain an approach based on the void *ab initio* concept for trades rejected from clearing due to non-credit related errors.

Consistent with proposed § 37.702(b)(1),[439] however, the Commission notes that SEFs would now be required to deem any swap submitted for clearing as void *ab initio* if a DCO rejects the trade from clearing due to credit reasons. Under this scenario, clearing members for the executing counterparties to the rejected trade must resolve the outstanding credit issue that prevented a DCO from accepting the trade for clearing. The ability for a clearing member to resolve credit issues, a process which is outside of a SEF's purview, is inconsistent with the SEF's ability to provide for the financial integrity of swaps entered into on the SEF in contravention of Core Principle 7 and proposed § 37.702(b)(1), which would require a SEF to coordinate with a DCO to facilitate prompt, efficient, and accurate processing and routing of transactions to the DCO.[440] In contrast, a SEF's role in this context is limited to controlling the process of correcting an operational or clerical error within the terms of a swap using the SEF's error trade-related rules and procedures. Therefore, a SEF should not rely upon a clearing member to resolve such credit issues, but instead must declare a swap that is rejected from clearing for credit reasons as void *ab initio*.

In addition to allowing a SEF to configure an approach to correcting non-credit related error trade swaps submitted to a DCO for clearing, however, the Commission emphasizes that proposed § 37.203(e) would generally require a SEF to establish baseline procedural requirements for an error trade policy for all swaps executed on its facility.

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[439] The Commission proposes to renumber § 37.702(b)(2) to § 37.702(b)(1). *See infra* Section XII.B.2.b.(1)—§ 37.702(b)(1) and § 39.12(b)(7)(i)(A)—"Prompt, Efficient, and Accurate" Standard.
[440] In some cases, clearing members and the DCO may not be able to resolve an outstanding credit issue, but the swap nevertheless remains void *ab initio*.

The proposed approach would permit a SEF to develop and adopt a more efficient approach based on the nature of the transaction and error, as well as the SEF's own operational and technological capabilities.[441] Given that market participants often execute subsequent swaps to hedge the risk of an initial transaction, this approach would help mitigate the potential exposure to market and execution risk that arises if such hedge positions are established against a swap that has been deemed void *ab initio*. Accordingly, a SEF may reduce that risk by facilitating a more targeted and timely correction of errors in the initial transaction that would not necessitate the resubmission of an entire transaction that has been voided.[442]

The proposed approach, in conjunction with the proposed adoption of more flexible methods of execution, would also render the current no-action relief unnecessary for those SEFs that choose to deem error trades as void *ab initio*.[443] For example, if a SEF maintains an approach similar to the current no-action relief, then the elimination of the prescriptive execution methods under § 37.9 would allow counterparties to execute a corrective trade via flexible methods of execution offered by the SEF.[444] Under the proposed approach, however, a SEF also may not choose to follow the void *ab initio*

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[441] *See* 17 CFR part 37 app. B (guidance to Core Principle 4—paragraph (a)(5)—"Risk controls for trading") (noting that risk controls such as error trade policies should be adapted to the unique characteristics of the trading platform and of the markets to which they apply). The Commission notes that based on its proposal to adopt separate error trade policy rules under § 37.205(e), it also proposes to eliminate the guidance to Core Principle 4 in Appendix B that specifies error trade policies as a type of risk control that a SEF may adopt. *See infra* Section IX.E.—§ 37.405—Risk Controls for Trading.

[442] The Commission notes, however, that to the extent that a DCO has its own protocols and policies for resolving error trades—both for error trades that are rejected for clearing due to non-credit related errors and for error trades that have been accepted for clearing—a SEF should coordinate its own approach with the DCO, pursuant to the requirements of proposed § 37.702(b)(1) (existing § 37.702(b)(2)), which requires a SEF to coordinate with a DCO, to which it submits transactions for clearing, to develop rules and procedures to facilitate prompt and efficient transaction processing in accordance with § 39.12(b)(7).

[443] NAL No. 17-27.

[444] To the extent that a SEF currently maintains a similar approach as set forth in the no-action relief, however, the Commission clarifies that a SEF could maintain those protocols and procedures, notwithstanding the adoption of the proposed version of § 37.203(e).

approach for non-credit related errors and instead adopt operational protocols or procedures to resolve an error trade that do not require the execution or resubmission of a corrective trade. Relief from the pre-arranged trading prohibition under § 37.203(a) would also be unnecessary; under the proposed approach, a SEF could allow counterparties to use flexible means of execution to execute a corrective trade.[445]

In conjunction with the proposed flexibility to correcting error trades, § 37.203 would also set forth general requirements that are intended to create a baseline consistency among SEF error trade policies. Proposed § 37.203(e)(1) defines an "error trade" as any swap transaction executed on a SEF that contains an error in any term, including price, size, or direction.[446] Proposed § 37.203(e)(2) would require a SEF to establish and maintain rules and procedures to help resolve error trades in a "fair, transparent, consistent, and timely manner." At a minimum, such rules would be required to provide the SEF with the authority to adjust trade terms and cancel trades; and specify the rules and procedures for market participants to notify the SEF of an error trade, including any time limits for notification. While the Commission is providing SEFs with flexibility in designing their error trade policies, the Commission believes that fairness, transparency, consistency, and timeliness should be key principles in a SEF's error trade policy.

Further, proposed § 37.203(e)(3) would establish a minimum set of notification requirements for a SEF. A SEF would be required to notify all of its market participants,

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[445] *See infra* note 319 and accompanying discussion (noting that the pre-arranged trading prohibition is intended to maintain the integrity of price competition and market risk that is incident to trading in the market).

[446] This definition, however, would not include a swap trade that is rejected from clearing for credit reasons, as discussed above. Therefore, the Commission notes that proposed § 37.203(e) would not apply to such trades.

as soon as practicable, of (i) any swap transaction that is under review pursuant to the SEF's error trade rules and procedures; (ii) a determination that the trade under review is or is not an error trade; and (iii) the resolution of any error trade, including any trade term adjustment or cancellation. The Commission proposes an "as soon as practicable" standard based on competing considerations, such as the need to maintain orderly trading versus the need for timely transparency. Under this proposed approach, a SEF may determine that making error trade information available at a particular point in time is not practicable, given 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.

Proposed § 37.203(e)(4) would allow a SEF to establish non-reviewable ranges. The Commission has observed that in the interests of minimizing market disruption and maintaining orderly trading, many SEFs have established non-reviewable ranges during the course of trading. Therefore, the Commission believes that to allow SEFs to maintain existing beneficial market practices, a SEF should continue to be able to establish such ranges, which may be adjusted based on market conditions. Pursuant to proposed § 37.203(e)(2), however, the Commission emphasizes that such ranges must be established and administered in a fair, transparent, consistent, and timely manner.

The Commission recognizes that identifying and resolving error trades in a timely manner is important to promote market integrity and efficiency and ensure that trade data, which market participants rely upon to inform their swaps trading decisions, accurately reflects prevailing market pricing at any given time. The Commission believes that

proposed § 37.203(e) would accomplish these goals for market participants and the market as a whole.

Request for Comment

The Commission requests comments on all aspects of proposed § 37.203(e). The Commission may consider alternatives to its proposed error trade policy requirements and requests comment on the following questions:

(46) Does the lack of a void *ab initio* requirement for non-credit related errors create concerns about market risk with respect to error trades that have been executed, but have not been voided despite the rejection from clearing? If so, should a SEF be limited in the types of errors that may be corrected without void *ab initio*, *e.g.*, errors that do not create market risk? Should the Commission adopt a mandatory void *ab initio* requirement that certain types of errors, *e.g.*, those that do cause market risk, must be resolved via a corrective trade approach? Or should counterparties otherwise have the ability to maintain breakage agreements to address such risks?

(47) Is the Commission's proposed definition of "error trade" overly broad or narrow? Should the definition or requirement specifically address certain types of errors, such as the wrong affiliate counterparty or the wrong product identified?

(48) Is the Commission's proposed definition of "error trade" 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? If not, then how should the term "error trade" be defined to better discern this situation from a situation where a true rejection for credit reasons has occurred? Similarly, is the Commission's proposed

definition of "error trade" sufficiently clear so that the SEF knows which errors are required to be treated as error trades and which errors are required to be treated as void *ab initio*? If not, please explain. Should the Commission's definition of "error trade" specifically state that it does not include rejections from clearing for credit reasons?

(49) Should trades that are rejected by a DCO for insufficient credit be required to be deemed to be void *ab initio* by SEFs? If so, should the Commission codify such a requirement under proposed § 37.203(e) or elsewhere in the Commission's regulations?

(50) Are SEFs and DCOs able to distinguish between trades that are rejected from clearing due to insufficient credit from those trades that are rejected because they are error trades? Why or why not?

(51) The proposed regulations require that error trades be resolved in a timely manner, recognizing that a SEF may not be in a position to resolve every error trade within a specific time frame. Would requiring resolution of an error trade "as soon as practicable" or within a specific time frame lead to quicker resolutions and reduce risk for market participants? If so, what time frame would be appropriate and should it vary based on other factors, such as the nature of the product or transaction type, whether the error was a participant error or system error, or whether the error was discovered before or after the trade was cleared?

(52) Should a SEF be permitted to adjust or cancel an error trade without consulting with the parties to the trade in some or all circumstances, or should the Commission require a SEF to consult with or obtain the consent of the parties to an error trade in some or all circumstances?

(53) Should market participants be required to report all errors to a SEF or are there certain errors that are immaterial and do not otherwise require correction?

(54) What type of error trade policy should a SEF be required to adopt for swap transactions that are subject to an exception to the prohibition on pre-execution communications under proposed § 37.201(b), given that such swaps may be negotiated or arranged away from the SEF's trading system or platform?

(55) Should a SEF be required to specify who may request a review of a trade as a potential error trade? Should the ability to request a review be limited to the parties to a trade or should market participants affected by the trade also have the ability to request a review?

(56) Are there alternative requirements that would enhance efficiency and transparency in the error trade resolution process?

(57) Should the Commission require SEFs to notify all market participants of an error trade and the resolution of such trade or only a smaller subset of participants? Should the Commission provide any time frame for such notice?

(58) Should a DCO be required to notify a SEF of the reason why a trade was rejected from clearing? If so, what type of information should the Commission require the DCO to provide to the SEF in such a circumstance?

6. § 37.203(f)—Investigations[447]

Existing § 37.203(f) currently sets forth requirements for SEFs with respect to conducting investigations of their market participants for potential rule violations.[448]

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[447] The Commission proposes to retitle § 37.203(f) to "Investigations" from "Investigations and investigation reports" based on the proposed changes described below.
[448] 17 CFR 37.203(f).

Existing § 37.203(f)(1) requires a SEF to have procedures that require its compliance staff to conduct investigations of possible rule violations.[449] The rule further requires that an investigation be commenced upon Commission staff's request or upon discovery of information by a SEF that indicates a reasonable basis for finding that a violation has occurred or will occur. Existing § 37.203(f)(2) requires that investigations be completed in a timely manner, defined as twelve months after an investigation is opened, absent enumerated mitigating circumstances.[450] Existing § 37.203(f)(3) requires a SEF's compliance staff to submit an investigation report for disciplinary action any time staff determines that a reasonable basis exists for finding a rule violation,[451] while existing § 37.203(f)(4) requires compliance staff to prepare an investigation report upon concluding an investigation and determining that no reasonable basis exists for finding a rule violation.[452] Existing §§ 37.203(f)(3)-(4) enumerate the items that must be included in the investigation report. Finally, existing § 37.203(f)(5) prohibits a SEF from issuing more than one warning letter to the same person or entity for the same rule violation during a rolling twelve-month period.[453]

The Commission proposes to amend existing § 37.203(f) to simplify and streamline the procedures for SEFs to conduct investigations and prepare investigation reports. First, the Commission proposes to amend § 37.203(f)(1) to state that each SEF must establish and maintain procedures requiring compliance staff to conduct investigations, *including* the commencement of an investigation upon the receipt of a

[449] 17 CFR 37.203(f)(1).
[450] 17 CFR 37.203(f)(2).
[451] 17 CFR 37.203(f)(2).
[452] 17 CFR 37.203(f)(4).
[453] 17 CFR 37.203(f)(5).

request from Commission staff or upon the discovery or receipt of information by the SEF that indicates the existence of a reasonable basis for finding that a violation may have occurred or will occur (emphasis added). This proposed amendment reflects the Commission's view that SEFs may, and should have the right to, choose to initiate investigations under broader circumstances than the two instances identified in the existing provision.

Second, the Commission proposes to amend § 37.203(f)(2) to eliminate the twelve-month requirement for completing investigations and instead provide SEFs with the ability to complete investigations in a timely manner taking into account the facts and circumstances of the investigation. Based on its experience, the Commission recognizes that each investigation raises unique issues, facts, and circumstances that affect the time that it takes to complete the investigation. A SEF may complete some investigations in less than twelve months and complete some investigations in more than twelve months. The Commission also recognizes that the list of mitigating factors in the existing rule is not comprehensive, and other factors may affect the time of an investigation. Rather than prescribe a singular requirement, the Commission believes that it is more appropriate to establish general parameters for completing investigations. In conjunction with this amendment, the Commission also proposes guidance to Core Principle 2 in Appendix B to provide SEFs with reasonable discretion to determine that time frame.[454]

Third, the Commission proposes to streamline the requirements that apply to all SEF investigation reports, regardless of whether a reasonable basis exists for finding a

[454] The Commission proposes to add this guidance as paragraph (a)(2) to Core Principle 2 in Appendix B and eliminate the existing guidance, which currently states that a SEF should adopt and enforce any additional rules it believes are necessary to comply with § 37.203. The Commission views this guidance as unnecessary based on the proposed changes to § 37.203(f).

violation, by consolidating the provisions under existing § 37.203(f)(4) into a new proposed § 37.203(f)(3). Accordingly, proposed § 37.203(f)(3) would require a SEF's compliance staff to prepare a written investigation report to document the conclusion of each investigation. The proposed rule would maintain the existing requirement that each investigation report contain the following information: (i) the reason the investigation was initiated; (ii) a summary of the complaint, if any; (iii) the relevant facts; (iv) the compliance staff's analysis and conclusions; and (v) a recommendation as to whether disciplinary action should be pursued. To provide further clarity regarding the actions that a SEF may take once the investigation report is completed, the Commission proposes adding guidance to Core Principle 2 in Appendix B to provide that compliance staff should submit all investigation reports to the CCO or other compliance department staff responsible for reviewing such reports and determining next steps in the process; and the CCO or other responsible staff should have reasonable discretion to decide whether to take any action, such as presenting the investigation report to a disciplinary panel for disciplinary action.[455]

As part of the Commission's proposal to consolidate multiple existing warning letter requirements into a single provision under proposed § 37.206(c)(2), the Commission also proposes to eliminate the warning letter requirement under existing § 37.203(f)(5).[456]

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[455] The Commission proposes to add this guidance as paragraph (a)(3) to Core Principle 2 in Appendix B. The Commission notes that it provided similar clarification in the preamble to the SEF Core Principles Final Rule. SEF Core Principles Final Rule at 33515. As discussed below, the Commission proposes to renumber the existing language in paragraph (a)(3) to paragraph (a)(6), *see infra* Section VII.E.1.—§ 37.206(a)—Enforcement Staff; and eliminate the existing language in paragraph (a)(6), *see infra* Section VII.E.2.—§ 37.206(b)—Disciplinary Program.

[456] The Commission proposes to streamline and consolidate multiple existing provisions that address the SEF's use of warning letters—under existing § 37.203(f)(5), existing § 37.205(c)(2) with respect to audit

Request for Comment

The Commission requests comment on all aspects of proposed § 37.203(f) and the associated guidance to Core Principle 2 in Appendix B.

7. § 37.203(g)—Additional Sources for Compliance

The Commission is not proposing any amendments to § 37.203(g).

C. § 37.204—Regulatory Services Provided by a Third Party

Section 37.204, among other things, permits a SEF to contract with an RFA, another registered entity, or the Financial Industry Regulatory Authority ("FINRA") for the provision of regulatory services, subject to the requirement that the SEF supervises its regulatory service provider and retains exclusive authority over substantive decisions. As described below, the Commission proposes a series of amendments that would provide a SEF with further options in choosing and utilizing a regulatory service provider to assist with fulfilling its regulatory obligations, while still maintaining regulatory protections that relate to the use of an external services provider.

1. § 37.204(a)—Use of Regulatory Service Provider Permitted

Section 37.204(a) permits a SEF to contract with an RFA, another registered entity, or FINRA to assist the SEF in complying with the Act and Commission regulations, as approved by the Commission.[457] A SEF that elects to use the services of a regulatory service provider must ensure that the provider has the capacity and resources

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trail violations, and existing § 36.206(f) with respect to rule violations—into a single provision under proposed § 37.206(c)(2), as discussed below. *See infra* Section VII.E.3.—§ 37.206(c)—Hearings. Further, the Commission proposes to eliminate the existing language under paragraph (a)(1) of the guidance to Core Principle 2 in Appendix B, which states that a SEF's rules may authorize its compliance staff to issues warning letters or recommend that a disciplinary panel take such action. The Commission views this guidance as unnecessary based on the proposed changes to § 37.203(f).

[457] 17 CFR 37.204(a).

to provide timely and effective regulatory services.[458] A SEF remains responsible at all times for the performance of any regulatory services received, compliance with its obligations under the Act and Commission regulations, and the regulatory service provider's performance on its behalf.[459]

Based upon its experience with implementing part 37, the Commission is proposing to expand the scope of entities that may provide regulatory services under § 37.204(a) to include any non-registered entity approved by the Commission.[460] The Commission believes that this proposed expansion would be appropriate and notes that the Act does not address or proscribe the types of entities that SEFs may use for the provision of regulatory services; for example, the Commission used this basis originally to include FINRA among the list of entities that could provide regulatory services. Therefore, consistent with the statute, SEFs would be allowed to choose from a greater number of potential third-party providers. The Commission believes that this change would potentially increase competition among existing and potential regulatory service providers and, thus, reduce operating costs for SEFs, encourage innovation and technological developments, and mitigate barriers to entry for new SEFs.

Section 37.204(a), however, would also continue to be subject to important protections to ensure that a regulatory service provider provides effective regulatory services. To ensure each SEF's compliance with §§ 37.203(c)-(d), among other provisions, the Commission would continue to evaluate the sufficiency of a provider's compliance staff and resources and the capabilities of its automated trade surveillance

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[458] *Id.*
[459] *Id.*
[460] The Commission proposes to amend "Financial Industry Regulatory Authority" in the text of § 37.204(a) to "any non-registered entity."

system, and other capabilities.[461] Section 37.204(a) would still require each SEF to be responsible at all times for the performance of the regulatory services received, for compliance with the SEF's obligations under the Act and Commission regulations, and for the provider's performance on its behalf. Further, as discussed below, § 37.204(b) would still impose a duty to supervise the provider. Accordingly, the Commission believes that these protections, combined with the Commission's prior evaluation of any provider, support the ability of a SEF to consider an entity outside of an RFA, a registered entity, or FINRA.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.204(a).

2. § 37.204(b)—Duty to Supervise Regulatory Service Provider

Existing §§ 37.204(b)-(c) generally set forth a SEF's oversight responsibilities with respect to a regulatory service provider. Existing § 37.204(b) requires a SEF to retain sufficient compliance staff to supervise the quality and effectiveness of the services performed by a regulatory service provider; hold regular meetings with the regulatory service provider to discuss ongoing investigations, trading patterns, market participants, and any other matters of regulatory concern; and conduct and document periodic reviews of the adequacy and effectiveness of services provided on its behalf.[462] Existing § 37.204(c), however, requires a SEF to retain exclusive authority over all substantive decisions made by its regulatory service provider, such as decisions involving trade

[461] The Commission would evaluate a provider with respect to these requirements prior to approving any arrangement between a SEF and the provider, or during the course of conducting routine oversight of a SEFs self-regulatory program.
[462] 17 CFR 37.204(b).

cancellations, issuance of disciplinary charges, and access denials.[463] A SEF is also required to document any instance where its actions differ from those recommended by its regulatory service provider, including the reasons for the course of action recommended by the regulatory service provider and the reasons why the SEF chose a different course of action.[464]

The Commission proposes to combine and streamline the requirements of existing §§ 37.204(b)-(c) into a new proposed § 37.204(b). The Commission further proposes to maintain a SEF's duty to supervise its regulatory service provider, but to eliminate the requirement that the SEF hold regular meetings and conduct periodic reviews of the provider. Instead, the Commission proposes that a SEF be able to determine the necessary processes for supervising their regulatory service providers. Consistent with this proposed change, the Commission also proposes to provide each SEF with the option to allow its regulatory service provider to make substantive decisions, provided that, at a minimum, the SEF is involved in such decisions. Therefore, a SEF would have the discretion to determine how they are involved in such decisions. The proposed rule would keep the existing examples of substantive decisions, including the adjustment or cancellation of trades, the issuance of disciplinary charges, and denials of access to the SEF for disciplinary reasons. Finally, the Commission proposes to eliminate the requirement that a SEF document where its actions differ from the regulatory service provider's recommendations, deferring instead to the SEF and its regulatory service provider to mutually agree on the method that they will use to document substantive decisions.

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[463] 17 CFR 37.204(c).
[464] *Id*.

Based on its experience implementing the SEF regulatory framework, the Commission believes that some of the specific requirements currently prescribed under existing §§ 37.204(b)-(c) are unnecessary and overly prescriptive because SEFs, consistent with their position as self-regulatory organizations, remain ultimately responsible for the performance of any regulatory services received, for compliance with their obligations under the Act and Commission regulations, and for the regulatory service providers' performance on their behalf. Given a SEF's ultimate responsibility, the Commission believes that the SEF should be allowed to determine how best to supervise its regulatory service provider based on the services it receives and the nature of the SEF's operations and markets. The Commission also notes that this proposed approach is consistent with a SEF's discretion under Core Principle 1.[465] The Commission further believes that the discretion that SEFs and their regulatory service providers would have under § 37.204(b) to determine a mutually acceptable process may enable more timely decision making regarding substantive matters.[466]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.204(b).

3. § 37.204(c)—Delegation of Authority

The Commission proposes a new § 37.204(c) to delegate to DMO the authority to approve any regulatory service provider chosen by a SEF. This does not, however, prohibit the Commission from exercising authority to approve any third party regulatory service provider. The Commission anticipates that expanding the scope of entities that

[465] 7 U.S.C. 7b-3(f)(1)(B).

[466] The Commission notes that a commenter to the SEF Core Principles Final Rule stated that entrusting greater discretion to a regulatory service provider would provide for prompt decision-making. SEF Core Principles Final Rule at 33517.

may provide regulatory services under proposed § 37.204(a) may lead to a greater number of approval requests for such entities. Therefore, the Commission proposes to delegate this authority to ensure that such a review is conducted in an efficient manner. Such approval would require, at a minimum, that each regulatory service provider demonstrate that it has the capabilities and resources necessary to provide timely and effective regulatory services on behalf of the SEF, including adequate staff and automated surveillance systems, as required under proposed § 37.204(a).

Request for Comment

The Commission requests comment on all aspects of proposed § 37.204(c).

D. § 37.205—Audit Trail

Section 37.205 sets forth a SEF's audit trail requirements and generally requires a SEF to establish procedures to capture and retain information that may be used in establishing whether rule violations have occurred. Specifically, § 37.205(a) requires a SEF to have an audit trail; § 37.205(b) prescribes the elements of an acceptable audit trail program; and § 37.205(c) requires a SEF to enforce its audit trail requirements.[467]

Based on the Commission's experience with implementing part 37, including the SEF registration process, the Commission has observed that technology limitations have impacted SEFs' ability to comply with all of the audit trail requirements, particularly for orders submitted by voice and certain electronic communications that include instant messages and emails. Based on these observations, as well as the proposed ability for a SEF to offer flexible execution methods, the Commission proposes amendments to the audit trail requirements that seek to strike the appropriate balance between offering SEFs

[467] 17 CFR 37.205(a)-(c).

the ability to adopt such requirements that are best suited to their respective trading systems or platforms, while also ensuring that such programs enable SEFs to fulfill their self-regulatory obligations. The Commission believes that the proposed changes are consistent with Core Principle 2, which generally requires a SEF to capture information that may be used in establishing whether rule violations have occurred.[468]

1. § 37.205(a)—Audit Trail Required

Section 37.205(a) requires a SEF to capture and retain all audit trail data necessary to detect, investigate, and prevent customer and market abuses.[469] Such audit trail data must be sufficient to reconstruct all indications of interest, requests for quotes, orders, and trades.[470] The audit trail must also permit a SEF to track a customer order from the time of receipt through fill, allocation, or other disposition.[471]

The Commission proposes several amendments to streamline the existing requirements, account for different execution methods and swaps market practices, and eliminate redundancies with other part 37 requirements. Notwithstanding the proposed changes described above, the Commission emphasizes that the type of execution method offered by a SEF does not alter the obligation to capture all audit trail data necessary to detect, investigate, and enforce its rules pursuant to Core Principle 2.

First, the Commission proposes to clarify the existing language to specify that a SEF must capture and retain all audit trail data necessary to *reconstruct all trading on its facility*, detect and investigate customer and market abuses, and *take appropriate*

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[468] 7 U.S.C. 7b-3(f)(2).
[469] 17 CFR 37.205(a).
[470] *Id*.
[471] *Id*.

disciplinary action (emphasis added).[472] By replacing the requirement to "prevent" customer and market abuses with the requirement to "take appropriate disciplinary action" and specifying that the data must enable the SEF to reconstruct all trading on its facility, the Commission believes that § 37.205(a) would more accurately reflect the capabilities for which a SEF may use its audit trail data. The Commission notes that an audit trail cannot "prevent" customer and market abuses and the ability to "reconstruct" trading is already required under existing § 37.205(a), as described below.

Second, the Commission proposes to move the requirement that audit trail data shall be sufficient to reconstruct all indications of interest, requests for quotes, orders, and trades to the guidance to Core Principle 2 in Appendix B.[473] Given the proposal to allow each SEF to offer flexible methods of execution, as well as continuing advances in technology, the Commission believes that enumerating specific audit trail data in the regulatory language may unnecessarily limit the universe of data relevant to a SEF's audit trail. The Commission emphasizes that a SEF must capture all audit trail data related to each offered execution method that is necessary to reconstruct all trading on its facility, detect and investigate customer and market abuses, and take disciplinary action as noted above. The Commission also believes that SEFs must capture such a data set to be able to detect, investigate and enforce its rules under Core Principle 2, to reconstruct all trading under Core Principle 4, and to comply with the audit trail reconstruction program under proposed 37.205(c), as described below.

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[472] The Commission proposes to eliminate the introductory sentence under § 37.205, which states that a SEF shall establish procedures to capture and retain information that may be used in establishing whether rule violations have occurred, given that this language is duplicative of the audit trail requirements under § 37.205(a).

[473] The Commission proposes to add this guidance to paragraph (a)(4) to Core Principle 2 in Appendix B. As discussed below, the Commission proposes to eliminate the existing language in paragraph (a)(4), *see infra* Section VII.E.2.—§ 37.206(b)—Disciplinary Program.

Third, the Commission proposes to eliminate the requirement that a SEF capture post-execution allocation information in its audit trail data. During the SEF registration process, numerous SEFs indicated that post-execution allocations normally occur between the clearing firm or the customer and the DCO, or at the middleware provider.[474] Therefore, these SEFs represented that they typically do not have access to post-execution allocation information, and are unable to obtain such data from third parties, such as DCOs and SDRs, due to confidentiality concerns. Based on these representations, Commission staff has issued continuing no-action relief to SEFs from this requirement.[475] Based on its experience, the Commission understands that SEFs are still routinely unable to obtain this information pursuant to the requirements of §§ 37.205(a) and (b)(2).[476] Accordingly, in lieu of requiring that the audit trail track a customer order through "fill, allocation, or other disposition," the Commission proposes to require SEFs to capture the audit trail data only through execution on the SEF. The Commission understands that this proposed change is consistent with current swap market practices.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.205(a). In particular, the Commission requests comment on the following questions:

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[474] CFTC Letter No. 17-54, Re: No-Action Relief for Swap Execution Facilities from Certain Audit Trail Requirements in Commission Regulation 37.205 Related to Post-Execution Allocation Information at 2 (Oct. 31, 2017).

[475] *Id*.

[476] The Commission notes that § 37.205(b)(2) also requires a SEF's audit trail to include an electronic transaction history database that captures, among other elements, the identity of each account to which fills are allocated. 17 CFR 37.205(b)(2). As discussed below, the Commission proposes to eliminate this requirement. *See infra* note 484 and accompanying discussion.

(59) Is the scope of the proposed audit trail requirements sufficiently clear? If not, then please explain. Is the scope overly broad or narrow to enable a SEF to comply with its obligations under the Act? If so, please explain. Would a SEF's audit trail obligations be impacted by the Commission's proposed approach to pre-execution communications? If so, then how?

(60) What challenges, if any, do SEFs encounter in capturing or retaining audit trail data?

(61) Are there any specific audit trail data points that are too costly or burdensome for a SEF to capture or maintain?

(62) Is the proposed guidance to this section appropriate? Are SEFs currently capturing all indications of interest, requests for quotes, orders, and trades? Is the meaning of "indications of interest" sufficiently clear? If not, please provide suggestions on how to clarify this term. Should a SEF be required to capture all indications of interest and requests for quotes to enable it to comply with its obligations under the Act? Are there other data points that should be added to the guidance?

2. § 37.205(b)—Elements of an Acceptable Audit Trail Program

Section 37.205(b) requires, among other things, that SEFs retain all original source documents; maintain a transaction history database; conduct electronic analysis; and safely store all audit trail data.[477] Section 37.205(b)(1) requires that a SEF's audit trail include original source documents and specifies the nature and content of such documents.[478] Section 37.205(b)(2) requires a SEF's audit trail program to include an electronic transaction history database and specifies the required elements of an adequate

[477] 17 CFR 37.205(b).
[478] 17 CFR 37.205(b)(1).

database.[479] Section 37.205(b)(3) requires a SEF's audit trail program to include electronic analysis capability with respect to all audit trail data in the transaction history database.[480] Section 37.205(b)(4) requires a SEF's audit trail program to safely store all audit trail data retained in the transaction history database.[481]

a. § 37.205(b)(1)—Original Source Documents; § 37.205(b)(2)—Transaction History Database; § 37.205(b)(3)—Electronic Analysis Capability

The Commission proposes to eliminate certain elements of the original source documents requirement under § 37.205(b)(1) that specify the nature and content of the original source documents,[482] as such requirements may not capture the appropriate universe of content. The Commission also believes that the detailed requirements are not necessary; as discussed above, the general requirement that a SEF must capture all audit trail data necessary to reconstruct all trading on its facility, detect and investigate customer and market abuses, and take disciplinary action is sufficient to guide a SEF as to the content of its original source documents, which would be based on the SEF's execution methods, trading operations, and markets. Section 37.205(b)(1), however, would maintain that the SEF's audit trail must include original source documents, including unalterable, sequentially-identified records on which trade execution information is originally recorded, whether recorded manually or electronically.

The Commission further proposes to amend § 37.205(b)(2) to revise the scope of audit trail data that must be captured in a SEF's electronic transaction history database.

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[479] 17 CFR 37.205(b)(2).
[480] 17 CFR 37.205(b)(3).
[481] 17 CFR 37.205(b)(4).
[482] Section 37.205(b)(1) requires, among other things, that records for customer orders (whether filled, unfilled, or cancelled, each of which shall be retained or electronically captured) shall reflect the terms of the order, an account identifier that relates back to the account(s) owner(s), the time of order entry, and the time of trade execution. A SEF must also require that all orders, indications of interest, and requests for quotes be immediately captured in the audit trail. 17 CFR 37.205(b)(1).

Specifically, the Commission proposes to eliminate the requirement that the database include all indications of interest, requests for quotes, orders, and trades entered into a SEF's trading system or platform. Instead, the SEFs would be required to include (i) trades executed by voice or by entry into a SEF's electronic trading system or platform; and (ii) orders that are entered into its electronic trading system or platform. Similar to proposed § 37.203(d), this proposed amendment recognizes that a SEF may not have a cost-effective and efficient method for inputting orders submitted by voice or certain other electronic communications, such as instant messaging and email, into an electronic transaction history database, given that they are not in the same format as orders and trades that are entered into a SEF's electronic trading system or platform.[483] As noted above, the Commission emphasizes that a SEF must continue to keep a record of all orders entered by voice (*i.e.*, oral communications) or certain other electronic communications, such as instant messaging and email. Such a record, however, would not need to be included in the SEF's electronic transaction history database given the formatting challenges.

The Commission additionally proposes to eliminate the remaining requirements of § 37.205(b)(2) that detail the information that must be included in transaction history database, given that these requirements are already captured in other audit trail requirements or do not comport with existing swaps market practices.[484] Consistent with

[483] *See supra* Section VII.B.4.—§ 37.203(d)—Automated Trade Surveillance System.

[484] For example, customer type indicator code ("CTI") is used in futures trading to designate the capacity in which the person was executing a trade—for the person's own account; for a proprietary account; on behalf of another member; or a for customer. Many DCM-based automated trade surveillance systems are programmed to detect aberrations in CTI code usage that may indicate potential rule violations. The Commission understands, however, that a SEF's automated trade surveillance system does not use CTI codes to detect potential rule violations. Therefore, the Commission proposes to eliminate this requirement. Further, as discussed above, since SEFs cannot routinely obtain post-execution allocation

the proposed amendments to § 37.205(b)(2), the Commission further proposes to amend § 37.205(b)(3) to clarify that a SEF's electronic analysis capability must enable the SEF to reconstruct "any trade executed by voice or by entry into a swap execution facility's electronic trading system or platform and any order entered into its electronic trading system or platform" rather than "indications of interest, requests for quotes, orders, and trades."

These proposed amendments are consistent with feedback received regarding the audit trail requirements during the SEF registration process. Some SEFs that offer voice-based trading systems or platforms stated that they do not have the requisite technology to conduct an electronic analysis of audit trail data that is not entered into a SEF's electronic trading system or platform, such as oral communications, electronic instant messages, and emails. The Commission understands that during that time, such technology, if available, would have been costly for SEFs to adopt and would not have been fully capable of digitizing oral communications in a sufficiently accurate manner to conduct effective surveillance.

While the Commission is aware that promising technologies are developing in this area, it does not believe that a viable, cost-effective automated technology solution currently exists. Currently, SEFs that offer any form of voice-based trading system or platform are required, as a condition to their registration, to establish voice audit trail surveillance programs to ensure that they can reconstruct a sample of voice trades and review such trades for possible trading violations. The proposed amendments to §§

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information, it is not possible to identify "each account to which fills are allocated." *See supra* note 476 and accompanying discussion. Therefore, the proposed amendment to § 37.205(b)(2) would also eliminate the requirement to include post-execution allocation information in a SEF's transaction history database.

37.205(b)(2)-(3) would relieve a SEF from establishing or maintaining such a program, but the proposed audit trail reconstruction requirement under § 37.205(c), as discussed below, would apply instead. Nonetheless, a SEF must continue to conduct electronic analysis, using an automated trade surveillance system that meets the requirements of proposed § 37.203(d).

The Commission further proposes to eliminate the safe storage requirement under § 37.205(b)(4), given that it is generally duplicative of the requirements under Core Principle 14 and related regulations.[485] As discussed below, however, the Commission proposes a non-substantive amendment to move the requirement that a SEF must protect audit trail data from unauthorized alteration, accidental erasure, or other loss to § 37.1401(c), which addresses system safeguard requirements.[486]

Request for Comment

The Commission requests comment on all aspects of proposed §§ 37.205(b)(1)-(3).

3. § 37.205(c)—Audit Trail Reconstruction[487]

Section 37.205(c) generally requires a SEF to enforce its audit trail and recordkeeping requirements.[488] Section 37.205(c)(1) requires enforcement through annual reviews and prescribes the minimum components that must be included in such reviews.[489] Section 37.205(c)(2) requires that a SEF establish an enforcement program

[485] 7 U.S.C. 7b-3(f)(14); 17 CFR 37.1401.
[486] *See infra* Section XIX.A.—§ 37.1401(c).
[487] The Commission proposes to retitle § 37.205(c) to "Audit trail reconstruction" from "Enforcement of audit trail requirements" based on the proposed changes described below.
[488] 17 CFR 37.205(c).
[489] 17 CFR 37.205(c)(1).

and to impose meaningful sanctions against persons and firms where deficiencies are found.[490]

The Commission proposes to eliminate the existing audit trail enforcement requirements under § 37.205(c) and adopt an audit trail reconstruction requirement instead.[491] The Commission believes that the primary goal of audit trail enforcement is to ensure that a SEF's audit trail enables it to reconstruct trading and conduct effective surveillance to fulfill its Core Principle 2 obligations. To that end, audit trail enforcement focuses on reviewing certain components of the audit trail data to ensure that a SEF's audit trail data is complete and accurate. Existing audit trail reviews include a (1) review of randomly selected samples of front-end audit trail data; (2) review of the process by which user identifications are assigned and records relating to user identifications are maintained; (3) review of the usage patterns of user identifications to identify violations of user identification rules; and (4) review of account numbers and CTI codes for accuracy and proper use. The Commission understands that these reviews focus on components of the audit trail that are generally not relevant to SEFs. For example, SEFs have represented that there is little, if any, "front-end audit trail data" that is not already captured by the SEF, and that many of the data points for review, such as user identifications, account numbers, and CTI codes, are not used in the same manner as they are for DCMs. Therefore, the Commission believes that requiring SEFs to conduct an

[490] 17 CFR 37.205(c)(2). The Commission notes that § 37.205(c)(2) also imposes a warning letter requirement for audit trail violations. As discussed below, the Commission proposes to streamline and consolidate this provision into proposed § 37.206(c)(2). *See infra* Section VII.E.6.—§ 37.206(f)—Warning Letters.

[491] Notwithstanding these proposed changes, the Commission notes that to comply with the general audit trail requirement under proposed § 37.205(a), which requires a SEF to capture all audit trail data related to each offered execution method that is necessary to reconstruct all trading on its facility, detect and investigate customer and market abuses, and take disciplinary action, the SEF must ensure that market participants are submitting accurate and complete audit trail data.

audit trail enforcement program based on the requirements of existing § 37.205(c) serves a limited purpose.

The Commission believes that ensuring a SEF's audit trail is accurate and sufficient to conduct effective surveillance—the primary goals of audit trail enforcement—would be better served through an audit trail reconstruction program that focuses on verifying the accuracy of audit trail data and a SEF's ability to comprehensively and accurately reconstruct all trading on its facility in a timely manner. As discussed above, the Commission is aware that SEFs that offer any form of a voice-based trading system or platform do not currently have cost-effective solutions for consolidating certain types of data, such as oral communications, electronic instant messages, and emails, inputting them into an electronic transaction history database, and loading and processing them into an automated system to reconstruct trading. Given that the ability to reconstruct all trading is an essential component to conducting effective surveillance and is currently not being conducted in a routine, automated manner for certain key data, the Commission proposes to require that a SEF establish a program to verify its ability to comprehensively and accurately reconstruct all trading on its facility in a timely manner. The Commission also proposes to adopt guidance to Core Principle 2 in Appendix B specifying that an effective audit trail reconstruction program should annually review an adequate sample of executed and unexecuted orders and trades from each execution method offered to verify compliance with § 37.205(c).[492]

[492] The Commission proposes to add this guidance to paragraph (a)(5) to Core Principle 2 in Appendix B. 17 CFR part 37 app. B. As discussed below, the Commission proposes to eliminate the existing language in paragraph (a)(5). *See infra* Section VII.E.2.—§ 37.206(b)—Disciplinary Program.

Since SEFs that offer only electronic trading systems or platforms can use their automated trade surveillance systems to reconstruct trading, the reconstructions under proposed § 37.205(c) would serve to verify the accuracy of their audit trail data. A SEF that offers any form of voice-based trading could comply with proposed § 37.205(c) by conducting manual reconstructions, including orders entered by oral communications, instant messages, and email, and trades executed by voice that are captured by the SEF's electronic transaction history database. In addition to verifying the accuracy of the audit trail data for SEFs that offer electronic trading systems or platforms, these reconstructions would help ensure that in the absence of such an automated solution, a SEF that offers voice-based trading is able to reconstruct trading as necessary, including when they are investigating problematic trading activity.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.205(c) and the associated guidance to Core Principle 2 in Appendix B. In particular, the Commission requests comment on the following questions:

(63) What factors should a SEF consider in selecting an adequate sample of orders and trades for reconstruction?

(64) Should SEFs be required to annually reconstruct a minimum number or orders and trades? If so, what is the minimum number?

(65) Should SEFs be required to conduct annual audit trail reviews of their members and firms that are subject to recordkeeping requirements? If so, what should these reviews include?

E. § 37.206—Disciplinary Procedures and Sanctions

Section 37.206 generally requires a SEF to establish rules that deter abuses and have the capacity to enforce those rules though prompt and effective disciplinary action. The disciplinary rules that implement this requirement require a SEF to maintain sufficient enforcement staff, establish disciplinary panels, follow certain disciplinary procedures that afford respondents procedural safeguards, and impose sanctions that are commensurate to the violations committed.[493] The rules prescribe the use of various sanctions, including suspension or expulsion of members or market participants; customer restitution; and issuance of warning letters.[494]

Since the adoption of § 37.206, the Commission has considered whether alternative cost-effective methods exist for complying with Core Principle 2's requirement to establish and enforce trading, trade processing, and participation rules that deter abuses, and have the capacity to investigate and enforce such abuses.[495] Based on its experience with the part 37 implementation, the Commission believes that alternative disciplinary methods exist that would ensure that SEFs maintain robust disciplinary structures necessary to enforce compliance with their rules and deter abusive trading to promote market integrity. The Commission acknowledges that § 37.206 is a limited approach that is based in many respects on its experience with oversight of DCM disciplinary programs.[496] While the Commission believes that all SEFs should be subject to certain threshold requirements, it also believes that SEFs should be able to use their

[493] 17 CFR 37.206(a)-(f).
[494] 17 CFR 37.206(e)-(f).
[495] 7 U.S.C. 7b-3(f)(2)(B).
[496] *See* SEF Core Principles Final Rule at 33520-21 (noting that the disciplinary procedures in the part 37 proposed rules paralleled the procedures for DCMs).

experience and knowledge to establish disciplinary procedures that are appropriate for their own markets and market participants. The Commission notes that this approach is consistent with the reasonable discretion afforded to SEFs under Core Principle 1.[497] Therefore, the Commission proposes to streamline the SEF disciplinary program rules, discussed further below.[498]

1. § 37.206(a)—Enforcement Staff

Section 37.206(a) requires a SEF to establish and maintain sufficient enforcement staff and resources to effectively and promptly prosecute possible rule violations within the disciplinary jurisdiction of the SEF.[499]

The Commission proposes to change the word "prosecute" to "enforce" to more accurately describe the requirements under § 37.206(a), given that every rule violation may not lead to a prosecution.

The Commission also proposes to amend the guidance to Core Principle 2 in Appendix B that addresses a SEF's enforcement staff.[500] The Commission proposes eliminating the language stating that a SEF's enforcement staff may operate as part of the SEF's compliance staff. The Commission no longer believes this language is necessary, given that SEFs should have the option to determine the appropriate structure for their

[497] 7 U.S.C. 7b-3(f)(1)(B).
[498] The Commission proposes to eliminate the introductory sentence under § 37.206, which states that a SEF shall establish trading, trade processing, and participation rules that will deter abuses and have the capacity to enforce such rules through prompt and effective disciplinary action, including suspension or expulsion of members or market participants who violate the rules of the swap execution facility, given that this language is duplicative of requirements elsewhere in this part, including Core Principle 2 and various provisions under § 37.206.
[499] 17 CFR 37.206(a).
[500] The Commission proposes to renumber paragraph (a)(3) to paragraph (a)(6) of the guidance to Core Principle 2 in Appendix B and adopt the amendments described above. 17 CFR part 37 app. B.

disciplinary programs, including their enforcement staff, discussed further below with respect to § 37.206(b).

Request for Comment

The Commission requests comment on all aspects of proposed § 37.206(a) and the associated guidance to Core Principle 2 in Appendix B.

2. § 37.206(b)—Disciplinary Program[501]

Section 37.206(b) currently requires SEFs to establish one or more disciplinary panels that meet the composition requirements of part 40 and do not include a SEF's compliance staff or any person involved in adjudicating any other stage of the same proceeding.[502]

The Commission proposes to amend § 37.206(b) to permit a SEF to administer its disciplinary program through not only one or more disciplinary panels, as currently allowed, but also through its compliance staff. As discussed above, this amendment provides SEFs with the ability to adopt a cost-effective disciplinary structure that best suits their markets and market participants, while still effectuating the requirements and protections of Core Principle 2 through compliance staff, disciplinary panels, or some combination of both.[503]

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[501] The Commission proposes to retitle § 37.206(b) to "Disciplinary program" from "Disciplinary panels" based on the proposed changes described below.

[502] 17 CFR 37.206(b). The Commission proposed composition requirements for disciplinary panels, but has not adopted those requirements in a final rule. Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 FR 63732, 63752 (Oct. 18, 2010).

[503] While the participation of SEF compliance staff could present a possible conflict of interest, the Commission believes that this concern is adequately addressed through the SEF's CCO. Under proposed § 37.1501(c)(2), a CCO would be required to take reasonable steps to resolve any material conflicts of interest. *See infra* Section XX.A.3.—§ 37.1501(c)—Duties of Chief Compliance Officer. Further, a CCO would be required to conduct an annual assessment of the SEF's policies on the handling of conflicts of interest. *See infra* Section XX.A.4.—§ 37.1501(d)—Preparation of Annual Compliance Report. The

The Commission also proposes other amendments to § 37.206(b), including non-substantive revisions, to streamline certain existing composition requirements for disciplinary panels.[504] For SEFs that elect to administer their disciplinary program though compliance staff, the Commission proposes to amend § 37.206(b) to exclude compliance staff from the requirements under § 1.64(c)(4). Section 1.64, among other things, prescribes rules that govern the composition of an SRO's major disciplinary committee.[505] The Commission recognizes that a SEF's compliance staff could qualify as a "[m]ajor disciplinary committee"[506] under § 1.64(a)(2) when imposing sanctions under the proposed rule; therefore, the staff would otherwise be subject to the composition requirement of § 1.64(c)(4), which requires "sufficient different membership interests."[507] Accordingly, the Commission believes these amendments are necessary to effectuate the proposed rule of allowing compliance staff to administer a SEF's disciplinary program.

Commission also notes that the SEF's disciplinary practices are within the scope of the Commission's examinations.

[504] The Commission proposes to amend the panel composition language by replacing the reference to part 40 with "applicable Commission regulations." Additionally, paragraph (a)(11)(ii) of the guidance to Core Principle 2 in Appendix B currently specifies that the composition of the appellate panels should be consistent with part 40 and should not include any members of the SEF's compliance staff or any person involved in adjudicating any other stage of the same proceeding. 17 CFR part 37 app. B. To avoid duplicative language, the Commission proposes to consolidate these provisions under § 37.206(b) to require that any *disciplinary panel* or *appellate panel* established by a SEF must meet the composition requirements of applicable Commission regulations, and shall not include any member of the SEF's compliance staff or any person involved in adjudicating any other stage of the same proceeding (emphasis added). The Commission also proposes to eliminate paragraph (a)(11) of the guidance to Core Principle 2 in Appendix B as noted below. 17 CFR part 37 app. B.

[505] 17 CFR 1.64.

[506] Section 1.64(a)(2) defines "major disciplinary committee" as a committee of persons authorized by a self-regulatory organization to conduct disciplinary hearings, settle disciplinary charges, or impose disciplinary sanctions. Such a committee may also hear appeals of cases involving any violation of a SRO's rules, except for rules related to decorum or attire; financial requirements; reporting or recordkeeping; and violations that do not involve fraud, deceit or conversion. 17 CFR 1.64(a)(2). Under § 37.2, SEFs are subject to all applicable Commission regulations, including § 1.64.

[507] Section 1.64(c)(4) requires that each major disciplinary committee, or hearing panel thereof, include sufficient different membership interests so as to ensure fairness and prevent special treatment or preference for any person in the conduct of a committee's or panel's responsibilities. 17 CFR 1.64(c)(4).

Consistent with the Commission's intention to streamline requirements while still effectuating the Core Principle 2 requirements, the Commission proposes to eliminate the guidance to Core Principle 2 in Appendix B that specifies protocols for the SEF to handle charges and settlement offers.[508] Given that proposed § 37.206(b) would permit SEFs to administer their disciplinary program through compliance staff, the Commission does not believe that this detailed guidance is necessary. Instead, the Commission proposes new guidance to specify that a SEF's rules governing the adjudication of a matter by the SEF's disciplinary panel should be fair, equitable, and publicly available.[509]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.206(b) and the associated guidance to Core Principle 2 in Appendix B.

3. § 37.206(c)—Hearings

Section 37.206(c) requires a SEF to adopt rules that provide certain minimum procedural safeguards for any hearing. In general, the rule requires a fair hearing, promptly convened after reasonable notice to the respondent; and a copy of the hearing to be made and be a part of the record of the proceeding if the respondent requested the hearing..[510]

The Commission proposes to eliminate § 37.206(c). First, the detailed hearing procedures under existing § 37.206(c) are not necessary, as SEFs that choose to establish

[508] The Commission proposes to eliminate paragraphs (a)(4)-(9) of the guidance to Core Principle 2 in Appendix B. 17 CFR part 37 app. B.
[509] The Commission proposes to add this guidance as paragraph (a)(7) to Core Principle 2 in Appendix B. 17 CFR part 37 app. B.
[510] 17 CFR 37.206(c).

a disciplinary panel have reasonable discretion to do so pursuant to Core Principle 1.[511] Second, the Commission notes that requirements for hearings under § 37.206(c) would not apply to SEFs that choose to administer their disciplinary program through compliance staff. Third, as noted above, the Commission proposes to add guidance to Core Principle 2 in Appendix B that a SEF's rules relating to disciplinary panel procedures should be fair, equitable, and publicly available.[512] The Commission believes this guidance adequately captures the principal procedural objectives when SEFs are conducting disciplinary hearings and obviates the need for the otherwise prescriptive regulatory requirements. Consistent with the Commission's elimination of § 37.206(c), the Commission also proposes to eliminate the guidance to Core Principle 2 in Appendix B that specifies detailed guidelines for disciplinary hearing protocols.[513]

Request for Comment

The Commission requests comment on all aspects of the proposed elimination of § 37.206(c) and the associated guidance to Core Principle 2 in Appendix B.

4. § 37.206(d)—Decisions

Section 37.206(d) requires a disciplinary panel to render a written decision promptly following a hearing.[514] The rule also provides detailed items to be included in the decision, such as a notice or summary of charges, the answer, and a statement of finding and conclusions with respect to each charge.[515]

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[511] 7 U.S.C. 7b-3(f)(1)(B).
[512] *See supra* note 509.
[513] The Commission proposes to eliminate paragraph (a)(10) of the guidance to Core Principle 2 in Appendix B. 17 CFR part 37 app. B.
[514] 17 CFR 37.206(d).
[515] *Id*.

The Commission proposes to eliminate the prescriptive requirements under § 37.206(d). This proposed elimination is consistent with other proposed amendments to § 37.206 that would allow a SEF to exercise discretion in establishing its disciplinary procedures pursuant to Core Principle 2. The Commission, however, also proposes to add guidance to Core Principle 2 in Appendix B to specify that a SEF's rules should require the disciplinary panel to promptly issue a written decision following a hearing or the acceptance of a settlement offer.[516] Consistent with the Commission's elimination of the requirements under § 37.206(d), the Commission also proposes to eliminate the guidance to Core Principle 2 in Appendix B that specifies guidelines for a SEF's ability to provide rights of appeal to respondents and issue a final decision.[517]

Request for Comment

The Commission requests comment on all aspects of the proposed elimination of § 37.206(d) and the associated guidance to Core Principle 2 in Appendix B.

5. § 37.206(e)—Disciplinary Sanctions

Existing § 37.206(e) requires that all disciplinary sanctions imposed by a SEF must be commensurate with the violations committed and must be clearly sufficient to deter recidivism or similar violations by other market participants.[518] A SEF is also required to consider a respondent's disciplinary history when evaluating appropriate sanctions.[519] In the event of demonstrated customer harm, any disciplinary sanction must

[516] The Commission proposes to add this guidance as part of paragraph (a)(7) to Core Principle 2 in Appendix B. 17 CFR part 37 app. B.
[517] The Commission proposes to eliminate paragraphs (a)(11)-(12) of the guidance to Core Principle 2 in Appendix B. 17 CFR part 37 app. B.
[518] 17 CFR 37.206(e).
[519] *Id*.

include full customer restitution, except where the amount of restitution, or to whom it should be provided, cannot be reasonably determined.[520]

The Commission proposes to consolidate the requirements that apply to disciplinary sanctions and warning letters, under existing § 37.206(e) and existing § 37.206(f),[521] respectively, into a new proposed § 37.206(c).[522] Consistent with the Commission's goal to provide SEFs with a greater ability to develop cost-effective approaches to administer their disciplinary programs based on their markets and market participants, the Commission believes that a SEF should have greater discretion to choose between taking disciplinary action or issuing a warning letter. Accordingly, as discussed below, the Commission proposes under § 37.206(c)(2) to expand the current use of warning letters by allowing a SEF to issue more than one warning letter over a rolling twelve-month period for violations that involve minor recordkeeping or reporting infractions. To balance the expanded authority to issue warning letters and ensure their proper use by SEFs, the Commission also proposes under § 37.206(c)(1) to extend the existing criteria for issuing disciplinary sanctions to warning letters. Specifically, proposed § 37.206(c)(1) would require that all warning letters and sanctions imposed by a SEF must be commensurate with the violations committed and shall be clearly sufficient to deter recidivism or similar violations by other market participants. Further, all warning letters and sanctions, including summary fines and sanctions imposed pursuant

[520] *Id*.
[521] Existing § 37.206(f) states that where a rule violation is found to have occurred, no more than one warning letter may be issued per rolling twelve-month period for the same violation.
[522] The Commission proposes to retitle § 37.206(c) to "Warning letters and sanctions" from "Hearings" based on the proposed changes described below.

to an accepted settlement offer, must take into account the respondent's disciplinary history.[523]

The Commission also proposes several amendments to related guidance to Core Principle 2 in Appendix B that are consistent with the proposed changes and are intended to allow a SEF to determine how to issue warning letters and sanctions. First, the Commission proposes to adopt guidance to Core Principle 2 in Appendix B to state that SEFs should have reasonable discretion in determining when to issue warning letters and apply sanctions.[524] Second, the Commission also proposes to eliminate detailed guidance regarding the procedures for taking emergency disciplinary action. The guidance, however, would maintain that a SEF may impose a sanction or take summary action as necessary to protect the best interest of the marketplace.[525]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.206(c)(1) and the associated guidance to Core Principle 2 in Appendix B. In particular, the Commission requests comment on the following question:

(66) Should the Commission provide further explanation regarding the meaning of "minor" recordkeeping or reporting infractions?

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[523] The Commission proposes to add the term "summary fine" to clarify that summary fines are among the types of disciplinary sanctions that may be issued and would be subject to the requirements of the proposed rule.

[524] The Commission proposes to add this guidance as paragraph (a)(9) to Core Principle 2 in Appendix B. 17 CFR part 37 app. B.

[525] The Commission proposes to renumber paragraph (a)(14) to paragraph (a)(8) to Core Principle 2 in Appendix B. 17 CFR part 37 app. B.

6. § 37.206(f)—Warning Letters

Existing § 37.206(f) states that where a rule violation is found to have occurred, no more than one warning letter may be issued per rolling twelve-month period for the same violation.[526]

As part of a new proposed § 37.206(c)(2) noted above, the Commission proposes to amend this provision to establish a more practical approach to the use of warning letters. Under the proposed approach, a SEF would be allowed to issue more than one warning letter over a rolling twelve-month period for violations that involve minor recordkeeping or reporting infractions. Given the *de minimis* nature of such infractions, the Commission believes that a SEF should have the ability to determine whether they merit the issuance of a warning letter or sanction. The Commission also proposes to clarify that the twelve-month limitation on warning letters applies to the same individual who is found to have committed the same rule violation, rather than an entity. The Commission acknowledges that applying the limitation to subject entities is not practical because many of them have hundreds of employees trading on behalf of the entity.[527] Further, the Commission notes that the rolling twelve-month period begins tolling once the SEF finds that a violation occurred, rather than the date that the subject activity occurred.

The Commission also proposes to eliminate guidance to Core Principle 2 in Appendix B that currently specifies that a SEF may adopt summary fines for violations of rules related to the failure to timely submit accurate records required for clearing or

[526] 17 CFR 37.206(f).
[527] The Commission notes, however, that this provision would be evaluated in conjunction proposed § 37.206(c)(1).

verifying each day's transactions.[528] The Commission notes that § 37.206(c)(1) as proposed would already specify that a SEF may issue summary fines as a sanction.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.206(c)(2) and the associated guidance to Core Principle 2 in Appendix B. In particular, the Commission requests comment on the following question:

(67) Is the Commission's approach to warning letters appropriate? Should the Commission allow SEFs to issue more than one warning letter to the same individual within a rolling twelve-month period for other rule violations in addition to minor recordkeeping or reporting infractions? If so, should the Commission specify which rule violations? If so, identify those rule violations and explain why.

7. § 37.206(g)—Additional Sources for Compliance

The Commission is not proposing any amendments to § 37.206(g).[529]

F. Part 9—Rules Relating to Review of Exchange Disciplinary, Access Denial or Other Adverse Actions

Part 9 of the Commission's regulations details the process and procedures for the Commission's review of exchange disciplinary, access denial, or other adverse actions.[530] The rules also address the procedures and standards governing filing and service, motions, and settlement; the process that exchanges must follow in providing notice of a

[528] The Commission proposes to eliminate paragraph (a)(13) of the guidance to Core Principle 2 in Appendix B. 17 CFR part 37 app. B.
[529] The Commission proposes to renumber § 37.206(g) to § 37.206(d) based on the proposed changes described above.
[530] 17 CFR part 9. For these purposes, the Commission interprets references to "exchange" to part 9 to mean DCMs and SEFs.

final disciplinary action to the subject of the action and to the Commission; and the publication of such notice.[531]

The Commission is proposing several non-substantive amendments to part 9 that correspond to certain proposed amendments to the Core Principle 2 regulations under part 37.[532] As discussed above, the Commission proposes to eliminate various disciplinary procedures under proposed § 37.206 and the applicable guidance to Core Principle 2 in Appendix B to part 37 to streamline existing Core Principle 2 requirements and provide SEFs with discretion in administering their disciplinary programs.[533] These proposed changes include eliminating requirements concerning disciplinary decisions under § 37.206(d) and eliminating various procedures detailed in guidance to Core Principle 2 concerning settlement offers;[534] sanctions upon persons who impede the progress of disciplinary hearings;[535] the right to appeal adverse actions;[536] and summary fines for violations of rules regarding the timely submission of records.[537] To the extent that the part 9 regulations contain cross-references to these part 37 provisions, the Commission proposes to eliminate those references.[538]

Specifically, the Commission proposes to eliminate those references under § 9.11(b)(2), which govern the content requirements for SEF disciplinary and access denial notices that must be filed with the person subject to the action. Currently, the notice of

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[531] *Id*.
[532] The Commission also proposes to renumber § 9.1(b)(4) to § 9.1(c) and § 9.1(c) to § 9.1(d).
[533] *See supra* Section VII.E.—§ 37.206—Disciplinary Procedures and Sanctions.
[534] *See supra* note 508 (elimination of paragraph (a)(9)).
[535] *See supra* note 513 (elimination of paragraph (a)(10)(vi)).
[536] *See supra* note 517 (elimination of in paragraph (a)(11)(iv))
[537] *See supra* note 528 (elimination of paragraph (a)(13)).
[538] The Commission also proposes to renumber the cross-references under § 9.2(k), § 9.12(a)(1), and § 9.24(a)(2) from paragraph (a)(14) to paragraph (a)(8) of the guidance to Core Principle 2 in Appendix B. *See supra* note 525.

such actions must be provided as a copy of a written decision, which accords with § 37.206(d) and guidance to Core Principle 2 in Appendix B relating to the use of written decisions where a disciplinary panel accepts a settlement offer;[539] and paragraph (a)(11)(iv), where an appellate panel responds to appeals of adverse decisions by a disciplinary panel.[540] Alternatively, § 9.11(b)(2) provides that SEFs may file a written notice that includes the items listed under §§ 9.11(b)(3)(i)-(vi).[541] Given the proposed elimination of § 37.206(d) and associated guidance to Core Principle 2, the Commission proposes that the contents of the SEF disciplinary or access denial notice be limited to the information specified under §§ 9.11(b)(3)(i)-(vi).

Under § 9.1(b)(2), § 9.2(k) , and § 9.12(a)(3), the Commission also proposes to eliminate references to paragraph (a)(13) of the guidance to Core Principle 2 in Appendix B, which addresses the issuance of summary fines for failing to submit certain records in a timely manner. To replace those references, the Commission proposes to add new regulatory language that accounts for summary fines being permitted under the rules of the SEF for recordkeeping or reporting violations.

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[539] 17 CFR part 37 app. B (guidance to Core Principle 2—paragraph (a)(9)(iii)—"Settlement offers").
[540] 17 CFR part 37 app. B (guidance to Core Principle 2—paragraph (a)(11)(iv)—"Right to appeal").
[541] Section 9.11(b)(3) requires that the notice of a disciplinary action or access denial action include the following: (i) the name of the person against whom the disciplinary action or access denial action was taken; (ii) a statement of the reasons for the disciplinary action or access denial action, detailing the exchange product which was involved, as applicable, and whether the violation that resulted in the action also resulted in financial harm to any customers together with a listing of any rules which the person who was the subject of the disciplinary action or access denial action was charged with having violated or which otherwise serve as the basis of the exchange action; (iii) a statement of the conclusions and findings made by the exchange with regard to each rule violation charged or, in the event of settlement, a statement specifying those rule violations which the exchange has reason to believe were committed; (iv) the terms of the disciplinary action or access denial action; (v) the date on which the action was taken and the date the exchange intends to make the disciplinary or access denial action effective; and (vi) except as otherwise provided under § 9.1(b), a statement informing the party subject to the disciplinary action or access denial action of the availability of Commission review of the exchange action pursuant to section 8c of the Act and this part. 17 CFR 9.11(b)(3).

Under § 9.2(k) and § 9.12(a)(2), the Commission further proposes to eliminate references to paragraph (a)(10)(vi) of the guidance to Core Principle 2 in Appendix B, which addresses the use of sanctions for persons who impede the progress of disciplinary hearings. To replace those references, the Commission proposes new regulatory language that accounts for SEFs imposing disciplinary action on a person for impeding the progress of a hearing under the rules of the SEF.

VIII. Part 37—Subpart D: Core Principle 3 (Swaps Not Readily Susceptible to Manipulation)

Core Principle 3 specifies that a SEF shall permit trading only in swaps that are not readily susceptible to manipulation.[542]

A. § 37.301—General Requirements

Section 37.301 further implements Core Principle 3 by requiring a SEF, at the time that it submits a new swap contract to the Commission, to demonstrate that the swap is not readily susceptible to manipulation by providing the information required in Appendix C to part 38.[543] Section 37.301 also states that in addition to referring to Appendix C to part 38, a SEF may refer to the guidance to Core Principle 3 in Appendix

[542] The Commission codified Core Principle 3 under § 37.300. 17 CFR 37.300.

[543] Appendix C to part 38—"Demonstration of Compliance That a Contract Is Not Readily Susceptible to Manipulation"—provides guidance regarding (i) the information that a new futures contract submission should include; (ii) estimations of deliverable supplies; (iii) contract terms and conditions that should be specified for physically-delivered contracts; (iv) demonstration that a cash-settled contract is reflective of the underlying cash market and is not readily subject to manipulation or distortion; (v) contract terms and conditions that should be specified for cash-settled contracts; (vi) requirements for options on futures contracts; (vii) the terms and conditions for non-price based futures contracts; and (vii) the terms and conditions for swap contracts. 17 CFR part 38 app. C ("Appendix C to part 38"). The Commission amended and updated this guidance to address swap transactions in 2012 as part of a part 38 rulemaking for designated contract markets. Core Principles and Other Requirements for Designated Contract Markets, 77 FR 36612 (Jun. 19, 2012).

B.[544] With respect to swaps, this guidance is similar in scope to the guidance to Appendix C to part 38.

Appendix C to part 38 for DCMs, as applied by § 37.301 to SEFs, provides guidance regarding the relevant considerations for evaluating if a new or existing swap contract is readily susceptible to manipulation.[545] The objective of this guidance, which applies the guidance for futures contracts to swaps as applicable, is intended to ensure that a given contract is not readily susceptible to manipulation and will provide a reliable pricing basis, as well as promote cash and swaps price convergence. Among other things, the guidance states that a swap contract submitted under part 40 should conform to prevailing commercial practices, such that the settlement or delivery procedures adopted for a swap contract should reflect the underlying cash market.[546] For cash-settled swap contracts, the guidance explains that the cash settlement index should be based on a reliable price reference series that accurately reflects the underlying market value, is not readily susceptible to manipulation, and is highly regarded by industry/market participants.[547] For physically-settled swap contracts, the guidance explains that the terms and conditions should provide for adequate deliverable supply and be designed to avoid impediments to the delivery of the commodity.[548]

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[544] 17 CFR 37.301.
[545] *See generally* Appendix C to part 38.
[546] *See* paragraph (g)(4) of Appendix C to part 38, which references various provisions related to contract terms and conditions requirements for futures contracts.
[547] *See* paragraph (g)(1) of Appendix C to part 38.
[548] Paragraph (g)(4) of Appendix C to part 38, which applies to swaps, refers to paragraph (b)(2), which specifies contract term and condition requirements for futures contracts settled by physical delivery. Paragraph (b)(2) specifies various criteria related to quality standards of the underlying commodity, delivery point/area specifications, and specification of the delivery period. The Commission notes that paragraph (b)(1) generally specifies that the terms and conditions should be designed to avoid any impediments to delivery so as to promote convergence between the price of the futures contract and the cash market value of the commodity at the expiration of the contract. Paragraph (b)(1)(i)(A) specifies that

1. Appendix C to Part 37—Demonstration of Compliance that a Swap Contract is Not Readily Susceptible to Manipulation

The Commission proposes to eliminate the existing cross-reference to Appendix C to part 38 under § 37.301 and establish a separate Appendix C to part 37 to provide specific guidance to SEFs for complying with the requirements of Core Principle 3.[549] In conjunction with the Commission's proposal to create a separate Appendix C to part 37, the Commission also proposes to adopt conforming changes to the guidance to Core Principle 3 in Appendix B.[550]

Specifically, proposed Appendix C to part 37 specifies (1) measures that a SEF should take to determine that a cash-settled swap contract is reflective of the underlying cash market, is not readily subject to manipulation or distortion, and is based on a cash price series that is reliable, acceptable, publicly available, and timely; (2) terms and conditions that should be specified for cash-settled swap contracts; (3) terms and conditions that should be specified for physically-settled swap contracts; (4) methodologies that should be utilized in estimating deliverable supplies; (5) terms and conditions that should be specified for options on swap contracts; and (6) guidance for options on physicals contracts.[551]

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the terms and conditions should result in a deliverable supply that is sufficient to ensure that the contract is not susceptible to price manipulation or distortion.

[549] The Commission also proposes a conforming non-substantive amendment to § 37.301 to update the reference to Appendix C to part 37.

[550] The proposed amendments to Appendix B would eliminate the existing explanatory guidance to Core Principle 3, which the Commission is proposing to address in the proposed Appendix C to part 37; and replace the existing cross-reference to sections of Appendix C to part 38 with a general reference to Appendix C to part 37.

[551] "Options on physicals" refers to option contracts that do not provide for exercise into an underlying futures contract. Upon exercise, options on physicals can be settled via physical delivery of the underlying commodity or by a cash payment. *See* proposed Appendix C to part 37—paragraph (d)—"Guidance for options on physicals contracts."

The Commission believes that the proposed amendments would streamline the guidance to Core Principle 3 in a single appendix that is dedicated to part 37. A separate appendix for SEFs and swaps trading from the guidance provided in Appendix C to part 38, which primarily applies to DCMs and futures trading, reflects good regulatory practice that provides greater clarity and certainty. The proposed Appendix C to part 37 would serve as a streamlined source of guidance for new and existing SEFs when developing new swap products to list for trading and when monitoring their existing swap products.[552] Based on the number of swap contracts that SEFs currently list for trading and will likely submit in the future, the Commission believes that a separate guidance in part 37 is appropriate for SEFs.

The Commission believes that the proposed Appendix C to part 37 also clarifies a SEF's obligations pursuant to Core Principle 3 because the guidance specifically addresses swap contracts and reflects the diverse and non-standardized nature of the swaps market, including swaps traded on SEFs. In particular, the guidance provides SEFs with additional flexibility for certain terms and conditions for non-standardized swap contracts.[553] This flexibility reflects the negotiated nature of non-standardized swap contracts. Similarly, the proposed Appendix C includes specific guidance for options on swap contracts. This guidance is not currently included in Appendix C to part 38, which focuses primarily on futures products. This proposed guidance, however, is consistent

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[552] The guidance in Appendix C to this part is based on best practices that were developed over the past three decades by the Commission and other market regulators in their review of product submissions. *See* Core Principles and Other Requirements for Designated Contract Markets, 75 FR 80572, 80582 (proposed Dec. 22, 2010).

[553] The Commission notes that for purposes of establishing the terms and conditions of a swap that it lists for trading, a SEF has discretion to determine whether the swap is standardized or non-standardized in nature. For example, the Commission understands that the swaps subject to the current trade execution requirement are generally standardized swaps. *See supra* notes 33-34 (describing the characteristics of the swaps that have been submitted as "available to trade").

with previous Commission expectations with respect to contract design and transparency of option contract terms.

Request for Comment

The Commission requests comments on all aspects of the proposed guidance to Core Principle 3 in Appendix C to part 37. In particular, the Commission requests comment on the following questions:

(68) Is the scope and content of the proposed guidance appropriately tailored for swap contracts? If not, then please explain any changes.

(69) Is the additional flexibility for certain terms and conditions for non-standardized swap contracts appropriate? If not, please explain why.

IX. Part 37—Subpart E: Core Principle 4 (Monitoring of Trading and Trade Processing)

Core Principle 4 requires a SEF to establish and enforce rules or terms and conditions that define, or specifications that detail, the trading procedures to be used in entering and executing orders traded on or through the facilities of the SEF and procedures for trade processing of swaps on or through the facilities of the SEF.[554] Core Principle 4 also requires a SEF to monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures.[555] As part of its monitoring responsibilities, a SEF must establish methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.[556] As described below, §§ 37.401-408 further implement Core Principle 4 by establishing requirements that a SEF

[554] 7 U.S.C. 7b–3(f)(4). The Commission codified Core Principle 4 under § 37.400. 17 CFR 37.400.
[555] *Id*.
[556] *Id*.

monitor trading activity on its facility and beyond its own market in certain circumstances.

The Commission received feedback from SEFs during the part 37 implementation that certain Core Principle 4 requirements are unnecessarily broad and create impracticable monitoring burdens upon SEFs, especially those requiring a SEF to monitor activity beyond its own markets. Based on its experience, the Commission has assessed this feedback and proposes amendments that would establish more practical monitoring requirements. These amendments, which in many cases would narrow a SEF's monitoring obligations to trading activity on its own facility, allow a SEF greater discretion to devise its own monitoring systems and protocols to suit the products that it offers for trading in a manner compliant with Core Principle 4. The Commission also proposes several amendments to the regulations under Core Principle 4 to conform to the proposed Appendix C to part 37, which sets forth guidance for SEFs to mitigate a swap contract's susceptibility to manipulation when developing new products and monitoring existing products.[557]

A. § 37.401—General Requirements

Section 37.401 currently implements Core Principle 4 by setting forth requirements for SEFs to monitor market activity for the purpose of detecting manipulation, price distortions, and disruptions.[558] Existing § 37.401(a) creates an ongoing obligation for a SEF to collect and evaluate data on its market participants' market activity to detect and prevent, among other things, disruptions to the physical-

[557] *See supra* Section VIII.A.1.—Appendix C—Demonstration of Compliance that a Swap Contract is Not Readily Susceptible to Manipulation.
[558] 17 CFR 37.401.

delivery or cash-settlement process where possible.[559] Existing § 37.401(b) requires a SEF to examine general market data in order to detect and prevent manipulative activity that would result in the failure of market prices to reflect the normal forces of supply and demand.[560] Existing § 37.401(c) requires a SEF to demonstrate an effective program for conducting real-time monitoring of trading for the purpose of detecting and resolving abnormalities.[561] Existing § 37.401(d) requires a SEF to demonstrate the ability to comprehensively and accurately reconstruct daily trading activity.[562]

In the preamble to the SEF Core Principles Final Rule, the Commission clarified that § 37.401(a) requires a SEF to monitor its market participants' trading activity and reference data beyond its own market on an ongoing basis in certain instances.[563] The Commission also clarified that § 37.401(b) requires a SEF to monitor and evaluate "general market data," such as the pricing of the underlying commodity or a third-party index or instrument used as a reference price of its swaps.[564] The Commission further clarified that the requirements with respect to "general market data" means that a SEF shall monitor and evaluate general market conditions related to its swaps.[565] Despite commenters' concerns about the lack of available information to meet the scope of these

[559] 17 CFR 37.401(a).
[560] 17 CFR 37.401(b).
[561] 17 CFR 37.401(c). The guidance to Core Principle 4 in Appendix B provides that an acceptable program may include some monitoring on a T+1 basis. 17 CFR part 37 app. B (guidance to Core Principle 4—paragraph (a)(1)—"General requirements").
[562] 17 CFR 37.401(d).
[563] SEF Core Principles Final Rule at 33528, 33530.
[564] *Id*. at 33528.
[565] *Id*.

requirements, the Commission stated that such monitoring would be necessary to comply with Core Principle 4.[566]

The Commission proposes to amend § 37.401 to establish more practical trade monitoring requirements that are based on information about trading activity that is actually accessible to SEFs and, therefore, are more consistent with current practice in swaps and other derivatives markets. First, the Commission proposes to clarify under proposed § 37.401(a) that a SEF must conduct real-time market monitoring of "trading activity" on its own facility to identify (i) disorderly trading; (ii) any market or system anomalies; and (iii) instances or threats of manipulation, price distortion, and disruption.[567] This proposed amendment, among other things, incorporates the existing requirement under § 37.203(e) that requires a SEF to conduct real-time market monitoring.[568] Second, the Commission proposes to specify under proposed § 37.401(b) that a SEF has discretion to determine when to collect and evaluate data on its market participants' trading activity beyond its own market, *i.e.*, as necessary to detect and prevent manipulation, price distortion, and, where possible, disruptions of the physical-delivery or cash-settlement process, rather than on an "ongoing basis."[569] This data

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[566] *Id.* at 33527-28. *See also* ISDA, Path Forward for Centralized Execution of Swaps 6 (2015) (explaining that a SEF should not be required to monitor other markets for manipulation because SEFs do not have, and cannot be expected to obtain, sufficient information about other marketplaces).

[567] The Commission also proposes to renumber subsection (c) to subsection (a) and amend the requirement as described.

[568] The Commission notes that existing § 37.203(e) specifies that a SEF must conduct real-time market monitoring of all trading activity on its system(s) or platform(s) to identify "disorderly trading and any market or system anomalies." As discussed above, the Commission is proposing to eliminate this provision and establish those requirements under proposed § 37.401(a) to streamline the existing regulations. *See supra* note 438.

[569] The Commission proposes to renumber existing subsection (a) to subsection (b) and amend the requirement as described. In the adopting part 37, the Commission also clarified that "market activity" in existing § 37.401(a) means the "trading activity" of a SEF's market participants. SEF Core Principles Final Rule at 33528. The Commission proposes a non-substantive revision to replace "market activity" with "trading activity."

would include market participants' trading in (i) the index or instrument used as a reference price; (ii) the underlying commodity for the listed swap; and (iii) any related derivatives markets.

In proposing these changes, the Commission recognizes that Core Principle 4 does not explicitly mandate the existing requirements under §§ 37.401(a)-(b) and has also learned that requiring a SEF to monitor trading activity beyond its own market on an "ongoing basis" has imposed impractical burdens, particularly given that many swaps trade both on multiple SEFs and on an OTC basis. For a swap subject to the trade execution requirement, a SEF is currently required to continually monitor trading for the same or similar swap listed on multiple SEFs. For a listed swap not subject to the requirement, the SEF must additionally monitor trading for the same swap or similar swap traded bilaterally away from a SEF.[570] Given that many SEFs list the same or similar swaps that are traded bilaterally—with a large amount of related trading activity occurring away from a SEF's own market—expecting each SEF to maintain an ongoing collection and monitoring program for these elements is impractical and not consistent with current practice in other derivatives markets.[571] SEFs have also demonstrated that this scope and frequency of monitoring is difficult because they currently lack the capability to obtain sufficient trading information. Accordingly, the Commission's proposed changes are intended to align a SEF's obligation to monitor beyond its own

[570] For example, the Commission notes that multiple SEFs offer the same fixed-to-floating USD-denominated IRS in standard benchmark tenors that are currently subject to the trade execution requirement.

[571] For example, a SEF offering an FX non-deliverable forward cannot reasonably monitor over a dozen SEFs that offer equivalent non-deliverable forward products and the market participants engaging in hundreds of equivalent bilateral transactions away from a SEF.

market more closely with current practice and obligations in other derivatives markets, where there is not an ongoing monitoring requirement.

Given the practical challenges discussed above in complying with the existing Core Principle 4 monitoring requirements, the Commission believes that a SEF should monitor beyond its own market as necessary to detect and prevent manipulation, price distortion, and, where possible, disruptions of the physical-delivery or cash-settlement processes. Further, such monitoring should be conducted when necessary to detect manipulative activity that would result in the failure of the market price to reflect the normal forces of supply and demand. In such cases, the SEF should be able to determine the instances in which it needs to collect and evaluate data related to that activity. As proposed, the scope of this data corresponds to the existing requirements of § 37.404, which require a SEF to have the ability to obtain this trading information.[572] These amendments would ensure that SEFs can still collect additional information based on a legitimate need, but would also reduce the significant and otherwise duplicative effort among SEFs to collect and evaluate trading and other information on an ongoing basis. The Commission believes that these revised monitoring requirements not only reflect current practice in other markets, but also would continue to protect the integrity of the swaps markets.

[572] The Commission notes that a SEF may collect this data on market participants' trading activity directly from its market participants pursuant to Core Principle 5, which requires a SEF to establish and enforce rules that provide the authority to obtain information from its participants. 17 CFR 37.501. Further, § 37.503 requires a SEF to share information, as required by the Commission or as necessary and appropriate, to fulfill its regulatory responsibilities. 17 CFR 37.503. The Commission notes that it is proposing various amendments to the Core Principle 5 regulations, as discussed below, but is maintaining these requirements. *See infra* Section X.—Part 37—Subpart F: Core Principle 5 (Ability to Obtain Information).

The Commission also proposes to amend § 37.401(c) to establish more practical monitoring requirements with respect to a SEF's obligation to monitor general market data. The Commission proposes to clarify that a SEF has the discretion to determine when to monitor and evaluate such data beyond its own market, *i.e.*, as necessary to detect and prevent manipulative activity that would result in the failure of the market price to reflect the normal forces of supply and demand.[573] The Commission notes that the existing provision does not specify the required scope or frequency of monitoring such data, which is used to evaluate market conditions and includes, among other things, pricing in a third-party index or instrument used as a reference price. As noted further below with respect to monitoring requirements for cash-settled swaps, the Commission has observed that SEFs do not have full access to certain types of data, such as the pricing of proprietary third-party indexes.[574] Therefore, providing a SEF with the discretion to monitor and evaluate general market data on an as-needed basis would align the requirement to SEF capabilities and current market practices.

Finally, the Commission proposes to consolidate the trade reconstruction requirements under existing § 37.401(d) and existing § 37.406 into a new proposed § 37.401(d), which would require a SEF to have the ability to comprehensively and accurately reconstruct all trading activity on its facility for the purpose of detecting instances or threats of manipulation, price distortion, and disruptions.

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[573] The Commission proposes to renumber existing subsection (b) to subsection (c) and amend the requirement as described.

[574] *See infra* Section IX.C.—§ 37.403—Additional Requirements for Cash-Settled Swaps (discussing the proposed elimination of the requirement to monitor the pricing of the reference price where a third-party index or instrument is used).

The Commission also proposes certain non-substantive changes to eliminate demonstration-based requirements under existing §§ 37.401(c)-(d). As noted above, the Commission proposes to set forth an affirmative monitoring requirement, rather than a demonstration requirement. The Commission notes that demonstration of compliance could otherwise be required upon Commission request under § 37.5(b), which requires a SEF to provide a written demonstration that it is in compliance with its obligations under the Act.[575]

The Commission further proposes to eliminate duplicative language and adopt various conforming changes to the guidance to Core Principle 4 in Appendix B.[576]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.401 and the associated guidance to Core Principle 4 in Appendix B. In particular, the Commission requests comment on the following question:

(70) The Commission has observed that SEFs may provide input into market pricing information, such as third-party indexes, that is available to market participants, which includes executed prices, prices from executable or indicative bids and offers, views of trading specialists, or prices from related instruments in other markets. Should the Commission's general market monitoring requirements require SEFs to monitor this type of information—for example, pricing provided by its own trading specialists?

[575] 17 CFR 37.5(b).

[576] The Commission proposes these changes in paragraph (a)(1) to the guidance to Core Principle 4 in Appendix B. 17 CFR part 37 app. B.

B. § 37.402—Additional Requirements for Physical-Delivery Swaps

For swaps settled by physical delivery, § 37.402 requires that a SEF monitor each swap's terms and conditions as they relate to the underlying commodity market and monitor the "availability of supply" of the underlying commodity, as specified by the swap's delivery requirements.[577] The Commission also provided additional guidance to Core Principle 4 in Appendix B to specify that a SEF should monitor the general "availability" of the commodity specified by the swap; the commodity's characteristics; the delivery locations; and if available, information related to the size and ownership of deliverable supplies.[578] In the SEF Core Principles Final Rule, the Commission explained that using the phrase "availability of supply" and providing the associated guidance was intended to provide a SEF with additional flexibility in response to commenter feedback that the proposed regulation was, among other things, duplicative, unmanageable, and created the risk of conflicting conclusions.[579]

The Commission proposes to clarify a SEF's monitoring obligations with respect to physical-delivery swaps under § 37.402 to be consistent with the guidance in proposed Appendix C to part 37 and ensure that the SEF can comply with Core Principles 3 and 4.[580] Among other things, a swap contract's terms and conditions should assure the availability of adequate deliverable supplies, such that the contract is not readily

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[577] 17 CFR 37.402.
[578] 17 CFR part 37 app. B (guidance to Core Principle 4—paragraph (a)(2)—"Physical-delivery swaps").
[579] *See* SEF Core Principles Final Rule at 33529 (explaining the Commission's revision of the proposed requirement that a SEF monitor whether the supply is "adequate" to the "availability" of the supply; and replacing detailed proposed requirements to monitor the supply, marketing, and ownership of the commodity to be physically delivered with similar guidance in Appendix B).
[580] Proposed Appendix C to part 37, among other things, provides related guidance on the design of physically-settled swap contracts that should be adopted by a SEF to minimize their susceptibility to manipulation. *See* paragraph (b) of the proposed Appendix C to part 37—"Guidance for physically-settled swaps." 17 CFR part 37 app. C.

susceptible to price manipulation.[581] To ensure that a swap contract's terms and conditions remain appropriately designed, § 37.402 would require a SEF to (i) monitor the swap's terms and conditions as they relate to the underlying commodity market by reviewing the convergence between the swap's price and the price of the underlying commodity, and make a good-faith effort to resolve conditions that are interfering with convergence or notify the Commission of such conditions; and (ii) monitor the availability of the supply of the commodity specified by the delivery requirements of the swap, and make a good-faith effort to resolve conditions that threaten the adequacy of supplies or the delivery process or notify the Commission of such conditions.[582]

The Commission notes that Core Principles 3 and 4 place affirmative obligations on SEFs to permit trading only in swaps that are not readily susceptible to manipulation and prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process, respectively. As such, proposed § 37.402 places affirmative obligations on a SEF to make a good-faith effort to resolve conditions that are interfering with convergence or that threaten the adequacy of supplies or the delivery process. The Commission recognizes, however, that a SEF may not always be able to resolve these

[581] Proposed Appendix C to part 37 specifies that a SEF should estimate the deliverable supply for which the swap is not readily susceptible to price manipulation. To assure the availability of adequate deliverable supplies, the swap contract terms and conditions, in particular, should be designed based upon an adequate assessment of the potential range of deliverable supplies and should account for variations in the patterns of production, consumption, and supply over a period of at least three years. *See id.* (paragraph (b)(iii)—"Accounting for variations in deliverable supplies").

[582] The Commission also proposes to (i) amend the guidance to Core Principle 4 in Appendix B to define "price convergence" as the process whereby the price of a physically-delivered swap converges to the spot price of the underlying commodity as the swap nears expiration; and (ii) make conforming changes. 17 CFR part 37 app. B.

conditions; therefore, proposed § 37.402 allows the SEF to notify the Commission of such conditions.[583]

The Commission further proposes corresponding amendments to the associated guidance to Core Principle 4 in Appendix B.[584] The Commission proposes a non-substantive revision to clarify that a SEF should monitor physical-delivery swaps listed on its facility. To conform to Core Principle 4, the Commission also proposes to clarify that a SEF should monitor for conditions that may cause a swap to become susceptible to manipulation, price distortion, or disruptions;[585] such conditions would include those that influence the convergence between the swap's price and the price of the underlying commodity. This proposed language would conform to the proposed guidance for physically-settled swaps in the proposed Appendix C to part 37, which states that a physically-settled swap contract's terms and conditions should be designed to avoid any impediments to the delivery of the commodity so as to promote convergence between the value of the swap contract and the cash market value of the commodity at the expiration of the swap contract.[586]

The Commission also proposes a non-substantive change to eliminate the demonstration-based requirement under § 37.402. As noted above, the Commission proposes to set forth an affirmative monitoring requirement for SEFs, rather than a demonstration requirement. The Commission notes that demonstration of compliance could otherwise be required upon Commission request under § 37.5(b), which requires a

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[583] A SEF should provide electronic notification to the Commission at *submissions@cftc.gov* and DMO at *DMOSubmissions@cftc.gov*.
[584] 17 CFR part 37 app. B (guidance to Core Principle 4—paragraph (a)(2)—"Physical-delivery swaps").
[585] *Id.*
[586] *See* 17 CFR part 37 app. C (paragraph (b)(iv) of the proposed Appendix C to part 37—"Contract terms and conditions").

SEF to provide a written demonstration that it is in compliance with its obligations under the Act.[587]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.402 and the associated guidance to Core Principle 4 in Appendix B.

C. § 37.403—Additional Requirements for Cash-Settled Swaps

For cash-settled swaps, § 37.403(a) requires that a SEF monitor the pricing of the reference price used to determine cash flows or settlement of a swap.[588] Where the reference price is formulated or computed by the SEF, § 37.403(b) requires a SEF to demonstrate that it monitors the continued appropriateness of its methodology for deriving that price.[589] Where the reference price relies on a third-party index or instrument, § 37.403(c) requires a SEF to demonstrate that it monitors the continued appropriateness of the index or instrument.[590] The Commission provided additional guidance to Core Principle 4 in Appendix B to specify that a SEF should monitor pricing abnormalities in the index or instrument used to calculate the reference price to avoid manipulation, price disruptions, or market distortions.[591] For self-formulated or self-computed reference prices, the SEF should amend the existing methodology or impose new methodologies where such threats exist. For pricing based on a third-party index or

[587] 17 CFR 37.5(b).
[588] 17 CFR 37.403(a).
[589] 17 CFR 37.403(b).
[590] 17 CFR 37.403(c).
[591] 17 CFR part 37 app. B (guidance to Core Principle 4—paragraph (a)(3)—"Cash-settled swaps"). *See* SEF Core Principles Final Rule at 33529 (stating that market participants may have incentives to disrupt or manipulate reference prices for cash-settled swaps and stating that SEFs must monitor the pricing of the reference price in order to comply with Core Principle 4's requirement to prevent manipulation, price distortion, and disruptions of the cash settlement process).

instrument, a SEF should conduct due diligence to ensure that the contract is not susceptible to manipulation.[592]

Based on its experience, the Commission acknowledges that the requirement imposed by § 37.403(a) to monitor the methodologies behind third-party indexes or instruments is not realistic due to the proprietary nature of these indexes and instruments. The Commission has observed that many SEFs offer swaps for which pricing is based on benchmark prices or benchmark indices owned or administered by third parties, such as the Intercontinental Exchange, Inc. ("ICE"),[593] IHS Markit Ltd. ("IHS Markit"),[594] and the European Money Markets Institute ("EMMI").[595] For example, many SEFs offer IRS for trading that rely on LIBOR or EURIBOR as the underlying benchmark, which are based upon submissions from panel banks. The Commission believes that requiring a SEF to monitor the inputs and calculations involved in ICE's or EMMI's methodologies when calculating their respective benchmarks on an ongoing basis is impractical.[596] The Commission understands that as a general matter, certain aspects of these benchmarks

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[592] *Id*.

[593] ICE serves as the current administrator for ICE Swap Rate (formerly known as ISDAFix), which serves as a benchmark for swap rates and spreads for IRS. ICE, About ICE Swap Rate, https://www.theice.com/iba/ice-swap-rate. ICE also serves as the current administrator for ICE LIBOR (formerly known as BBA LIBOR), which is a widely-adopted benchmark for short-term interest rates that is used to specify the floating rate for fixed-to-floating IRS. ICE, ICE Libor-Overview, https://www.theice.com/iba/libor.

[594] IHS Markit owns and operates several tradeable CDS indices that are based on a basket of single-name CDS. IHS Markit, Indices, https://ihsmarkit.com/products/indices.html.

[595] EMMI, a non-profit making association whose members are national banking associations in the EU-member states, serves as the current administrator for Euribor and EONIA, which are widely-adopted benchmarks for euro-denominated IRS. EMMI, 2 Benchmarks, https://www.emmi-benchmarks.eu.

[596] The Commission notes, however, that ICE and EMMI offer general information on the methodologies for calculating their respective benchmarks. For example, ICE states that it determines the ICE Swap Rate benchmark, which represents the mid-price for the fixed leg of IRS, based on tradeable quotes from regulated, electronic, multilateral trading venues. *See* ICE, Calculation of ICE Swap Rate from Tradeable Quotes, *available at* https://www.theice.com/publicdocs/ICE_Swap_Rate_Full_Calculation_Methodology.pdf; *see also* EMMI, Euribor Code of Conduct, *available at* https://www.emmi-benchmarks.eu/assets/files/D2712J-2014-Euribor%20Code%20of%20Conduct%2001Oct2013%20-%20Revised%201%20June%202016-%20final%20new.pdf.

remain proprietary in nature. Therefore, the Commission acknowledges that SEFs do not necessarily have full access to the information to monitor trading to detect disruptions or manipulations of indexes or reference rates administered by other industry participants. Further, the Commission notes that these entities are subject to their own monitoring and oversight mechanisms.[597]

Based on these considerations, the Commission proposes to eliminate the requirement under § 37.403(a) that SEFs monitor the "pricing" of the reference price used to determine cash flows or settlement.[598] Where the reference price relies on a third-party index or instrument, a SEF would continue to be required under proposed § 37.403(b) (existing § 37.403(c)) to monitor the "appropriateness" of the index or instrument; the Commission, however, proposes to amend this requirement to additionally require a SEF to take appropriate action, including selecting an alternate index or instrument for deriving the reference price, where there is a threat of manipulation, price distortion, or market disruption.[599] The Commission believes that sufficient information is generally available to SEFs to comply with this proposed requirement. Based on this proposed requirement, the Commission expects that a SEF would take action with respect to its use of a third-party index or instrument for a listed swap contract that would inhibit the SEF's ability to prevent manipulation pursuant to

[597] ICE maintains an oversight committee for LIBOR, which is responsible for reviewing the methodology, scope, and definition of the benchmark (including assessing its underlying market and usage); overseeing any changes to the benchmark; and overseeing and reviewing an associated code of conduct. ICE, Governance & Oversight, https://www.theice.com/iba/libor#methodology. EMMI maintains a Steering Committee, which is responsible for similar functions with respect to Euribor. EMMI, Steering Committee, https://www.emmi-benchmarks.eu/euribor-org/steering-committee.html.

[598] The Commission notes, however, that a SEF would be required under proposed § 37.401(b) to monitor trading in the index or instrument used as a reference price..

[599] The Commission proposes to renumber existing subsection (c) to subsection (b) and amend the language as described.

Core Principles 3 and 4. Where a SEF formulates and computes the reference price, the Commission proposes to amend § 37.403(b) to require a SEF to take appropriate action, including amending the methodology, where there is a threat of manipulation, price distortion, or market disruption.[600] In contrast to the circumstances where a SEF relies on a third-party index or instrument, the SEF could monitor its own methodology for deriving the reference price.

The Commission believes that these proposed amendments would provide greater clarity and establish more practical requirements for SEFs to monitor the reference prices, including the index or instrument used to calculate them, in a manner that is consistent with Core Principle 4. Further, the Commission believes that these proposed amendments are consistent with the proposed guidance in Appendix C to part 37 regarding the design of cash-settled swap contracts. Among other things, that guidance specifies that the SEF should ensure that the reference price used for its contract is not readily susceptible to manipulation by assessing its reliability as an indicator of cash market values in the underlying commercial market.[601]

The Commission also proposes a non-substantive change to eliminate the demonstration-based requirements under § 37.403. As noted above, the Commission proposes to set forth an affirmative monitoring requirement, rather than a demonstration requirement. The Commission notes that demonstration of compliance could otherwise

[600] The Commission proposes to renumber existing subsection (b) to subsection (a) and amend the language as described.
[601] *See* 17 CFR part 37 app. C (paragraph (a)(ii) of the proposed Appendix C to part 37—"Reference price susceptibility to manipulation").

be required upon Commission request under § 37.5(b), which requires a SEF to provide a written demonstration that it is in compliance with its obligations under the Act.[602]

Given the changes to § 37.403 proposed above, the Commission proposes to delete the existing associated guidance in Core Principle 4 in Appendix B.[603]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.403 and the elimination of the associated guidance to Core Principle 4 in Appendix B.

D. § 37.404—Ability to Obtain Information

Section 37.404(a) provides that a SEF must demonstrate that it has access to sufficient information to assess whether trading in swaps listed on its market, in the index or instrument used as a reference price, or in the underlying commodity for its listed swaps is being used to affect prices on its market.[604] Section 37.404(b) requires a SEF to have rules that require its market participants to keep records of their trading, including records of their activity in the index or instrument used as a reference price, the underlying commodity, and related derivatives markets; and make those records available to the SEF, its regulatory service provider if applicable, and the Commission.[605] The Commission specified in the guidance to Core Principle 4 in Appendix B that a SEF may limit the application of these requirements to market participants who conduct "substantial trading" on its facility.[606]

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[602] 17 CFR 37.5(b).
[603] The Commission proposes to eliminate paragraph (a)(3).
[604] 17 CFR 37.404(a).
[605] 17 CFR 37.404(b).
[606] 17 CFR part 37 app. B (guidance to Core Principle 4—paragraph (a)(4)—"Ability to obtain information").

The Commission proposes several amendments to the associated guidance to Core Principle 4 in Appendix B. In particular, the Commission proposes to eliminate a SEF's ability to limit the application of proposed § 37.404(a) and proposed § 37.404(b) to only those market participants who conduct "substantial trading" on its facility. The Commission notes that it has not provided SEFs with any additional guidance, *e.g.*, volume-based metrics or similar factors, as to what constitutes "substantial trading" by a market participant. Eliminating this guidance would not only remove an ambiguity as to whom § 37.404 applies, but also promote a more comprehensive and effective monitoring requirement that would require a SEF to have the ability to obtain information from all of its market participants, thereby better fulfilling the objectives of Core Principle 4.[607] In addition, based on its experience, the Commission believes that market participants are keeping records of their related trading, so eliminating the "substantial" requirement should not impose additional burdens. In addition to this amendment, the Commission also proposes several non-substantive amendments to the guidance.[608]

The Commission also proposes a non-substantive change to eliminate the demonstration-based requirement under § 37.404(a).[609] As noted above, the Commission proposes to set forth an affirmative monitoring requirement, rather than a demonstration

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[607] The Commission notes, however, that the scope of this requirement would be based on the proposed definition of "market participant" under § 37.2(b), which would limit § 37.404 to persons who access the SEF directly or through a third-party functionality, or otherwise direct an intermediary to trade on their behalf. *See supra* Section IV.B.2.a.—Applicability of § 37.404(b) to Market Participants.

[608] The Commission proposes to streamline and move the guidance that currently specifies that a SEF can adopt information-sharing agreements with other trading venues or a third-party regulatory service provider where position and trading information is not available directly from market participants. The Commission proposes to move this guidance to paragraph (a) of the guidance to Core Principle 5 because the applicable requirements for a SEF to adopt information-sharing practices are addressed under proposed § 37.503, as discussed below.

[609] The Commission also proposes to eliminate similar associated guidance to Core Principle 4 in Appendix B.

requirement. The Commission notes that demonstration of compliance could otherwise be required upon Commission request under § 37.5(b), which requires a SEF to provide a written demonstration that it is in compliance with its obligations under the Act.[610]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.404 and the associated guidance to Core Principle 4 in Appendix B.

E. § 37.405—Risk Controls for Trading

Section 37.405 requires that a SEF establish and maintain risk control mechanisms to prevent and reduce the potential risk of market disruptions, including, but not limited to, market restrictions that pause or halt trading in market conditions prescribed by the SEF.[611] The associated guidance to Core Principle 4 in Appendix B, among other things, provides examples of the different types of risk controls that a SEF may adopt based on whether or not they are appropriate to the characteristics of the trading platform or market offered by the SEF.[612] Among those types of controls, the guidance specifies that a SEF may establish clear error-trade and order cancellation policies.

The Commission proposes two amendments to § 37.405 to align the existing requirement with the proposed amendments to other Core Principle 4 regulations. First, the Commission proposes to clarify that a SEF is required to have risk control mechanisms to prevent and reduce market disruptions, as well as price distortions on their facility. This proposed change is consistent with Core Principle 4, which requires a SEF

[610] 17 CFR 37.5(b).
[611] 17 CFR 37.405.
[612] 17 CFR part 37 app. B (guidance to Core Principle 4—paragraph (a)(5)—"Risk controls for trading").

to monitor trading to prevent price distortions and disruptions to the delivery or cash settlement process.[613] Second, the Commission proposes to limit this requirement to swaps trading activity occurring on a SEF's own facility, which would be consistent with the proposed changes to § 37.401(a).

The Commission also proposes several amendments to the associated guidance to Core Principle 4 in Appendix B. First, the Commission proposes to eliminate the reference to intraday position limit risk controls, which generally do not apply to a SEF because the Commission has yet to establish position limit rules for swaps. Second, the Commission proposes to clarify that a SEF's risk controls should be adapted to the swap contracts that it lists for trading; this amendment does not reflect a substantive change, but rather would be consistent with the proposed guidance in Appendix C to part 37, which provides that a SEF may adapt certain risk controls for swap contracts based on whether they are standardized or non-standardized.[614] Third, the Commission proposes to eliminate the language specifying that a SEF may adopt an error trade policy; the Commission notes that, as described above, proposed § 37.203(e) would require a SEF to adopt an error trade policy for trading on its facility. The Commission also proposes to make several other non-substantive conforming and clarifying amendments to the guidance.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.405 and the associated guidance to Core Principle 4 in Appendix B.

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[613] 7 U.S.C. 7b-3(f)(4)(b).

[614] *See supra* Section VIII.A.1.—Appendix C—Demonstration of Compliance that a Swap Contract is Not Readily Susceptible to Manipulation.

F. § 37.406—Trade Reconstruction

Section 37.406 requires that a SEF have the ability to comprehensively and accurately reconstruct all trading on its facility, and that audit-trail data and reconstructions be made available to the Commission in a form, manner, and time that is acceptable to the Commission.[615]

Given the proposed consolidation with § 37.401(d), as described above, the Commission proposes to eliminate § 37.406.[616] The Commission also notes that the requirement to make information available to the Commission is already addressed under Core Principle 5 regulations, discussed further below.[617]

Request for Comment

The Commission requests comment on all aspects of the proposed elimination of § 37.406.

G. § 37.407—Regulatory Service Provider; § 37.408—Additional Sources for Compliance[618]

The Commission is not proposing any amendments to §§ 37.407-408.

X. Part 37—Subpart F: Core Principle 5 (Ability to Obtain Information)

Core Principle 5 requires a SEF to establish and enforce rules that allow the facility to obtain any "necessary information" to perform any of the functions described in CEA section 5h; provide the information to the Commission upon request; and have the capacity to carry out international information-sharing agreements as the Commission

[615] 17 CFR 37.406.
[616] As discussed above, proposed § 37.401(d) would require a SEF to have the ability to comprehensively and accurately reconstruct all trading activity on its facility for the purpose of detecting instances or threats of manipulation, price distortion, and disruptions.
[617] *See infra* Section X.B.—§ 37.502—Provide Information to the Commission.
[618] The Commission proposes to renumber §§ 37.407-408 to §§ 37.406-407, given the proposed elimination of existing § 37.406.

may require.[619] The Commission further implemented Core Principle 5 under §§ 37.501-504. Based on the Commission's understanding of current SEF operational practices, the Commission is proposing several amendments, including non-substantive changes, to these implementing regulations, as described below.

A. § 37.501—Establish and Enforce Rules

Section 37.501 specifies that a SEF's rules must allow it to obtain sufficient information to fulfill its functions and obligations under part 37, including the capacity to carry out such international information-sharing agreements as the Commission may require.[620] The Commission proposes a non-substantive amendment to eliminate the duplicative language under § 37.501 regarding a SEF's capacity to carry out international information-sharing agreements. The Commission notes that this requirement is already established under Core Principle 5.

B. § 37.502—Provide Information to the Commission

Existing § 37.502 requires a SEF to adopt rules that allow it to collect information on a routine basis, allow for the collection of non-routine data from its market participants, and allow for its examination of books and records kept by its market participants.[621]

The Commission proposes to eliminate existing § 37.502.[622] The Commission notes that the language of this requirement is duplicative of the general requirement that SEFs have the ability to obtain information from their market participants, as already set

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[619] 7 U.S.C. 7b-3(f)(5). The Commission codified Core Principle 5 under § 37.500. 17 CFR 37.500.
[620] 17 CFR 37.501.
[621] 17 CFR 37.502.
[622] The Commission proposes to renumber existing § 37.503 to § 37.502 and retitle the provision to "Provide information to the Commission" from "Collection of information" based on the proposed changes described below.

forth in Core Principle 5 and § 37.501. Eliminating the requirement that a SEF must have rules to allow it to examine books and records is also consistent with the Commission's proposed amendment to § 37.203(b), which would replace a similar existing requirement with a more general rule that would allow a SEF to tailor its rules for collecting books and records from market participants.[623]

Request for Comment

The Commission requests comment on all aspects of the proposed elimination of existing § 37.502.

C. § 37.503—Information-Sharing[624]

Existing § 37.504 requires a SEF to share information with other regulatory organizations, data repositories, and third-party data reporting services as required by the Commission or as otherwise necessary and appropriate to fulfill its self-regulatory and reporting responsibilities.[625] Section 37.504 also states that appropriate information-sharing agreements can be established with the specified entities or the Commission can act in conjunction with the SEF to carry out such information sharing.

The Commission proposes to establish a more straightforward and streamlined information-sharing requirement by eliminating the specifically enumerated list of entities with which a SEF must share information and adopting conforming amendments. Instead, a SEF would be required to generally share information, as required by the Commission, or as appropriate to fulfill its self-regulatory and reporting responsibilities.

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[623] *See supra* Section VII.B.2.—§ 37.203(b)—Authority to Collect Information (proposing an amendment to require that a SEF have the authority to collect information required to be kept by persons subject to the SEF's recordkeeping rules).

[624] The Commission proposes to renumber existing § 37.504 to § 37.503 and retitle the provision to "Information-sharing" from "Provide information to the Commission" based on the proposed changes described below.

[625] 17 CFR 37.504.

Rather than limiting the types of entities that a SEF may share information with, however, a SEF would have the flexibility to share information with third parties that it may utilize to carry out those responsibilities, including affiliated entities. This broader and more adaptive approach to information-sharing practices would better accommodate, for example, a SEF's ability to use different types of regulatory service providers pursuant to the proposed amendments under § 37.204. The Commission emphasizes, however, that SEFs would not be required to share information with competitor entities. In relevant situations where information or data may need to be shared across different markets to help identify manipulation, price distortions or other disruptions, for example, the Commission anticipates that it will continue working in conjunction with SEFs to help establish such information-sharing arrangements.

The Commission also proposes a non-substantive revision by moving certain provisions from the existing guidance to Core Principle 4 to the guidance to Core Principle 5 in Appendix B.[626] This proposed guidance would specify that if position and trading information is available through information-sharing agreements with other trading venues or a third-party regulatory service provider, then the SEF should cooperate, to the extent practicable, in such information-sharing agreements.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.503 and the associated guidance to Core Principle 5 in Appendix B.

[626] The Commission proposes to move this guidance from paragraph (a)(4) to Core Principle 4 to paragraph (a) to Core Principle 5 in Appendix B.

D. § 37.504—Prohibited Use of Data Collected for Regulatory Purposes[627]

Section 37.7—"Prohibited use of data collected for regulatory purposes"—prohibits a SEF from using, for business or marketing purposes, any proprietary data or personal information it collects or receives, from or on behalf of any person, for the purpose of fulfilling its regulatory obligations, unless the person clearly consents to the SEF's use of such data or information in such manner.[628] The purpose of this provision is to protect customer privacy and prevent a SEF from using information, obtained for compliance purposes, to otherwise advance its commercial interests.[629] Section 37.7 also provides that a SEF, where necessary for regulatory purposes, may share such data or information with one or more SEFs or DCMs registered with the Commission.[630]

The Commission proposes to create a more cohesive rule with respect to information-sharing practices under Core Principle 5 by moving existing § 37.7 to a new proposed § 37.504 and amending the current language of the requirement. Consistent with the existing prohibition, the Commission proposes that a SEF that shares such proprietary data or personal information with a third party shall ensure that that third party does not use the data or information for business or marketing purposes, unless the person from whom such data or information was obtained clearly consents to its use for business or marketing purposes (including consent to use by those third parties with whom the SEF may share such information). This proposed amendment corresponds to the Commission's other proposed amendments that would expand the scope of entities

[627] The Commission proposes to retitle § 37.504 to "Prohibited use of data collected for regulatory purposes" from "Information-sharing agreements" based on the proposed changes described below.
[628] 17 CFR 37.7.
[629] SEF Core Principles Final Rule at 33492.
[630] 17 CFR 37.7.

with whom a SEF may share information, including § 37.503, which would provide a SEF with greater flexibility in selecting a third-party provider to fulfill its self-regulatory and reporting responsibilities; and § 37.204, which would allow the SEF to utilize a broader scope of third-party entities, including non-registered affiliates to provide regulatory services, subject to Commission approval.[631]

In the course of using such a provider, a SEF may need to share proprietary data or personal information with that third party. To the extent that § 37.504 would continue to limit SEFs from using this type of information for non-regulatory purposes, the Commission believes that the objective of protecting customer privacy and preventing the use of data for commercial purposes should also equally apply to third parties that obtain access to such data or information from a SEF for regulatory purposes. The Commission believes that the proposed amendments achieve this objective.

Request for Comment

The Commission requests comments on all aspects of proposed § 37.504.

XI. Part 37—Subpart G: Core Principle 6 (Position Limits or Accountability)

Core Principle 6 requires a SEF that is a trading facility to adopt, as is necessary and appropriate, position limits or position accountability levels for each swap contract to reduce the potential threat of market manipulation or congestion.[632] For contracts that are subject to a federal position limit under CEA section 4a(a), the SEF must set its position limits at a level that is no higher than the limit established by the Commission; and

[631] In this regard, the Commission notes that under its proposed amendments to § 37.204, a SEF would be permitted to contract with any entity for the provision of services to assist in complying with the Act and Commission regulations, subject to Commission approval. *See supra* Section VII.C.1.—§ 37.204(a)—Use of Regulatory Service Provider Permitted.

[632] 7 U.S.C. 7b-3(f)(6). The Commission codified Core Principle 6 under § 37.600. 17 CFR 37.600.

monitor positions established on or through the SEF for compliance with the Commission's limit and the limit, if any, set by the SEF.[633]

A. § 37.601—Additional Sources for Compliance; Guidance to Core Principle 6 in Appendix B

Section 37.601 further implements Core Principle 6 and specifies that until such time that compliance is required under part 151 of the Commission's regulations, a SEF may refer to the associated guidance and/or acceptable practices set forth in Appendix B to part 37.[634] The guidance to Core Principle 6 in Appendix B provides a SEF with reasonable discretion to comply with Core Principle 6 and sets forth how a SEF may demonstrate compliance for trading that occurs on its own market.[635] The Commission notes that it has proposed new language for § 37.601 and new corresponding guidance to Core Principle 6 in Appendix B in a re-proposal of a position limits rulemaking, pending further Commission action.[636]

The Commission proposes to eliminate the language of § 37.601 and the existing corresponding guidance to Core Principle 6, based on its intent to address this issue in a separate rulemaking. Until that time, the Commission clarifies that SEFs have reasonable discretion to determine how to comply with Core Principle 6 pursuant to Core Principle 1.[637] This approach is consistent with the existing approach under § 37.601 and the associated guidance to Core Principle 6.

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[633] *Id*.
[634] 17 CFR 37.601.
[635] 17 CFR part 37 app. B (guidance to Core Principle 6—paragraph (a)—"Guidance").
[636] Position Limits for Derivatives, 81 FR 96704 (proposed Dec. 30, 2016).
[637] 7 U.S.C. 7b-3(f)(1).

Request for Comment

The Commission requests comment on all aspects of the proposed elimination of § 37.601 and the associated guidance to Core Principle 6 in Appendix B.

XII. Part 37—Subpart H: Core Principle 7 (Financial Integrity of Transactions); § 39.12—Participant and Product Eligibility

Core Principle 7 requires a SEF 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).[638] As described further below, §§ 37.700-703 implement Core Principle 7 by establishing requirements for SEFs to facilitate the processing and routing of swap transactions to a DCO for clearing. Section 39.12(b)(7), which implements Core Principle C for DCOs, sets forth corresponding requirements for registered DCOs that specify the time frame for acceptance or rejection of transactions submitted to the registered DCO from DCMs and SEFs.[639]

As described further below, the Commission is proposing several amendments to the implementing regulations and § 39.12(b)(7), including amendments to certain "straight-through processing" obligations that apply to SEFs, DCMs, and DCOs.[640]

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[638] The Commission codified Core Principle 7 under § 37.700. 17 CFR 37.700.

[639] 17 CFR 39.12(b)(7). Core Principle C for DCOs, among other things, requires that each DCO establish appropriate standards for determining the eligibility of agreements, contracts, or transactions submitted to the DCO for clearing. 7 U.S.C. 7a-1(c)(2)(C)(i)(II). Section 39.12(b) implements Core Principle C for DCOs by setting forth product eligibility requirements. 17 CFR 39.12(b).

[640] The Commission notes that § 39.12(b)(7) also applies to the acceptance or rejection for clearing by a DCO of (i) futures and options on futures transactions and (ii) swaps submitted by a DCM. Accordingly, the Commission's proposed amendments to § 39.12(b)(7) would also apply to those transactions. *See infra* Section XII.B.2.b.(2)—§ 39.12(b)(7)(ii)—AQATP Standard for Registered DCOs.

A. § 37.701—Required Clearing

Section 37.701 requires that transactions executed on or through a SEF that are subject to the clearing requirement, or are voluntarily cleared by the counterparties, must be cleared through a registered DCO or an exempt DCO.[641]

The Commission proposes to amend § 37.701 to require a SEF to establish a direct and independent clearing agreement with each registered DCO or exempt DCO to which the SEF submits swap transactions for clearing.[642] During the part 37 implementation, the Commission observed that some SEFs would route swap transactions to certain exempt DCOs for clearing without having established a direct clearing agreement with those DCOs. Rather than enter a direct agreement with the exempt DCO, the SEF would establish the capacity to route transactions through the use of a third-party service provider. Such routing arrangements occurred pursuant to a services agreement between the SEF and the provider; the provider, in turn, maintained a separate agreement with the exempt DCO.

A SEF's use of a third-party service provider to route swap transactions to a DCO for clearing may generally be appropriate, but the Commission believes that the indirect routing of transactions for clearing must occur pursuant to a direct and independent clearing services agreement between the SEF and each DCO utilized by the SEF. 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

[641] 17 CFR 37.701.
[642] The Commission proposes to renumber the existing requirement under § 37.701 as subsection (a) based on a new requirement proposed under subsection (b), described below.

prompt and efficient processing of transactions in accordance with the DCO's obligations under § 39.12(b)(7)(i)(A).[643] Such an agreement would provide greater certainty to market participants that the SEF has the appropriate processes to facilitate swaps clearing. The Commission also believes that the terms established in a direct clearing agreement between the SEF and DCO would 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.

The Commission also proposes a non-substantive amendment to § 37.701 to eliminate "or through" from the language of the existing requirement. The Commission notes that this proposed amendment is a conforming change to other part 37 regulations and does not affect the scope of transactions that are required to be cleared pursuant to the clearing requirement in CEA section 2(h)(1)(A).[644]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.701.

B. § 37.702—General Financial Integrity

1. § 37.702(a)

Section 37.702(a) requires a SEF to establish minimum financial standards for its members, which include at a minimum a requirement that each member qualifies as an

[643] Section 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. 17 CFR 39.12(b)(7)(i)(A). As discussed below, § 39.12(b)(7)(i)(A), as amended, would apply to both the processing and routing of transactions to the DCO for clearing. *See infra* Section XII.B.2.b.(1)—§ 37.702(b)(1) and § 39.12(b)(7)(i)(A)—"Prompt, Efficient, and Accurate" Standard.

[644] The Commission notes that Core Principle 7 refers to swaps "entered on or through" the SEF, but notes that the existing requirement under § 37.701 specifically applies to "executed" transactions, which are submitted for clearing.

ECP pursuant to CEA section 1a(18).[645] The Commission proposes a non-substantive amendment to § 37.702(a) to replace the term "member" with "market participant." The Commission notes that its proposed definition of "market participant" under § 37.2(b) would capture the universe of persons and entities that participate on SEFs and would be subject to minimum financial requirements, including a SEF's members.[646]

2. § 37.702(b) and § 39.12(b)(7)—Time Frame for Clearing

Existing § 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 the SEF.[647] The two provisions are intended to ensure that SEFs and registered DCOs coordinate and work together to facilitate the "straight-through processing" of transactions from execution through clearing,[648] which the Divisions have described as the "near[-]instantaneous acceptance or rejection of each trade. . . ."[649] In order for a DCO to clear a SEF swap transaction, existing § 37.702(b)(1) requires a SEF to ensure that it has the capacity to route transactions to the DCO in a manner acceptable

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[645] 17 CFR 37.702(a).

[646] *See supra* Section IV.B.2.—§ 37.2(b)—Definition of "Market Participant." The Commission notes that CEA section 2(e) limits swaps trading to ECPs, as defined by section 1a(18) of the Act. 7 U.S.C. 2(e).

[647] The Commission notes that part 39 only applies to registered DCOs and does not apply to exempt DCOs. Accordingly, the Commission notes that § 37.702(b) only refers to registered DCOs.

[648] Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 FR 21278, 21283 (Apr. 9, 2012) ("Timing of Acceptance for Clearing Final Rule").

[649] 2013 Staff STP Guidance at 2. *See also infra* notes 658-659 and accompanying discussion. The Commission has previously stated that the "acceptance or rejection for clearing in close to real time is crucial for both effective risk management and for the efficient operation of trading venues." Timing of Acceptance for Clearing Final Rule at 21285. The Commission notes that § 39.12(b)(7) applies to a DCO with respect to (i) futures and options on futures transactions and (ii) swaps submitted by a DCM for clearing. To the extent that the Commission is addressing the proposed amendments to § 39.12(b)(7), as discussed further below, in conjunction with proposed amendments to § 37.702(b)(2), the discussion focuses on swaps routed by a SEF to a DCO for clearing. *See also infra* note 673 (noting that at this time the Commission is not proposing corresponding amendments to § 38.601(b), which establishes analogous processing and routing requirements for DCMs). As discussed below, however, the proposed amendments to § 39.12(b)(7) would also apply to those transactions, including swaps, futures, and options on futures, submitted by a DCM to a DCO for clearing. *See infra* Section XII.B.2.b.(2)—§ 39.12(b)(7)(ii)—AQATP Standard for Registered DCOs.

to the registered DCO for purposes of clearing.[650] Existing § 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).[651] Section 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 (emphasis added).[652]

Sections 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 (the "AQATP" standard).[653] Section 39.12(b)(7)(ii) applies this standard to registered DCOs for transactions, including swaps, that are "executed competitively on or subject to the rules" of a SEF or DCM and requires the registered DCO to accept or reject a transaction for clearing pursuant to the AQATP standard "after execution" of the transaction.[654] For swaps "not executed on or subject to the rules" of a SEF or DCM or "executed non-competitively on or subject to the rules" of a SEF or DCM, § 39.12(b)(7)(iii) requires a registered DCO to accept or reject a swap for clearing pursuant to the AQATP standard "after submission" of the swap to the DCO.[655] In adopting the AQATP standard, the

[650] 17 CFR 37.702(b)(1).
[651] 17 CFR 37.702(b)(2).
[652] 17 CFR 39.12(b)(7)(i)(A). The Commission notes that "transactions" refers to swaps submitted by a SEF or DCM, as well as futures and options on futures submitted by a DCM.
[653] 17 CFR 39.12(b)(7).
[654] 17 CFR 39.12(b)(7)(ii).
[655] 17 CFR 39.12(b)(7)(iii).

Commission noted that it intended for the requirement to track the evolving industry standard, based on technological developments.[656]

The Divisions subsequently issued the 2013 Staff STP Guidance to further clarify the application of "straight-through processing" obligations for swaps that apply to SEFs, DCMs, and DCOs under § 37.702(b), § 38.601(b),[657] and § 39.12(b)(7), respectively.[658] The Divisions stated that the standard for straight-through processing, *i.e.*, the "near instantaneous acceptance or rejection" of a transaction by a DCO, is critical to providing certainty of execution and clearing, which in turn would reduce costs and reduce risk.[659] To achieve that standard, the guidance expressed the view that SEFs, DCMs, and registered DCOs must facilitate swap transaction processing through several requirements. With respect to SEFs, the guidance expressed the view that a SEF must ensure that a clearing FCM has been identified in advance for each party on an order-by-order basis; and facilitate the mandatory pre-execution screening of orders by each clearing FCM for compliance with risk-based limits, *i.e.*, "pre-execution credit screening," in accordance with a clearing FCM's obligations under § 1.73.[660] The guidance also expressed the view that a DCO must meet a specific time frame, *i.e.*, ten seconds, to satisfy its obligation under the AQATP standard.[661]

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[656] Timing of Acceptance for Clearing Final Rule at 21285-86.
[657] Section 38.601(b) applies to DCMs and establishes processing and routing requirements that are analogous to § 37.702(b) for SEFs. 17 CFR 38.601.
[658] 2013 Staff STP Guidance at 2. The 2013 Staff STP Guidance also specified straight-through processing requirements for FCMs under § 1.74. *Id.* at 2-3. *See infra* note 660.
[659] 2013 Staff STP Guidance at 2.
[660] 2013 Staff STP Guidance at 3. Section 1.74 applies similar straight-through processing requirements to FCMs, including the requirement that a FCM to coordinate with any DCO to which it is a clearing member to establish systems that enable the FCM, or the DCO acting on its behalf, to accept or reject each trade submitted to the DCO for clearing as quickly as would be technologically practicable if fully automated systems were used. 17 CFR 1.74.
[661] 2013 Staff STP Guidance at 5.

a. "Prompt and Efficient" Standard and AQATP Standard

Based on data received by DCR, the 2013 Staff STP Guidance expressed the view that compliance with the AQATP standard under § 39.12(b)(7)(ii) means that a registered DCO must accept or reject such trades for clearing within ten seconds after submission to the DCO.[662] Given that existing § 37.702(b)(2) and § 38.601(b) require SEFs and DCMs, respectively, to coordinate with DCOs in processing transactions for clearing, the 2013 Staff STP Guidance accordingly expressed the view that a SEF or DCM must route swaps to a DCO in compliance with the AQATP standard.[663]

The 2013 Staff STP Guidance also expressed the view that the AQATP standard applies to swap transactions that are routed to a DCO through a SEF's or DCM's use of a post-execution, third-party manual affirmation hub ("affirmation hub").[664] The Divisions further explained in a follow-up letter to the 2013 Staff STP Guidance (the "2015 Supplementary Staff Letter") that a SEF or DCM may send executed trade terms to such a hub to be manually affirmed by the counterparties prior to routing the transaction to the DCO for clearing.[665] According to market participants, this process may take minutes or hours, or occasionally may occur overnight.[666] The Divisions acknowledged that such affirmation hubs can promote prompt and efficient processing by helping counterparties identify and correct potential errors in a transaction's terms prior to routing to a DCO for clearing.[667] The Divisions also stated their belief, however, that the Commission

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[662] *Id*.
[663] *Id*. at 4.
[664] *Id*.
[665] Straight Through Processing and Affirmation of SEF Cleared Swaps, CFTC Letter No. 15-67 (Dec. 21, 2015) ("2015 Supplementary Staff Letter").
[666] *Id*. at 2.
[667] The Divisions noted that if an erroneous swap is cleared immediately after execution, the counterparties would have to address the errors after clearing, which may be difficult and costly. Additionally,

intended the AQATP standard to account for the need to refine and reduce errors to facilitate prompt and efficient processing.[668]

The 2015 Supplementary Staff Letter expressed the view that the AQATP standard for transactions routed to an affirmation hub would be satisfied if the transactions were routed to and received by the relevant DCO no more than ten minutes after execution.[669] In establishing this standard, the Divisions noted the interaction between a DCO's requirements under § 39.12(b)(7) with a SEF's or a DCM's requirements under § 37.702(b) and § 38.601(b), respectively.[670] Accordingly, based on the interaction between these respective requirements, the staff letter expressed the view that a SEF or DCM is also obligated under the AQATP standard—at least to the extent that the SEF uses a third-party affirmation hub acting as its agent—to ensure that the DCO receives the transaction no later than ten minutes after execution.[671] The Divisions stated, however, that they would continue to review this standard and take further action as necessary, based in part on industry developments.[672]

b. Proposed Approach to Straight-Through Processing

The Commission notes that the Divisions provided views regarding several aspects of straight-through processing in the 2013 Staff STP Guidance and the 2015

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counterparties may have to bear significant margin costs until an error is corrected because the swap may have been cleared at the wrong DCO; the swap terms may contain the wrong counterparty; or the swap may contain incorrect economic terms. *Id*.

[668] *Id*. at 3. The Commission previously stated that the use of an affirmation hub for routing a swap to a DCO for clearing would be permissible, provided that such routing complies with § 37.702(b) and the trade is processed in accordance with § 39.12, among other related Commission requirements. SEF Core Principles Final Rule at 33535.

[669] 2015 Supplementary Staff Letter at 3.

[670] *Id*. at 1-2.

[671] *Id*. at 3.

[672] *Id*. The Commission also previously stated that it would monitor the implementation of the AQATP standard and propose amendments in the future. Timing of Acceptance for Clearing Final Rule at 21286.

Supplementary Staff Letter. The Commission also understands that certain aspects of the guidance and staff letter may be unclear when read in conjunction with existing regulations. Therefore, the Commission seeks to provide clarity under the proposed regulatory framework with respect to the straight-through processing requirements for SEFs and DCOs through the proposed clarifications and amendments described below.[673]

(1) § 37.702(b)(1) and § 39.12(b)(7)(i)(A)—"Prompt, Efficient, and Accurate" Standard

The Commission proposes several amendments to streamline and align the straight-through processing requirements between SEFs and DCOs.[674] First, the Commission proposes to eliminate the duplicative requirement under existing § 37.702(b)(1) that requires SEFs to have the capacity to route transactions to the DCO for purposes of clearing. Accordingly, the Commission proposes to renumber existing § 37.702(b)(2) to a new proposed § 37.702(b)(1) and revise the existing "prompt and efficient" standard for SEFs to "prompt, efficient, and *accurate*" to conform to the requirement for DCOs (emphasis added). The Commission notes that this proposed amendment would establish the same requirement for both SEFs and DCOs, respectively, to coordinate with one another to facilitate the processing of swaps for clearing. To clarify the functions that are subject to straight-through processing requirements, the

[673] Notwithstanding the fact that § 39.12(b)(7), the 2013 Staff STP Guidance, and the 2015 Supplementary Letter also apply to DCMs as described above, the scope of this proposed rule does not include a similar proposed amendment to § 38.601(b) for DCMs that submit (i) futures and options on futures; and (ii) swaps to a DCO for clearing. The Commission may propose a conforming amendment in a future proposed rulemaking that applies to DCMs. As discussed herein, however, a DCO's obligations under the proposed amendments to § 39.12(b)(7) would apply equally to futures and options on futures and swaps executed on a SEF or DCM, or executed pursuant to the rules of a DCM. *See supra* note 640.

[674] To the extent that the Commission is addressing the proposed amendments to § 39.12(b)(7)(i)(A) in conjunction with the proposed amendments to § 37.702(b)(1), the discussion focuses on swaps routed by a SEF to a DCO for clearing. *See also supra* note 673 (noting that the Commission is not proposing corresponding amendments to § 38.601(b), which establishes analogous processing and routing requirements for DCMs, at this time). The proposed amendments to § 39.12(b)(7)(i)(A), however, would also apply to those transactions, including swaps, futures, and options on futures submitted by a DCM to a DCO for clearing.

Commission also proposes to specify under proposed § 37.702(b)(1) that this standard applies to the "routing" of swaps by a SEF to a DCO for clearing.[675] Further, the Commission proposes a non-substantive amendment to specify that a SEF's obligation to coordinate with DCOs should be in accordance with the DCOs' obligations under § 39.12(b)(7)(i)(A).[676]

The Commission also notes that some uncertainty exists about the interaction between the "prompt, efficient, and accurate" standard[677] and the AQATP standard for registered DCOs, based in part on the 2013 Staff STP Guidance and 2015 Supplementary Staff Letter. Accordingly, the Commission proposes that the "prompt, efficient, and accurate" standard applies to (i) each SEF, under proposed § 37.702(b)(1), with respect to the processing and routing of transactions to a DCO; and (ii) each registered DCO, under § 39.12(b)(7)(i)(A), with respect to any coordination needed to assist a SEF with implementing any procedures or systems to facilitate the processing and routing of swaps to the DCO. For the avoidance of doubt, the Commission proposes that the AQATP standard does not apply to the processing and routing of transactions. As discussed further below, the Commission proposes that the AQATP standard set forth under §§ 39.12(b)(7)(ii)-(iii) specifically applies to a registered DCO's acceptance or rejection of a

[675] The Commission acknowledges that the term "processing" in the existing requirement may encompass the routing of swaps from a SEF to a DCO, but proposes to amend the language to include "routing" for greater clarity and the avoidance of doubt.
[676] The current language under § 37.702(b)(2) requires SEFs to work with each DCO in accordance with the requirements of § 39.12(b)(7). The Commission's proposal would amend the requirement to specify § 39.12(b)(7)(i)(A), which imposes a corresponding obligation on DCOs to work with SEFs to develop rules to facilitate the "prompt, efficient, and accurate processing" of transactions.
[677] As noted above, the Commission is proposing to amend the existing standard for SEFs under § 37.702(b)(2) (renumbered as § 37.702(b)(1)) to "prompt, efficient, and accurate."

transaction from a SEF or DCM, *i.e.*, when the DCO receives the transaction.[678] The Commission believes that this proposed approach establishes a requirement for a SEF that addresses its functions—to process and route swaps to the DCO—that is appropriately distinct from a DCO's functions—to accept or reject a swap from clearing upon submission of the swap to the DCO, among other things. For further clarity, the Commission specifies that the SEF's requirement to process and route swaps in a prompt, efficient, and accurate manner also includes the SEF's transmission and delivery of the swap to the DCO; accordingly, the "submission" of a swap by the SEF to the DCO is deemed to have occurred upon the DCO's receipt of the swap.

In particular, the Commission proposes that the "prompt, efficient, and accurate" standard also applies to the processing and routing of swaps from a SEF to a DCO via affirmation hubs.[679] The Commission acknowledges the beneficial role of these mechanisms and intends to facilitate their use to reduce error rates and related costs prior to routing a swap to the DCO. Instead of the ten-minute time frame set forth in the 2015 Supplementary Staff Letter, however, the Commission proposes that the "prompt, efficient, and accurate" standard would allow swaps subject to affirmation via third-party hubs to be processed and routed to the DCO in a manner that accounts for existing market practices and technology, as well as market conditions at the time of execution.

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[678] The Commission notes that it is proposing amendments to streamline § 39.12(b)(7)(ii)-(iii), as discussed below. *See infra* Section XII.B.2.b.(2)—§ 39.12(b)(7)(ii)—AQATP Standard for Registered DCOs.

[679] The Commission notes that the 2015 Supplementary Staff Letter expresses the view that the AQATP standard applies to a SEF's use of affirmation hubs to process and route trades to a DCO. 2015 Supplementary Staff Letter at 3. As discussed further below, however, the Commission proposes that the AQATP standard applies to a registered DCO after submission of the trade to the DCO for clearing. Proposed § 37.702(b)(1) and § 39.12(b)(7)(i)(A), as amended, would require SEFs and DCOs to respectively coordinate and work together to effect the "prompt, efficient, and accurate" standard.

Based on the Divisions' experience with the ten-minute time frame, the Commission believes that a qualitative interpretation of "prompt, efficient, and accurate" is more appropriate than imposing a specific time standard upon SEFs for processing and routing transactions to the DCO. The Commission 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 time frame when using manual affirmation hubs. Further, the Commission believes that maintaining a specific time standard would be inconsistent with the proposed expansion of the trade execution requirement and the availability of flexible execution methods under the proposed framework. In particular, the expansion of the trade execution requirement will lead to the trading of a broader array of swaps on SEFs, many of which are likely more complex in nature and require more time for affirmation to occur. The inability to comply with a specific time frame could hinder the anticipated growth of trading in additional products on SEFs and impede the ability to utilize flexible means of execution. Further, a specific time frame may also limit the use—and therefore the benefits—of affirmation hubs. Therefore, the Commission believes that a rigid time frame for processing and routing trades from a SEF to a DCO is inappropriate under the proposed regulatory framework.

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. The Commission, however, expects that market and technological developments will enable processing and routing through affirmation hubs to occur in increasingly shorter time intervals. Further, the Commission notes that under the qualitative standard, transactions that can be reasonably

affirmed on a fully automatic basis after execution should be affirmed in that manner.[680] In such cases, the Commission believes that "prompt, efficient, and accurate" processing and routing would occur in a much shorter time frame, *e.g.*, less than ten minutes.

Where affirmation hubs are not utilized, the Commission believes that the "prompt, efficient, and accurate" standard would also result in a trade being processed and routed from a SEF to a DCO in a much shorter time frame. As noted above, that exact time frame would depend on swap market practices and technology, as well as market conditions at the time of execution. The Commission expects that the industry will continue to reduce time frames for transaction processing and routing to a DCO. The Commission emphasizes that it will continue to monitor time frames and industry developments with respect to transaction processing to ensure that SEFs and DCOs facilitate prompt, efficient, and accurate transaction processing and routing.

(2) § 39.12(b)(7)(ii)—AQATP Standard for Registered DCOs

In addition to specifying that the "prompt, efficient, and accurate" standard applies to SEFs with respect to processing and routing transactions, the Commission proposes to clarify that the AQATP standard applies to a DCO's acceptance or rejection of a transaction for clearing upon submission to the DCO, *i.e.*, when the DCO receives the transaction. The Commission also proposes to delete existing § 39.12(b)(7)(iii) as unnecessary.[681] The Commission notes that this approach is generally consistent with the 2013 Staff STP Guidance with respect to swaps, but this proposal specifies that the AQATP standard applies exclusively to the DCO and is triggered upon submission of the

[680] The Commission notes that this statement is consistent with the views expressed by the Divisions in the 2015 Supplementary Staff Letter. *Id.* at 3.
[681] As discussed below, the Commission notes that it is proposing amendments to streamline §§ 39.12(b)(7)(ii)-(iii) into a single provision.

agreement, contract, or transaction[682] to the DCO from a SEF, a DCM, or counterparties that submit swaps directly to the DCO for clearing. Therefore, a DCO's ability to comply with the AQATP standard for accepting or rejecting a trade is distinct from the length of time it takes an entity such as a SEF or DCM to process and route a trade to the DCO.[683] As discussed below, the DCO's obligation to comply with the AQATP standard is also independent from the method of execution or venue by which counterparties execute an agreement, contract, or transaction, given that the DCO's obligation to accept or reject that executed agreement, contract, or transaction only begins from the point after which it has been submitted to the DCO, *i.e.*, when the DCO receives the transaction. If a SEF, DCM, or counterparty to a bilaterally-executed agreement, contract, or transaction delays the submission of a cleared swap to a DCO for clearing, then it would not impact the DCO's obligation to accept or reject on an AQATP basis after it has received the transaction.

In conjunction with clarifying that the AQATP standard applies to registered DCOs, the Commission proposes to streamline and consolidate §§ 39.12(b)(7)(ii)-(iii) to establish one AQATP standard for registered DCOs under a new proposed § 39.12(b)(7)(ii) for all agreements, contracts, and transactions, regardless of whether they

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[682] The Commission notes that both CEA section 1a(15), which defines a DCO, and § 39.12(b)(1), which establishes product eligibility for DCOs, refer to "agreements, contracts, or transactions." Similarly, CEA section 1a(47), which defines a "swap," also refers to an "agreement, contract, or transaction." To conform to these provisions, the Commission proposes non-substantive amendments to §§ 39.12(b)(7)(i)-(ii) to apply to all "agreements, contracts, and transactions." The Commission notes that this conforming change does not alter the substantive scope of a DCO's obligations under proposed § 39.12(b)(7). Core Principle 7 and its implementing regulations, however, refer to "swaps" and "transactions" interchangeably without intending to impose a substantive distinction on a SEF's obligations. For example, § 37.700 refers to "swaps" while §§ 37.701-702 refer to "transactions," but the Commission's use of "transaction" is intended to refer generally to *transactions of swaps* on the SEF and not intended to differentiate among agreements, contracts, or transactions that constitute swaps (emphasis added).

[683] Under proposed § 37.702(b)(1), a SEF's obligation to submit swaps for clearing to the DCO includes the SEF's obligation to process and route swaps and is subject to the prompt, efficient, and accurate standard.

(i) are executed competitively or non-competitively; (ii) are executed on or pursuant to the rules of a SEF or DCM; or (iii) are swaps, futures contracts, or options on futures contracts.[684] The Commission also proposes that this AQATP standard would apply to all such agreements, contracts, and transactions *after submission* to the DCO, rather than *after execution*, as currently required for competitively executed transactions on or subject to the rules of a DCM or SEF under existing § 39.12(b)(7)(ii) (emphasis added). The Commission believes that a DCO should be able to accept or reject a trade for clearing in a similar AQATP standard time frame after receiving the transaction, regardless of the manner of execution—competitive or non-competitive—or whether the trade has been processed and routed by a SEF or DCM, a third-party affirmation hub, or the counterparties themselves on a direct basis. As applied to swaps, a DCO would be subject to the same AQATP standard, regardless of whether the swap is subject to the trade execution requirement or otherwise voluntarily cleared.

The AQATP standard reflects the Commission's belief that acceptance or rejection for clearing in close to real time is crucial both for effective risk management and for the efficient operation of trading venues.[685] While the Commission did not prescribe a rigid time frame for acceptance or rejection for clearing when adopting existing §§ 39.12(b)(7)(ii)-(iii), the Commission did note that the performance standard would

[684] Based on this consolidation, the Commission proposes to eliminate the existing language of § 39.12(b)(7)(iii).

[685] *See* Timing of Acceptance for Clearing Final Rule at 21285. In recognizing that some trading venues may not be fully automated, the Commission stated that the use of manual steps would be permitted, as long as the process could operate within the same timeframes as the automated systems. *Id*. The Commission also noted that the timeframe for acceptance by clearing FCMs (outlined under § 1.74) and DCOs is stricter than the timeframes for submission by SDs and MSPs. *Id*. The Commission noted that "where execution is bilateral and clearing is voluntary, the delay between execution and submission to clearing is, of necessity, within the discretion of the parties to some degree. The Commission believes, however, that prudent risk management dictates that once a trade has been submitted to a clearing member or a DCO, the clearing member or DCO must accept or reject it as quickly as possible." *Id*.

require action in a matter of milliseconds or seconds, or at most, a few minutes, not hours or days.[686] The Commission notes that Commission staff continues to monitor reports from DCOs about their ability to accept or reject trades for clearing in a timely matter. To date, the Commission has not been made aware of significant delays or difficulties meeting the ten-second standard articulated in the 2013 Staff STP Guidance. Accordingly, as DCOs have been able to accept or reject trades within ten seconds after submission by the SEF for the past five years, the Commission proposes that this standard continue for registered DCOs under the AQATP standard under proposed § 39.12(b)(7)(ii).

(3) §§ 37.702(b)(2)-(3)—Pre-Execution Credit Screening

With respect to the pre-execution credit screening of orders for compliance with risk-based limits, the 2013 Staff STP Guidance expressed the view that (i) a clearing FCM must be identified in advance for each counterparty on an order-by-order basis for trades intended for clearing; and (ii) a SEF must facilitate pre-execution screening by each clearing FCM in accordance with § 1.73 on an order-by-order basis.[687] To facilitate such screening in practice, SEFs have provided their respective clearing FCMs with a "pre-trade credit screening" functionality that allows them to screen orders executed on the facility.[688] The Divisions have viewed pre-trade credit screening functionalities as

[686] *See id*. For example, IRS were executed and cleared with an average time of 1.9 seconds on CME platforms in early 2012. *Id*.
[687] 2013 Staff STP Guidance at 3.
[688] SEFs have been able to facilitate the use of their pre-trade credit screening functionalities by clearing FCMs for swap block trades pursuant to time-limited no-action relief provided by Commission staff, which allows market participants to execute swap block trades on the SEF that are intended to be cleared. *See infra* Section XXII.A.—§ 43.2—Definition—Block Trade; § 37.203(a)—Elimination of Block Trade Exception to Pre-Arranged Trading. As discussed below, the Commission is proposing to amend the definition of "block trade" under § 43.2 to continue to allow clearing FCMs to comply with § 1.73 by using pre-execution credit screenings on the SEF.

beneficial to facilitate "prompt and efficient" transaction processing in accordance with straight-through processing requirements.[689]

With respect to pre-execution screening by each clearing FCM, the 2013 Staff STP Guidance viewed §§ 1.73(a)(2)(i)-(ii) as requiring a clearing FCM to conduct pre-execution screening of orders for execution on a SEF or DCM for compliance with risk-based limits.[690] The 2013 Staff STP Guidance further expressed the view that § 1.73 provides FCMs with the ability to reject orders before execution; as a result, orders that have satisfied clearing FCMs' pre-execution limits are deemed accepted for clearing and thereby subject to a guarantee by the clearing FCM upon execution.[691] Accordingly, the 2013 Staff STP Guidance expressed the view that a clearing FCM may not reject a trade that has passed its pre-execution credit screening filter because this would violate the

[689] 2013 Staff STP Guidance at 2-3. With respect to establishing pre-execution credit screenings, the 2013 Staff STP Guidance expressed the view that SEFs and FCMs should work together to effect the risk-based limits to ensure straight-through processing of swaps. *Id*.

[690] 2013 Staff STP Guidance at 1-2. Section 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 CFR 1.73(a)(1). Similarly, § 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). Section 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 CFR 1.73(a)(2)(ii). Section 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 CFR 1.73(a)(2)(iii). The Commission notes that paragraph (a)(2)(i)-(ii) apply to "orders," while paragraph (a)(2)(iii) applies to "transactions." In addition, paragraph (a)(2)(iii) is limited to transactions executed "bilaterally." In contrast, the Commission stated in the final rule adopting § 1.73 that paragraph (a)(2)(i) refers to "automated trading systems," such as CME's Globex, while paragraph (a)(2)(ii) includes "non-automated markets such as open outcry exchanges or voice brokers." *See* Timing of Acceptance for Clearing Final Rule at 21288. As the Commission affirmatively included voice brokers in connection with paragraph (a)(2)(ii), transactions executed through voice brokers do not fall under paragraph (a)(2)(iii). Accordingly, § 1.73(a)(2)(iii) only applies where two parties transact directly with one another, outside of a SEF or DCM.

[691] 2013 Staff STP Guidance at 3.

AQATP standard, under which trades should be accepted or rejected for clearing as soon as technologically practicable as if fully automated systems were used.[692]

With respect to the requirement that a clearing FCM must be identified in advance for trades intended for clearing, the 2013 Staff STP Guidance noted that the Commission has already required parties to have a clearing arrangement in place with a clearing FCM in advance of execution and that in cases where more than one DCO offered clearing services, the parties would also need to specify in advance where the trade should be sent for clearing.[693] Accordingly, the 2013 Staff STP Guidance expressed the view that no trade intended for clearing may be executed on or subject to the rules of a SEF unless a clearing FCM was identified in advance for each party on an order-by-order basis.[694]

In conjunction with the Commission's proposal to clarify and amend straight-through processing requirements, the Commission proposes to adopt these two obligations—that each market participant identify a clearing member in advance and that a SEF facilitate pre-execution credit screening—under §§ 37.702(b)(2)-(3), respectively. The Commission believes that the proposed requirements are consistent with the proposed approach to straight-through processing as described above. In particular, the use of pre-execution credit screening functionalities help SEFs and DCOs to both meet their respective straight-through processing requirements by reducing the number of transactions that are rejected from clearing by a DCO. The Commission notes that pre-

[692] *Id*.
[693] *See* Timing of Acceptance for Clearing Final Rule at 21284.
[694] 2013 Staff STP Guidance at 3.

execution credit screening has become a fundamental component of the swaps clearing infrastructure.[695]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.702 and §§ 39.12(b)(7)(i)-(ii). In particular, the Commission requests comment on the following questions:

(71) The proposed "prompt, efficient, and accurate" standard, as applied to trades submitted to a DCO for clearing via third-party affirmation hubs would take into consideration evolving swap market practices and technology, as well as current market conditions at the time of execution. Is the proposed approach appropriate? Why or why not? Does the approach provide sufficient guidance regarding the standard?

(72) Is the distinction sufficiently clear between (i) the submission and related processing and routing of a swap by a SEF to a DCO under the "prompt, efficient, and accurate" standard and (ii) the DCO's decision to accept or not accept a swap under the AQATP standard? Does the approach provide sufficient clarity regarding the distinct, but interrelated, roles of SEFs and DCOs? Why or why not?

(73) The 2013 Staff STP Guidance and 2015 Supplementary Staff Letter apply to "intended to be cleared swaps," including swaps subject to the clearing requirement and swaps that are voluntarily cleared by the counterparties. Should these requirements apply to voluntarily-cleared swaps?

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[695] As noted above, the 2013 Staff STP Guidance expressed the view that a clearing FCM may not reject a trade that has passed its pre-execution credit screening filter because such a rejection would violate the AQATP requirement. 2013 Staff STP Guidance at 3. The Commission expects that this practice which is beneficial to market participants by providing trade certainty in as minimal a time delay as possible, will continue. The screening of transactions by a clearing FCM does not, however, prevent the DCO from rejecting a swap for clearing.

(74) Proposed §§ 39.12(b)(7)(ii) would eliminate the distinction when applying the AQATP standard between (i) trades that are executed competitively and (ii) trades that are not executed competitively or are executed away from a SEF or DCM. Is the proposed approach appropriate? Why or why not?

(75) Proposed § 39.12(b)(7)(ii) would apply the AQATP standard after submission to the DCO, rather than after execution. Is the proposed approach appropriate? Why or why not?

(76) Proposed § 39.12(b)(7)(ii) would apply the AQATP standard after submission to the DCO, rather than after execution, for all swaps, futures, and options on futures submitted for clearing. Proposed § 39.12(b)(7)(ii) would apply to all agreements, contracts, and transactions submitted to the DCO for clearing. Is the proposed approach appropriate? Why or why not?

(77) Should a DCO have the flexibility to have additional time to address instances in which a clearing member has insufficient credit on deposit for the DCO to accept an agreement, contract, or transaction for clearing? If so, should the Commission require the DCO to have rules and procedures for the DCO's process to address those instances?

3. Applicability of § 37.702(b) to SEFs that Do Not Facilitate Clearing

The Commission proposes to amend the introductory language under proposed § 37.702(b) to specify that its requirements apply only to those transactions routed through a SEF to a registered DCO for clearing rather than, as currently required, to any transaction cleared by a DCO. While not meant to reflect a substantive change, the Commission believes that this amendment would clarify that the requirements of § 37.702(b) do not apply to a SEF that does not facilitate the clearing of applicable listed

swaps that are not subject to the clearing requirement. The requirements would apply, however, if the SEF offers to facilitate the clearing of such swaps.[696] Therefore, to the extent counterparties choose to voluntary clear such transactions through a SEF that offers to facilitate clearing for such swaps, § 37.702(b) would then apply to the SEF.

C. § 37.703—Monitoring for Financial Soundness

Section 37.703(a) requires a SEF to monitor its members to ensure that they continue to qualify as an ECP pursuant to CEA section 1a(18).[697] The Commission proposes a non-substantive amendment to proposed § 37.703 to replace the term "member" with "market participant." The Commission notes that its proposed definition of "market participant" under § 37.2(b) would capture the universe of persons and entities that participate on SEFs and would be subject to minimum financial requirements, including a SEF's members.[698]

XIII. Part 37—Subpart I: Core Principle 8 (Emergency Authority)

Core Principle 8 requires a SEF to adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, as is necessary

[696] The Commission notes that certain SEFs, such as those that facilitate trading in FX non-deliverable forward products, do not hold themselves out as offering services to facilitate clearing with a DCO. As a result, the straight-through processing requirements, including the "prompt, efficient, and accurate" standard and pre-execution credit screening requirements, would not apply to such SEFs, even if the counterparties subsequently voluntarily clear a swap away from the SEF. The Commission notes that a SEF could offer to facilitate the clearing of certain listed swaps, to which § 37.702(b)'s requirements would apply, while not offering to facilitate the clearing of other of its listed swaps, to which § 37.702(b)'s requirements would not apply. The Commission notes, however, that the requirements of § 39.12(b)(7)(ii) apply to all agreements, contracts, and transactions submitted to a DCO for clearing, regardless of whether a particular swap is subject to the clearing requirement pursuant to section 2(h)(1) of the CEA.
[697] 17 CFR 37.703.
[698] *See supra* Section IV.B.2.—§ 37.2(b)—Definition of "Market Participant." The Commission notes that CEA section 2(e) limits swaps trading to ECPs, as defined by section 1a(18) of the Act. 7 U.S.C. 2(e).

and appropriate, including the authority to liquidate or transfer open positions in any swap or to suspend or curtail trading in a swap.[699]

A. § 37.801—Additional Sources for Compliance

Section 37.801 further implements Core Principle 8 by referring SEFs to associated guidance and/or acceptable practices set forth in Appendix B to comply with § 37.800.[700] The guidance to Core Principle 8 specifies, among other things, the types of emergency actions that a SEF should take in particular to address perceived market threats, and states that the SEF should promptly notify the Commission of its exercise of emergency action.

The Commission proposes to amend the guidance to Core Principle 8 by eliminating references to certain emergency actions that the Commission understands a SEF, as a matter of general market practice, would not be able to adopt, including imposing special margin requirements and transferring customer contracts and the margin. Since SEFs do not own the contracts, they do not have the ability to impose margin or transfer contracts. Additionally, the Commission proposes several non-substantive amendments to the guidance.[701]

Request for Comment

The Commission requests comment on all aspects of the proposed associated guidance to Core Principle 8 in Appendix B.

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[699] 7 U.S.C. 7b-3(f)(8). The Commission codified Core Principle 8 under § 37.800. 17 CFR 37.800.
[700] 17 CFR 37.801.
[701] For example, the Commission proposes to eliminate the reference to § 40.9, as this section is currently reserved by the Commission.

XIV. Part 37—Subpart J: Core Principle 9 (Timely Publication of Trading Information)

The Commission is not proposing any amendments to the regulations under Core Principle 9.

XV. Part 37—Subpart K: Core Principle 10 (Recordkeeping and Reporting)

Core Principle 10 requires a SEF, among other things, to maintain records of all activities related to the business of the facility, including a complete audit trail, in a form and manner acceptable to the Commission for a period of five years.[702] Section 37.1001 implements this requirement by requiring a SEF to maintain an audit trail for all swaps executed on or subject to the rules of the SEF, among other types of records. The Commission proposes a non-substantive amendment to § 37.1001 to eliminate "or subject to the rules of" from the existing requirement. This proposed amendment confirms to conforms to the proposed amendment to the "block trade" definition under § 43.2, discussed further below.[703]

XVI. Part 37—Subpart L: Core Principle 11 (Antitrust Considerations)

The Commission is not proposing any amendments to the regulations under Core Principle 11.

XVII. Part 37—Subpart M: Core Principle 12 (Conflicts of Interest)

The Commission has not adopted any regulations under Core Principle 12 and is not proposing any regulations at this time.

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[702] 7 U.S.C. 7b-3(f)(10). The Commission codified Core Principle 10 under § 37.1000. 17 CFR 37.1000.
[703] *See infra* Section XXII.—Part 43—§ 43.2—Definition of "Block Trade."

XVIII. Part 37—Subpart N: Core Principle 13 (Financial Resources)

Core Principle 13 requires a SEF to have adequate financial, operational, and managerial resources to discharge each of its responsibilities.[704] To achieve financial resource adequacy, a SEF must maintain financial resources sufficient to cover its operating costs for a period of at least one year, calculated on a rolling basis.[705] The Commission implemented Core Principle 13 by adopting §§ 37.1301-1307 to specify (i) the eligible types of financial resources that may be counted toward compliance (§ 37.1302); (ii) the computation of projected operating costs (existing § 37.1303); (iii) valuation requirements (existing § 37.1304); (iv) a liquidity requirement for those financial resources that is equal to six months of a SEF's operating costs (existing § 37.1305); and (v) reporting obligations to the Commission (§ 37.1306).

The Commission implemented these regulations to ensure a SEF's financial strength so that it could discharge its responsibilities, ensure market continuity, and withstand unpredictable market events.[706] During the part 37 implementation, the Commission has continued to receive feedback from several SEFs that the existing requirements impose impractical financial and operating burdens.[707] Among other things, these SEFs have contended that the amount of financial resources that a SEF is required to maintain has proven to be unnecessary and confines resources that could otherwise be allocated toward operational growth and further innovation. To address some of these

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[704] 7 U.S.C. 7b-3(f)(13). The Commission codified Core Principle 13 under § 37.1300. 17 CFR 37.1300.
[705] *Id*.
[706] When the Commission adopted § 37.1301(a), it recognized that a "SEF's financial strength is vital to ensure that the SEF can discharge its core principle responsibilities . . . ." SEF Core Principles Final Rule at 33538-39.
[707] *See* WMBAA, Re: Project KISS at 5 (Sept. 29, 2017) ("2017 WMBAA Letter").

concerns, Commission staff issued two guidance documents regarding the calculation of operating costs.[708]

Based on its experience with overseeing the financial resources requirements, the Commission proposes several amendments to the Core Principle 13 regulations that would achieve a better balance between ensuring SEF financial stability, promoting SEF growth and innovation, and reducing unnecessary costs. The Commission's proposed amendments, which include the addition of acceptable practices to Core Principle 13 in Appendix B, are based in part on existing Commission staff guidance, feedback received from SEFs, and Commission experience gained from ongoing oversight. As discussed in detail further below, the Commission's proposed changes consist of (i) clarification of the scope of operating costs that a SEF must cover with adequate financial resources; (ii) acceptable practices, based on existing Commission staff guidance, that address the discretion that a SEF has when calculating projected operating costs pursuant to proposed § 37.1304; (iii) amendments to the existing six-month liquidity requirement for financial resources held by a SEF; and (iv) streamlined requirements with respect to financial reports filed with the Commission. The proposed changes also would include non-substantive amendments to clarify certain existing requirements, including the renumbering of several provisions to present the requirements in a more cohesive manner.

[708] CFTC Letter No. 17-25; CFTC Letter No. 15-26, Division of Market Oversight Guidance on Calculating Projected Operating Costs by Swap Execution Facilities (Apr. 23, 2015) ("CFTC Letter No. 15-26").

A. § 37.1301—General Requirements

1. § 37.1301(a)

Existing § 37.1301(a) requires a SEF to maintain financial resources that are sufficient to enable it *to perform its functions in compliance* with the SEF core principles set forth in section 5h of the Act (emphasis added).[709] Existing § 37.1301(c) relates to this requirement and specifies that a SEF's financial resources are sufficient if their value is "at least equal to" the SEF's operating costs for a one-year period, on a rolling basis.[710]

Certain SEFs have stated that existing § 37.1301(a), when read in conjunction with § existing 37.1301(c), can be construed to state that operational costs incurred for functions that are not germane to discharging SEF core principle responsibilities must be included in a financial resources calculation. According to those SEFs, requiring those costs to be included would require a SEF to allocate additional resources to comply with the requirement, which would hinder its ability to allocate that capital to operational growth and innovation, thereby creating unnecessary burdens.[711]

The Commission proposes to consolidate the requirement under existing § 37.1301(c) into a new proposed § 37.1301(a) and adopt several amendments. First, the Commission proposes to amend the types of operating costs that must be included in a SEF's financial resources determination. As proposed, a SEF would be required to maintain adequate financial resources to cover the operating costs that a SEF needs to "comply" with the SEF core principles and any applicable Commission regulations, rather than "perform its functions in compliance with" the core principles. For example,

[709] 17 CFR 37.1301(a).
[710] 17 CFR 37.1301(c).
[711] *See* 2017 WMBAA Letter at 6 (stating that the financial resource requirements should focus on fixed costs required for compliance, rather than variable costs and staff-related costs that are not essential).

under the current requirement, a SEF must maintain financial resources to continue to afford all of its existing activities (for example, activities such as product research or business development), even if such activities are not mandated by any core principle or regulatory requirement. Under the proposed amendment, a SEF would not need to include costs that are not necessary to comply with the SEF core principles and any applicable Commission regulations when calculating its operating costs.

The Commission believes that the proposed regulation represents a better and more balanced regulatory approach to implementing the Core Principle 13 requirements. Some SEF operational costs may not be necessary for discharging core principle and regulatory responsibilities, and therefore, should not be included when calculating a SEF's financial resources. Rather than require a SEF to allocate capital to account for such operating costs, the proposed amendment permits SEFs to allocate their capital to other areas, thereby furthering the goal of promoting SEF growth and innovation.[712] Therefore, proposed § 37.1301(a) would achieve a better balance between ensuring that a SEF is financially stable, while also providing the SEF with greater discretion to allocate its limited resources.[713] Further, the proposed amendment would remove a potential

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[712] The Commission understands that businesses, particularly nascent SEFs or SEFs developing new product lines, may incur relatively greater expenses in growing new business, compared to established SEFs or existing product lines. The Commission notes that under the proposed acceptable practices to Core Principle 13 in Appendix B, costs related to marketing and business development could be excluded from a SEF's projected operating cost calculations. *See infra* Section XVIII.D.1.—Acceptable Practices to Core Principle 13 in Appendix B.

[713] The Commission believes that the proposed financial resources obligations in the aggregate would better ensure market stability and the financial viability of SEFs. While proposed § 37.1301(a), along with the associated acceptable practices to Core Principle 13, may reduce the total amount of financial resources that a SEF must hold under § 37.1301(a), the Commission believes that such a change should not affect market integrity or the financial viability of SEFs. SEFs may include illiquid financial assets, as opposed to cash or cash equivalents, towards satisfying this requirement. The Commission, however, has also recognized that based on its experience, illiquid resources are less effective for ensuring an entity's viability, especially in times of market volatility where it may be difficult to timely sell illiquid assets or avoid a significant haircut on such assets. Consequently, the Commission believes that the amount of

barrier for new SEF entrants who may otherwise have been deterred by the relatively higher capital costs posed by a broad reading of the existing requirement.

The Commission also proposes several non-substantive changes to align proposed § 37.1301(a) more closely to Core Principle 13 requirements. To reflect the ongoing nature of the Core Principle 13 requirements, the Commission proposes to specify that a SEF must maintain adequate financial resources on an "ongoing basis." For consistency purposes with Core Principle 13, the Commission also proposes to replace the word "sufficient" with "adequate" and adopt additional language to specify that a SEF's financial resources will be considered "adequate" if their value "exceeds," rather than is "at least equal to," one year's worth of operating costs,[714] calculated on a rolling basis pursuant to the requirements for calculating such costs under proposed § 37.1304.[715]

Further, as noted above, the Commission proposes to adopt additional language to clarify that a SEF's financial resources must be adequate to comply with the SEF core principles and any "applicable Commission regulations." This amendment is intended to clarify that a SEF's resource adequacy obligation under proposed § 37.1301(a) also applies to any resources needed for complying with any additional regulatory

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liquid assets that a SEF must hold, which the Commission addresses under proposed § 37.1303, more effectively protects market integrity and the financial viability of SEFs. As discussed below, proposed § 37.1303 would explicitly require SEFs to maintain sufficient liquidity to cover their projected wind-down costs, with a minimum liquidity level in an amount no less than three months of projected operating costs where wind-down costs would be less than three months of projected operating costs. *See infra* Section XVIII.C.—§ 37.1303—Liquidity of Financial Resources.

[714] The Commission notes that it is also proposing a non-substantive amendment to refer to "projected operating costs" instead of "operating costs" to conform to existing § 37.1304 and § 37.1307, both of which refer to "projected operating costs." The Commission notes that during informal discussions with SEFs, Commission staff and SEFs have generally referred to SEFs' "projected" operating costs.

[715] As discussed below, proposed § 37.1304 (which the Commission proposes to renumber from existing § 37.1303) would continue to provide SEFs with reasonable discretion to calculate their projected operating costs to determine their financial resources requirement under § 37.1301(a) and their liquidity requirement under proposed § 37.1303.

requirements that the Commission has promulgated.[716] The Commission notes that SEFs are already complying with this clarification in practice.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1301(a). In particular, the Commission requests comment on the following question:

(78) To what extent does a requirement for SEFs to maintain financial resources to cover operational costs needed only for core principle and regulatory compliance reduce the financial resources that a SEF needs to maintain, as opposed to the current requirement? Would such a reduction, if any, impair the stability of either the SEF or the marketplace or the marketplace's confidence in the SEF market structure? Would this proposed change encourage innovation or new entrants into the marketplace?

2. § 37.1301(b)

Section 37.1301(b) requires a SEF that also operates as a DCO to also comply with the financial resource requirements for DCOs under § 39.11.[717] The Commission proposes to amend § 37.1301(b) to permit SEFs that also operate as DCOs to file a single financial report under § 39.11 that covers both the SEF and DCO.[718] This proposed approach would streamline and simplify the SEF financial report filing process set forth

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[716] The Commission notes that under Core Principle 1, a SEF must comply with any rule or regulation promulgated by the Commission pursuant to section 8a(5) of the Act. 17 CFR 37.100. For a SEF to discharge its responsibilities pursuant to Core Principle 13, which include complying with the SEF core principles, it is required to ensure that its financial resources are adequate to comply with those rules or regulations.

[717] 17 CFR 37.1301(b).

[718] *See* Derivatives Clearing Organization General Provisions and Core Principles, 76 FR 69334 (Nov. 8, 2011). Section 39.11 establishes requirements that a DCO will have to meet in order to comply with Core Principle B (Financial Resources) for DCOs. Core Principle B requires a DCO to possess financial resources that, at a minimum, exceed the total amount that would enable the DCO to meet its financial obligations to its clearing members, notwithstanding a default by a clearing member creating the largest financial exposure for the DCO in extreme but plausible conditions; and enable the DCO to cover its operating costs for a period of one year, as calculated on a rolling basis. 7 U.S.C. 7a-1(c)(2)(B)(ii).

under § 37.1306 and would also be consistent with the requirement for DCMs under § 38.1101(a)(3), which permits DCMs that operate as a DCO to file a single financial report.[719]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1301(b).

3. § 37.1301(c)

Given the proposed consolidation with § 37.1301(a), as described above, the Commission proposes to eliminate § 37.1301(c).

B. § 37.1302—Types of Financial Resources

Section 37.1302 sets forth the types of financial resources available to SEFs to satisfy the general financial resources requirement.[720] These resources include the SEF's own capital, meaning its assets minus liabilities calculated in accordance with U.S. generally accepted accounting principles; and any other financial resource deemed acceptable by the Commission.[721] The Commission proposes a non-substantive amendment to the current language by referring to generally accepted accounting principles "in the United States" to conform to the proposed amendments to § 37.1306 described further below.[722]

C. § 37.1303—Liquidity of Financial Resources[723]

Existing § 37.1305—"Liquidity of financial resources"—currently requires a SEF to maintain unencumbered, liquid financial assets, *i.e.*, cash and/or highly liquid

[719] 17 CFR 38.1101(a)(3).
[720] 17 CFR 37.1302.
[721] *Id.*
[722] *See infra* Section XVIII.F.1.—§ 37.1306(a).
[723] The Commission proposes to renumber existing § 37.1305 to § 37.1303 and amend the requirement as described.

securities, that are equal to at least six months of a SEF's operating costs.[724] If any portion of a SEF's financial resources is not sufficiently liquid, then a SEF is permitted to take into account a committed line of credit or similar facility to meet this requirement.[725] In adopting this rule, the Commission explained that the liquidity requirement is intended to ensure that a SEF could continue to operate and wind down its operations in an orderly fashion, if necessary.[726] The Commission also determined that a six-month period would be an accurate assessment of how long it would take for a SEF to wind down in an orderly manner, absent support for alternative time frames.[727]

The Commission proposes to amend the minimum amount of liquid financial resources that a SEF must include from six months of operating costs to the greater of (i) three months of a SEF's projected operating costs or (ii) the projected costs for a SEF to wind down its business, as determined by the SEF.[728] The Commission acknowledges that in the SEF Core Principles Final Rule, it rejected a three-month requirement based on a lack of cited support for a shorter time frame.[729] Based on its own past oversight of SEFs and DCMs and feedback from registered SEFs since the adoption of part 37, however, the Commission recognizes that the existing six-month requirement is not necessary. Rather, the Commission believes that the proposed requirement, which sets the minimum amount of unencumbered, liquid financial assets that a SEF must maintain

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[724] 17 CFR 37.1305.
[725] *Id*.
[726] The Commission stated that "the purpose of the liquidity requirement is so that all SEFs have liquid financial assets to allow them to continue to operate and to wind down in an orderly fashion" and that the Commission "view[ed] a six month period as appropriate for a wind-down period . . . ." SEF Core Principles Final Rule at 33540.
[727] *Id*.
[728] The Commission notes that it is proposing to specify "projected" operating costs for consistency with the cost calculation requirement under § 37.1304, discussed below. *See infra* Section XVIII.D.—§ 37.1304—Computation of Costs to Meet Financial Resources Requirement.
[729] SEF Core Principles Final Rule at 33540.

at three months of projected operating costs, would be sufficient to fulfill the goal of ensuring that a SEF can continue to operate and, if necessary, wind down its SEF operations in an orderly fashion.

Since the adoption of part 37, many SEFs have continued to maintain that a six-month minimum requirement is not necessary and that some of their liquid assets would be better applied toward growth initiatives.[730] Consistent with that feedback, the Commission has observed over time that the wind downs or ownership changes of several registered trading platforms, including SEFs and DCMs, have occurred within a much shorter time frame.[731] Based on this experience, the Commission acknowledges that a SEF may be better positioned to determine the amount of liquid financial resources needed to continue its operations and to conduct an orderly wind down. Under the proposed change, SEFs would be able to use the additional resources to invest in other areas of their operations. Accordingly, compared to the existing static six-month requirement, the Commission believes that a liquid resources requirement of the "greater of" either (i) three months of projected operating costs or (ii) projected wind-down costs would better ensure an orderly wind down for SEFs and ensure a more efficient allocation of resources for SEFs that require a wind-down period of less than six months. Further, by explicitly requiring a SEF to maintain sufficient liquidity to conduct an orderly wind down of its business, this approach would also better protect against the risk

[730] *See* 2017 WMBAA Letter at 5 (citing argument that a shorter liquidity requirement would allow for a SEF to allocate capital for innovation).

[731] For example, the Commission notes that the DCM Green Exchange LLC had its designation vacated and ceased operations. Similarly, the DCM Kansas City Board of Trade was acquired by CME Group and had its designation vacated; it ultimately ceased operations. Likewise, Javelin SEF, LLC was acquired by Bats Global Markets, Inc., which in turn was subsequently acquired by CBOE SEF, LLC. In each case, the Commission observed a relatively efficient process.

of failure in the unlikely event that a SEF would require a wind-down period of longer than six months.

The Commission also proposes a non-substantive amendment to clarify that if a SEF has a deficiency in satisfying this requirement, then it may overcome that deficiency by obtaining a committed line of credit or similar facility in an amount at least equal to that deficiency.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1303. In particular, the Commission requests responses to the questions below.

(79) Is the Commission's proposed requirement for a SEF to have liquid assets equal to the greater of either three months of projected operating costs or projected wind-down costs an appropriate approach? If not, then what should the Commission adopt as a more appropriate liquidity requirement and why? Would a SEF's wind-down period generally be longer or shorter than three months?

(80) Would the change to the liquidity requirement under proposed § 37.1303 impair the stability of either the SEF or the marketplace? Would proposed § 37.1303 encourage innovation or new entrants into the marketplace?

D. § 37.1304—Computation of Costs to Meet Financial Resources Requirement[732]

Existing § 37.1303—"Computation of projected operating costs to meet financial resource requirement"—currently requires a SEF to make a reasonable calculation of its projected operating costs for each fiscal quarter over a twelve-month period to determine the amount of financial resources needed to comply with the financial resource

[732] The Commission also proposes to renumber existing § 37.1303 to § 37.1304 and amend the requirement as described.

requirement.[733] Existing § 37.1303 further provides that a SEF has reasonable discretion to determine the methodology that it uses to compute its projected operating costs, although the Commission may review the SEF's methodology and require the SEF to make changes as appropriate.[734]

The Commission proposes to amend the existing requirement to specify that a SEF must also make a reasonable calculation of projected wind-down costs, but would have reasonable discretion in adopting the methodology for calculating such costs. This proposed addition is consistent with the reasonable discretion already provided for calculating projected operating costs and corresponds to § 37.1303, which incorporates the calculation of a SEF's wind-down costs into the liquidity determination. The Commission also proposes two non-substantive amendments that would add a reference to § 37.1303, given that a SEF must calculate projected operating costs to determine how to comply with the liquidity requirement; and eliminate the twelve-month requirement, given that proposed § 37.1301(a) already establishes that the financial resource requirement applies on a one-year, rolling basis.

1. Acceptable Practices to Core Principle 13 in Appendix B

To help SEFs comply with Core Principle 13, which requires a SEF to calculate its operating costs as part of a financial resources determination, the Commission is proposing acceptable practices to Core Principle 13 in Appendix B associated with § 37.1304. The proposed acceptable practices expound upon the reasonable discretion that SEFs have for computing projected operating costs in determining their financial resource requirements. Among other things, these acceptable practices would further

[733] 17 CFR 37.1303.
[734] *Id*.

explain which operating costs are not necessary to comply with the SEF core principles and the Commission's regulations. The Commission notes that these acceptable practices generally incorporate existing guidance provided by Commission staff.[735]

The proposed acceptable practices state that calculations of projected operating costs, *i.e.*, those that are necessary for the SEF to comply with the SEF core principles and any applicable Commission regulations, should be based on a SEF's current business model and anticipated business volume.[736] In particular, if the SEF offers more than one bona fide execution method, then a SEF would be allowed to include the costs of only one of those methods in calculating projected operating costs.[737] A bona fide method refers to a method actually used by SEF participants and not established by a SEF on a *pro forma* basis merely for the purpose of complying with—or evading—the financial resources requirement.

This approach would still require SEFs to maintain sufficient financial resources to ensure their financial viability, but also provide greater flexibility to SEFs to compute operating costs, consistent with the reasonable discretion provided under proposed § 37.1304. Although neither the CEA nor the Commission's regulations require a SEF to have more than one execution method, this flexibility could encourage SEFs to innovate and experiment in offering a variety of trading systems or platforms compared to the

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[735] The proposed acceptable practices to Core Principle 13 in Appendix B are based in part upon existing DMO staff guidance. *See* CFTC Letter No. 17-25 and CFTC Letter No. 15-26.

[736] In determining a SEF's projected operating costs under § 37.1301(a) or § 37.1303, a calculation based upon a hypothetical business model that has lower associated costs or lower business volume, and is intended to underestimate or minimize the level of required financial resources, would not be appropriate. As stated in the proposed acceptable practices, however, a SEF may account for any projected modification to its business model, *e.g.*, the addition or subtraction of business lines or operations or other changes, in its calculations and therefore any projected increase or decrease in revenue or operating costs from those changes over the next 12 months.

[737] For example, if a SEF offers both an order book and RFQ system, then the SEF may include the costs associated with one of those methods and exclude the costs associated with the other method.

current requirements. Accordingly, this flexibility would mitigate possible disincentives for a SEF to limit the number and types of execution methods that it might otherwise develop and offer, were it required to account for the associated operating costs for all offered execution methods in a calculation. In excluding any of these expenses, however, a SEF would need to document and justify those exclusions pursuant to proposed requirements under § 37.1306, discussed further below.[738]

The proposed acceptable practices would also specify that a SEF may exclude certain expenses in making a "reasonable" calculation of projected operating costs. These expenses include, in part, marketing and development costs; variable commissions paid to SEF trading specialists, the payment of which is contingent on whether the SEF collects associated revenue from transactions on its systems or platforms;[739] and costs for other SEF personnel who are not necessary to enable a SEF to comply with the core principles, based on its current business model and business volume.[740] Further, a SEF may exclude any non-cash costs, including depreciation and amortization. The Commission notes that excluding these expenses would be consistent with the proposed financial resource requirement and proposed liquidity requirement because they do not reflect costs necessary for a SEF to comply with the SEF core principles or Commission regulations.

In addition to allowing a SEF to exclude certain projected operating costs, the proposed acceptable practices further specify that a SEF may pro-rate, but not exclude,

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[738] *See infra* Section XVIII.F.3.—§ 37.1306(c).
[739] *See* CFTC Letter No. 17-25.
[740] For example, if a SEF requires a certain amount of SEF trading specialists to operate a voice-based or voice-assisted trading system or platform, but hires additional personnel to enhance its operations to benefit market participants, then the SEF would only need to include the minimum number of trading specialists needed to operate the trading system or platform based on its current business volume and take into account any projected increase or decrease in business volume in its projected operating cost calculations.

certain expenses in calculating projected operating costs. The Commission recognizes that some costs may be only partly attributable to a SEF's ability to comply with the SEF core principles and the Commission's regulations; therefore, only those attributed costs would need to be included in a SEF's projected operating costs. Accordingly, a SEF may pro-rate expenses that are shared with affiliates, *e.g.*, the costs of administrative staff or seconded employees that a SEF shares with affiliates. Further, a SEF may also pro-rate expenses that are attributable in part to operational aspects that are not required to comply with the SEF core principles, *e.g.*, costs of a SEF's office rental space, to the extent that it is also used to house marketing personnel. In pro-rating any such expenses, however, a SEF would need to document and justify those pro-rated expenses pursuant to proposed requirements under § 37.1306, discussed further below.[741]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1304 and the associated acceptable practices to Core Principle 13 in Appendix B. In particular, the Commission requests comment on the following question:

(81) The proposed acceptable practices would permit a SEF to include only the costs related to one of the bona fide execution methods that it offers. Should a SEF instead be required to include in its projected operating costs the expenses related to all of its execution methods? Why or why not?

E. § 37.1305—Valuation of Financial Resources[742]

Section 37.1304—"Valuation of financial resources"—currently requires a SEF, at least once each fiscal quarter, to compute the current market value of each financial

[741] *See infra* Section XVIII.F.3.—§ 37.1306(c).
[742] The Commission proposes to renumber § 37.1304 to § 37.1305 and amend the requirement as described.

resource used to meet its financial resources requirement under § 37.1301.[743] The requirement is designed to address the need to update valuations when there may have been material fluctuations in market value that could impact a SEF's ability to satisfy its financial resource requirement.[744] When valuing a financial resource, the SEF must reduce the value, as appropriate, to reflect any market or credit risk specific to that particular resource, *i.e.*, apply a haircut.[745]

The Commission proposes a non-substantive amendment to add an applicable reference to § 37.1303. The Commission notes that in addition to calculating the current market value of each financial resource used to satisfy its financial resource requirement, compliance with the liquidity requirement would require a SEF to utilize the current market value of the applicable financial resources.

F. § 37.1306—Reporting to the Commission

1. § 37.1306(a)

Section 37.1306 establishes a SEF's financial reporting requirements to the Commission. Section 37.1306(a)(1) currently requires that at the end of each fiscal quarter or upon Commission request, a SEF must report to the Commission (i) the amount of financial resources necessary to meet the financial resources requirement of § 37.1301; and (ii) the value of each financial resource available to meet those requirements as calculated under § 37.1304.[746] Section 37.1306(a)(2) additionally requires a SEF to provide the Commission with a financial statement, including a balance

[743] 17 CFR 37.1304.
[744] SEF Core Principles Final Rule at 33539.
[745] A "haircut" is a deduction taken from the value of an asset to reserve for potential future adverse price movement in such asset. *Id.* at 33539 n.772.
[746] 17 CFR 37.1306(a)(1).

sheet, income statement, and statement of cash flows of the SEF or its parent company.[747] In lieu of submitting its own financial statements, a SEF may submit the financial statements of its parent company.[748]

The Commission proposes several amendments to § 37.1306(a)(2). First, the Commission proposes to require a SEF to prepare its financial statements in accordance with generally accepted accounting principles in the United States ("GAAP"). For a SEF that is not domiciled in the U.S. and is not otherwise required to prepare its financial statements in accordance with GAAP, the Commission would allow that SEF to prepare its statements in accordance with either the International Financial Reporting Standards issued by the International Accounting Standards Board, or a comparable international standard as the Commission may accept in its discretion. The Commission notes that the quality and transparency of SEF financial reports submitted under the existing requirement have varied and believes that the GAAP-based requirement would promote consistency and better ensure a minimum reporting standard across financial submissions.

The Commission also proposes to require a SEF to provide its own financial statements, rather than allow a SEF the option of submitting the statements of its parent company. The Commission notes that it may lack jurisdiction over a SEF's parent company or its affiliates; in such instances, the Commission could not consider the parent company's financial resources in determining whether the SEF itself possesses adequate financial resources. Therefore, the Commission believes that a separate SEF financial

[747] 17 CFR 37.1306(a)(2).
[748] *Id*.

statement would more clearly demonstrate evidence of the SEF's compliance with Core Principle 13.

In addition to the proposed amendments to § 37.1306(a)(2), the Commission proposes non-substantive revisions to § 37.1306(a)(1) to add appropriate references to § 37.1303 to § 37.1305, as discussed above. In addition to specifying the amount of financial resources necessary to comply with § 37.1301, a SEF's quarterly report must include the amount of financial resources necessary to comply with the liquidity requirement. Further, the amounts specified in the report must be based on the current market value of each financial resource and computed as reasonable calculations of the SEF's projected operating costs and wind-down costs.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1306(a). In particular, the Commission requests comment on the questions below:

(82) Should the Commission require a SEF's financial reports to be audited? Would requiring an audited annual financial report improve Commission oversight? What costs would be associated with an audit requirement?

(83) Instead of submitting four financial reports as currently required, should the Commission require a semi-annual report and an audited annual report?

(84) Would providing the Commission with the discretionary authority to request that SEFs provide audited financial statements, as necessary or appropriate, help the Commission meet its oversight responsibilities?

(85) Financial statements currently submitted by SEFs do not need to comply with GAAP. What are the costs and benefits of requiring GAAP-compliant financial submissions?

2. § 37.1306(b)

Section 37.1306(b) currently requires a SEF to make its financial resource calculations on the last business day of its fiscal quarter.[749] The Commission proposes a non-substantive amendment to § 37.1306(b) that would add the word "applicable" before "fiscal quarter" in the existing rule text.

3. § 37.1306(c)

Section 37.1306(c) sets forth documentation requirements for a SEF's financial reporting obligations. Section 37.1306(c)(1) requires a SEF to provide the Commission with sufficient documentation explaining the methodology used to calculate its financial resource requirements under § 37.1301.[750] Section 37.1306(c)(2) requires a SEF to provide sufficient documentation explaining the basis for its valuation and liquidity determinations.[751] To provide such documentation, § 37.1306(c)(3) requires SEFs to provide copies of certain agreements that evidence or otherwise support its conclusions.[752]

Based on the proposed amendments to the Core Principle 13 regulations described above, the Commission proposes conforming amendments to § 37.1306(c) to require a SEF to specify the methodology used to compute its financial resource and liquidity requirements. The documentation to be provided must be sufficient for the Commission to determine that the SEF has made reasonable calculations of projected operating costs and wind-down costs under § 37.1304. As proposed, §§ 37.1306(c)(2)(i)-(iv)[753] would

[749] 17 CFR 37.1306(b).
[750] 17 CFR 37.1306(c)(1)
[751] 17 CFR 37.1306(c)(2).
[752] 17 CFR 37.1306(c)(3).
[753] The Commission proposes to consolidate paragraphs (c)(1)-(3) into paragraphs (c)(1)-(2) and adopt the proposed requirements as described.

require that the SEF, at a minimum (i) list all of its expenses, without exclusion; (ii) identify all of those expenses that the SEF excluded or pro-rated in its projected operating cost calculations and explain the basis for excluding or pro-rating any expenses; (iii) include documentation related to any committed line of credit or similar facility used to meet the liquidity requirement;[754] and (v) identify estimates of all of the costs and the projected amount of time required for any wind down of operations, including the basis for those estimates.

The proposed requirement does not necessarily create new obligations, but rather clarifies a SEF's existing obligations based upon existing guidance provided by Commission staff.[755] Further, the proposed requirement is specifically intended to ensure that a SEF has sufficient financial resources, particularly in light of the discretion provided to SEFs to compute their projected operating costs and wind-down costs. Therefore, the Commission believes that maintaining the general obligation for each SEF to identify all of its expenses in its financial report, including those that correspond to activities that are not needed for compliance or otherwise are excluded or pro-rated from projected operating costs, is appropriate on an ongoing basis.

The Commission further believes that proposed §§ 37.1306(c)(2)(i)-(iv) would address the current lack of adequate documentation or insufficient identification of excluded or pro-rated expenses by some SEFs in submitting their projected operating

[754] The Commission notes that it is also proposing a non-substantive change to eliminate the current language in paragraph (c)(3) regarding copies of insurance coverage or other arrangement evidencing or otherwise supporting the SEF's conclusions. The Commission notes that subsection (c) still requires a SEF to provide sufficient documentation explaining the methodology used to compute its financial resource requirements; therefore, if insurance coverage or other arrangements are necessary to explain a SEF's methodology, then the SEF must submit such documentation. The Commission also notes, however, that such documentation may not be required in all cases; proposed paragraph (c)(2) provides minimum requirements.

[755] *See* CFTC Letter No. 17-25 at 4.

costs based on Commission staff guidance. Absent the guidance, the Commission notes that the existing rule has created burdens for Commission staff when determining whether a SEF complies with Core Principle 13. In its experience thus far, the Commission recognizes that Commission staff has devoted additional effort to obtain the appropriate documentation from SEFs. Therefore, the Commission believes that adding greater specificity to the existing requirement would mitigate the time and resources required to determine a SEF's compliance with the financial resource requirements.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1306(c).

4. § 37.1306(d)

Section 37.1306(d) requires a SEF to file its financial report no later than forty calendar days after the end of each of the SEF's first three fiscal quarters and no later than sixty calendar days after the end of the SEF's fourth fiscal quarter, or at such later time as the Commission may permit.[756]

The Commission proposes to extend the due date for each SEF's fourth fiscal quarter report from sixty to ninety days following the end of the quarter. This new proposed due date conforms with the due date for the SEF annual compliance report under proposed § 37.1501(e)(2).[757] The Commission recognizes that preparing multiple year-end reports, which includes a fourth-quarter financial report and an annual compliance report, for concurrent submission imposes resource constraints on a SEF.[758]

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[756] 17 CFR 37.1306(d).

[757] *See infra* Section XX.A.5.—§ 37.1501(e)—Submission of Annual Compliance Report and Related Matters.

[758] The Commission also notes that it is proposing to require a SEF to submit an updated Technology Questionnaire under § 37.1401(g) at the same time on an annual basis. *See infra* Section XIX.B.—§ 37.1401(g)—Program of Risk Analysis and Oversight Technology Questionnaire.

Therefore, the Commission believes that such potential constraints justify an additional thirty days to prepare and concurrently file the SEF's fourth quarter financial report along with its annual compliance report.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1306(d).

5. § 37.1306(e)

The Commission proposes to add a new requirement under § 37.1306(e) for each SEF to provide notice to the Commission of its non-compliance with the financial resource requirements no later than forty-eight hours after the SEF knows or reasonably should have known of its non-compliance.[759] Each SEF has an ongoing obligation to comply with the requirements under Core Principle 13. The proposed requirement would clarify that the SEF cannot wait until filing its quarterly financial reports to notify the Commission that it no longer satisfies the Core Principle 13 financial resources requirements. In some instances, the Commission has not been informed of a SEF's non-compliance with the financial resource requirements until the filing of a quarterly financial report. The Commission believes, however, that prompt notification of non-compliance is necessary for the Commission to conduct proper market oversight and ensure market stability on an ongoing basis.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1306(e).

[759] For example, if a SEF knows or reasonably should know that its assets will no longer cover its projected operating costs for the next twelve months, as calculated on a rolling basis, then the SEF should notify the Commission within forty-eight hours.

G. § 37.1307—Delegation of Authority

Section 37.1307(a) currently delegates authority to the Director of DMO, or other staff as the Director may designate, to perform certain functions that are reserved to the Commission under the Core Principle 13 regulations, including reviewing the methodology used to compute projected operating costs.[760]

The Commission proposes to amend § 37.1307(a)(2) to clarify that the Commission may additionally delegate the authority to review and make changes to the methodology used by a SEF to determine the market value of its financial resources under § 37.1305 and the methodology that SEFs use to determine their wind-down costs under § 37.1304. Further, the Commission would delegate the ability to request the additional documentation related to the calculation methodologies used under § 37.1306(c) and the notification of non-compliance under § 37.1306(e). The proposed amendments also include several additional non-substantive amendments based on the proposed amendments to Core Principle 13 regulations, as described above.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1307.

XIX. Part 37—Subpart O: Core Principle 14 (System Safeguards)

Core Principle 14 requires that SEFs (i) establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk, through the development of appropriate controls and procedures, and automated systems that are reliable, secure, and have adequate scalable capacity; (ii) establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for

[760] 17 CFR 37.1307(a).

the timely recovery and resumption of operations and the fulfillment of the SEFs' responsibilities and obligations; and (iii) periodically conduct tests to verify that backup resources are sufficient to ensure continued order processing and trade matching, price reporting, market surveillance, and maintenance of a comprehensive and accurate audit trail.[761] The Commission promulgated rules under § 37.1401 to further implement those requirements.[762]

The Commission is not proposing any amendments to existing §§ 37.1401(a)-(b), (e)-(f), (g)-(i), or (k)-(m), other than non-substantive changes to paragraph references that are based on the changes described below.

A. § 37.1401(c)

Section 37.1401(c) requires each SEF to maintain a business continuity-disaster recovery plan and resources, emergency procedures, and backup facilities sufficient to enable timely recovery, resumption of its operations, and resumption of its ongoing fulfillment of its responsibilities and obligations as a SEF following any disruption of its operations.[763] A SEF's business continuity-disaster recovery plan and resources generally should enable resumption of trading and clearing of swaps executed on or pursuant to the rules of the SEF during the next business day following the disruption.

As noted above, the Commission proposes to move the existing requirement under § 37.205(b)(4)—"Safe storage capability"—that a SEF must protect audit trail data from unauthorized alteration, accidental erasure, or other loss to a more appropriate

[761] 7 U.S.C. 7b-3(f)(14). The Commission codified Core Principle 14 under § 37.1400. 17 CFR 37.1400.
[762] 17 CFR 37.1401.
[763] 17 CFR 37.1401(c).

provision under proposed § 37.1401(c).[764] The Commission also proposes additional non-substantive amendments to § 37.1401(c). First, the Commission proposes to eliminate the sentence that references "critical financial markets" and § 40.9, which do not exist.[765] Second, the Commission proposes to replace the reference to "designated clearing organization" with "derivatives clearing organization," which is the appropriate term under the Commission's regulations. Finally, the Commission proposes to eliminate the reference to swaps executed "pursuant to the rules of" a SEF, which conforms to the proposed amendment to the "block trade" definition under § 43.2, discussed further below.[766]

B. § 37.1401(g)—Program of Risk Analysis and Oversight Technology Questionnaire

Existing Exhibit V to Form SEF in Appendix A requires an applicant for SEF registration to file an Operational Capability Technology Questionnaire ("Questionnaire") in order to demonstrate compliance with Core Principle 14 and § 37.1401.[767] The current version of the Questionnaire requests documents and information pertaining to the following eight areas of an applicant's program of risk analysis and oversight: (i) organizational structure, system descriptions, facility locations, and geographic distribution of staff and equipment; (ii) risk analysis and oversight; (iii) system operations; (iv) systems development methodology; (v) information security; (vi) physical security and environmental controls; (vii) capacity planning and testing; and

[764] *See supra* Section VII.D.2.a.—§ 37.205(b)(1)—Original Source Documents; § 37.205(b)(2)—Transaction History Database; § 37.205(b)(3)—Electronic Analysis Capability.
[765] The Commission further proposes to eliminate the reference to "critical financial market" under § 37.1401(d).
[766] *See infra* Section XXII.—Part 43—§ 43.2—Definition of "Block Trade."
[767] 17 CFR part 37 app. A.

(viii) business continuity and disaster recovery. The current version of the Questionnaire is located on the Commission's website.[768]

The Commission proposes a new provision under § 37.1401(g) to require each SEF to annually prepare and submit an up-to-date Questionnaire to Commission staff not later than 90 calendar days after the SEF's fiscal year-end.[769] The Commission notes that where information previously submitted on the Questionnaire remains current, the annual update may note that fact, rather than fully describe the same information again.

The updated version of the Questionnaire requests documents and information in the following nine areas to assist the Commission in assessing a SEF's compliance with the Act and Commission regulations: (i) organizational structure, system descriptions, facility locations, and geographic distribution of staff and equipment, including organizational charts and diagrams; (ii) enterprise risk management program and governance, including information regarding the Board of Directors, audits, and third-party providers; (iii) information security, including storage of records, access controls, and cybersecurity threat intelligence capabilities; (iv) business continuity and disaster recovery plan and resources, including testing and recovery time objectives; (v) capacity planning and testing; (vi) system operations, including configuration management and event management; (vii) systems development methodology, including quality assurance;

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[768] SEF Operational Capability Technology Questionnaire, *available at* https://www.cftc.gov/sites/default/files/idc/groups/public/@industryoversight/documents/file/seftechnologyquestionnaire.pdf.

[769] The Commission notes that based on the proposed amendments to Form SEF in Appendix A discussed above, Exhibit V would be re-designated as Exhibit Q of Form SEF. The up-to-date questionnaire would be called the "Program of Risk Analysis and Oversight Technology Questionnaire" and would be located in Appendix A to part 37. *See supra* note 169 and accompanying discussion. Based on the proposed addition of subsection (g), the Commission proposes to renumber the existing provisions under subsections (g)-(i) to subsections (h)-(j), respectively. Based on the renumbering of these provisions, the Commission also proposes conforming non-substantive amendments to update applicable cross-references to these provisions in proposed paragraphs (a)(3), (h)(5), (i)(1)-(i)(7), and subsection (m).

(viii) physical security and environmental controls; and (ix) testing, including vulnerability, penetration, and controls testing. While the majority of the updated Questionnaire is unchanged from the current version, the Commission is making certain amendments, including the addition of enterprise technology risk assessments, board of director and committee information, third-party service provider information, and cybersecurity threat intelligence capabilities to keep up-to-date with the rapidly changing field of system safeguards and cybersecurity.

The proposed annual update is designed to reduce overall compliance-related burdens and enhance internal operational efficiency for SEFs. First, the Commission would use the Questionnaire as the basis for Systems Safeguards Examination ("SSE") document requests. The Commission believes that maintaining an updated Questionnaire would limit SSE document requests and the effort required to respond to these requests—a SEF would be able to provide updated information and documents for sections of the Questionnaire that have changed since the last annual filing.[770] Second, the Commission would use the Questionnaire to conduct required system safeguards oversight and maintain a current profile of the SEF's automated systems.[771] Annual updates would reduce the need for separate requests and the burden of responding to these requests. Third, annual updates would assist a SEF's obligation to provide timely advance notice of

[770] To the extent that still-current information and documents were provided in the most recent update to the Questionnaire, a SEF responding to an SSE document request would be able to reference that fact, rather than resubmit such information and documents.

[771] The Commission notes that proposed subsection (h) (renumbered from existing subsection (g)) requires a SEF to provide to the Commission systemsafeguards-related books and records, including (i) current copies of its business continuity-disaster recovery plans and other emergency procedures; (ii) all assessments of its operational risks or systemsafeguards-related controls; (iii) all reports concerning system safeguards testing and assessment required by this chapter; and (iv) all other books and records requested by Commission staff in connection with Commission oversight of system safeguards or maintenance of a current profile of the SEF's automated systems. *Id.*

all material (i) planned changes to automated systems that may impact the reliability, security, or adequate scalable capacity of such systems; and (ii) planned changes to the SEF's program of risk analysis and oversight.[772] Fourth, annual updates, which a SEF would submit concurrently with its annual compliance report, could provide information and documents that are potentially useful in preparing that report.[773]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1401(g).

C. § 37.1401(j)

Section 37.1401(j) specifies that for registered entities deemed by the Commission to be "critical financial markets," § 40.9 sets forth requirements for maintaining and dispersing disaster recovery resources in a manner sufficient to meet a same-day recovery time objective in the event of a wide-scale disruption. The Commission proposes to eliminate this provision, given that the Commission has not defined "critical financial markets" and such requirements do not exist under § 40.9.

XX. Part 37—Subpart P: Core Principle 15 (Designation of Chief Compliance Officer)

Core Principle 15 requires each SEF to designate a CCO and sets forth its corresponding duties.[774] Among other responsibilities, a CCO is required to ensure that the SEF complies with the CEA and applicable rules and regulations, as well as establish and administer required policies and procedures.[775] Core Principle 15 also requires the

[772] 17 CFR 37.1401(f)(1)-(2).
[773] The Commission is proposing under § 37.1306(d) and § 37.1501(e)(2), respectively, to require a SEF to submit its fourth quarter financial report and annual compliance report no later than ninety days after the SEF's fiscal year end.
[774] 7 U.S.C. 7b-3(f)(15). The Commission codified Core Principle 15 under § 37.1500. 17 CFR 37.1500.
[775] 7 U.S.C. 7b-3(f)(15)(B)(iv)-(v).

CCO to prepare and file an annual compliance report ("ACR") to the Commission.[776] The Commission further promulgated requirements under § 37.1501 to implement these requirements.[777] Based on its experience during part 37 implementation, the Commission proposes several amendments to § 37.1501, in particular to streamline requirements related to the composition of the ACR and provide more useful information to the Commission.

A. § 37.1501—Chief Compliance Officer

1. § 37.1501(a)—Definitions

Core Principle 15 requires a CCO to report directly to the SEF's "board [of directors]" or the SEF's "senior officer"[778] and consult either the board or the senior officer to resolve conflicts of interest.[779] Section 37.1501(a) defines "board of directors,"[780] but does not define "senior officer."[781] In the SEF Core Principles Final Rule, the Commission noted that it would not adopt a definition of "senior officer," but noted that the statutory term would only include the most senior executive officer of the legal entity registered as a SEF.[782]

The Commission proposes to define a "senior officer" under § 37.1501(a) as the chief executive officer or other equivalent officer of the SEF. Across the various organizational structures that SEFs have established, the Commission has observed that a senior officer often may be the appropriate individual to whom a CCO would report

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[776] 7 U.S.C. 7b-3(f)(15)(D).
[777] 17 CFR 37.1501.
[778] 7 U.S.C. 7b-3(f)(15)(B)(i). The Commission also notes that the CEA does not define "senior officer."
[779] 7 U.S.C. 7b-3(f)(15)(B)(iii).
[780] Section 37.1501(a) defines "board of directors" as the board of directors of a SEF, or for those SEFs whose organizational structure does not include a board of directors, a body performing a function similar to a board of directors. 17 CF 37.1501(a).
[781] 17 CFR 37.1501(a).
[782] SEF Core Principles Final Rule at 33544.

regarding SEF activities. Therefore, this proposed definition would clarify the permissible reporting lines for the CCO and would provide specificity to the Commission's proposed amendments to the Core Principle 15 regulations, as described below. Among other things, the proposed requirements would enable the senior officer to have greater oversight responsibilities over the CCO consistent with Core Principle 15.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1501(a). In particular, the Commission requests comment on the questions below.

(86) Is the Commission's proposed definition of "senior officer" sufficiently clear and complete? If not, then please provide an explanation of those aspects of the definition that you believe are insufficiently clear or inadequately addressed.

(87) Are there any officers that may meet the definition of "senior officer," but pose a potential conflict of interest? If so, identify such officers and the types of conflicts that may arise.

(88) Should the Commission add any other definitions to proposed § 37.1501(a)?

2. § 37.1501(b)—Chief Compliance Officer[783]

Sections 37.1501(b)-(c) set forth certain baseline requirements for the SEF CCO position. Section 37.1501(b)—"Designation and qualifications of chief compliance officer"— requires a SEF to designate an individual to serve as the CCO; requires the CCO to have the authority and resources to help fulfill the SEF's statutory and regulatory duties, including supervisory authority over compliance staff; and establishes minimum

[783] The Commission proposes to retitle § 37.1501(b) to "Chief compliance officer" from "Designation and qualifications of chief compliance officer" based on the proposed changes described below.

qualifications for the designated CCO.[784] Section 37.1501(c)—"Appointment, supervision, and removal of chief compliance officer"—establishes the respective authorities of the SEF board of directors and senior officer to designate, supervise, and remove the CCO; and requires the CCO to meet with the SEF's board and regulatory oversight committee ("ROC") on an annual and quarterly basis, respectively, and provide them with information as requested.[785]

The Commission proposes to amend, clarify, and eliminate various existing requirements under §§ 37.1501(b)-(c) and consolidate the remaining provisions into § 37.1501(b), as described below. The Commission proposes to eliminate duplicative rules to Core Principle 15, including requirements that a SEF designate a CCO[786] and the CCO report directly to the board or the senior officer.[787] With respect to the CCO's obligations to a ROC, Core Principle 15 does not require a SEF to establish a ROC and the Commission has not finalized a rule that establishes requirements for a ROC; therefore, the Commission proposes to eliminate the existing ROC-related requirements from part 37.[788]

Consistent with Core Principle 15, which requires the CCO to report to the SEF's board or senior officer, the Commission also proposes amendments to the consolidated requirement under § 37.1501(b) to allow the SEF's senior officer to have the same oversight responsibilities over the CCO as the board. First, the Commission proposes to

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[784] 17 CFR 37.1501(b).
[785] 17 CFR 37.1501(c).
[786] The Commission proposes to eliminate this requirement under existing paragraph (b)(1), which the Commission proposes to retitle to "Authority of chief compliance officer" from "Chief compliance officer required."
[787] The Commission proposes to eliminate this requirement under existing paragraph (c)(2).
[788] These requirements include a mandatory quarterly meeting with the ROC under existing subparagraph (c)(1)(iii); and the requirement that the CCO provide self-regulatory program information to the ROC under existing subparagraph (c)(1)(iv). Conflicts of Interest Proposed Rule at 36741-42.

allow a CCO to consult with the board of directors or senior officer of the SEF as the CCO develops the SEF's policies and procedures.[789] Second, the Commission also proposes to allow a CCO to meet with the senior officer of the SEF, in addition to the board of directors, on an annual basis.[790] Third, the Commission further proposes to allow the CCO to provide self-regulatory program information to the SEF's senior officer, in addition to the board of directors.[791]

The Commission further proposes to eliminate the limitations on authority to remove a CCO, which currently restricts that removal authority to a majority of the board, or in the absence of a board, a senior officer.[792] Instead, the Commission proposes a more simplified requirement under proposed § 37.1501(b) to establish that (i) the board or the senior officer may appoint or remove the CCO;[793] and (ii) the SEF must notify the Commission within two business days of the appointment or removal (on an interim or permanent basis) of the CCO.[794] Based on its experience, the Commission recognizes that in many instances, the senior officer may be better positioned than the board to provide day-to-day oversight of the SEF and the CCO, as well as to determine whether to

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[789] The Commission proposes the amendment under proposed subparagraph (b)(1)(i).
[790] The Commission proposes to renumber existing subparagraph (c)(1)(iii) to paragraph (b)(5), based on the proposed consolidation of existing subsections (b)-(c), and amend the requirement as described.
[791] The Commission proposes to renumber existing subparagraph (c)(1)(iv) to paragraph (b)(6), based on the proposed consolidation of existing subsections (b)-(c), and amend the requirement as described.
[792] The Commission proposes to eliminate this requirement under existing paragraph (c)(3).
[793] The Commission proposes to consolidate and amend the requirements under existing subparagraph (c)(1)(i) in part, which addresses the appointment of a CCO by the board or senior officer, with existing subparagraph (c)(3)(i), which currently addresses the removal of a CCO. Based on the proposed consolidation of existing subsections (b)-(c), the Commission proposes to renumber this consolidated provision to paragraph (b)(3) and retitle the consolidated provision to "Appointment and removal of chief compliance officer."
[794] The Commission notes that notification to the Commission of the appointment and removal of a CCO is currently required under existing subparagraph (c)(1)(i) and existing subparagraph (c)(3)(ii), respectively. Based on the proposed consolidation of existing subsections (b)-(c), the Commission proposes to consolidate and amend these notification requirements, and renumber the consolidated requirement to subparagraph (b)(3)(i).

remove a CCO. Therefore, consistent with Core Principle 15, the Commission believes that a SEF's senior officer should have the same CCO oversight authority as the SEF's board of directors. This proposed amendment is consistent with Core Principle 15, which does not mandate a voting percentage to approve or remove the CCO. The Commission also believes that these proposed amendments would not only allow a SEF to more appropriately designate, appoint, supervise, and remove a CCO based on the SEF's particular corporate structure, size, and complexity, but also continue to ensure a level of independence for its CCO that is appropriate to comply with Core Principle 15.

Based on the proposed consolidation of existing §§ 37.1501(b)-(c), the Commission also proposes several non-substantive amendments to the remaining provisions under proposed § 37.1501(b), including the renumbering of certain existing provisions.[795]

a. Acceptable Practices to Core Principle 15 in Appendix B

The Commission proposes a new acceptable practice to Core Principle 15 in Appendix B associated with § 37.1501(b)(2)(i), which requires a CCO to have the background and skills appropriate to the position.[796] The proposed acceptable practice would provide a non-exclusive list of factors that a SEF may consider when evaluating an individual's qualifications to be a CCO and state that a SEF may make a determination based on the totality of a person's qualifications. The Commission believes that a non-

[795] The Commission proposes to renumber the requirements under existing paragraph (b)(2)—"Qualifications of chief compliance officer"—to proposed subparagraphs (b)(2)(i)-(ii). The Commission also proposes to retitle existing subparagraph (c)(1)(ii), which specifies that the board or the senior officer must approve the CCO's compensation, to "Compensation of the chief compliance officer." Based on the proposed consolidation of existing subsections (b)-(c), the Commission is proposing to renumber this requirement to paragraph (b)(4).

[796] The Commission proposes to add this provision in paragraph (b)(1) of the acceptable practices to Core Principle 15 in Appendix B. 17 CFR part 37 app. B.

exclusive list provides the clarity that SEFs have sought as to a CCO's requisite qualifications, but still allows a board and senior officer reasonable flexibility in appointing a CCO.

The proposed acceptable practice also states that a SEF should be especially vigilant regarding potential conflicts of interest when appointing a CCO. The Commission notes that the preamble to the SEF Core Principles Final Rule stated "a conflict of interest may compromise a CCO's ability to effectively fulfill his or her responsibilities as a CCO…."[797] The Commission continues to believe that conflicts of interest could affect a CCO's ability to effectively fulfill his or her responsibilities. Accordingly, a SEF should be especially vigilant in this regard when appointing a CCO. The Commission also continues to believe that a SEF should have policies and procedures in place to handle instances where its CCO has conflicts of interest.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1501(b) and the associated acceptable practices to Core Principle 15 in Appendix B.

3. § 37.1501(c)—Duties of Chief Compliance Officer[798]

Section 37.1501(d)—"Duties of chief compliance officer"—currently requires a CCO, at a minimum, to (i) oversee and review the SEF's compliance with the Act and Commission regulations;[799] (ii) resolve any conflicts of interest that may arise, including in certain enumerated circumstances;[800] (iii) establish and administer written policies and

[797] SEF Core Principles Final Rule at 33543-44.
[798] The Commission proposes to renumber existing subsection (d) to subsection (c).
[799] 17 CFR 37.1501(d)(1).
[800] 17 CFR 37.1501(d)(2). A CCO is specifically required to address conflicts between (i) business considerations and compliance requirements; (ii) business considerations and the requirement that the SEF

procedures reasonably designed to prevent violations of the Act and Commission regulations;[801] (iv) take reasonable steps to ensure compliance with the Act and Commission regulations;[802] (v) establish procedures for the remediation of noncompliance issues identified by the CCO through certain specified protocols;[803] (vi) establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues;[804] (vii) establish and administer a compliance manual and a written code of ethics;[805] (viii) supervise a SEF's self-regulatory program;[806] and (ix) supervise the effectiveness and sufficiency of any regulatory services provided to the SEF in accordance with § 37.204.[807]

The Commission proposes to adopt several substantive and non-substantive amendments to clarify and streamline these duties. The Commission proposes to consolidate certain existing provisions and specify that the CCO may identify noncompliance matters through "any means," in addition to the currently prescribed means; and clarify that the procedures followed to address noncompliance issues must be "reasonably designed" by the CCO to handle, respond, remediate, retest, and resolve noncompliance issues identified by the CCO.[808] These proposed amendments

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provide fair, open, and impartial access under § 37.202; and (iii) a SEF's management and board members. 17 CFR 37.1501(d)(2)(i)-(iii).

[801] 17 CFR 37.1501(d)(3).

[802] 17 CFR 37.1501(d)(4).

[803] 17 CFR 37.1501(d)(5).

[804] 17 CFR 37.1501(d)(6).

[805] 17 CFR 37.1501(d)(7).

[806] 17 CFR 37.1501(d)(8).

[807] 17 CFR 37.1501(d)(9).

[808] Existing paragraph (d)(5) requires a CCO to establish procedures for remediation of noncompliance issues identified through a compliance office review, look-back, internal or external audit finding, self-reported error, or validated complaint. Existing paragraph (d)(6) requires a CCO to establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of non-compliance issues. The Commission proposes to consolidate and amend these requirements and renumber the consolidated requirement to paragraph (c)(5).

acknowledge that a CCO may not be able to design procedures that detect all possible noncompliance issues and reflect that a CCO may utilize a variety of resources to identify noncompliance issues beyond a limited set of means.

The Commission also proposes to amend a CCO's duty to resolve conflicts of interest.[809] First, the Commission proposes to limit a CCO's duty to address only "material" conflicts of interest. This proposed amendment reflects the Commission's view that the current requirement is overly broad and impractical because a CCO cannot reasonably be expected to resolve every potential conflict of interest that may arise. Consistent with this view, the Commission also proposes to refine the scope of the CCO's duty to taking only "reasonable steps" to resolve "material" conflicts of interest that may arise.[810] The Commission further proposes to eliminate the existing enumerated conflicts of interest to avoid any inference that they are an exhaustive list of conflicts that a CCO must address.[811]

The Commission believes that these proposed amendments do not weaken a CCO's statutory duty to address conflicts of interest, but rather reflect the CCO's practical ability to detect and resolve conflicts. Moreover, the proposed amendments reflect the Commission's belief that a CCO should have discretion to determine the conflicts that are material to his or her SEF's ability to comply with the Act and the Commission's regulations. The Commission believes that these proposed changes are consistent with Core Principle 15.

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[809] The Commission proposes to renumber existing paragraph (d)(2), which addresses the CCO's duty to resolve conflicts of interest, to paragraph (c)(2) and amend the requirement as described.

[810] The Commission also proposes to eliminate "a body performing a function similar to the board of directors" under proposed paragraph (c)(2) (existing paragraph (d)(2)), as this phrase is already included in the definition of "board of directors" under § 37.1501(a).

[811] These provisions are currently set forth under existing subparagraphs (d)(2)(i)-(iii). *See supra* note 800.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1501(c).

4. § 37.1501(d)—Preparation of Annual Compliance Report[812]

Existing § 37.1501(e)—"Preparation of annual compliance report"—currently requires the CCO to annually prepare and sign an ACR that, at a minimum (i) describes the SEF's written policies and procedures, including the code of ethics and conflicts of interest policies;[813] (ii) reviews the SEF's compliance with the Act and Commission regulations in conjunction with the SEF's policies and procedures;[814] (iii) provides a self-assessment of the effectiveness of the SEF's policies and procedures, including areas of improvement and related recommendations for the SEF's compliance program or resources;[815] (iv) lists material changes to the policies and procedures;[816] (v) describes the SEF's financial, managerial, and operational resources, including compliance program staffing and resources, a catalogue of investigations and disciplinary actions, and a review of the disciplinary committee's performance;[817] (vi) describes any material compliance matters identified through certain enumerated mechanisms, *e.g.*, compliance office review or lookback, and explains how they were resolved;[818] and (vii) certifies that, to the best of the CCO's knowledge and reasonable belief and under penalty of law, the ACR report is accurate and complete.[819]

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[812] The Commission proposes to renumber existing subsection (e) to subsection (d).
[813] 17 CFR 37.1501(e)(1).
[814] 17 CFR 37.1501(e)(2)(i).
[815] 17 CFR 37.1501(e)(2)(ii)-(iii).
[816] 17 CFR 37.1501(e)(3).
[817] 17 CFR 37.1501(e)(4).
[818] 17 CFR 37.1501(e)(5).
[819] 17 CFR 37.1501(e)(6).

During part 37 implementation, the Commission has gained experience and received feedback with respect to the ACR requirements. The Commission notes that some of the required ACR content has provided the Commission with minimal meaningful insight into a SEF's compliance program. For example, some of the content is duplicative of information obtained by the Commission from other reporting channels, such as the system-related information that a SEF must file pursuant to Core Principle 14[820] and rule certifications filed pursuant to part 40 of the Commission's regulations.[821] Various SEF CCOs have also provided feedback that certain ACR content requires substantial time to prepare and includes some information that does not change frequently.[822] They have requested that the Commission simplify these requirements and provide additional time to file the reports. The Commission also notes, however, that many SEFs have not provided sufficient details that describe and assess whether their respective policies and procedures (*e.g.*, rulebooks, compliance manuals, conflict of interest policies, code of ethics, governance documentation, and third-party service agreements) comply with the Act and Commission regulations.

Based upon its experience in reviewing ACRs, the Commission is proposing certain amendments that would eliminate duplicative or unnecessary information

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[820] The Commission notes that proposed subsection (h) (existing subsection (g)) requires a SEF to produce systemsafeguards-related books and records that include current copies of its business continuity-disaster recovery plans and emergency procedures, assessments of its operational risks and controls, and reports concerning systemsafeguards testing and assessments.

[821] Among other information required to be submitted to the Commission pursuant to part 40, a SEF is required to provide the Commission with amendments to its rulebook and compliance manual.

[822] *See* CFTC Letter No. 17-61, No-Action Relief for Swap Execution Facilities from Compliance with the Timing Requirements of Commission Regulation 37.1501(f)(2) Relating to Chief Compliance Officer Annual Compliance Reports and Commission Regulation 37.1306(d) Relating to Fourth Quarter Financial Reports at 2-3 (Nov. 20, 2017) ("NAL No. 17-61") (citing testimonials from SEFs that the preparation of an ACR requires an extensive information gathering process, including a review and documentation of information gathered on an entity-wide basis).

requirements and streamline existing requirements. These amendments would reduce unnecessary regulatory burdens and compliance costs associated with certain aspects of ACRs. The Commission is also proposing certain amendments to enhance the usefulness of ACRs by enabling the Commission to assess the effectiveness of a SEF's compliance and self-regulatory programs. The proposed revisions represent a simplified approach that continues to effectuate Core Principle 15.

The Commission proposes to refine the scope of some of the required ACR content that it believes is otherwise duplicative, unnecessary, or burdensome. Under the proposed approach, a SEF would no longer need to include in its ACR either a review of all the Commission regulations applicable to a SEF or an identification of the written policies and procedures designed to ensure compliance with the Act and Commission regulations.[823] The Commission believes that instead requiring an ACR to include a description and self-assessment of the effectiveness of the SEF's written policies and procedures to "reasonably ensure" compliance with the Act and applicable Commission regulations is more closely aligned with the corresponding provisions of Core Principle 15 and would still allow the Commission to properly assess the SEF's compliance and self-regulatory programs.[824] Similarly, the Commission also proposes to eliminate a

[823] The Commission proposes to eliminate these requirements in existing subparagraph (e)(2)(i) and the introductory language of existing paragraph (e)(2).

[824] As proposed, a SEF would continue to be required to describe the SEF's written policies and procedures, consistent with Core Principle 15. In addition to the required description, the Commission proposes to consolidate and amend existing subparagraph (e)(2)(ii), which requires a SEF to provide a self-assessment as to the effectiveness of its policies and procedures in the ACR, with existing paragraph (e)(1), and renumber the consolidated requirement to paragraph (d)(1). Further, the Commission proposes to consolidate and amend existing subparagraph (e)(2)(iii), which requires an ACR to discuss areas for improvement and recommend potential or prospective changes or improvements to a SEF's compliance program and resources, with existing paragraph (e)(3) and renumber the consolidated requirement to paragraph (d)(2). The Commission expects that the CCO will provide more nuanced and in-depth discussions through these consolidated provisions, rather than merely providing generalized responses.

required discussion of the SEF's compliance staffing and structure; a catalogue of investigations and disciplinary actions taken over the last year; and a review of disciplinary committee and panel performance.[825] An ACR would continue to be required to describe a SEF's financial, managerial, and operational resources set aside for compliance, which the Commission believes is sufficient information to assess a SEF's self-regulatory program.[826] By refining the scope of information required to be included in the ACR, the Commission anticipates that a SEF will be to devote its resources in providing more detailed, and ultimately better quality, information that will better help assess its compliance.

To facilitate the Commission's ability to assess a SEF's written policies and procedures regarding compliance matters, the Commission also proposes to require a SEF to discuss only material noncompliance matters and explain the corresponding actions taken to resolve such matters.[827] The Commission believes that requiring SEFs to focus on describing material non-compliance matters, rather than describing all compliance matters in similar depth, will streamline this requirement and provide more useful information to the Commission. Further, the Commission proposes to eliminate the enumerated mechanisms for identifying non-compliance issues, which conforms to the ability of a CCO to establish procedures to address non-compliance issues through "any means," as described above.[828]

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[825] The Commission proposes to eliminate these requirements under existing paragraph (e)(4).
[826] The Commission proposes to renumber the remaining requirements under existing paragraph (e)(4) to paragraph (d)(3) and adopt minor non-substantive amendments.
[827] The Commission proposes to renumber this requirement under existing paragraph (e)(5) to paragraph (d)(4) and adopt the amendments as described above and other non-substantive amendments.
[828] The Commission proposes to eliminate these enumerated mechanisms under existing paragraph (e)(5).

Consistent with these proposed amendments, the Commission also proposes to limit a SEF CCO's certification of an ACR's accuracy and completeness to "all material respects" of the report.[829] The Commission recognizes that CCOs have been hesitant to certify that an entire ACR is accurate and complete under the penalty of the law, without regard to whether a potential inaccuracy or omission would be a material error or not. Therefore, the Commission believes this proposed change will provide an appropriate balance between the SEF CCOs' concerns of potential liability with the material accuracy of an ACR submitted to the Commission.

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1501(d). In particular, the Commission requests comment to the questions below.

(89) Are the proposed revisions to the required content for ACRs appropriate? If not, then how should the Commission modify the required content?

(90) Are there any unintended consequences to removing the specific requirements regarding a description of a SEF's self-regulatory program's staffing and structure, a catalogue of investigations and disciplinary actions taken since the last ACR, and a review of the performance of the disciplinary committees and panels?

(91) Is it appropriate to limit the discussion of non-compliance matters to only those that are material in nature? If not, then why?

[829] The Commission proposes to renumber existing paragraph (e)(6) to paragraph (d)(5) and amend the requirement as described.

5. § 37.1501(e)—Submission of Annual Compliance Report and Related Matters[830]

Existing § 37.1501(f)(1) currently requires a CCO to provide an ACR to the board or, in the absence of a board, the senior officer for review.[831] The board of directors and senior officer may not require the CCO to change the ACR.[832] The SEF's board minutes or a similar written record must reflect the submission of the ACR to the board of directors or senior officer and any subsequent discussion of the report.[833] Additionally, the SEF must concurrently file the ACR and the fourth quarter financial statements with the Commission within 60 calendar days of the end of the SEF's fiscal year end.[834] The CCO must certify and promptly file an amended ACR with the Commission upon the discovery of any material error or omission in the report.[835] A SEF may request an extension to file the ACR with the Commission based on substantial, undue hardship in filing the ACR on time.[836]

The Commission proposes several amendments to simplify the ACR submission procedures. First, the Commission proposes to provide SEFs with an additional thirty days to file the ACR with the Commission, but no later than ninety calendar days after a SEF's fiscal year end.[837] This proposed extension is consistent with the basis provided by Commission staff in granting current no-action relief to SEFs that provides an

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[830] The Commission proposes to renumber existing subsection (f) to subsection (e). The Commission also proposes to retitle subsection (e) to "Submission of annual compliance report and related matters" from "Submission of annual compliance report" based on the proposed changes described below.
[831] 17 CFR 37.1501(f)(1).
[832] *Id.*
[833] *Id.*
[834] 17 CFR 37.1501(f)(2).
[835] 17 CFR 37.1501(f)(3).
[836] 17 CFR 37.1501(f)(4).
[837] The Commission proposes to renumber existing paragraph (f)(2) to paragraph (e)(2) and amend the requirement as described. The Commission also proposes to add a title to this paragraph—"Submission of annual compliance report to the Commission."

additional thirty days to prepare and file an ACR.[838] In particular, the Commission recognizes that in addition to the ACR, a CCO has other reporting obligations, such as the fourth quarter financial report required to be submitted under Core Principle 13 and other year-end reports; SEFs have indicated that these multiple reporting obligations present resource constraints on SEFs and their CCOs.[839] In addition to an extended deadline, the Commission proposes to replace the "substantial and undue hardship" standard required for filing ACR extensions with a "reasonable and valid" standard.[840] Further, the Commission proposes to eliminate the requirement that each SEF must document the submission of the ACR to the SEF's board of directors or senior officer in board minutes or some other similar written record;[841] the Commission notes that the Core Principle 15 recordkeeping requirement under proposed § 37.1501(f), as discussed further below, would incorporate this requirement.[842] The Commission also proposes to require a CCO to submit an amended ACR to the SEF's board of directors or, in the absence of a board of directors, the senior officer of the SEF, for review prior to submitting the amended ACR to the Commission; this approach is the same as the requirements that exist for submitting an initial ACR.[843]

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[838] NAL No. 17-61 at 4.
[839] *Id.* at 2-3.
[840] The Commission proposes to renumber existing paragraph (f)(4) to paragraph (e)(4) and amend the provision as described. The Commission also proposes to add a title—"Request for extension."
[841] The Commission proposes to eliminate this requirement under existing paragraph (f)(1).
[842] The Commission notes that existing § 37.1501(g) sets forth recordkeeping requirements for SEFs related to the CCO's duties. As discussed below, the Commission is proposing to amend those requirements. *See infra* Section XX.A.6.—§ 37.1501(f)—Recordkeeping.
[843] The Commission proposes to renumber existing paragraph (f)(3) to paragraph (e)(3) and add a title—"Amendments to annual compliance report." The Commission proposes to adopt this requirement under subparagraph (e)(3)(i). The Commission notes that under proposed subparagraph (e)(3)(ii), an amended ACR would be subject to the amended certification requirement, *i.e.*, a CCO must certify that the ACR is accurate and complete in all material respects.

In addition to the proposed amendments described above related to submitting the ACR, the Commission proposes certain non-substantive amendments to the remaining provisions under proposed § 37.1501(e).[844]

Request for Comment

The Commission requests comment on all aspects of proposed § 37.1501(e).

6. § 37.1501(f)—Recordkeeping[845]

Existing Section 37.1501(g)(1) currently requires a SEF to maintain a copy of written policies and procedures adopted in furtherance of compliance with the Act and the Commissions regulations;[846] copies of all materials created in furtherance of the CCO's duties under existing §§ 37.1501(d)(8)-(9);[847] copies of all materials in connection with the review and submission of the ACR;[848] and any records relevant to the ACR.[849] Existing § 37.1501(g)(2) requires the SEF to maintain these records in accordance with § 1.31 and part 45 of the Commission's regulations.[850]

The Commission proposes streamline the recordkeeping requirements that pertain to the CCO's duties and the preparation and submission of the ACR. Accordingly, the Commission proposes a revised general requirement under proposed § 37.1501(f) that would require the SEF to keep all records demonstrating compliance with the duties of the CCO and the preparation and submission of the ACR consistent with the recordkeeping requirements under §§ 37.1000-1001.

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[844] The Commission proposes to renumber existing paragraph (f)(1) to paragraph (e)(1), adopt non-substantive amendments to the existing language, and add a title—"Furnishing the annual compliance report prior to submission to the Commission."
[845] The Commission proposes to renumber existing subsection (g) to subsection (f).
[846] 17 CFR 37.1501(g)(1)(i).
[847] 17 CFR 37.1501(g)(1)(ii).
[848] 17 CFR 37.1501(g)(1)(iii).
[849] 17 CFR 37.1501(g)(1)(iv).
[850] 17 CFR 37.1501(g)(2).

7. § 37.1501(g)—Delegation of Authority[851]

Section 37.1501(h)—"Delegation of authority"—currently delegates the authority to grant or deny a SEF's request for an extension of time to file its ACR to the Director of DMO.[852] In addition to renumbering the provision based on the amendments described above, the Commission proposes to adopt non-substantive amendments that conform to the proposed amendments to the Core Principle 15 regulations discussed above.

XXI. Part 36—Trade Execution Requirement

The Commission is proposing regulations under part 36 to address the broadened scope of swaps that will become subject to the trade execution requirement based on the proposed interpretation of "makes the swap available to trade" in CEA section 2(h)(8). In addition to an implementing regulation, the Commission proposes several exemptions from the requirement for certain types of swap transactions, as discussed below. Further, the Commission proposes to require that SEFs and DCMs file a standardized form with the Commission that details the swaps that they respectively list for trading that are subject to the requirement. The Commission also proposes a new provision to compel the Commission to establish a centralized registry on its website that reflects (i) the SEFs and DCMs that list swaps subject to the requirement; and (ii) the particular swaps listed on each of those entities. To transition trading of additional swaps onto SEFs or DCMs pursuant to the requirement, the Commission additionally proposes a revised compliance schedule.

[851] The Commission proposes to renumber existing subsection (h) to subsection (g) based on the changes described above.
[852] 17 CFR 37.1501(h).

A. § 36.1—Trade Execution Requirement

1. § 36.1(a)—Trade Execution Requirement

The Commission proposes § 36.1(a) to codify the statutory language of the trade execution requirement, which requires counterparties to execute a swap that is subject to the clearing requirement on a DCM, a SEF or an exempt SEF unless no such entity "makes the swap available to trade" or the swap is subject to a clearing exception in CEA section 2(h)(7).[853] The Commission believes that the statutory phrase "makes the swap available to trade" specifies the listing of a swap by a DCM, a SEF, or an exempt SEF on its facility for trading.[854] Accordingly, § 36.1(a) would specify that counterparties must execute a transaction subject to the clearing requirement on a DCM, a SEF, or an Exempt SEF that lists the swap for trading.[855]

The Commission also proposes to exempt certain types of swap transactions from the trade execution requirement pursuant to its exemptive authority in CEA section 4(c). For the purposes of promoting responsible economic or financial innovation and fair competition, CEA section 4(c)(1) provides the Commission with the authority to exempt any agreement, contract, or transaction from any CEA provision, subject to specified factors.[856] CEA section 4(c)(2) prohibits the Commission from providing an exemption from any requirements in CEA section 4(c)(1), unless the Commission determines that (i)

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[853] 7 U.S.C. 2(h)(8)(B). The Commission interprets "swap execution facility" in CEA section 2(h)(8)(B) to include a swap execution facility that is exempt from registration pursuant to CEA section 5h(g). *See supra* note 10. *See also supra* Section IV.I.4.a.—§ 36.1(a)—Trade Execution Requirement.

[854] *See supra* Section IV.I.4.a.—§ 36.1(a)—Trade Execution Requirement. As discussed below, the Commission is proposing an exemption from the requirement for swap transactions involving swaps that are listed for trading only by an Exempt SEF. *See infra* Section XXI.A.2.—§ 36.1(b)—Exemption For Certain Swaps Listed Only By Exempt SEFs.

[855] *See supra* Section IV.I.4.a.—§ 36.1(a)—Trade Execution Requirement.

[856] 7 U.S.C. 6(c)(1). CEA section 4(c)(1) is intended to allow the Commission to "provid[e] certainty and stability to existing and emerging markets so that financial innovation and market development can proceed in an effective and competitive manner." House Conf. Report No. 102–978, 102d Cong. 2d Sess. at 81 (Oct. 2, 1992), *reprinted in* 1992 U.S.C.C.A.N. 3179, 3213.

the requirement should not be applied to the agreement, contract, or transaction for which the exemption is sought; (ii) the exemption would be consistent with the public interest and the purposes of the Act; (iii) the agreement, contract, or transaction at issue will be entered into solely between appropriate persons;[857] and (iv) the agreement, contract, or transaction at issue will not have a material adverse effect on the ability of the Commission or exchange to discharge its regulatory or self-regulatory duties under the Act.[858]

As discussed below, the Commission specifically proposes exemptions from the trade execution requirement for the following transactions that would otherwise be subject to that requirement: (i) swap transactions involving swaps that are listed for trading only by an Exempt SEF; (ii) swap transactions for which the clearing exceptions in CEA section 2(h)(7) or the clearing exceptions or exemptions under part 50 apply; (iii) swap transactions that are executed as a component of a package transaction that includes a component that is a new issuance bond; and (iv) swap transactions between "eligible affiliate counterparties" ("inter-affiliate counterparties") that elect to clear such transactions, notwithstanding their ability to elect the relevant clearing exemption under § 50.52.

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[857] 7 U.S.C. 6(c)(3). CEA section 4(c)(3) includes a number of specified categories of persons within "appropriate persons" that are deemed as appropriate to enter into swaps exempted pursuant to CEA section 4(c). This includes persons the Commission determines to be appropriate in light of their financial profile or other qualifications, or the applicability of appropriate regulatory protections. For purposes of considering the CEA section 4(c) exemptions within this proposal, the Commission believes that ECPs would qualify as "appropriate persons."

[858] 7 U.S.C. 6(c)(2). Notwithstanding the adoption of exemptions from the Act, the Commission emphasizes that their use is subject to the Commission's antifraud and anti-manipulation enforcement authority. In this connection, § 50.10(a) prohibits any person from knowingly or recklessly evading or participating in, or facilitating, an evasion of CEA section 2(h) or any Commission rule or regulation adopted thereunder. 17 CFR 50.10(a). Further, § 50.10(c) prohibits any person from abusing any exemption or exception to CEA section 2(h), including any associated exemption or exception provided by rule, regulation, or order. 17 CFR 50.10(c).

2. § 36.1(b)—Exemption For Certain Swaps Listed Only By Exempt SEFs

The Commission proposes § 36.1(b) to establish an exemption from the trade execution requirement that may be elected by counterparties to a swap that is subject to the trade execution requirement, but is listed for trading only by Exempt SEFs.[859] The Commission believes that exempting these types of transactions from the trade execution requirement would be consistent with the objectives of CEA section 4(c).

As noted above, CEA section 2(h)(8)(A) provides that counterparties to transactions involving a swap subject to the clearing requirement must execute the transaction on a DCM designated under CEA section 5, a SEF registered under CEA section 5h or a SEF that is exempt from registration under CEA 5h(g).[860] CEA section 2(h)(8)(B), however, specifies that this requirement does not apply if no DCM or *swap execution facility* makes the swap available to trade (emphasis added).[861] The Commission interprets the phrase "swap execution facility" in CEA section 2(h)(8)(B) to include both registered SEFs and SEFs that are exempt from registration pursuant to section 5h(g), given the references in section 2(h)(8)(A) and the applicability of section 5h to both types of entities.[862] Therefore, under the Commission's proposed interpretation of "makes the swap available to trade," either a registered SEF or an Exempt SEF that lists a swap subject to the clearing requirement for trading can make the swap "available to trade," thereby triggering the trade execution requirement for that swap.

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[859] The Commission notes, however, that once a swap subject to the clearing requirement is listed by a SEF or a DCM, then counterparties may not use this exemption and would be required to comply with the trade execution requirement.
[860] 7 U.S.C. 2(h)(8)(A).
[861] 7 U.S.C. 2(h)(8)(B).
[862] *See supra* note 10.

While the Commission interprets CEA section 2(h)(8) to mean that the listing of a swap by an Exempt SEF would trigger the trade execution requirement, the Commission believes that it would be appropriate to exempt such listings from the requirement, given that the Commission does not oversee the listing of swaps by Exempt SEFs. To list new contracts SEFs submit their products for Commission review pursuant to the part 40 filing requirements.[863] The Commission reviews a new swap contract to ensure that it is consistent with the CEA and applicable Commission regulations, including the requirement that the contract not be susceptible to manipulation. Upon listing, a SEF, under Commission oversight, remains responsible for ensuring that the contract continues to comport with the CEA and applicable Commission regulations. In contrast, the Commission does not have oversight authority with respect to the listing of new contracts by Exempt SEFs.

The Commission believes that exempting swaps subject to the clearing requirement that are listed exclusively by Exempt SEFs should have little practical impact on the number of products that become subject to the trade execution requirement. Given the internationally competitive nature of the swaps industry, the Commission believes that SEFs and DCMs will likely list many of the same swaps listed by Exempt SEFs. The Commission also emphasizes that once the trade execution requirement is triggered for a particular swap by a SEF or DCM that lists the swap, the requirement may be satisfied by executing the swap on not only a SEF or DCM, but also on an Exempt SEF as well.

[863] 17 CFR 40.2-3.

a. Discussion of CEA Section 4(c) Enumerated Factors

For the reasons stated above, the Commission believes that exempting a swap subject to the clearing requirement that is listed for trading only on an Exempt SEF from triggering the trade execution requirement would be consistent with the objectives of CEA section 4(c).

Given that the number of swaps that are subject to the clearing requirement and only listed by Exempt SEFs is likely small, the Commission believes that the proposed exemption is appropriate and would be consistent with the public interest and purposes of the CEA. The Commission believes that the proposed regulation would not have a material adverse effect on the ability of the Commission or any SEF or DCM to discharge its regulatory or self-regulatory duties under the Act. The Commission notes that under the proposed exemption, swap agreements, contracts, and transactions would still be entered into solely between ECPs,[864] who the Commission believes, for purposes of this proposal, to be appropriate persons.

Request for Comment

The Commission requests comment on all aspects of proposed § 36.1(b), including whether the proposed exemptive relief is consistent with the public interest and the other requirements of CEA section 4(c). In particular, the Commission requests comment on the following question:

(92) Pursuant to its authority in CEA section 4(c), should the Commission exempt swaps that are subject to the clearing requirement and listed for trading only by an

[864] As noted above, pursuant to CEA section 2(e), it is unlawful for any U.S. person other than an ECP, as defined in CEA section 1a(18), to enter into a swap unless the swap is entered into on, or subject to the rules of, a DCM. 7 U.S.C. 2(e).

Exempt SEF from the trade execution requirement, until such swaps are listed by a SEF or DCM?

3. § 36.1(c)—Exemption for Swap Transactions Excepted or Exempted from the Clearing Requirement under Part 50

The Commission proposes § 36.1(c) to establish an exemption to the trade execution requirement for swap transactions for which an exception or exemption has been elected pursuant to part 50. The proposed exemption would apply to any transaction for which (i) a clearing exception under § 50.50 or a clearing exemption under § 50.51 or § 50.52 has been elected; or (ii) a future exemption that has been adopted by the Commission under part 50 would apply. The Commission has determined that exempting these types of transactions from the trade execution requirement would be consistent with the objectives of CEA section 4(c).

The Act and the Commission's regulations specify that certain transactions that are not subject to the clearing requirement are not subject to the trade execution requirement. CEA section 2(h)(8) clearly establishes that transactions that are not subject to the clearing requirement pursuant to a clearing exception in CEA section 2(h)(7) are not subject to the trade execution requirement.[865] CEA section 2(h)(7), *i.e.*, the end-user exception, provides a clearing exception to a swap transaction if one of the counterparties (i) is not a financial entity; (ii) is using the swap to hedge or mitigate commercial risk; and (iii) notifies the Commission about how it generally meets its financial obligations

[865] 7 U.S.C. 2(h)(8)(B).

associated with entering into uncleared swaps.[866] The Commission adopted requirements under § 50.50 to implement this exception.[867]

In contrast to swaps that are eligible for the end-user exception, however, swaps that are not subject to the clearing requirement based on other statutory authority are currently not expressly exempted from the trade execution requirement. Pursuant to its exemptive authority in CEA section 4(c), the Commission has provided additional exemptions from the clearing requirement for swaps between certain types of entities, as well as for certain types of swap transactions. Section 50.51 allows certain cooperatives—those that otherwise consist entirely of entities that would qualify for the end-user exception—to elect a clearing exemption for swaps executed with a member of an exempt cooperative.[868] Section 50.52 allows inter-affiliate counterparties who have "eligible affiliate counterparty status" to elect a clearing exemption for swaps that are entered into between the affiliated parties.[869] The Commission notes that it has also proposed, pursuant to CEA section 4(c), to exempt transactions by eligible bank holding companies, savings and loan holding companies, and community development financial institutions from the clearing requirement.[870]

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[866] 7 U.S.C. 2(h)(7).

[867] 7 U.S.C. 2(h)(7). Among other things, § 50.50 establishes when a swap transaction is considered to hedge or mitigate commercial risk; specifies how to satisfy the reporting requirement; and exempts small financial institutions from the definition of "financial entity." 17 CFR 50.50.

[868] 17 CFR 50.51. The exemption applies to swaps that are executed in connection with originating a loan or loans for the member of the cooperative, or hedging or mitigating commercial risk related to member loans or arising from swaps related to originating loans for members. 17 CFR 50.51(b)(1)-(2).

[869] 17 CFR 50.52. Counterparties have "eligible affiliate counterparty status" if one counterparty, directly or indirectly, holds a majority ownership interest in the other counterparty; or a third party, directly or indirectly, holds a majority ownership interest in both counterparties. 17 CFR 50.52(a)(1)(i)-(ii). To elect the exemption, such counterparties must also meet additional conditions, including reporting requirements. 17 CFR 50.52(b)-(c).

[870] Amendments to Clearing Exemption for Swaps Entered Into by Certain Bank Holding Companies, Savings and Loan Holding Companies, and Community Development Financial Institutions, 83 FR 44001 (proposed Aug. 29, 2018).

The Commission believes that applying the trade execution requirement to swaps that are eligible for a clearing exception or clearing exemption potentially mitigates the benefits that are associated with that exception or exemption. For example, a counterparty that determines not to clear a swap pursuant to a clearing exemption, but otherwise remains subject to the trade execution requirement, would be limited in where it may trade or execute that swap and may incur additional costs related to SEF onboarding. Therefore, in order to fully preserve the benefits of a clearing exception or clearing exemption, the Commission believes swaps that are excepted or exempted from the clearing requirement should not be subject to the trade execution requirement.

a. Discussion of CEA Section 4(c) Enumerated Factors

For the reasons stated above, the Commission believes that exempting a swap transaction, for which a clearing exception or clearing exemption have been elected pursuant to part 50, from the trade execution requirement would be consistent with the objectives of CEA section 4(c).

Given that the scope of this proposed exemption is limited and applies to transactions that are already excepted or exempted from the clearing requirement, the Commission believes that the proposed regulation would not have a material adverse effect on the ability of the Commission or any SEF or DCM to discharge its regulatory or self-regulatory responsibilities under the CEA and the Commission's regulations. The Commission believes that under the proposed exemption, swap transactions would still be entered into solely between ECPs, who the Commission believes, for purposes of this proposal, to be appropriate persons.[871]

[871] *See supra* note 857 (discussing the scope of "appropriate persons").

Request for Comment

The Commission requests comment on all aspects of proposed § 36.1(c), including whether the proposed exemptive relief is consistent with the public interest and the other requirements of CEA section 4(c). In particular, the Commission requests comment on the following question:

(93) Pursuant to its authority in CEA section 4(c), should the Commission exempt swap transactions that are subject to a clearing exception or clearing exemption under part 50 from the trade execution requirement?

4. § 36.1(d)—Exemption for Swaps Executed with Bond Issuance

The Commission proposes § 36.1(d) to establish an exemption to the trade execution requirement for swap transactions that are components of a "New Issuance Bond" package transaction. The Commission believes that exempting these types of transactions from the trade execution requirement would be consistent with the objectives of CEA section 4(c). This proposed approach is consistent with the time-limited no-action relief provided by Commission staff for this category of package transactions.[872]

New Issuance Bond package transactions include at least one individual swap component that is subject to the trade execution requirement and at least one individual component that is a bond[873] issued and sold in the primary market.[874] An underwriter (on

[872] *See supra* note 334 (describing the no-action relief from the trade execution requirement provided by Commission staff for categories of package transactions).

[873] The Commission notes that this proposed exemption would not apply to swap components of package transactions that include sovereign debt, such as U.S. Treasury bonds, notes, and bills.

[874] The Commission understands that a bond issued and sold in the primary market that may constitute part of a package transaction is a "security," as defined in section 2(a)(1) of the Securities Act of 1933 or section 3(a)(10) of the Securities Exchange Act of 1934. To the extent that counterparties may be facilitating package transactions that involve a security, or any component agreement, contract, or transaction over which the Commission does not have exclusive jurisdiction, the Commission does not opine on whether such activity complies with other applicable law and regulations.

behalf of an issuer) arranges the issuance of a bond packaged with a fixed-to-floating IRS that features the issuer as a counterparty. The terms of the IRS, which include tenor and payment terms, typically match the terms of the bond issuance. By issuing a bond with a fixed-to-floating IRS, issuers are able to effectively turn fixed-rate liabilities into variable rate liabilities, or vice versa.[875] To correspond the terms between these two components and facilitate the bond issuance in an efficient and cost-effective manner, the IRS component is customized and negotiated in a manner that closely corresponds to the bond issuance process.

Given the role of the issuer in the package transaction—both as issuer of the bond and a counterparty to the swap—and the process under which the swap is negotiated,[876] this type of package transaction has not been conducive to execution on a SEF trading system or platform. The Commission notes that the no-action relief that has been provided by Commission staff for these swaps components reflects the ongoing lack of an available execution method on an appropriate venue.[877] Based on the integral role of the bond issuance in facilitating the component swap execution, the Commission believes that the IRS component is not suitable for execution on a SEF, even where a SEF may offer flexible means of execution.

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[875] For example, a bond issuer seeks to pay variable rates on its bonds, but prospective investors may seek a fixed rate of return. By arranging a New Issuance Bond package transaction, the bond issuer can issue a fixed-rate bond and simultaneously enter into an offsetting IRS. The IRS enables the issuer to receive a fixed rate that matches the fixed rate on its bond to be issued, while paying the variable rate that it originally sought. Ultimately, this arrangement may allow the bond issuer to issue the fixed-rate bond at a lower cost.

[876] The Commission notes that these types of package transactions differ from other package transactions that involve the purchase or sale of a security in the secondary market, given that they involve the issuance of a new security.

[877] NAL No. 17-55 at 2-3.

Therefore, consistent with current no-action relief provided by Commission staff, the Commission proposes to exempt swap components of a New Bond Issuance package transaction from the trade execution requirement. The proposed exemption would establish that a "package transaction" consists of two or more component transactions executed between two or more counterparties, where (i) execution of each component transaction is contingent upon the execution of all other components transactions; and (ii) the component transactions are priced or quoted together as one economic transaction with simultaneous or near simultaneous execution of all components. The Commission recognizes the inherent challenges in trading or executing these swap components on a SEF or DCM and, therefore, recognizes the benefits of continuing to allow market participants to maintain established market practices with respect to this type of package transaction.

a. Discussion of CEA Section 4(c) Enumerated Factors

The Commission believes that exempting swap components of New Issuance Bond package transactions from the trade execution requirement would be consistent with the objectives of CEA section 4(c).

The Commission recognizes the importance of new bond issuances in helping market participants to raise capital and fund origination loans for businesses and homeowners. Accordingly, the Commission recognizes that allowing the swap components of New Bond Issuance package transaction to be executed away from a SEF or DCM—consistent with current market practice—is integral to facilitating the bond issuance. Further, the Commission recognizes that the proposed exemption is limited in

nature, *i.e.*, the swap transaction remains subject to all other applicable Commission rules and regulations.

The Commission believes, therefore, that the proposed exemption from the trade execution requirement for swap components of New Issuance Bond package transactions is appropriate and would be consistent with the public interest and purposes of the CEA. The Commission further believes that the proposed regulation would not have a material adverse effect on the ability of the Commission or any SEF or DCM to discharge its regulatory or self-regulatory duties under the CEA. The Commission notes that under the proposed exemption, swap transactions would still be entered into solely between ECPs, who the Commission believes, for purposes of this proposal, to be appropriate persons.

Request for Comment

The Commission requests comment on all aspects of the proposed exemption of swap components of New Issuance Bond package transactions from the trade execution requirement under proposed § 36.1(d), including whether the proposed exemptive relief is consistent with the public interest and the other requirements of CEA section 4(c). The Commission specifically requests comment on the following questions:

(94) Pursuant to its authority in CEA section 4(c), should the Commission exempt the swap components of a New Issuance Bond package transaction from the trade execution requirement?

(95) Is the proposed definition of "package transaction" in proposed § 36.1(d)(1) appropriate?

(96) Are there additional package transactions that should be exempt from the trade execution requirement? If so, then please describe in detail why such package

transactions should be exempt from the trade execution requirement, especially in light of the flexible means of execution the Commission is proposing to allow for all swaps listed by a SEF.

5. § 36.1(e)—Exemption for Swaps Executed Between Affiliates that Elect to Clear

The Commission proposes § 36.1(e) to establish an exemption from the trade execution requirement that may be elected by inter-affiliate counterparties to a swap that is submitted for clearing. Counterparties would be eligible to elect the exemption by meeting the conditions set forth under § 50.52(a) for "eligible affiliate counterparty" status.[878] The Commission notes that this proposed exemption would apply to transactions that inter-affiliate counterparties elect to clear, notwithstanding their ability to elect the clearing exemption.

Based on time-limited no-action relief granted by Commission staff, inter-affiliate counterparties that do not elect the § 50.52 clearing exemption are executing swaps away from a SEF or DCM that are otherwise subject to the trade execution requirement.[879] The relief has been granted to address the difficulty cited by market participants in executing

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[878] *See supra* note 869 (describing requirements for meeting "eligible affiliate counterparty" status).

[879] CFTC Letter No. 17-67, Re: Extension of No-Action Relief from Commodity Exchange Act Section 2(h)(8) for Swaps Executed Between Certain Affiliated Entities that Are Not Exempt from Clearing Under Commission Regulation 50.52 (Dec. 14, 2017) ("NAL No. 17-67"); CFTC Letter No. 16-80, Re: Extension of No-Action Relief from Commodity Exchange Act Section 2(h)(8) for Swaps Executed Between Certain Affiliated Entities that Are Not Exempt from Clearing Under Commission Regulation 50.52 (Nov. 28, 2016); CFTC Letter No. 15-62, Re: Extension of No-Action Relief from Commodity Exchange Act Section 2(h)(8) for Swaps Executed Between Certain Affiliated Entities that Are Not Exempt from Clearing Under Commission Regulation 50.52 (Nov. 17, 2015); CFTC Letter No. 14-136, Re: Extension of No-Action Relief from Commodity Exchange Act Section 2(h)(8) for Swaps Executed Between Certain Affiliated Entities that Are Not Exempt from Clearing Under Commission Regulation 50.52 (Nov. 7, 2014); CFTC Letter No. 14-26, Time-Limited No-Action Relief from the Commodity Exchange Act Section 2(h)(8) for Swaps Executed Between Certain Affiliated Entities Not Electing Commission Regulation § 50.52 (Mar. 6, 2014). As discussed above, the Commission previously stated that transactions subject to the inter-affiliate exemption from clearing would also be exempt from the trade execution requirement. *See supra* Section XXI.A.3.—§ 36.1(c)—Exemption for Swap Transactions Excepted or Exempted from the Clearing Requirement under Part 50.

inter-affiliate swap transactions through the required methods of execution prescribed for swaps subject to the trade execution requirement under § 37.9, *i.e.*, Order Book and RFQ System. In particular, executing these transactions via competitive means of execution would be difficult because inter-affiliate swaps are generally not intended to be executed on an arm's-length basis or based on fully competitive pricing.[880] Rather, such swaps are used as tools to manage risk between affiliates and are carried out through internal accounting processes.[881] Market participants have asserted that forcing these transactions to be executed through a SEF would impose unnecessary costs and inefficiencies without any related benefits.[882] The Commission believes that requiring these types of transactions to be executed on a SEF would likely confer less benefit to the overall swaps markets and inhibit inter-affiliate counterparties from efficiently executing these types of transactions for operational purposes.

a. Discussion of CEA Section 4(c) Enumerated Factors

The Commission believes that exempting a swap executed between inter-affiliate counterparties that is submitted for clearing from the trade execution requirement would be consistent with the objectives of CEA section 4(c).

As noted above, these transactions are not intended to be arm's-length, market-facing, or competitively executed under any circumstance, irrespective of the type of swap involved. Therefore, the nature of these transactions mitigates the potential benefits

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[880] *See* NAL No. 17-67 at 2.

[881] In the 2013 Inter-Affiliate Final Rule, commenters explained that corporate groups can use a single conduit in the market on behalf of multiple affiliates within the group, which permits the corporate group to net affiliates' trades. This netting effectively reduces the overall risk of the corporate group and the number of open positions with external market participants, which in turn reduces operational, market, counterparty credit, and settlement risk. Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21750, 21753-54 (Apr. 11, 2013).

[882] NAL No. 17-67 at 2.

of their execution on a SEF or a DCM. The Commission believes this proposed exemption would ensure that inter-affiliate counterparties would be able to efficiently utilize the risk management approach that best suits their individual needs, such as clearing inter-affiliate swaps, without being unduly influenced by whether that choice would require them to execute swaps on a SEF. Notably, the Commission's proposed rules would allow SEFs to provide more flexible means of execution and, thus, could address some of the issues currently cited with respect to executing inter-affiliate transactions on a SEF. Nevertheless, the Commission believes that the policy justifications described above support an exemption for such inter-affiliate swap transactions from the trade execution requirement.

The Commission believes, therefore, that the proposed exemption from the trade execution requirement for inter-affiliate counterparties is appropriate, and it would be consistent with the public interest and purposes of the CEA. Given the limited applicability of this proposed exemption to transactions only executed between inter-affiliates, the Commission believes that the proposed regulation would not have a material adverse effect on the ability of the Commission or any SEF or DCM to discharge its regulatory or self-regulatory duties under the CEA. Finally, the Commission notes that under the proposed exemption, swap transactions would still be entered into solely between ECPs, who the Commission believes, for purposes of this proposal, to be appropriate persons.[883]

Request for Comment

[883] *See supra* note 857 (discussing the scope of "appropriate persons").

The Commission requests comment on all aspects of proposed § 36.1(e), including whether the proposed exemptive relief is consistent with the public interest and the other requirements of CEA section 4(c). In particular, the Commission requests comment on the following questions:

(97) Pursuant to its authority in CEA section 4(c), should the Commission exempt transactions between inter-affiliate counterparties who do not elect the inter-affiliate clearing exemption from the trade execution requirement?

(98) Should the Commission also consider exempting end-users that meet the criteria for a clearing exception in CEA section 2(h)(7) from the trade execution requirement regardless of whether they elect to use the end-user clearing exception?

B. § 36.2—Registry of Registered Entities Listing Swaps Subject to the Trade Execution Requirement; Appendix A to Part 36—Form TER

The Commission currently provides information on its website regarding the swaps that are subject to the trade execution requirement. In addition to providing a chart that identifies those swaps,[884] the Commission also posts the corresponding MAT determinations submitted pursuant to part 40's rule filing procedures.[885] While this approach has been effective in informing market participants about the limited number of swaps currently subject to the trade execution requirement, the Commission expects that the number of swaps that would be subject to the requirement will increase. To ensure that market participants have notice of the swaps that are subject to the trade execution requirement and the venues listing those swaps, the Commission proposes to create a

[884] CFTC, Industry Filings—Swaps Made Available to Trade, *available at* https://www.cftc.gov/idc/groups/public/@otherif/documents/file/swapsmadeavailablechart.pdf.
[885] CFTC, Industry Filings—Swaps Made Available to Trade Determination, *available at* https://sirt.cftc.gov/sirt/sirt.aspx?Topic=%20SwapsMadeAvailableToTradeDetermination.

registry under § 36.2(a) that will set forth the swaps that are subject to the trade execution requirement, and the SEFs and DCMs that list such swaps.[886]

To help the Commission publish and maintain such a registry, the Commission also proposes a requirement under § 36.2(b) and Appendix A to part 36 that SEFs and DCMs submit a standardized Form TER. Form TER would detail the swaps that they list that are subject to or subsequently become subject to the clearing requirement. The Commission further proposes to require that a SEF or DCM 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. In addition, the Commission proposes that SEFs and DCMs file a Form TER, for any swaps they currently list that are subject to the clearing requirement, ten business days prior to the effective date of any final rule adopted from this notice. To effectuate this proposed change initially, the Commission is proposing that the effective date for proposed § 36.2 occur twenty days prior to effective date for the rest of this proposed rule. The Commission believes that this earlier effective period would provide SEFs and DCMs sufficient time to file their initial Form TERs and give Commission staff sufficient time to review and process these initial Form TERs. Finally, for swaps that are listed by a SEF or DCM that subsequently become subject to the clearing requirement, the Commission proposes to require that SEFs and DCMs file Form TER ten business days prior to the effective date of that requirement for such swaps. By requiring SEFs and DCMs to file Form TER prior to the effective date of such

[886] The Commission notes that the proposed registry would not include information regarding the swaps subject to the trade execution requirement that are listed by Exempt SEFs. The Commission, however, anticipates that it will provide a list of the Exempt SEFs on which market participants may execute those swaps, subject to their availability on those facilities.

requirements, Commission staff would have sufficient time to review, compile Form TERs, and publish its trade execution requirement registry on its website.

Form TER in Appendix A to part 36 would require a SEFs or DCM to provide the specific relevant economic terms of the swaps that it lists for trading. Each SEF or DCM that lists a swap that is subject to or becomes subject to the clearing requirement would be required to file an initial Form TER that details all such listed swaps. Any subsequent changes to a SEF's or DCM's listing of such swaps, such as additional listed swaps that later become subject to the clearing requirement, would require the SEF or DCM to amend its Form TER to reflect that scope. For IRS listed for trading, Form TER would require a SEF or DCM to specify (i) product class/specification; (ii) currency; (iii) floating rate index; (iv) stated termination date; (v) optionality; (vi) dual currencies; and (vii) conditional notional amounts. For CDS listed for trading, Form TER would require a SEF or DCM to specify (i) product class/specification; (ii) reference entities; (iii) region; (iv) indices; (v) tenor; (vi) applicable series; and (vii) tranche. The Commission notes that the scope of required information corresponds to the scope of information provided under § 50.4 for IRS and CDS that are subject to the clearing requirement.

The Commission believes that Form TER would provide the information needed to efficiently produce a trade execution requirement registry under § 36.2. Given the potentially large number of filings and swaps that would comprise the trade execution requirement registry, the Commission believes that uniform submissions through a standardized Form TER will foster efficient processing of the submissions and uniform presentation of relevant information in the registry.

The Commission also proposes to require under § 36.2(c) that DCMs and SEFs publicly post their respective Form TER filings on their respective websites, and promptly amend any inaccurate Form TERs.

Request for Comment

The Commission requests comment on all aspects of proposed § 36.2 and proposed Form TER in Appendix A to part 36. In particular, the Commission requests comment on the following questions:

(99) Does the proposed Form TER request appropriate and sufficient information? If not, then what information should the Commission request, and why?

(100) What information should the Commission include in the trade execution requirement registry, and why?

C. § 36.3—Trade Execution Requirement Compliance Schedule

The Commission observes that with the proposed elimination of the existing MAT determination process and the expanded scope of swaps that would be subject to the trade execution requirement under proposed § 36.1, counterparties may require additional time to prepare and update their business practices and technological and operational capabilities to trade and execute these swaps on a SEF or DCM. For example, market participants would have to directly on-board to a SEF or DCM, or otherwise avail themselves of other means of access, to continue trading those swaps that become newly subject to the trade execution requirement. Therefore, the Commission proposes to eliminate the existing trade execution requirement compliance schedule[887] and to replace it with a new compliance schedule, based on participant type, for the

[887] 17 CFR 37.12, 38.11.

additional swaps that become subject to the expanded trade execution requirement. The proposed compliance schedule would be triggered on the effective date of any final rule adopted from this notice. The Commission has designed this proposed compliance schedule to ensure a smooth and timely implementation of the expanded requirement.

In formulating the proposed compliance schedule, the Commission considered the expanded scope of swaps that would become subject to the trade execution requirement. The Commission also referred to the compliance schedule previously established for the initial implementation of the clearing requirement, with a focus on the defined categories of market participants and respective levels of swap trading activity.[888] Accordingly, the proposed approach recognizes that different categories of counterparties have different abilities and resources for achieving compliance and is designed to provide counterparties with sufficient time to adapt to the expanded trade execution requirement.

The proposed schedule would establish different compliance dates for different categories of counterparties, as described below. As specified under proposed § 36.3(d), however, nothing in this proposed compliance schedule should be construed to prohibit counterparties from voluntarily complying with the trade execution requirement sooner than prescribed in the proposed compliance schedule. Finally, the Commission notes that pursuant to proposed § 36.3(b), the compliance schedule would not apply to swaps that are already subject to the trade execution requirement before the effective date of any final rule. Accordingly, market participants must continue to comply with the existing trade execution requirement for those swaps.

1. § 36.3(c)(1)—Category 1 Entities

[888] 17 CFR 50.25.

Under § 36.3(c)(1), a Category 1 entity, which would include swap dealers, major swap participants, security-based swap dealers, or major security-based swap participants, would have ninety days to comply with the expanded trade execution requirement when it executes a swap transaction with another Category 1 entity or a non-Category 1 entity that voluntarily seeks to execute the swap on a SEF, a DCM, or an Exempt SEF. The Commission believes that a ninety-day time frame would be a reasonable period for these entities because they possess experience in the swaps market and resources to comply with the requirement sooner than other counterparties. Further, the Commission believes that Category 1 entities are generally the most active participants in the swaps market, often serving as market makers and liquidity providers to other participants. As the initial category of participants that are required to comply with the expanded trade execution requirement, the Commission believes that Category 1 entities are best equipped to work internally and with the trading venues, *i.e.*, SEFs and DCMs, to operate under the expanded trade execution requirement.

The Commission also believes that ninety days is a reasonable period of time for SEFs and DCMs to prepare to facilitate trading in additional swaps that would become subject to the expanded trade execution requirement. In particular, the Commission notes that some SEFs already list many of the types of swaps that would become subject to the expanded requirement.[889] Therefore, the Commission expects that the SEFs and DCMs that list these types of swaps would be both technologically and operationally ready to offer the expanded number of swaps within ninety days.

2. § 36.3(c)(2)—Category 2 Entities

[889] *See supra* note 280.

The Commission proposes § 36.3(c)(2) to provide Category 2 entities with 180 days to comply with the expanded trade execution requirement when they execute swap transactions with a Category 1 entity, another Category 2 entity, or other counterparties that voluntarily seek to execute the swap on a SEF, a DCM, or an Exempt SEF. Category 2 entities would include commodity pools; private funds as defined in section 202(a) of the Investment Advisers Act of 1940; or persons predominantly engaged in activities related to the business of banking, or in activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act of 1956.

The Commission believes that a significant amount of swaps trading would migrate to SEFs or DCMs upon the compliance date for Category 2 entities because they consist of many active liquidity takers. Nevertheless, the Commission believes that an additional ninety days to comply with the expanded trade execution requirement would be reasonable for Category 2 entities, given that they may not have the same level of swaps trading expertise or resources as Category 1 entities. The Commission believes that it is essential for these entities to have sufficient time to transition their trading to venue-based environments.

3. § 36.3(c)(3)—Other Counterparties

The Commission proposes § 36.3(c)(3) to provide all entities that are not either Category 1 entities or Category 2 entities with 270 days to comply with the expanded trade execution requirement. The Commission believes that entities that do not qualify as either a Category 1 entity or Category 2 entity should be provided the greatest amount of time to comply with the expanded trade execution requirement because they likely have less sophistication in swaps trading. Of all of the participants in the swaps market, the Commission believes that the participants in this category are least likely to have on-

boarded to or have experience trading swaps through SEFs or DCMs. Further, the Commission understands that onboarding onto such venues can be an intensive and time-consuming process. Therefore, the Commission believes that this additional time will help ensure that these participants have sufficient time to onboard or establish means of access and are prepared to trade on a SEF or DCM.

4. § 36.3(e)—Future Compliance Schedules

Under proposed § 36.3(e), the Commission would devise an appropriate compliance schedule when additional swaps listed by a SEF or DCM are subject to the trade execution requirement in the future *i.e.,* after the effective date of any final rules that are associated with this part and upon the issuance of additional clearing requirement determinations. The Commission believes that this approach will provide it with sufficient flexibility to promote compliance in a manner that balances the Commission's policy goal of promoting trading on SEFs and DCMs while also accounting for different considerations, such as the nature of the swap products, their availability on multiple trading venues, and the readiness of relevant market participants to trade those products through a SEF or DCM.

Request for Comment

The Commission requests comment on all aspects of the proposed compliance schedule in proposed § 36.3. The Commission specifically requests comment on the following questions:

(101) Are the proposed compliance schedules for Category 1 Entities, Category 2 Entities, and all other entities appropriate? If not, then should the Commission consider longer or shorter compliance time frames and why?

(102) Are the entities included in Category 1 and Category 2 appropriate? If not, then please explain why. Should additional entities be included within either Category 1 or Category 2 and why?

(103) Are the compliance schedule time frames adequate for SEFs and DCMs to be technologically and operationally ready for the expanded trade execution requirement? If not, then what alternative compliance schedule time frame should the Commission consider and why?

(104) How should the Commission handle the compliance schedules for any future expansions of the trade execution requirement?

XXII. Part 43—§ 43.2—Definition of "Block Trade"

Section 43.2 defines a swap "block trade" as a publicly reportable swap transaction that (i) involves a swap that is listed on a SEF or DCM; (ii) occurs away from the SEF's or DCM's trading system or platform and is executed pursuant to the SEF's or DCM's rules and procedures; (iii) has a notional or principal amount at or above the appropriate minimum block trade size applicable to such swap; and (iv) is reported subject to the rules or procedures of the SEF or DCM and the rules set forth under part 43, including the appropriate time delay requirements set forth under § 43.5.[890] In specifying these elements, the Commission considered the treatment of block trades in various swap and non-swap markets.[891] In particular, the Commission looked to the futures markets, where futures block trades are "permissible, privately-negotiated transaction[s] that equal[] or exceed[] a DCM's specified minimum quantity of futures or

[890] 17 CFR 43.2.
[891] Real-Time Public Reporting of Swap Transaction Data, 75 FR 76140, 76159 (proposed Dec. 7, 2010) (discussion of block trades with respect to futures).

options contracts and is executed away from the DCM's centralized market but pursuant to its rules."[892] Accordingly, the Commission's regulatory definition of a "block trade" for swaps closely tracks this futures market concept of a block trade.

Similar to futures block trades, the Commission requires that swap block trades "occur away" from a SEF's or a DCM's trading system or platform, but pursuant to the SEF's or a DCM's rules and procedures.[893] The Commission clarified the "block trade" definition by stating that "[a]ny swap that is executed on a SEF or a DCM's trading system or platform, regardless of whether it is for a size at or above the appropriate minimum block size for such swap, is not a block trade under this definition…."[894] Accordingly, to receive the fifteen-minute public reporting delay that block trades are entitled to under § 43.5(d), the swap transaction not only must have a notional amount at or above the appropriate minimum block size, but must also "occur away" from the SEF's or the DCM's trading system or platform.[895]

Given that block trades must occur away from a SEF's or a DCM's trading system or platform, the enumerated prohibition on pre-arranged trading as an abusive trading practice under § 37.203(a) allows block trades as an exception.[896] This exception

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[892] *Id*.
[893] 17 CFR 43.2.
[894] Procedures To Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 78 FR 32866, 32904 n.425 (May 31, 2013).
[895] CEA section 2(a)(13) requires the Commission to establish rules that govern the real-time reporting of swap transaction and pricing data to the public, but also directs the Commission, among other things, to prescribe rules that specify the appropriate reporting time delay for block trades, including the criteria for determining what constitutes a block trade. 7 U.S.C. 2(a)(13).
[896] "Pre-arranged trading" is prohibited as an abusive trading practice under § 37.203(a). This prohibition generally applies to market participants who communicate with one another to pre-negotiate the terms of a trade away from a trading system or platform, but then execute the trade on the trading system or platform in a manner that appears competitive and subject to market risk. Accordingly, the Commission intended the prohibition to maintain the integrity of price competition and market risk that is incident to trading in the market. *See supra* Section VI.A.2.—§ 37.203(a)—Pre-Arranged Trading Prohibition; § 37.9—Time Delay Requirement.

allows transactions that meet or exceed the requisite block size to be privately negotiated to avoid potentially significant, adverse price impacts that would occur if traded on trading systems or platforms that offer pre-trade price transparency.

A. § 43.2—Definition—Block Trade; § 37.203(a)—Elimination of Block Trade Exception to Pre-Arranged Trading

During the part 37 implementation process, SEFs and market participants informed the Commission that for swap transactions that are intended to be cleared, requiring that such swaps to "occur away" from a SEF's trading system or platform creates an issue with carrying out pre-execution credit screening.[897] These market participants note that, in many cases, clearing FCMs are unable to conduct pre-execution credit screening for such block trades because they are unaware that a block trade has occurred away from a SEF until after it has been executed and reported to the SEF.[898] Accordingly, SEFs were unable to facilitate pre-execution credit checks for block trades.

DMO acknowledged this operational challenge and accordingly has granted ongoing no-action relief from the requirement that swap block trades "occur away" from a SEF.[899] Based on Commission staff no-action relief, a SEF may allow market participants to execute swap block trades that are intended to be cleared on a SEF's non-

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[897] For the Commission's discussion of pre-execution credit screening requirements, *see supra* Section XII.B.2.b.(3)—§§ 37.702(b)(2)-(3)—Pre-Execution Credit Screening.

[898] CFTC Letter No. 17-60, Re: Extension of No-Action Relief for Swap Execution Facilities from Certain "Block Trade" Requirements in Commission Regulation 43.2 at 2 (Nov. 14, 2017) ("NAL No. 17-60").

[899] NAL No. 17-60; CFTC Letter No. 16-74, Re: Extension of No-Action Relief for Swap Execution Facilities from Certain "Block Trade" Requirements in Commission Regulation 43.2 (Oct. 7, 2016); CFTC Letter No. 15-60, Re: Extension of No-Action Relief for Swap Execution Facilities from Certain "Block Trade" Requirements in Commission Regulation 43.2 (Nov. 2, 2015); CFTC Letter No. 14-118, No-Action Relief for Swap Execution Facilities from Certain "Block Trade" Requirements in Commission Regulation 43.2 (Sept. 19, 2014).

Order Book trading system or platform.[900] As a result, FCMs and SEFs have been able to comply with their respective pre-execution credit screening obligations.

The Commission proposes to revise certain elements of the "block trade" definition under § 43.2. First, the Commission proposes to eliminate the "occurs away" requirement for swap block trades. Second, the Commission proposes to require that to the extent counterparties seek to execute any swap that has a notional or principal amount at or above the appropriate minimum block trade size applicable to such swap on a SEF, they must do so on a SEF's trading system or platform. For swaps listed by a SEF for trading that participants intend to execute on the SEF and submit for clearing, the Commission believes that the proposed revised definition would (i) allow FCMs to conduct pre-execution credit screenings in accordance with § 1.73; and (ii) allow SEFs to facilitate those screenings in accordance with the Commission's proposed requirement under § 37.702(b).[901] In addition, for swaps listed by a SEF that participants intend to execute on the SEF, but do not intend to submit for clearing, participants would no longer be permitted to submit an already-executed block trade to the SEF pursuant to its rules; such transactions would be required to be executed on the SEF.

The Commission notes that this revised block trade definition is consistent with the provisions of the Dodd-Frank Act. CEA section 2(a)(13), as amended by the Dodd-Frank Act, directs the Commission to prescribe criteria for determining what constitutes a block trade for the purpose of establishing appropriate post-trade reporting time delays.

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[900] NAL No. 17-60 at 2-3.

[901] The Commission notes that proposed § 37.702(b) applies to SEFs that list (i) swaps that are subject to the clearing requirement; and/or (ii) swaps that are not subject to the clearing requirement, but for which the SEF facilitates processing and routing to a DCO for clearing. *See supra* Section XII.B.3.—Applicability of § 37.702(b) to SEFs that Do Not Facilitate Clearing.

The provision, however, does not set forth any pre-trade requirements, such as a requirement that the transaction be executed away from a SEF. Second, requiring block trades to be executed on a SEF for those swaps listed by the SEF, rather than allowing them to be executed away from the SEF, would also facilitate the statutory SEF goal of promoting swaps trading on SEFs.[902]

The revised definition also corresponds with other proposed changes to the SEF regulatory framework. For example, the Commission believes that allowing SEFs to use flexible means of execution for swap transactions negates the need to allow swap block trade execution to occur away from SEFs. Similarly, the Commission's proposed approach to pre-execution communications should facilitate swap block trade execution on SEFs; proposed § 37.201(b) would generally prohibit participants from conducting such communications away from the SEF, except for communications regarding a listed swap that is not subject to the trade execution requirement, among other exceptions.[903] Accordingly, participants may pre-negotiate block trades with one another for those swaps away from a SEF and submit them to the SEF for execution. This approach would allow participants to comply with the proposed definition, *i.e.*, the swap must be executed on a SEF, but also facilitate compliance with pre-execution credit screening requirements if the swap is intended to be cleared.

To conform to the amended block trade definition, the Commission also proposes to eliminate the block trade exception to the pre-arranged trading prohibition under § 37.203(a). Given that block trades would no longer occur away from a SEF, but would be executed on a SEF via flexible means of execution, the Commission expects that

[902] *See* 7 U.S.C. 7b-3(e).
[903] *See supra* Section VI.A.2.a.—§ 37.201(b)—Pre-Execution Communications.

market participants will have sufficient ability to continue to execute such transactions through a SEF's trading system or platform.

Request for Comment

The Commission requests comments on all aspects of proposed § 43.2. The Commission specifically requests comment on the following questions:

(105) Should the Commission limit the type of execution methods that may be utilized to permit block trades to receive a public reporting delay as set forth in Commission regulation § 43.5(d)? If so, then which methods of execution for block trades should be precluded from receiving a public reporting delay, and why? Would views on this question change if the public dissemination delay for a block trade was extended beyond fifteen minutes? If so, then please explain why.

(106) Should the Commission allow all swap block trades on SEFs to be negotiated through pre-execution communications and then submitted to SEFs for execution? Please explain why or why not.

XXIII. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act[904] requires Federal agencies, in promulgating regulations, to consider the impact of those regulations on small businesses. The regulations adopted herein will directly affect SEFs, DCMs, DCOs, SDs, MSPs and certain ECPs. The Commission has previously established certain definitions of ''small entities'' to be used by the Commission in evaluating the impact of its regulations on

[904] 5 U.S.C. 601 *et seq*.

small entities in accordance with the Regulatory Flexibility Act.[905] The Commission has also previously determined that SEFs,[906] DCMs,[907] DCOs,[908] SDs,[909] MSPs[910] and ECPs[911] are not small entities for the purpose of the Regulatory Flexibility Act.

Therefore, the Chairman, on behalf of the Commission, pursuant to 5 U.S.C. 605(b), hereby certifies that the proposed rules will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995, 44 U.S.C. 3501 *et seq*. ("PRA") imposes certain requirements on Federal agencies (including the Commission) in connection with conducting or sponsoring any "collection of information,"[912] as defined by the PRA. Among its purposes, the PRA is intended to minimize the paperwork burden to the private sector, to ensure that any collection of information by a government agency is put to the greatest possible uses, and to minimize duplicative information collections across the government.[913]

The PRA applies to all information, regardless of form or format, whenever the government is obtaining, causing to be obtained, or soliciting information, and includes required disclosure to third parties or the public, of facts or opinions, when the

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[905] Policy Statement and Establishment of Definitions of "Small Entities" for Purposes of the Regulatory Flexibility Act, 47 FR 18618 (Apr. 30, 1982)("1982 Policy Statement").
[906] Core Principles and Other Requirements for Swap Execution Facilities, 78 FR 33476, 33548 (Jun. 4, 2013).
[907] 1982 Policy Statement.
[908] A New Regulatory Framework for Clearing Organizations, 66 FR 45604, 45609 (Aug. 29, 2001).
[909] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 FR 30596, 30701 (May 23, 2012).
[910] *Id*.
[911] *See* 66 FR 20740, 20743 (Apr. 25, 2001).
[912] For purposes of this PRA discussion, the terms "information collection" and "collection of information" have the same meaning, and this section will use the terms interchangeably.
[913] 44 U.S.C. 3501.

information collection calls for answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, ten or more persons.[914] The PRA requirements have been determined to include not only mandatory, but also voluntary information collections, and include both written and oral communications.[915]

The Commission's proposed amendments would result in a collection of information within the meaning of the PRA, as discussed below. Under the PRA, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number from the Office of Management and Budget ("OMB"). The proposed rulemaking would amend parts 9, 36, 37, 38, 39, and 43 of the Commission's regulations to include new information collections, eliminate certain existing information collections, and modify existing information collections.[916]

OMB control number 3038-0074 currently covers, among other things, all information collections arising in part 37 (other than the information collections related to existing § 37.10) and part 9.[917] OMB control number 3038-0052 covers, among other

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[914] 44 U.S.C. 3502.
[915] 5 CFR 1320.3(c)(1).
[916] The proposed amendments would not substantially or materially modify existing information collection burdens, or create new information collection burdens, under parts 9, 39, and 43.
[917] The Commission notes that this OMB control number covers all information collections in part 37, including Subpart A and the SEF core principles, *i.e.*, Subparts B through P, and the appendices thereto, *i.e.*, Appendix A (Form SEF), Appendix B (guidance and acceptable practices), and proposed Appendix C (guidance to Core Principle 3). This OMB control number also includes all information collections related to part 9 to the extent applicable to SEFs. For clarity, existing § 37.10(a) is not covered under this OMB control number, but rather is subject to a separate information collection under OMB control number 3038-0099. The Commission further notes that in the most recent request for an extension of OMB control number 3038-0074, the Commission stated in the renewal notice that OMB control number 3038-0074 "covers all information collections in part 37 of the Commission's regulations, including Subpart A and the SEF core principles (*i.e.*, Subparts B and C) . . . . [other than] any information collections related to § 37.10 . . . ." The Commission notes that the reference to "Subparts B and C" should specify "Subparts B through P" instead. Agency Information Collection Activities Under OMB Review, 81 FR 65630, n.1 (Sep. 23, 2016) ("2016 Part 37 PRA Renewal").

things, information collections arising in part 38 (other than the information collections related to § 38.12).[918] OMB control number 3038-0099 covers the information collections related to the "available to trade" determination ("MAT determination") process under § 37.10 and § 38.12. Accordingly, the proposed rulemaking would amend OMB control numbers 3038-0074 and 3038-0052; however, the Commission proposes to eliminate OMB control number 3038-0099 along with the corresponding MAT determination information collections under § 37.10 and § 38.12. Instead, the Commission proposes to transfer the corresponding MAT determination information collections under § 37.10 and § 38.12 to part 36, and the related information collections related to the MAT determination process for SEFs and DCMs will be incorporated under OMB control numbers 3038-0074 and 3038-0052, respectively. The Commission, therefore, is submitting this proposal to OMB for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11.

The collections of information under these proposed amendments are necessary to implement certain provisions of the CEA, as amended by the Dodd-Frank Act. Among other provisions in the CEA, CEA section 8a(5) provides the Commission with authority to promulgate rules as reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of the CEA.[919]

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[918] The Commission notes that this OMB control number covers all information collections in part 38 of the Commission's regulations, including Subpart A and the DCM core principles, *i.e.*, Subparts B through X. This OMB control number also includes all information collections related to part 9 to the extent applicable to DCMs. The Commission also notes for clarity that existing § 38.12 is not covered under this OMB control number, but rather is subject to a separate information collection with OMB control number 3038-0099.

[919] The full authority provided under part 37 of the Commission's regulations includes: 7 U.S.C. 1a, 2, 5, 6, 6c, 7, 7a-2, 7b-3, and 12a, as amended by Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, tit. VII-VIII, 124 Stat. 1376 (2010).

If the proposed amendments are adopted, responses to the proposed collections of information generally would be mandatory, although certain collections of information could vary based upon a SEF's discretion or level of business. For example, a SEF has the discretion to establish the scope of its trading operations, *e.g.*, determining which swaps to list for trading, which may affect the various burden hours discussed herein.

The Commission will protect proprietary information according to the Freedom of Information Act and 17 CFR part 145, "Commission Records and Information." In addition, section 8(a)(1) of the CEA strictly prohibits the Commission, unless specifically authorized by the CEA, from making public "data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers." The Commission is also required to protect certain information contained in a government system of records according to the Privacy Act of 1974, 5 U.S.C. 552a.

As discussed in the preamble to the final rules for part 37 ("SEF Core Principles Final Rule"), the methodology the Commission used to formulate the proposed estimates reflect an average across all SEFs (and in respect to proposed part 36, all SEFs and DCMs).[920] By definition, averages are meant to serve as only a reference point; the Commission understands that due to both discretionary and mandatory requirements, some SEFs may go above the estimated burden hours to complete information collection requirements, while others may stay below those estimates.[921]

1. Information Provided by Reporting Entities/Persons

[920] Core Principles and Other Requirements for Swap Execution Facilities, 78 FR 33476, 33551 (Jun. 4, 2013).
[921] *Id*.

The following is a brief description of the information collections for SEFs, and as applicable DCMs and other market participants, under the proposed amendments to parts 36, 37 and 38.[922] To the extent that the Commission does not identify a specific provision, the Commission does not believe that any associated change substantively or materially modifies an existing information collection burden or creates a new one.[923]

The Commission notes that some of the proposed amendments are covered by other OMB control numbers. For example, some amendments would require SEFs to promulgate new rules that are required to be submitted to the Commission pursuant to part 40 of the Commission's regulations.[924] PRA burdens, if any, related to the submission by a SEF to the Commission of new rules, policies and procedures, and amendments have been accounted for in the previous information collection burden estimate associated with part 40, which governs the process by which SEFs must submit rules and amendments to the Commission.[925] Additionally, some of the hours associated with those information collections would not be deemed to be "burden hours" if they result from "usual and customary" business practices.[926]

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[922] As noted above, the Commission proposes to eliminate the MAT determination process for DCMs under § 38.12

[923] For the purposes of the PRA discussion herein, the Commission will not discuss the proposed amendments to parts 9, 39, and 43 because it has determined that they would not impose new information collection burdens or substantively or materially modify existing burdens therein. Further, the Commission will not discuss any proposed amendments to parts 36, 37, and 38 unless the Commission has determined that such changes would create, eliminate, or substantively or materially modify existing information collections or related burden hours.

[924] For example, proposed §§ 37.201(a)(1)-(3) would require a SEF to establish rules governing its operation that specify (i) the protocols and procedures for trading and execution, including entering, amending, cancelling, or executing orders for each execution method; (ii) the manner or circumstances in which the swap execution facility may exercise discretion in facilitating trading and execution for each execution method; and (iii) the sources and methodology for generating any market pricing information provided to facilitate trading and execution for each execution method.

[925] Provisions Common to Registered Entities, 76 FR 44776, 44789 (July 27, 2011).

[926] 5 CFR 1320.3(b)(2). For example, proposed § 37.6(b)(2)(iii) would require a SEF to establish and enforce rules to require the intermediary to transmit the confirmation or trade evidence record to the

a. § 37.3(a)—Requirements for Registration

The Commission expects that as a result of the proposed application of the SEF registration requirement under § 37.3(a), additional swaps broking entities will register as SEFs. For PRA purposes, the Commission previously had revised the current number of registered SEFs from 23[927] to the current 25[928] and had estimated approximately 4 new SEF applicants per year.[929]

The Commission notes that based on data from the National Futures Association ("NFA"), more than 300 interdealer brokers that are registered with the NFA as "introducing brokers" are also "swap firms," *i.e.*, interdealer brokers that are registered as introducing brokers and also designated to deal with swap products. The Commission, however, does not expect that proposed § 37.3(a) will result in all swap interdealer brokers registering as SEFs. The Commission understands that some of these entities may (i) already be affiliated with current SEFs and could operate as part of their respective affiliated SEFs rather than registering as new, separate SEFs; (ii) merge, become affiliated with, or otherwise be acquired by registered SEFs; or (iii) adjust their business practices such that they would not be required to register as a SEF. Additionally, some of these entities may be currently registered as introducing broker swap firms, but are not currently in the business of swaps trading and therefore do not

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respective counterparty "as soon as technologically practicable" upon receipt of the confirmation or trade evidence record from the SEF. The Commission notes that SEF members and market participants acting in an intermediary capacity and executing swaps on behalf of customers, as a matter of industry practice, generally make such confirmations available to their customers, *i.e.*, the swap counterparties. Accordingly, this proposed amendment reflects an existing "usual and customary practice" that would create a new information collection but would not impose any associated burden hours.

[927] 2016 Part 37 PRA Renewal at 65631.

[928] Agency Information Collection Activities: Notice of Intent To Revise Collection Numbers 3038-0052 and 3038-0074, Core Principles and Other Requirements for Designated Contract Markets, and Core Principles and Other Requirements for Swap Execution Facilities, 83 FR 1609, 1611 (Jan. 12, 2018).

[929] 2016 Part 37 PRA Renewal at 65631.

trigger the SEF registration requirement. Additionally, the Commission notes that certain non-U.S. interdealer brokers may also be affiliated with platforms that are currently exempt or may become exempt in the future from Commission registration, and therefore, would not need to separately register as SEFs.

The Commission initially estimates that up to 60 swaps broking entities, including interdealer brokers, and one Single-Dealer Aggregator Platform would register as SEFs as a result of the proposed application of the SEF registration requirement under § 37.3(a).[930] Consequently, for the purposes of this PRA analysis, the Commission estimates that the proposed application of § 37.3(a) will impose an initial, non-recurring information collection burden of 295 burden hours associated with the SEF registration process for these 60 entities.[931] The Commission does not believe that the proposed application of the SEF registration requirement in § 37.3(a) would impose new information collection burdens or substantively or materially modify existing burdens for registered SEFs.

In connection with the Commission's proposed clarification of the registration requirement, the Commission would propose to delay the application of the registration requirement with respect to (i) swaps broking entities, including interdealer brokers for a six-month period; and (ii) foreign swaps broking entities, including foreign interdealer

[930] The Commission estimates that approximately 40-60 swaps broking entities, including interdealer brokers would be required to register as SEFs as a result of the proposed application of the SEF registration requirement in § 37.3(a). Similarly, the Commission is aware of one Single-Dealer Aggregator Platform, which is affiliated with a SEF. For the purposes of this PRA, 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. For further discussion, *see infra* Section XXIII.C.3.c.—Costs (cost discussion related to the SEF registration requirement).

[931] As noted below, based on the proposed changes to the SEF registration requirements described herein, the Commission is reducing the estimated burden hours associated with the registration process by 5 hours from 300 hours to 295 hours.

brokers that facilitate swaps trading for U.S. persons for two-year period, provided that in each case the subject entity submits a request to the Commission with certain information.[932] As noted above, the Commission expects in the aggregate that approximately 60 such entities, including swaps broking entities and foreign swaps broking entities, would be required to register as SEFs, and the Commission estimates that all such relevant entities would request a delay. Accordingly, the Commission estimates that the voluntary request to delay the registration requirement will impose an initial, non-recurring information collection burden of 1 burden hour associated with the SEF registration process for each of these 60 entities. The Commission does not believe that the clarification in proposed § 37.3(a) would impose new information collection burdens or substantively or materially modify existing burdens for registered SEFs.

b. § 37.3(b)—Procedures for Registration

Proposed § 37.3(b) would streamline Form SEF by consolidating, amending, and eliminating several of the existing exhibits.[933] The Commission believes that these changes would establish a clearer and more simplified application for SEF applicants that would still provide the Commission with sufficient information needed to determine compliance. The Commission believes that the proposed streamlined Form SEF will

[932] The request would include the (i) entity's name as it appears in the entity's charter; (ii) name and address of the entity's ultimate parent company; (iii) any names under which the entity does business; (iv) address of principal executive office; (v) a contact person's name, address, phone number, and email address; (vi) asset classes and swap products for which the entity facilitates trading; and (vii) any registrations, authorizations, or licenses held. Foreign broking entities additionally would need to provide (viii) certification that it currently arranges or negotiates swap transactions for U.S. persons; (ix) home country regulator or regulators; and (x) any registrations, authorizations, or licenses held in the entity's home country.

[933] For further discussion on the specific changes, *see supra* Section IV.C.3.b.—§ 37.3(b)(1)—Application for Registration.

reduce the initial, non-recurring burden hours associated with the application process for SEF registration by approximately 5 burden hours.

c. § 37.3(c)—Amendment to an Order of Registration

Proposed § 37.3(c) would eliminate the requirement that a SEF amend Form SEF when requesting an amended order of registration from the Commission. Instead, a registered SEF would file a request with the Commission for an amended order pursuant to proposed § 37.3(c), but would no longer be required to file updated exhibits to Form SEF, although a SEF would be required to provide the Commission with any additional information and documentation as the Commission deems necessary.[934] The Commission estimates that approximately 1 SEF per year seeks to amend its registration order and that the proposed change would save that SEF approximately 2 burden hours.

d. § 37.5(c)—Provision of Information Relating to a Swap Execution Facility

Proposed § 37.5(c) would amend the existing notification requirements related to transfers of equity interest in a SEF. Proposed § 37.5(c)(1) would require a SEF to file a notice with the Commission regarding any transaction that results in the transfer of direct or indirect ownership of fifty percent or more of the equity interest of a SEF as opposed

[934] The Commission notes that it proposes to eliminate the existing language under § 37.3(b) that specifies the use of part 40 to file application amendments subsequent to registration. The Commission emphasizes that not all of the information from the Form SEF exhibits need to be updated pursuant to part 40 subsequent to registration—for example, certain part 37 provisions already require SEFs to update their information on an ongoing basis. Under § 37.1306, a SEF is required to file financial reports, including fiscal year end reports, which precludes the need to amend new Exhibit G (existing Exhibit I) and file it through part 40. As discussed above, the Commission clarifies that part 40 only applies to information from application exhibits that constitute a "rule," as defined under § 40.1(i). The Commission generally interprets the § 40.1(i) rule definition broadly to encompass governance documentation (proposed Exhibit C); fees (proposed Exhibit H); rulebooks (proposed Exhibit J); compliance manuals (proposed Exhibit K); participant agreements (proposed Exhibit L); SDR-related agreements (proposed Exhibit M); clearing-related agreements (proposed Exhibit N); other third-party agreements (proposed Exhibit O); and information related to execution methods (proposed Exhibit P). Therefore, registered SEFs have already been submitting changes to these types of documentation pursuant to the part 40 rule filing procedures.

to only direct ownership transfers as currently required.[935] As part of that notification, a SEF may incur burdens that are similar to those incurred when providing a notice of a direct change, including providing details of the proposed transaction and how the transaction would not adversely impact the SEF's ability to comply with the SEF core principles and the Commission's regulations, responding to any requests for supporting documentation from the Commission, and updating any ongoing changes to the transaction. Accordingly, the Commission estimates that approximately 1 additional SEF per year would need to notify the Commission as a result of an indirect equity transfer and that the proposed amendment would impose a one-time, non-recurring information collection of approximately 10 burden hours on such SEF.

e. § 37.6(b)(1)—Legally Binding Documentation

Proposed §§ 37.6(b)(1)(i)-(ii) would amend the existing swap documentation requirements by establishing separate transaction documentation requirements for cleared and uncleared swaps, respectively. Under existing § 37.6(b), a SEF is required to provide each counterparty to a transaction with a written "confirmation" that contains all of the terms of a swap transaction at the time of the swap's execution for both cleared and uncleared swap transactions, including (i) "economic terms" specific to the transaction and (ii) non-transaction specific "relationship terms" governing the relationship between the two counterparties.[936] To include all of the terms of a uncleared swap into a confirmation, a SEF would comply with § 37.6(b) by incorporating by reference the

[935] Transfer of ownership in an "indirect" manner may occur through a transaction that involves the transfer of ownership of a SEF's direct parent or an indirect parent, and therefore, implicates effective change in ownership of the SEF's equity interest.

[936] As noted above, economic terms include, for example, swap product, price, trade date, settlement date, and notional amount. "Relationship terms" generally govern all transactions between two counterparties, *e.g.*, default provisions, margin requirements, and governing law. *See supra* Section IV.F.—§ 37.6—Enforceability.

relevant terms set forth in the previously-negotiated agreements and documents, as long as the SEF had obtained these agreements prior to execution.[937]

Proposed § 37.6(b)(1)(i), which would continue to apply the existing confirmation requirement to cleared swap transactions, would not alter the information collection burdens with respect to cleared swaps. For uncleared swaps, however, proposed § 37.6(b)(1)(ii) would require a SEF to provide a "trade evidence record" that memorializes the terms that are agreed upon by the counterparties on the SEF. In contrast to the requirement for cleared swaps, proposed § 37.6(b)(1)(ii) would not require the trade evidence record to include all the terms of the swap transaction, including relationship terms contained in underlying documentation between the counterparties, nor would the SEF need to obtain or maintain the underlying agreements prior to the execution of the swap transaction.[938] To the extent that such terms either (i) are agreed upon between the counterparties in underlying documentation established away from the SEF and continue to govern the transaction post-execution or (ii) are not required to establish legal certainty for a specific transaction, a SEF would not be required to incorporate those terms into a trade evidence record. The proposed approach would address the challenges that have prevented SEFs from fully complying with § 37.6(b) by reducing the administrative burdens for SEFs, who under the proposal would not be required to obtain, incorporate, or reference those previous agreements; and for counterparties, who would not be required to submit all of their relevant documentation with other potential counterparties to the SEF.

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[937] SEF Core Principles Final Rule at 33491 n.195.

[938] The Commission anticipates that the terms listed in a trade evidence record would include, at a minimum, the transaction's "economic terms," *e.g.*, trade date, notional amount, settlement date, and price.

As a result, the Commission believes that the proposed amendments would reduce a SEF's annual recurring information collection burden for uncleared swap transactions. Accordingly, the Commission estimates that proposed § 37.6(b)(1)(ii) would reduce annual recurring information collection burdens by about 375 hours per SEF.[939]

f. § 37.203(d)—Automated Trade Surveillance System

Proposed § 37.203(d) would eliminate the prescriptive automated trade surveillance system capabilities requirements enumerated in existing § 37.203(d), except for the ability of a SEF to reconstruct sequence of market activity, and would instead require that a SEF's automated trade surveillance system be capable of detecting and "reconstructing" potential trade practice violations.[940]

As a result, the proposed rule would provide each SEF with the flexibility to determine what capabilities its automated trade surveillance system must have, based on the nature of the SEF's trading systems or platforms, to satisfy its core principle compliance responsibilities. Although it is possible that SEFs use their discretion to decrease the information collections and related burden hours, SEFs would still be

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[939] The Commission previously estimated that the process to obtain, review, incorporate, and maintain the previously-negotiated agreements takes approximately 1.5 hour per SEF participant and that on average, a SEF has about 375 participants. For purposes of this PRA discussion herein, however, the Commission is revising its estimate of the number of burden hours that the proposal would eliminate and will assume that each such agreement takes approximately 1.0 hours per SEF participant. Accordingly, 375 participants x 1.0 hour per participant = 375 estimated burden hours. The Commission also notes that this estimate of 375 burden hours includes the burden estimates in connection with § 37.1001, which establishes a SEF's recordkeeping obligations. Supporting Statement for New and Revised Information Collections, Core Principles and Other Requirements for Swap Execution Facilities, OMB Control Number 3038-0074, (Sept. 23, 2016), https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201609-3038-005.

[940] The Commission notes that this proposed change is consistent with the proposed amendments to §§ 37.205(b)(2)-(3), as discussed below, that would similarly limit a SEF's electronic transaction history database and electronic analysis capability requirements. The Commission, however, emphasizes that a SEF must continue to have the capability to load and process all executed trades, including those resulting from orders entered by voice or certain other electronic communications, such as instant messaging and email.

obligated to comply with the same underlying core principle obligations with which they must currently comply. As a result, the Commission estimates and assumes that SEFs would continue to fulfill their information collection burdens in a manner similar to the status quo. Accordingly, the Commission assumes that proposed § 37.203(d) would not impose new information collection burdens or substantively or materially affect SEFs' total burden hours.

g. § 37.203(e)—Error Trade Policy

Proposed § 37.203(e) would require SEFs to establish an error trade policy that, among other things, would notify all market participants of (i) any swap transaction that is under review; (ii) any determination by the SEF that the swap transaction under review either has been determined to be or not to be an error trade; and (iii) the resolution of any error trade, including any trade term adjustment or trade cancellation. To the extent that SEFs currently are not explicitly required to provide market participants with notice of any of these events, proposed § 37.203(e) would impose a new information collection burden on SEFs.[941] The Commission estimates that proposed § 37.203(e) would increase a SEF's annual recurring information collection burden by approximately 15 burden hours, based on an estimate that a SEF on average would incur approximately 15 error trade reviews per year.[942] Because most SEFs already have established and currently

[941] The Commission notes that existing § 37.203(e) provides SEFs with the authority to cancel or adjust prices for error trades if necessary to mitigate market disruption; in connection with this authority, existing § 37.203(e) also requires SEFs to make any such adjustments and cancellations transparent to market participants. 17 CFR 37.203(e). To the extent that proposed § 37.203(e) requires SEFs to provide notice to market participants for error trades in additional circumstances, the proposed amendment imposes a new collection of information.

[942] As noted above, proposed § 37.203(e) would require a SEF to provide market participants with a first notice upon the initiation of a review of an alleged error trade, a second notice upon any determination as to whether such swap transaction is or is not an error trade, and a third notice upon the resolution of the review, including any trade term adjustment or trade cancellation. The Commission estimates that each

maintain the necessary personnel and systems to provide such notices to its market participants, the Commission believes that the proposed amendment would not require SEFs to expend initial, non-recurring burden hours in order to comply.

h. § 37.205(a)—Audit Trail Required

Proposed § 37.205(a) would make several changes to SEFs' audit trail compliance obligations. First, the proposed amendment would replace the requirement that SEFs must "detect, investigate, and prevent" customer and market abuse with a requirement instead that SEFs must be able to "reconstruct all trading on its facility, detect and investigate customer and market abuses, and take appropriate disciplinary action." Second, the Commission proposes to move the requirement that audit trail data shall be sufficient to reconstruct all indications of interest, requests for quotes, orders and trades, to the guidance to Core Principle 2 in Appendix B.[943] Third, the Commission proposes to eliminate the requirement that SEFs capture post-execution allocation information in their audit trail data; in lieu of requiring the audit trail track a customer order through "fill, allocation, or other disposition," the Commission proposes to require SEFs to capture the audit trail data only through execution on the SEF since the Commission has learned from SEFs' representations that SEFs are unable to routinely obtain post-allocation information as required by §§ 37.205(a) and (b)(2) from third parties, such as DCOs and SDRs.

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notice requires about 1/3 burden hours, for a total of 1 burden hour per error trade (1/3 burden hours x 3 notices = 1 burden hour per error trade for notices). Further, the Commission estimates that each SEF on average will have approximately 15 error trade reviews per year. Accordingly, 1 burden hour x 15 error trade reviews per year = 15 burden hours per year. The Commission notes, however, that certain error trades may be resolved more quickly than 1 hour or take longer than 1 hour depending on the availability and coordination of the counterparties and relevant SEF personnel.

[943] The Commission proposes to add this guidance to paragraph (a)(4) to Core Principle 2 in Appendix B. The Commission proposes to eliminate the existing language in paragraph (a)(4). *See infra* Section VII.E.2.—§ 37.206(b)—Disciplinary Program.

To the extent that the Commission is providing SEFs with greater discretion in fulfilling their information collection obligations with respect to audit trail requirements under § 37.205, the Commission estimates and assumes that SEFs would continue to fulfill their information collection burdens in a manner similar to the status quo. Accordingly, the Commission assumes that proposed § 37.205(a) would not substantively or materially affect a SEF's total information collection burden hours.[944]

i. § 37.205(b)—Elements of an Acceptable Audit Trail Program

Proposed § 37.205(b) would narrow the scope of audit trail data that must be captured in a transaction history database under existing § 37.205(b)(2) by eliminating the requirement that SEFs include in their electronic transaction history database "all indications of interest, requests for quotes, and order and trades entered into" a SEF's trading system or platform. Instead, the SEFs would be required to include only "trades" executed via voice or via entry into a SEF's electronic trading system but must include all "orders" that are entered into an electronic trading system. The Commission additionally proposes to eliminate the remaining requirements of § 37.205(b)(2) detailing the information that must be included in transaction history database. Consistent with the

[944] As the Commission discussed above, certain existing requirements under § 37.205(a) are either unfeasible or impose greater information collection burdens than the Commission originally had estimated, *e.g.*, the requirement to collect post-execution trade allocation information. Subsequently, Commission staff provided no-action relief with respect to such obligations. *See, e.g.*, CFTC Letter No. 15-68, Re: No-Action Relief for Swap Execution Facilities from Certain Audit Trail Requirements in Commission Regulation 37.205 Related to Post-Execution Allocation Information (Dec. 22, 2015) (subsequently extended in CFTC Letter No. 17-54, Re: No-Action Relief for Swap Execution Facilities from Certain Audit Trail Requirements in Commission Regulation 37.205 Related to Post-Execution Allocation Information (Oct. 31, 2017)). Accordingly, the 2016 Part 37 PRA Renewal took into consideration in its revised PRA burden hour estimates the unfeasibility with complying with such requirements and the corresponding no-action relief. As a result, the Commission's proposal to eliminate such information collections under the proposal would not result in a net change to a SEF's aggregate burden hours because the 2016 Part 37 PRA Renewal already considered such relief and non-compliance with such requirements in its revised estimate. The Commission notes that, otherwise, the burden hour estimate in the 2016 Part 37 PRA Renewal would have been even greater.

changes to § 37.205(b)(2), the Commission further proposes to amend § 37.205(b)(3) to clarify that a SEF's electronic analysis capability must enable the SEF to reconstruct transactions, rather than "indications of interest, requests for quotes, orders, and trades."

To the extent that the Commission is providing SEFs with greater discretion in fulfilling their information collection obligations with respect to audit trail requirements under § 37.205, the Commission estimates and assumes that SEFs would continue to fulfill their information collection burdens in a manner similar to the status quo. Accordingly, the Commission assumes that proposed § 37.205(b) would not substantively or materially affect a SEF's total information collection burden hours.

j. § 37.205(c)—Audit Trail Reconstruction

Proposed § 37.205(c) would eliminate the existing requirements for a SEF to establish an annual audit trail review and a related enforcement program and instead require the SEF to "establish a program to verify its ability to comprehensively and accurately reconstruct all trading on its facility…." The Commission believes that this change will provide SEFs with discretion regarding what records they must maintain in order to comply with their information collection requirements, *i.e.*, to determine what components of their audit, if incomplete or inaccurate, could impair their ability to conduct effective surveillance, and to determine and implement the most effective means for enforcing compliance with their audit trail and recordkeeping requirements. [945] The Commission also proposes to adopt guidance to Core Principle 2 in Appendix B

[945] Notwithstanding these proposed changes, the Commission notes that to comply with the general audit trail requirement under proposed § 37.205(a), a SEF must capture all audit trail data necessary to reconstruct all trading on its facility, detect and investigate customer and market abuses, and take disciplinary action, the SEF must ensure that market participants are submitting accurate and complete audit trail data.

specifying that an effective audit trail reconstruction program should annually review an adequate sample of executed and unexecuted orders and trades from each execution method offered to verify compliance with § 37.205(c).[946]

To the extent that the Commission is providing SEFs greater discretion in fulfilling their information collection obligations with respect to audit trail requirements under § 37.205, the Commission estimates and assumes that SEFs would continue to fulfill their information collection burdens in a manner similar to the status quo. Accordingly, the Commission will assume that proposed § 37.205(c) would not substantively or materially affect a SEF's total information collection burden hours.

k. §§ 37.206(b)-(d)—Disciplinary Program

The Commission proposes to eliminate the existing requirements under (i) § 37.206(c), which currently specify certain minimum requirements for a SEF disciplinary hearing, including providing a transcript of the hearing to a respondent under certain conditions; and (ii) § 37.206(d), which requires that a disciplinary panel render a written decision promptly following a hearing, along with a detailed list of information that the SEF must include in the decision. Proposed § 37.206(b) would generally require a SEF to establish a disciplinary program to enforce its rules and provide the SEF with the discretion to administer that program through compliance staff instead of mandatory disciplinary panels. The Commission also proposes to add guidance to Core Principle 2 in Appendix B to specify that a SEF's rules governing the adjudication of a matter by the SEF's disciplinary panel should be fair, equitable, and publicly available and that a SEF's

[946] The Commission proposes to add this guidance to paragraph (a)(5) to Core Principle 2 in Appendix B. 17 CFR part 37 app. B. As discussed below, the Commission proposes to eliminate the existing language in paragraph (a)(5) to Core Principle 2 in Appendix B, *see supra* Section VII.E.2.—§ 37.206(b)—Disciplinary Program.

rules should require the disciplinary panel to promptly issue a written decision following a hearing or the acceptance of a settlement offer.[947]

To the extent that the Commission is providing SEFs greater discretion in fulfilling their information collection requirements with respect to carrying out disciplinary hearing and issuing hearing decisions, the Commission estimates and assumes that SEFs would continue to fulfill their information collection burdens in a manner similar to the status quo. Accordingly, the Commission will assume that proposed §§ 37.206(b)-(d) would not substantively or materially affect a SEF's total information collection burden hours.

l. § 37.401—General Requirements for Monitoring of Trading and Trade Processing

Proposed § 37.401(b) would require that a SEF collect and evaluate data on its market participants' trading activity outside of the SEF "as necessary" rather than "on an ongoing basis" as currently required.[948] Similarly, proposed § 37.401(c) would require a SEF to monitor and evaluate general market data to detect and prevent manipulative activity "as necessary."[949] The Commission anticipates that this will reduce annual recurring information collection burden hours by approximately 50 burden hours per SEF.

m. § 37.1301(b)—General Requirements for Financial Resources

Proposed § 37.1301(b) would permit SEFs that also operate as DCOs to file a single financial report under § 39.11 that covers both the SEF and DCO. Because this proposed approach would streamline and simplify the SEF financial reporting

[947] The Commission proposes to add this guidance as part of a new paragraph (a)(7) to Core Principle 2 in Appendix B.
[948] The proposed amendment would renumber existing subsection (a) to subsection (b).
[949] The proposed amendment would renumber existing subsection (b) to subsection (c).

requirement process under § 37.1306, the Commission estimates that the proposed change would decrease annual recurring information collection burden by 5 burden hours. The Commission also estimates that 1 SEF will take advantage of this approach per year.

n. § 37.1306—Financial Reporting to the Commission

Proposed § 37.1306 would make several changes that would affect SEFs' information collection burden hours. First, proposed § 37.1306(a) would require SEFs' quarterly financial statement to be prepare in accordance with GAAP.[950] Because GAAP-compliant financial statements generally require additional effort compared to non-GAAP compliance financial statements, the Commission estimates that the proposed change would increase annual recurring information collection burden hours by 10 burden hours and not impose an initial, non-recurring burden.

Second, proposed § 37.1306(c), among other things, would require a SEF to determine all of the costs that a SEF would incur to wind down its operations and the amount of time for the projected wind-down period, as well as explain the basis for its determinations. The Commission estimates that proposed § 37.1306(c) will impose an initial, non-recurring information collection of 20 burden hours associated with the SEF's obligation to provide a description of the costs and timing of a projected wind-down scenario, along with the basis for its determination. Additionally, the Commission

[950] Alternatively, if a SEF is not domiciled in the United States and is not otherwise required to prepare financial statements in accordance with GAAP, then proposed § 37.1306(a)(2)(ii) would allow the SEF to submit financial statements prepared in accordance with either International Financial Reporting Standards issued by the International Accounting Standards Board, or a comparable international standard that the Commission may otherwise accept in its discretion.

estimates that this information collection burden would impose 5 annual recurring information collection burden hours after the initial year to update this information.[951]

o. § 37.1401(g)—Program of Risk Analysis and Oversight Technology Questionnaire

Proposed § 37.1401(g) would require a SEF to annually submit an up-to-date questionnaire that would be located in Appendix A to part 37 ("Questionnaire") based on the existing Operational Capability Technology Questionnaire located in Exhibit V to Form SEF in Appendix A.[952] A SEF would only need to submit new changes to the Questionnaire and would not need to resubmit any information that has not changed. An applicant for SEF registration is required to file the Questionnaire pursuant to Form SEF in order to demonstrate compliance with Core Principle 14 and § 37.1401.[953] The

[951] The Commission notes that existing § 37.1306(c) requires a SEF to provide "[s]ufficient documentation" explaining both the methodology it used to compute its financial resources requirement as well as the basis for its determinations regarding its liquidity requirements. In addition to the change discussed above, proposed § 37.1306(c) would clarify the type of information that SEFs must include in the financial statements they submit to the Commission, including (i) list all of its expenses, without exclusion, and (ii) identification of all expenses that the SEF excluded or pro-rated in its projected operating cost calculations and explain the basis for excluding or pro-rating any expenses. The Commission believes that these changes are neither an addition nor modification to existing burden hours since the Commission is merely clarifying the type of documentation that must be provided to be deemed "sufficient" and are not intended to increase burden hours or the information that the Commission originally intended for SEFs to provide. Accordingly, other than as discussed above, the Commission believes that the proposed amendment to § 37.1306(c) would not impose new information collection burdens on SEFs or substantively or materially modify existing burdens.

[952] The Commission notes that based on the proposed amendments to Form SEF in Appendix A, Exhibit V would be re-designated as Exhibit Q of Form SEF. The up-to-date questionnaire would be called the "Program of Risk Analysis and Oversight Technology Questionnaire" and would be located in Appendix A to part 37. To the extent that still-current information and documents were provided in the most recent update to the Questionnaire, a SEF responding to a System Safeguards Examination document request would be able to reference that fact, rather than resubmitting such information and documents.

[953] The current version of the Questionnaire requests documents and information pertaining to the following nine areas of an applicant's program of risk analysis and oversight, including: (i) organizational structure, system descriptions, facility locations, and geographic distribution of staff and equipment, including organizational charts and diagrams; (ii) enterprise risk management program and governance, including information regarding the Board of Directors, audits, and third-party providers; (iii) information security, including storage of records, access controls, and cybersecurity threat intelligence capabilities; (iv) business continuity and disaster recovery plan and resources, including testing and recovery time objectives; (v) capacity planning and testing; (vi) system operations, including configuration management and event management; (vii) systems development methodology, including quality assurance; (viii) physical security and environmental controls; and (ix) testing, including vulnerability, penetration, and controls testing.

majority of the updated Questionnaire would remain unchanged, although the proposal would additionally include enterprise technology risk assessments, board of director and committee information, third-party service provider information, and cybersecurity threat intelligence capabilities in order to keep up-to-date with the rapidly changing field of system safeguards and cybersecurity.

The Commission believes that the aggregate burden hours imposed on SEFs are mitigated for several reasons. First, an annually-updated Questionnaire would limit the work required of SEFs in responding to a System Safeguards Examination document requests to providing updated information and documents for sections of Exhibit Q that have changed since the last annual filing. Second, SEFs currently must provide similar information under existing §§ 37.1401(f)-(g).[954] Third, much of the information comprising a SEF's annual compliance report would be able to be used for the Questionnaire. Accordingly, the Commission estimates that proposed § 37.1401(g) would establish a new collection of information with annual recurring burden hours of 8 burden hours per SEF.

[954] The Commission notes that proposed subsection (h) (renumbered from existing subsection (g)) requires a SEF to provide to the Commission system safeguards-related books and records, including (1) current copies of its business continuity-disaster recovery plans and other emergency procedures; (2) all assessments of its operational risks or system safeguards-related controls; (3) all reports concerning system safeguards testing and assessment required by this chapter; and (4) all other books and records requested by Commission staff in connection with Commission oversight of system safeguards or maintenance of a current profile of the SEF's automated systems. Moreover, § 37.1401(f) requires a SEF to provide Commission staff with timely advance notice of all material planned changes to automated systems that may impact reliability, security, or adequate scalable capacity of such systems and planned changes to the SEF's program of risk analysis and oversight.

p. § 37.1501(d)—Preparation of Annual Compliance Report

Proposed § 37.1501(d)[955] would make several changes that would generally reduce burden hours for SEFs. First, under proposed § 37.1501(d) a SEF would no longer need to include in its annual compliance report ("ACR") either a review of all the Commission regulations applicable to a SEF or identify the written policies and procedures designed to ensure compliance with the Act and Commission regulations. Instead, the Commission believes that requiring an ACR to include a description and self-assessment of the effectiveness of the SEF's written policies and procedures to "reasonably ensure" compliance with the Act and applicable Commission regulations is more closely aligned with the corresponding provisions of Core Principle 15 and would still allow the Commission to properly assess the SEF's compliance and self-regulatory programs. Accordingly, the Commission estimates that proposed § 37.1501(d) would reduce annual recurring information collection burden hours by approximately 10 burden hours per SEF.

Second, proposed § 37.1501(d)(3) would maintain the current requirement that an ACR describe the "financial, managerial, and operational resources" set aside for compliance with the Act and Commission regulations, but would eliminate the requirement that a SEF specifically discuss its compliance staffing and structure; a catalogue of investigations and disciplinary actions taken over the last year; and a review of disciplinary committee and panel performance. The Commission estimates that proposed § 37.1501(d)(3) would reduce annual recurring information collection burden hours by approximately 5 burden hours per SEF.

[955] The proposed amendment would renumber existing subsection (e) to subsection (d).

Third, to facilitate the Commission's ability to assess a SEF's written policies and procedures regarding compliance matters, proposed § 37.1501(d)(4) would require a SEF to discuss only material noncompliance matters and explain the corresponding actions taken to resolve such matters.[956] The Commission believes that requiring SEFs to focus on describing material non-compliance matters, rather than describing all compliance matters in similar depth, will streamline this requirement and provide more useful information to the Commission. Further, the Commission proposes to eliminate the enumerated mechanisms for identifying non-compliance issues, which conforms to the ability of a chief compliance officer ("CCO") to establish procedures to address non-compliance issues through "any means," as described above. Accordingly, the Commission estimates that this change would reduce annual recurring information collection burden hours per SEF by 3 burden hours.

Fourth, proposed § 37.1501(d)(5) would limit a SEF CCO's certification of an ACR's accuracy and completeness to "all material respects" of the report. The Commission understands that CCOs have been hesitant to certify that an entire ACR is accurate and complete under the penalty of the law, without regard to whether a potential inaccuracy or omission would be a material error or not. Accordingly, since the Commission believes that the proposed change would entail fewer burdens for a CCO to collect the necessary information to enable the CCO to certify the ACR, the Commission estimates that this change would reduce annual recurring information collection burden hours per SEF/CCO by 10 burden hours.

[956] The Commission proposes to renumber paragraph (e)(5) to paragraph (d)(4) and adopt the amendments as described above and other non-substantive amendments.

q. Part 36—Trade Execution Requirement

Proposed part 36 would address the swap trade execution requirement and would eliminate the MAT determination process under existing § 37.10 and § 38.12, as well as the associated compliance schedules set forth under § 37.11 and § 38.11. Proposed § 36.2 would require SEFs and DCMs to each respectively file a standardized form ("Form TER") to the Commission that details the swaps that they list for trading that are subject to the trade execution requirement, as well as include such information on their respective websites. The Commission estimates that filing these forms and providing the related information on their website will create a new information collection with an initial, non-recurring burden of approximately 5 burden hours per SEF to complete and submit Form TER. Additionally, the Commission estimates that this requirement will impose approximately 5 annual recurring burden hours per SEF related to updating, or confirming no changes need to be made to, Form TER. As noted above, there are 25 SEFs currently registered with the Commission, and the Commission expects up to another 60 SEFs to register as a result of the Commission's proposed application of the SEF registration requirement. Accordingly, the Commission estimates that the information collection burdens related to Form SEF will impose an aggregate of 425 initial, non-recurring burden hours across 85 entities and an aggregate of 425 annual recurring burden hours across the same.[957]

[957] The current 25 registered SEFs + the 60 entities that the Commission expects would register as a result of the Commission's proposed application of the SEF registration requirement = 85 total entities. Accordingly, 85 total entities x 5 hours per entity = 425 total hours for all SEF entities. The Commission notes that the related burden hours for the current MAT determination process are included in separate OMB control number 3038-0099, which estimates 5 annual recurring responses that average 16 burden hours per response, for a total estimate of 80 annual recurring burden hours across all SEFs and DCMs. The Commission proposes to eliminate OMB control number 3038-0099 and transfer the relevant burden to OMB control numbers 3038-0052 and 3038-0074. While the Commission expects additional swap

2. Information Collection Comments

The Commission invites the public to comment on any aspect of the paperwork burdens discussed herein, particularly for those provisions for which the Commission proposes to eliminate specific requirements and instead provide SEFs with discretion in complying with their information collection obligations. Copies of the supporting statements for the collections of information from the Commission to OMB are available by visiting RegInfo.gov. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to (i) evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information proposed to be collected; and (vi) minimize the burden of the proposed collections of information on those who are to respond, including through the use of appropriate automated collection techniques or other forms of information technology.

Those desiring to submit comments on the proposed information collection requirements should submit them directly to the Office of Information and Regulatory Affairs, OMB, by fax at (202) 395-6566, or by email at OIRAsubmissions@omb.eop.gov. Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final

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products and transactions would become subject to the Commission's revised interpretation of the trade execution requirement in CEA section 2(h)(8), the Commission also expects that 60 additional entities would register as SEFs as a result of the Commission's application of the SEF registration requirement. *See supra* Section XXIII.B.1.a.—§ 37.3(a)—Requirements for Registration. Accordingly, the Commission expects that any additional burden hours associated with any increase in the number of swap products traded on SEF or in swap transaction volume would be covered by the additional burden hours associated with the 60 new entities that the Commission expects to register as SEFs.

rule preamble. Refer to the "Addresses" section of this notice of proposed rulemaking for comment submission instructions to the Commission.

C. Cost-Benefit Considerations

1. Introduction

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.[958] Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors further below. Prior to the section 15(a) consideration for each set of rules, the Commission separately discusses the costs, benefits, and potential alternatives to the approach for the proposed regulations, organized in the following manner:

- SEF Registration

  (1) Application of SEF Registration Requirement

  (2) SEF Registration Process and Related Forms

- Market Structure and Trade Execution

  (1) Elimination of Minimum Trading Functionality and Execution Method Requirements

  (2) Trade Execution Requirement and Elimination of MAT Process

[958] 7 U.S.C. 19(a).

(3) Pre-Execution Communications and Block Trades

(4) Impartial Access

- Compliance and SRO Responsibilities

(1) SEF Trading Specialists

(2) Rule Compliance and Enforcement

(i) Definition of "Market Participant"

(ii) Audit Trail and Surveillance Program

(iii) Compliance and Disciplinary Programs

(iv) Regulatory Service Provider

(3) Error Trade Policy

(4) Chief Compliance Officer

(5) Recordkeeping, Reporting, and Information-Sharing

(i) Equity Interest Transfer

(ii) Confirmation and Trade Evidence Record

(iii) Information-Sharing

(6) System Safeguards

- Design and Monitoring of Swaps

(1) Swaps Not Readily Susceptible to Manipulation

(2) Monitoring of Trading and Trade Processing

- Financial Integrity of Transactions
- Financial Resources

The Commission recognizes that the proposed rules may impose costs, but currently lacks the requisite data and information to reasonably estimate them. This lack

of data and information is attributable in part to the discretion that a SEF would have under the proposed rules to achieve compliance by adopting different measures. Accordingly, the Commission cannot predict the approach that each SEF would adopt to achieve such compliance. Additionally, the initial and recurring compliance costs for any particular SEF or market participant would depend on the size, existing infrastructure, level of swap activity, and practices and cost structure of the relevant entity. Costs or benefits may be impacted, for example, if certain entities seek to avoid the regulations attendant to SEFs by reducing their swap activities. In situations where the Commission is unable to quantify the costs and benefits, the Commission identifies and considers the costs and benefits of the applicable proposed rules in qualitative terms.

The Commission notes that this consideration is based on its understanding that the swaps market functions internationally with (i) transactions that involve U.S. firms occurring across different international jurisdictions; (ii) some entities organized outside the U.S. that are prospective Commission registrants; and (iii) some entities typically operating both within and outside the U.S. who follow substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the cost-benefit discussion below refers to the effects of the proposed rules on all subject swaps activity, whether based on their actual occurrence in the U.S. or on their connection with, or effect on, U.S. commerce pursuant to CEA section 2(i).[959]

[959] Pursuant to CEA section 2(i), activities outside of the U.S. are not subject to the swap provisions of the CEA, including any rules prescribed or regulations promulgated thereof, unless those activities either have a direct and significant connection with activities in, or effect on, commerce of the United States; or contravene any rule or regulation established to prevent evasion of a Dodd-Frank Act-enacted provision of the CEA. 7 U.S.C. 2(i).

The Commission generally requests comment on all aspects of its cost-benefit considerations, including the identification and assessment of any costs and benefits not discussed therein; the potential costs and benefits of the alternatives that the Commission discussed in this release; data and any other information to assist or otherwise inform the Commission's ability to quantify or qualitatively describe the costs and benefits of the proposed rules; and substantiating data, statistics, and any other information to support positions posited by commenters with respect to the Commission's discussion. Commenters may also suggest other alternatives to the proposed approach where the commenters believe that they would be appropriate under the CEA and would provide a more appropriate cost-benefit profile.

2. Baseline

The primary focus of the proposed rules is to amend requirements set forth for swap execution facilities under part 37 of the Commission's regulations;[960] the process for a SEF or DCM to make a swap "available to trade" under parts 37 and 38, respectively;[961] and related regulations under parts 39 and 43. Hence, the Commission believes that the baseline for the consideration of costs and benefits is the existing regulations set forth in part 37; § 37.10 and § 38.12; § 39.12(b)(7); and § 43.2. For this reason, the Commission is considering the changes to costs and benefits, as compared to the baseline, resulting from the proposed regulations discussed herein. The Commission notes that some of the proposed rules would codify existing, time-limited no-action relief

[960] The Commission adopted the part 37 regulations in 2013. Core Principles and Other Requirements for Swap Execution Facilities, 78 FR 33476 (Jun. 4, 2013) ("SEF Core Principles Final Rule").

[961] The Commission adopted the regulation establishing the process for a SEF or DCM to make a swap "available to trade" in 2013. Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available to Trade, Swap Transaction Compliance and Implementation Schedule, and Trade Execution Requirement Under the Commodity Exchange Act, 78 FR 33606 (Jun. 4, 2013) ("MAT Final Rule").

and other guidance issued by Commission staff that market participants and SEFs may have relied upon to alter their compliance practices with respect to certain existing rules. To the extent that market participants have relied upon such relief or staff guidance, the magnitude of the actual costs and benefits of the proposed rules may not be as significant. The Commission's cost-benefit discussion will note instances where the Commission believes that market participants or SEFs have operated under relevant no-action relief or staff guidance.

3. SEF Registration

a. Overview

(1) Application of SEF Registration Requirement

The Commission proposes to apply the SEF registration requirements in CEA section 5h(a)(1) and § 37.3(a)(1) to both (i) swaps broking entities, including interdealer brokers, that facilitate multiple-to-multiple swaps trading away from SEFs; and (ii) Single-Dealer Aggregator Platforms that aggregate single-dealer pages. Accordingly, these entities would be required to either register as a SEF or become a part of an existing SEF. Other alternatives, however, include adjusting their activity to avoid the SEF registration requirement; or in the case of foreign swaps broking entities, which includes foreign interdealer brokers that currently facilitate trading, *i.e.*, negotiation or arrangement, of swaps transactions for U.S. persons ("Eligible Foreign Swaps Broking Entities"), working with the appropriate regulator within their country of domicile to seek an exemption from registration pursuant to CEA section 5h(g).[962]

[962] Pursuant to CEA section 5h(g), the Commission may exempt facilities from SEF registration if the 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. 7 U.S.C. 7b-3(g).

The Commission is also proposing to delay the compliance date of any final rule that applies the SEF registration requirement. For foreign swaps broking entities, the Commission proposes to delay the compliance date for a period of two years. This proposed delay would provide more time for the Commission to further develop its cross-border regulatory regime, including clarifying the cross-border jurisdictional reach of the SEF registration requirement under CEA section 2(i). For U.S. swaps broking entities, including interdealer brokers, the Commission proposes to delay the compliance date for a period of six months in order to provide such entities time to obtain SEF registration.

(2) SEF Registration Process and Related Forms

The Commission proposes several clarifying and streamlining amendments to Form SEF. Some of the proposed amendments would amend or eliminate several of the information requirements set forth in the existing exhibits. For example, the Commission is proposing to consolidate certain exhibits regarding governance (existing Exhibits C and G) and personnel (existing Exhibits E and F), as well as eliminate an exhibit regarding the financial resources of any affiliates (existing Exhibit J). The Commission is also proposing to clarify certain information requirements not explicitly enumerated in the existing requirements, but which have been incorporated in practice as part of the existing SEF application review process. For example, SEF applicants would need to provide additional information in Form SEF about, among other things, the asset classes the SEF applicant intends to list and submit for clearing (new Exhibit N). The Commission is also proposing to eliminate the requirement to use Form SEF to request an amended order of registration; under the proposed rules, a registered SEF would be able to file a request with the Commission for an amended order of registration.

Finally, the Commission proposes to revise § 37.4 to exclude product submissions from the SEF registration process. Section 37.4 currently permits a SEF applicant to submit the terms and conditions of swaps that it intends to list for trading as part of its application for registration. Section 37.4 also requires the Commission to consider such swaps for approval at the time that the Commission issues a SEF's registration order or, for a dormant SEF, reinstatement of registration. As proposed, a SEF applicant would have to obtain registration prior to submitting product terms and conditions or related amendments under § 40.2 or § 40.3, which govern the submission of new product terms and conditions or related amendments by registered entities.

b. Benefits

(1) Application of SEF Registration Requirement

The Commission believes that ensuring that all entities operating trading systems or platforms that facilitate swaps *trading* between multiple market participants are subject to the SEF registration requirement would impart substantial benefits on the swaps market (emphasis added). Ensuring that "multiple-to-multiple" swaps trading activity occurs on a registered SEF should concentrate the liquidity formation on SEFs and provide oversight benefits and efficiencies that enhance 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; combined with the proposed interpretation of the trade execution requirement discussed below, which would require additional swaps to be executed on a SEF, the proposed application of the registration requirement should bring a material amount of swaps trading activity under SEF oversight. 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, among other things, 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. Among other things, the Commission believes that access to such services could benefit certain market participants more than others, in particular those who have not previously established access to such services.

(2) SEF Registration Process and Related Forms

The proposed amendments to Form SEF may benefit potential SEF applicants, including those swaps broking entities and Single-Dealer Aggregator Platforms that the Commission anticipates would elect to register as SEFs, by making a more efficient and potentially less burdensome SEF registration process. The Commission anticipates that certain changes to Form SEF would reduce duplicative information requirements, while also continuing to ensure that it receives sufficient information to determine whether the applicant is in compliance with the core principles and Commission regulations. The additional proposed information requirements include information that Commission staff has been requesting in practice as part of the SEF registration process after applicants

submit Form SEF. Thus, requiring this information on Form SEF should increase the efficiency of the SEF registration process by reducing the number of follow-up questions and requests. The Commission also anticipates that these proposed requirements will reduce the amount of time that the Commission needs to review a completed application.

The Commission also proposes conforming amendments to Form SEF that are consistent with the proposed regulations. The proposed amendments prompting the revision or elimination of certain existing information requirements relate to, among other things, proposed amendments to existing execution method and financial resource requirements, as discussed below. The proposal to eliminate the temporary registration provisions that have expired should have no direct impact on costs or benefits. Additionally, the Commission proposes to exclude product submissions from the SEF application process. The Commission believes that separating these two processes would likely promote efficiency for both Commission staff and SEF applicants. Otherwise, the review of a SEF applicant's registration application could be unnecessarily delayed or stayed because Commission staff may require additional consideration or analysis of the novelty or complexity of the proposed product.

c. Costs

(1) Application of SEF Registration Requirement

Any swaps broking entity or Single-Dealer Aggregator Platform that elects to register as a SEF would incur the costs of registering, owning, and operating a SEF. The Commission previously discussed the costs of registering and operating a SEF in the SEF Core Principles Final Rule;[963] these costs and benefits are further modified by the

[963] SEF Core Principles Final Rule at 33567.

proposed amendments described in the preamble above and cost-benefit considerations discussed further below.

These entities are likely to incur initial setup costs to upgrade or create their existing systems or platforms to comply with the SEF core principles and Commission regulations applicable to SEFs, including the SEF registration requirement. The Commission recognizes that the additional ongoing marginal and fixed costs of maintaining a SEF could be significant for some of these entities. For example, some of these entities would have to educate their employees on SEF compliance practices; hire additional employees such as a CCO; and develop additional functions such as audit trail, trade surveillance, recordkeeping, and market monitoring.

To avoid or mitigate some of these costs, some swaps broking entities may become a part of a SEF with whom they are affiliated, thereby leveraging existing resources; nevertheless, they would likely still incur one-time costs and some ongoing costs. The Commission also notes that many swaps broking entities are currently registered with the Commission as introducing brokers ("IBs"); as such, they already follow certain similar regulatory requirements, including those related to oversight and recordkeeping. Therefore, the SEF registration costs to these entities would likely be lower since they already adhere to similar regulatory obligations. A Single-Dealer Aggregator Platform also would need to register as or join a SEF, thereby likely incurring similar costs.[964] Similarly, the Commission believes that the cost for an unaffiliated Single-Dealer Aggregator Platform to become a SEF or join a SEF would be greater than the cost for a Single-Dealer Aggregator Platform already affiliated with a SEF.

[964] The Commission is aware of one Single-Dealer Aggregator Platform that is currently affiliated with a SEF.

The Commission estimates that there are approximately 40-60 swaps broking entities, including interdealer brokers, that would need to either register as a SEF or join a SEF as a result of the Commission's proposed application of the SEF registration requirement.[965] For some of these entities, the cost to become a SEF or affiliate with a SEF may compel them to cease operating trading systems or platforms that facilitate multiple-to-multiple swaps trading between market participants. To mitigate these registration costs, the Commission is proposing a six-month delay to the compliance date for applicable U.S. swaps broking entities. This proposed delay would provide additional time for U.S. swaps broking entities to become registered as SEFs, thereby increasing the opportunity for them to continue operating without interruption.

Smaller swaps broking entities or smaller Single-Dealer Aggregator Platforms may be more likely than larger entities or platforms to abstain from SEF activities to avoid the SEF registration requirement. Smaller entities or platforms are less likely to have existing technology and procedures or available resources to comply with new SEF requirements; therefore, their initial costs of compliance with those requirements may be larger or have a proportionally greater effect on smaller entities. Market participants may also bear some costs if some entities abstain from SEF activities. For example, market participants who have utilized these entities to trade swaps would no longer be able to do so for swaps that must be traded on a SEF or swaps that they would otherwise want to execute on a SEF. Therefore, these participants would incur costs that could include search and transition costs to identify and onboard to new SEFs. In transitioning to a new

[965] These estimates are based on introducing broker information made available from the National Futures Association ("NFA"). The NFA information indicates that there more than 300 registered IBs currently designated as a "swap firm" that broker swap products.

platform, those market participants may incur less favorable financial terms or have access to reduced services.

The Commission estimates that approximately 10-20 of the swaps broking entities that would potentially need to either register as a SEF or join a SEF are located outside of the U.S. or otherwise have operations outside of the U.S. ("Eligible Foreign Swaps Broking Entities"). To mitigate these registration costs, the Commission is proposing a two-year delay to the compliance date for Eligible Foreign Swaps Broking Entities. The proposed delay is likely sufficient for these entities either to register as SEFs in an orderly manner or to become subject to comparable and comprehensive supervision from their home regulators, and thus become eligible for an exemption to the SEF registration requirement pursuant to CEA section 5h(g). This proposed delay would also allow these entities more time to avoid operational disruptions, which should mitigate costs for these entities and limit disturbances in the swaps markets, while the Commission addresses the application of CEA section 2(i).

The delayed compliance date for Eligible Foreign Swaps Broking Entities would also delay the prospective benefits discussed above for those swaps trading on these foreign entities. However, the 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. The proposed six-month implementation window for U.S. swaps broking entities would also delay the benefits discussed above, but the amount of time needed for

an entity to obtain SEF registration renders the compliance with the registration requirement by the compliance date of any final rule impractical.

Additionally, some customers of swaps broking entities and Single-Dealer Aggregator Platforms may incur the costs of "onboarding" with a SEF, to the extent that these market participants are not currently customers of a SEF. The Commission's proposal to expand the trade execution requirement to include all swaps subject to the clearing requirement that are listed on a SEF would prevent market participants from trading these swaps off-SEF in most instances. Accordingly, those market participants who wish to continue to trade these swaps would have to onboard to a SEF. The Commission estimates that up to 807 market participants in the interest rate swaps ("IRS") market trade cleared swaps exclusively off-SEF and thus may need to onboard to a SEF.[966] While the IRS market is the largest market by both trading volume and by notional amount outstanding[967] among all swap asset classes, additional market participants trading cleared swaps in the credit asset class may also need to onboard to a

[966] To estimate the number of market participants in the IRS market that would choose to onboard with a SEF, the Commission first analyzed IRS trading during January 2018 and identified market participants who traded cleared IRS but did not trade an IRS on a SEF during that month. Then, the Commission compared the list of legal entity identifiers ("LEIs") associated with those market participants to the LEIs of market participants who transacted on a SEF within the 2017 calendar year and identified the LEIs that have never transacted on a SEF during the sample period analyzed. The Commission identified 807 unique LEIs who traded a cleared IRS in January 2018 but did not trade an IRS on a SEF in 2017 or in January 2018. The Commission notes that these 807 LEIs made up 21 percent of total IRS notional traded in January 2018 and accounted for 38 percent of the trades.

[967] According to the International Swaps and Derivatives Association ("ISDA") SwapsInfo, the notional volume of trading in IRS in 2017 was about $192 trillion, as compared to about $7 trillion for credit. ISDA, ISDA SwapsInfo Weekly Analysis: Week Ending December 22, 2017, http://analysis.swapsinfo.org/2017/12/ird-and-cds-weekly-trading-volume-week-ending-december-22-2017/ ("2017 ISDA SwapsInfo Weekly Analysis"). According to the Bank of International Settlement statistics on the global OTC derivatives market, IRS constitute 69 percent of the total OTC derivatives market, by notional. Bank of International Settlement, https://stats.bis.org/statx/srs/table/d5.1.

SEF.[968] Market participants that must onboard to a SEF would incur costs to integrate their system with a SEF's interface as well as to train personnel to comply with a SEF's rulebook. For some market participants, this may require programming new ways to view, receive, and export information. Onboarding would also subject these market participants and their trading to the SEF's jurisdiction, which market participants may view as another disadvantage. As a result of the costs related to onboarding and trading on SEFs, certain market participants may reduce their use of swaps.[969]

To the extent that a market participant's swaps are already executed on a SEF after being arranged by a swaps broking entity, however, the Commission does not anticipate that the market participant would incur significant additional internal costs by using the SEF for the entire trading process. Some SEFs may charge higher fees for these trades due to the additional oversight the Commission contemplates that the SEF would provide.

(2) SEF Registration Process and Related Forms

The Commission proposes to reduce some information requirements as part of the proposed Form SEF, but would require additional information in other areas. As a result, the Commission believes that some proposed changes to Form SEF would reduce costs while others would increase costs. However, the Commission believes that the cost of preparing Form SEF, as proposed to be amended, is likely to be comparable to the cost of preparing the existing Form SEF. Since the additional information required by Form SEF

[968] The Commission has not estimated the number of additional market participants in the credit asset class (who do not also trade IRS) that may onboard to a SEF as a result of the proposal.

[969] Similar to the point made above regarding entities potentially refraining from SEF activities, any perceived disadvantages of transacting on SEFs may cause some market participants to alter their risk management processes to avoid or reduce their transactions on SEFs. If these market participants were to use more costly or less effective risk management strategies in place of swaps, this could increase the cost or reduce the effectiveness of risk management in general.

generally consists of information that the Commission has been requesting as part of the registration process, SEF applicants already likely incur the costs associated with providing that information. Additionally, the Commission proposes to remove the product submission process from the SEF application process. SEF applicants may incur additional administrative costs associated with completing the product submission apart from a SEF application.[970] However, the Commission believes these additional costs will mostly be related to the format and manner of submission, as the content of a product submission would materially remain the same.

d. Section 15(a) Factors[971]

(1) Protection of Market Participants and the Public

The Commission believes that the proposed application of the statutory SEF registration requirement to certain entities not currently registered as SEFs should protect market participants and the public by helping to ensure that entities that meet the SEF definition provide the protections associated with SEF core principles and the Commission's regulations. As noted above, these protections include audit trail, trade surveillance, market monitoring, recordkeeping, and anti-fraud and market manipulation rules. The proposed amendments to the SEF registration process should maintain the protection of market participants and the public by continuing to help ensure that SEF

[970] The Commission notes that this change—and the concomitant benefits and costs—also would affect dormant SEFs, which like SEF applicants currently may include proposed products as part of their process to obtain reinstatement of their registration from dormancy.

[971] The discussion here and in the other section 15(a) discussions below cover the proposed amendments that the Commission has identified as being relevant to the areas set out in section 15(a) of the CEA: (i) protection of market participants and the public; (ii) efficiency, competitiveness, and financial integrity of futures markets; (iii) price discovery; (iv) sound risk management practices; and (v) other public interest considerations. For proposed amendments that are not specifically addressed within the respective CEA section 15(a) factor discussion, the Commission has not identified any effects.

applicants provide the Commission with the information it needs to determine whether the SEF applicant will be able to comply with the SEF core principles and Commission regulations.

(2) Efficiency, Competitiveness, and Financial Integrity of Markets

The Commission believes that the proposed application of the statutory SEF registration requirement to certain entities not currently registered should enhance the competitiveness and financial integrity of markets since these registered SEFs would be subject to relevant SEF core principles, including, among others, Core Principles 2, 4, and 15. The Commission also believes that the proposal would subject entities providing similar services to comparable regulations, thus increasing the competitiveness of SEFs. The greater use of SEF functions, such as pre-trade credit screening, submission to DCOs for clearing, and reporting to SDRs should also enhance efficiencies in the swaps market. Proposed Form SEF should continue to provide a means for SEF applicants to demonstrate compliance with core principles related to financial integrity, including Core Principle 13 regarding SEF financial resources.

(3) Price Discovery

The Commission believes that the application of the statutory SEF registration requirement to certain entities not registered as SEFs may further price discovery in swaps, given that more swap transactions would be traded on SEFs and more market participants would be participating on SEFs. This increased trading may enhance the liquidity of the swaps market on SEFs. The Commission believes that, generally, market participants would have access to better price discovery in more liquid markets.

(4) Sound Risk Management Practices

The Commission believes that the proposed application of the statutory SEF registration requirement to certain entities not currently registered as SEFs may further sound risk management practices by helping to ensure that swaps trading occurs subject to the rules of the SEF and receive the protections associated with the SEF core principles and Commission regulations.

(5) Other Public Interest Considerations

The Commission believes that the proposal that entities that meet the SEF definition must register as SEFs should further the public interest consideration of promoting trading of swaps on SEFs as stated in CEA section 5h(e).

Request for Comment

The Commission requests comment on all aspects of the consideration of the costs and benefits of the provisions related to SEF registration. The Commission estimates that there would be 40 to 60 newly-registered SEFs. For those newly-registered SEFs, and with the understanding that costs will vary depending on the entity, what would be the average cost for a newly-registered SEF to comply with the Commission's proposed new SEF regime? If possible, please provide itemized costs per requirement. What would be the on-going costs to comply with that regime?

The Commission believes that many swaps broking entities, including interdealer brokers, are currently affiliates of a registered SEF. As a result, the cost of integrating a swaps broking entity's non-registered SEF into its current SEF registration regime will be significantly less than those of newly-registered SEFs, *i.e.*, those entities that do not have a registered SEF as an affiliate. Is the Commission's assumption correct? If not, then

why not? What would be the cost of integrating and updating an entity's compliance program to reflect the proposed rule's new and amended requirements? What would be the on-going costs to comply?

4. Market Structure and Trade Execution

a. Overview

(1) Elimination of Minimum Trading Functionality and Execution Method Requirements

Based on its increased understanding of swaps trading dynamics and the increased scope of swaps that would become subject to the trade execution requirement, the Commission proposes to eliminate the prescribed execution methods under § 37.9 for swaps subject to the trade execution requirement. In addition, the Commission proposes to eliminate the minimum trading functionality and Order Book provisions under §§ 37.3(a)(2)-(3). As a result, for any swap that it lists, a SEF would be able to offer any execution method that is consistent with the SEF definition in CEA section 1a(50) and the general rules related to trading and execution consistent with the SEF core principles and proposed part 37 rules. In particular, a SEF would be allowed to offer flexible methods of execution for any swap that it lists for trading, regardless of whether or not the swap is subject to the trade execution requirement.

In order to effect Core Principle 2, the existing rules under § 37.201 would be replaced with new general, disclosure-based trading and execution rules that would apply to any execution method offered by a SEF. Proposed § 37.201(a) would require a SEF to specify (i) the protocols and procedures for trading and execution; (ii) the extent to which the SEF may use its "discretion" in facilitating trading and execution; and (iii) the sources and methodology for generating any market pricing information.

(2) Trade Execution Requirement and Elimination of MAT Process

The Commission proposes to eliminate the "Made Available to Trade" ("MAT") process and proposes to interpret the trade execution requirement in CEA section 2(h)(8) to require swaps to be executed on a SEF or DCM if a swap is both subject to the clearing requirement in section 2(h)(1) of the Act and listed for trading on a SEF or DCM. The current rule, by contrast, creates a process for a swap to be categorized as "MAT" under § 37.10 and § 38.12 that is largely driven by a registered SEF or DCM.

The Commission further proposes to use its authority pursuant to CEA section 4(c)[972] to exempt four different types of swap transactions from the trade execution requirement. Specifically, the Commission proposes that counterparties be exempted from the trade execution requirement for (i) swap transactions involving swaps that are listed for trading only by an Exempt SEF (as opposed to a registered SEF or DCM); (ii) swap transactions that are subject to and meet the requirements of the clearing exception under 2(h)(7) of the Act or the clearing exceptions or exemptions under part 50 of the Commission's regulations; (iii) swap transactions that are executed as a component of a package transaction that includes a component that is a new issuance bond; and (iv) swap transactions between "eligible affiliate counterparties" ("inter-affiliate counterparties") that elect to clear such transactions, notwithstanding their ability to elect the clearing exemption under § 50.52.

To facilitate compliance with the proposed interpretation of the trade execution requirement, the Commission proposes a compliance schedule, based on participant type,

[972] CEA section 4(c) empowers the Commission, if certain conditions are met and subject to certain limitations, to "promote responsible economic or financial innovation and fair competition" by exempting any transaction or class of transactions, including swaps, from the provisions of the CEA. 7 U.S.C. 6(c).

for the additional swaps that would become subject to the trade execution requirement. Under the proposal, entities would fall into categories based on their swaps trading experience and resources: Category 1 entities would have a 90-day compliance timeframe; Category 2 entities would have 180 days, and all other relevant entities would have 270 days to allow them to onboard onto a SEF, a DCM, or an Exempt SEF and to comply with the trade execution requirement. The Commission also is proposing to establish a centralized registry on its website to identify those SEFs and DCMs that list swaps subject to the trade execution requirement and the particular swaps listed on each entity. To establish the registry, the Commission is proposing to require SEFs and DCMs to file a standardized Form TER, concurrently with any § 40.2 or § 40.3 product filing, that would detail the swaps that they list for trading that are subject to the clearing requirement. In turn, Form TER would provide a streamlined process to allow the Commission to provide market participants with a public registry of the SEFs and DCMs that list particular swaps for trading. Finally, the Commission is also proposing that DCMs and SEFs be required to publicly post their Form TER on their respective websites.

(3) Pre-Execution Communications and Block Trades

For swaps subject to the trade execution requirement, proposed § 37.201(b) would require a SEF to prohibit its market participants from engaging in pre-execution communications away from its facility, including negotiating or arranging the terms and conditions of a swap prior to its execution on the SEF via the SEF's methods of execution. In conjunction with prohibiting pre-execution communications and pre-arranged trading under § 37.203, the Commission is eliminating the fifteen-second time

delay requirement under § 37.9(b). Under proposed § 37.203, SEFs must prohibit pre-arranged trading for trading systems or platforms such as Order Books, where pre-arranged trading would be considered to be an abusive trading practice. This prohibition, however, would be subject to certain proposed exceptions. First, swap transactions that are not subject to the trade execution requirement would be excluded from the proposed prohibition. Second, package transactions that also include components that are not subject to the trade execution requirement would also be excluded from that proposed prohibition.

The Commission also proposes to revise the definition of "block trade" in existing § 43.2 to eliminate the "occurs away" requirement for swap block trades on SEFs. Pursuant to the revised definition, counterparties that seek to execute swaps at or above the block trade size on a SEF must do so on a SEF's trading system or platform, rather than away from the SEF pursuant to its rules as currently required. For swaps subject to the trade execution requirement, counterparties would not be able to conduct pre-execution communications to negotiate or arrange a block trade away from the SEF.[973] Commission staff has provided time-limited no-action relief from the "occurs away" requirement of the block trade definition under § 43.2, and the Commission understands that some market participants have elected to execute their block trades on-SEF pursuant to that relief.[974]

[973] The Commission notes that market participants may pre-negotiate or pre-arrange block trades for swaps that are not subject to the trade execution requirement subject to an exception to the proposed prohibition on pre-execution communications under proposed § 37.201(b).
[974] CFTC Letter No. 17-60, Re: Extension of No-Action Relief for Swap Execution Facilities from Certain "Block Trade" Requirements in Commission Regulation 43.2 (Nov. 14, 2017).

(4) Impartial Access

Proposed § 37.202 would modify the impartial access requirements to allow a SEF to devise its participation criteria based on its own trading operations and market. Specifically, a SEF would be required to establish rules that set forth impartial access criteria for accessing its markets, market services, and execution methods; such impartial access criteria must be transparent, fair, and non-discriminatory and applied to all similarly situated market participants. Based on this approach, the Commission would not require a SEF to maintain impartial access in a manner that promotes an "all-to-all" trading environment. Rather, a SEF would be allowed to serve different types of market participants or have different access criteria for different execution methods in order to facilitate trading for a desired market.

In addition to amending the impartial access requirement, the Commission also proposes several other related amendments. Under proposed § 37.202(a)(1), a SEF would no longer be required to provide impartial access to ISVs. Further, under proposed § 37.202(a)(2), a SEF would be allowed to establish fee structures in a fair and non-discriminatory manner. This revision would eliminate the existing requirement under § 37.202(a)(3), which requires a SEF to set "comparable fees" for "comparable access."

b. Benefits

(1) Elimination of Minimum Trading Functionality and Execution Method Requirements

The Commission believes that eliminating the minimum trading functionality requirement would provide several benefits. Based on its experience, the Commission has observed that market participants have generally not used Order Books for swaps

trading on SEFs despite their availability for all SEF-listed swaps.[975] The Commission recognizes that market participants view Order Books as unsuitable for trading in a large segment of the swaps market and believes that eliminating this requirement would reduce costs by enabling SEFs to discontinue their use as a method of execution or limit their availability, based on their own discretion, to swaps that are liquid enough to support such trading.[976] Moreover, new SEFs would be able to register without setting up an Order Book, which should significantly reduce the cost of establishing a SEF.

The Commission also believes that eliminating the required methods of execution for swaps subject to the trade execution requirement and instead allowing flexible means of execution on SEFs together with expanding the scope of swaps subject to the trade execution requirement, may further the statutory goal of promoting the trading of swaps on SEFs more effectively than the current SEF framework. As a result of their bespoke or customized structure, the Commission recognizes that swaps that currently are not MAT, but that would become subject to the trade execution requirement under the Commission's proposal, may be less liquid than current MAT swaps, and therefore, may be less suited for execution via an Order Book or a request-for-quote system that sends a quote to no less than three unaffiliated market participants and operates in conjunction with an Order Book ("RFQ System").

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[975] A recent research study finds that for index CDS, a minimal amount of trading activity on the two highest-volume SEFs occurs via an order book. Lynn Riggs, Esen Onur, David Reiffen & Haoxiang Zhu, Mechanism Selection and Trade Formation on Swap Execution Facilities: Evidence from Index CDS 10 (2017), https://www.cftc.gov/idc/groups/public/@economicanalysis/documents/file /oce_mechanism_selection.pdf ("2017 Riggs Study").

[976] The Commission notes that additional factors, such as the use of name give-up and the lack of certain trading features, may have also contributed to the limited use of Order Books.

Under the proposed approach, market participants would be allowed to utilize execution methods that best suit their trading needs and the swap being traded.[977] These needs may include the desire to minimize potential information leakage and front-running risks and/or the need to account for market conditions for those swaps at a given time.[978] Allowing market participants to choose the appropriate method of execution for their trading needs may increase market efficiency and lower transaction costs since market participants are expected to seek out the most efficient and cost-effective method of execution to carry out their swaps trading needs and to select the appropriate level of pre-trade transparency for their transactions.[979] For example, a market participant whose primary goal is obtaining best execution in the market can choose the execution method that provides the appropriate degree of pre-trade transparency, based on the swap's characteristics and the trader's execution options and their individual trading needs, including submitting a RFQ to more than three liquidity providers. A market participant that perceives benefits from maintaining a relationship with a particular liquidity provider

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[977] For example, Michael Barclay, Terrence Hendershott and Kenneth Kotz studied mechanism choice for U.S. Treasury securities and have found that Treasury securities move from primarily electronic trading to primarily voice trading when there is an exogenous decline in trading volume. Michael Barclay, Terrence Hendershott, Terrence & Kenneth Kotz, *Automation versus intermediation: Evidence from Treasuries going off the run*, 61 J. Fin. 2395–14 (2006).

[978] The 2017 Riggs Study finds that in the index CDS market customers exercise discretion over transacting via RFQ versus streaming quotes depending on the size of their trades or the urgency of their trading needs. The study also shows that customers can choose to send RFQs to more than the minimum required number of three participants when their trade size is smaller and again when their transactions are more urgent. 2017 Riggs Study at 10.

[979] Terrence Hendershott and Ananth Madhavan looked at trading in corporate bonds where customers can trade bonds either through voice solicitation of dealer quotes or through an electronic exchange that initiates an RFQ. Broadly speaking, Hendershott and Madhavan find that bonds that have characteristics associated with more frequent trading are more likely to be traded through the RFQ process, while trading tends to move to a voice mechanism when bonds go off-the-run and liquidity falls. Comparing the costs between execution methods, they found that electronic trades are associated with lower trading costs for small trades, but that voice solicitation is cheaper for larger trades. Terrence Hendershott & Ananth Madhavan *Click or call? Auction versus search in the over-the-counter market*, 70 J. Fin. 419-47 (2015).

(such a relationship may extend beyond the swap market) can choose an execution method that facilitates that goal.[980]

SEFs would have broader latitude to innovate and develop new and different methods of execution tailored to their markets. Accordingly, the proposed flexibility would enable SEFs to provide their market participants with additional choices for executing swaps subject to the trade execution requirement beyond the Order Book or RFQ System. Such methods could be more efficient for a broader range of swaps and various market liquidity conditions, which may allow SEFs to effectively promote appropriate counterparty and swap-specific levels of pre-trade price transparency.[981] This potential innovation of efficient, transparent, and cost-effective trading means would facilitate natural market evolution via SEFs, which may ultimately lower transaction costs and increase trading efficiency.

This approach may also increase SEF competition as SEFs seek to differentiate from one another based on execution methods that they offer. The Commission believes that such increased competition may lead to reduced costs and increased transparency for market participants. The Commission further believes that flexible means of execution may provide opportunities for new entrants in the SEF market. New entrants would be able to utilize unique or novel execution methods that are not currently offered by incumbent SEFs. The Commission believes that new entrants would help increase competition in the market, which may lead to reduced transaction costs.

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[980] The 2017 Riggs Study finds that in the index CDS market, customers are more likely to seek quotes via the RFQ process from dealers affiliated with their clearing members, as well as from dealers who make up a larger fraction of the customer's past trading volume. 2017 Riggs Study at 27.

[981] For example, Darrell Duffie and Haoxiang Zhu suggest that work-ups can sometimes be a more efficient means of transacting than a limit order book. *See* Darrell Duffie & Haoxiang Zhu, *Size Discovery*, 30 Rev. Fin. Stud. 1095-1150 (2017).

The Commission anticipates that SEFs with active Order Books would continue to offer them, such that customers who wish to transact on Order Books would continue to be able to do so. The Commission also notes that swap transactions on SEFs will continue to be subject to the part 43 real-time reporting requirements, so market participants would continue to benefit from the post-trade transparency associated with access to information about the most recent transaction price.

While the Commission is proposing to allow SEFs to utilize flexible methods of execution, the Commission is concurrently proposing under § 37.201(a) to require that SEFs implement various trading and execution-related rules, which would require SEFs to disclose in their rulebook the protocols and procedures of the execution methods they offer, including any discretion the SEF may have in facilitating trading and execution, *e.g.*, in regards to price formation or bid/offer matching. The Commission believes that these rules should provide market participants a requisite level of transparency by requiring SEFs to disclose information regarding their execution methods, trading systems, and operations. By requiring such disclosure, the Commission believes that SEFs would provide market participants with a consistent level of information so that they are better able to make fully informed decisions when selecting a SEF or particular execution method. The Commission believes that promoting such transparency also helps promote market efficiency and integrity.

(2) Trade Execution Requirement and Elimination of MAT Process

The Commission believes that expanding the scope of swaps that must be traded and executed on SEFs or DCMs would directly promote more SEF trading, which is one of the Dodd-Frank Act's statutory goals. As noted above, data analyzed by Commission

staff indicates that the percentage of IRS trading volume that is subject to the trade execution requirement declined from approximately 10 to 12 percent of total reported IRS volume in 2015 to approximately 7 to 9 percent of total reported IRS volume in 2017 and the first half of 2018.[982] According to an ISDA analysis, the share of total reported IRS volumes that occurred on SEFs since 2015 has ranged between approximately 55 to 57 percent of total reported IRS volumes.[983]

A recent ISDA analysis also shows that more than 85 percent of IRS trading volume is subject to the clearing requirement.[984] The Commission believes that much, but not all, of that trading volume consists of swaps that are listed for trading on a SEF. With respect to credit default swaps ("CDS"), ISDA's analysis has shown that 71 to 79 percent of trading volume in index CDS has occurred on SEFs since 2015,[985] while just over 89 percent of CDS trading volume is subject to the clearing requirement.[986] Since only a portion of IRS and CDS trading that is also subject to the clearing requirement has

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[982] Commission staff conducted an analysis of publicly available data accessed via Clarus Financial Technology ("Clarus"). In a separate analysis, ISDA found that only 5 percent of trading volume in IRS during 2015 and the first three quarters of 2016 consisted of IRS subject to the trade execution requirement. ISDA, ISDA Research Note: Trends in IRD Clearing and SEF Trading 1, 3, 11 (Dec. 2016), https://www.isda.org/a/xVDDE/trends-in-ird-clearing-and-sef-trading1.pdf ("2016 ISDA Research Note").

[983] *See, e.g.*, ISDA, ISDA SwapsInfo Weekly Analysis: Week Ending October 19, 2018, http://analysis.swapsinfo.org/2018/10/interest-rate-and-credit-derivatives-weekly-trading-volume-week-ending-october-19-2018/ ("2018 ISDA SwapsInfo Weekly Analysis"); ISDA, ISDA SwapsInfo Weekly Analysis: Week Ending December 22, 2017, http://analysis.swapsinfo.org/2017/12/ird-and-cds-weekly-trading-volume-week-ending-december-22-2017/ ("2017 ISDA SwapsInfo Weekly Analysis"); ISDA, ISDA SwapsInfo Weekly Analysis: Week Ending December 24, 2015, http://analysis.swapsinfo.org/2015/12/ird-and-cds-weekly-analysis-week-ending-december-24-2015/ ("2015 ISDA SwapsInfo Weekly Analysis").

[984] ISDA, ISDA Research Note: Actual Cleared Volumes vs. Mandated Cleared Volumes: Analyzing the US Derivatives Market 3 (July 2018), https://www.isda.org/a/6yYEE/Actual-Cleared-Volumes-vs-Mandated-Cleared-Volumes.pdf ("2018 ISDA Research Note").

[985] *See, e.g.*, 2018 ISDA SwapsInfo Weekly Analysis; 2017 ISDA SwapsInfo Weekly Analysis; 2015 ISDA SwapsInfo Weekly Analysis. These market share estimates are based on total SEF volume in the asset class divided by total volume in the asset class. In both cases, the volume is expressed in notional amount and includes both cleared and uncleared swaps. Since ISDA uses part 43 data that contains capped notional amounts pursuant to § 43.4(h), while the actual notional amounts are not capped, the Commission notes that these estimates likely overstate SEF market share.

[986] 2018 ISDA Research Note at 15-16.

occurred on SEFs, the Commission believes that additional IRS and CDS trading may transition to SEFs as a result of the proposed expansion of the trade execution requirement to cover all swaps that are subject to the clearing requirement and listed for trading on a SEF or DCM.

The Commission believes that the expanded trade execution requirement would ensure that more swaps trading occurs on SEFs. In turn, increased swaps trading on SEFs would help foster and concentrate liquidity and price discovery on SEFs. This may help increase market efficiency and competition between market participants, which would further decrease transaction costs. Further, the Commission believes that a broad trade execution requirement, in conjunction with the proposed prohibition on pre-execution communications, would ensure that swaps trading occurs on SEFs, which may further amplify the preceding benefits.

Bringing more swaps trading on to SEFs, including the entire liquidity formation process, would allow these swap trades to directly benefit from SEF oversight (including audit trail, trade surveillance, market monitoring, recordkeeping, and anti-fraud and market manipulation rules) and services that enhance market integrity (including pre-trade credit checks, straight through processing, and reporting to SDRs). Additionally, the Commission expects liquidity pools on SEFs to improve for various products that would become subject to the expanded trade execution requirement as a result of an increase in the number of market participants. This may further improve liquidity, and an increase in the number of products traded on SEFs, which would allow market participants to have direct access to more price observations for these products compared to the current SEF framework. With an increase in the amount of transactions on SEFs,

the Commission also believes, that since SEFs would have more market data, they may be better equipped to fulfill their Core Principle 4 duties, as discussed further below. As such, the Commission believes that with direct access to more trades, a SEF may be better situated to prevent manipulation, price distortion, or disruptions to the functioning of an orderly market, which is likely to benefit all market participants.

In conjunction with the Commission's proposed interpretation of the trade execution requirement, the Commission is proposing to exempt certain transactions from this requirement. The proposed exemptions in CEA section 4(c) cover (i) swap transactions involving swaps that are listed for trading only by an Exempt SEF; (ii) swap transactions that are subject to and meet the requirements of the clearing exception in CEA section 2(h)(7) or the clearing exceptions or exemptions under part 50 of the Commission's regulations; (iii) swap transactions that are executed as a component of a package transaction that includes a component that is a new issuance bond;[987] and (iv) swap transactions between inter-affiliate counterparties that elect to clear such transactions, notwithstanding their ability to elect the clearing exemption under § 50.52. The Commission believes that exempting these swap transactions that would otherwise be subject to the trade execution requirement would be beneficial for the swaps markets. These exemptions would appropriately calibrate the trade execution requirement to appropriate market participants and swap transactions, which can reduce the cost of trading.

[987] The Commission understands that a bond issued and sold in the primary market that may constitute part of a package transaction is a "security," as defined in section 2(a)(1) of the Securities Act of 1933 or section 3(a)(10) of the Securities Exchange Act of 1934. To the extent that counterparties may be facilitating package transactions that involve a security, or any component agreement, contract, or transaction over which the Commission does not have exclusive jurisdiction, the Commission does not opine on whether such activity complies with other applicable law and regulations.

The Commission is proposing to exempt swaps that are listed only by an Exempt SEF from triggering the trade execution requirement. Since it may be burdensome for a U.S. person to identify and onboard with an Exempt SEF that is the only platform listing a swap that is subject to the expanded trade execution requirement, the Commission believes that exempting these swaps from the trade execution requirement until they are listed by a registered SEF or a DCM would reduce such burdens.

The Commission is also proposing to exempt from the expanded trade execution requirement those transactions that are excepted or exempted from the clearing requirement. The Commission believes that swap transactions exempted from the clearing requirement may benefit from the proposed exemption by providing counterparties with flexibility regarding where they can trade or execute such swaps, which the Commission believes may help counterparties reduce transaction costs that they would otherwise incur from mandatory trading or execution on a SEF.

Furthermore, the Commission is proposing to exempt "package transactions" that involve swap and new issuance bond components. In light of the involvement of the bond issuer and the underwriter in arranging and executing a package transaction in conjunction with a new issuance bond and the unique negotiation and fit-for-purpose nature of these package transactions, the Commission understands that it remains difficult or impossible to trade these package transactions on a SEF. Market participants currently may rely on Commission staff's temporary no-action relief to trade MAT swaps that involve new issuance bonds away from a SEF.[988] The proposed rule would ensure that

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

package transactions involving new issuance bonds can be traded off-SEF on an ongoing basis.

Finally, the Commission proposes to exempt from the trade execution requirement any swap transaction between inter-affiliate counterparties that elect to clear such transactions, notwithstanding their ability to elect the clearing exemption under § 50.52. Under the current rules, inter-affiliate transactions are only exempt from the trade execution requirement if the inter-affiliate counterparties elect not to clear the transaction. However, despite these transactions not being intended to be price-forming or arm's length and therefore not suitable for trading on SEFs, inter-affiliate counterparties that elect to clear their inter-affiliate transactions are subject to the trade execution requirement. This proposal instead would treat cleared and uncleared inter-affiliate swap transactions the same with respect to the trade execution requirement. The Commission believes that this approach would be beneficial because inter-affiliate swap transactions do not change the ultimate ownership and control of swap positions (or result in netting) and permitting them to be executed internally (provided that they qualify for the clearing exemption under existing § 50.52) may reduce costs relative to requiring that they be executed on SEF. Finally, the Commission believes that this exemption may help ensure that inter-affiliate counterparties are not discouraged from clearing their inter-affiliate swap transactions in order to avoid having to trade them on SEFs subject to the trade execution requirement, which may have systemic risk benefits.[989]

[989] The Commission notes that the Division of Market Oversight had previously provided no-action relief that mirrors this proposal so these benefits may have already been realized. *See* CFTC Letter No. 17-67, Re: Extension of No-Action Relief from Commodity Exchange Act Section 2(h)(8) for Swaps Executed Between Certain Affiliated Entities that Are Not Exempt from Clearing Under Commission Regulation 50.52 (Dec. 14, 2017) ("NAL No. 17-67").

The proposed trade execution requirement compliance schedule is intended to recognize that different categories of counterparties have different abilities and resources for achieving compliance with the trade execution requirement. As such, a phased compliance schedule should benefit counterparties by providing them with more time to adapt to the expanded trade execution requirement.

Proposed Form TER, which would provide for a uniform submission by SEFs and DCMs of information on swaps subject to the clearing requirement that are listed by such SEFs and DCMs, is intended to provide the Commission with the information needed to create a trade execution registry. This registry, in combination with the proposal requiring that DCMs and SEFs publicly post their Form TER on their websites, should benefit market participants and the public by facilitating determinations of whether a swap is subject to the trade execution requirement.

(3) Pre-Execution Communications and Block Trades

The Commission proposes to prohibit pre-execution communications for transactions subject to the trade execution requirement. The Commission believes that this prohibition would ensure that for swaps subject to the trade execution requirement, the trading of such swaps actually occurs within the confines of the SEF, which the Commission believes, in conjunction with the proposed interpretation of the trade execution requirement, would help foster and concentrate liquidity and price discovery which may help increase market efficiency and decrease transaction costs, as discussed above. Further, the Commission believes that with trading occurring within the SEF, market participants would receive the protections associated with SEF trading, as discussed above. With an expanded scope of swaps subject to the trade execution

requirement, the Commission is concerned that allowing a disproportionate amount of SEF transactions to be pre-arranged or pre-negotiated away from the facility under the pretense of trading flexibility would undercut the impact of the expansion of the requirement. Without a limitation on pre-execution communications that occur away from the SEF, the SEF's role in facilitating swaps trading would be diminished, undermining the statutory goals of promoting greater swaps trading on SEFs and pre-trade price transparency.

The Commission does not intend to impose this prohibition on swap transactions not subject to the trade execution requirement and certain package transactions. These exceptions would allow those participants who wish to voluntarily execute such trades on a SEF to do so without having to alter their current trading practices. These exceptions are intended to recognize the practical realities of executing these types of swaps, which are often highly customized, on SEFs.

The Commission also proposes to amend the block trade definition to require that counterparties that seek to execute swaps that are above the block trade size on a SEF must do so on a SEF's trading system or platform and not away from the SEF pursuant to its rules. Requiring market participants to execute swap block trades on a SEF should help SEFs facilitate the pre-execution screening by futures commission merchants ("FCM") of transactions against risk-based limits in an efficient manner through SEF-based mechanisms. Further, the proposed amendments regarding block trades on SEFs would promote the statutory goal in CEA section 5h(e) of promoting swaps trading on SEFs. The Commission notes that many market participants currently rely on no-action

relief under which some block trades currently trade on-SEFs, and that this benefit has largely already been realized for these swaps.[990]

(4) Impartial Access

Proposed § 37.202 would allow SEFs greater discretion to establish certain types of trading markets for certain types of participants through the use of access criteria, including fees. The Commission recognizes that many SEFs believe they are limited in the types of trading markets and services that they can develop and maintain because the current impartial access rule can be applied to promote an "all-to-all" trading environment, which is neither required under Core Principle 2 nor is consistent with swaps market structure. The Commission recognizes that some SEFs would like to target specific sectors of the swaps market and tailor their trading systems or platforms, as well as swap products, for trading among certain types of market participants. The Commission believes that affirmatively allowing SEFs the ability to target and design their SEFs to cater to certain market participants should result in an overall increase in swap market liquidity.

The proposed clarification to the impartial access requirement should allow SEFs to adapt to existing trading practices in the swaps market, which feature different types of access-related practices. For example, the Commission recognizes that some entities in the dealer-to-dealer market, *e.g.*, interdealer broker operations, operate based on fee structures that account for a host of business considerations, including discounts based on past or current trading volume attributable to the market participant, market maker

[990] *See* CFTC Letter No. 17-60, Re: Extension of No-Action Relief for Swap Execution Facilities from Certain "Block Trade" Requirements in Commission Regulation 43.2 at 2 (Nov. 14, 2017) ("NAL No. 17-60").

participation, or pricing arrangements related to services provided by a SEF-affiliated entity involving other non-swap products. The Commission's proposed approach to fee requirements under § 37.202(a)(2) would allow these types of entities, which would be subject to the SEF registration requirement under the Commission's clarification of § 37.3(a), to continue to facilitate certain trading markets and maintain existing pools of liquidity. Maintaining certain types of markets, such as the dealer-to-dealer market, should be beneficial to all market participants, including participants in the dealer-to-client market. In particular, the availability of liquidity and certain pricing to a dealer's clients in the dealer-to-client market may be dependent upon the ability of dealers to operate in a dealer-to-dealer market, where it is easier to offload risk. The Commission expects that continuing to apply the existing approach—"comparable fees" for "comparable services"—to the dealer-to-dealer environment may diminish the economic benefits of, and therefore impede, SEFs from developing additional services to facilitate trading.

The Commission notes that the benefits from this proposed change may already be realized to some degree as *de facto* dealer-to-dealer SEFs already exist under the current rule, and it is difficult to predict what innovative services, if any, SEFs may offer in the future. However, the proposed rule would explicitly allow SEFs to provide tailored services, as long as they meet the requirement that their access rules are transparent, fair, and non-discriminatory.

c. Costs

(1) Elimination of Minimum Trading Functionality and Execution Method Requirements

The Commission proposes to eliminate the minimum trading functionality requirement that SEFs offer an Order Book for all swap transactions. The Commission notes that some market participants may not perceive a significant cost from the lack of availability of an Order Book because the Order Books on many SEFs exhibit little or no trading activity and contain few or no bids and offers, despite SEFs maintaining them over the past few years. This suggests that market participants are not currently using the available Order Books and may therefore not perceive a cost if the Order Books are eliminated.[991] As noted above, the Commission anticipates that SEFs with active Order Books would continue to offer them; however, the Commission also believes that these existing Order Books, as a result of greater flexibility in execution methods, may see a negative impact to liquidity, which may be offset by an increase in liquidity on SEFs that offer other means of execution. Market participants may incur costs to integrate their systems with the new trading methodologies offered by SEFs. For some market participants, this may require programming new ways to interact with SEFs. Expanding the requirement to use SEFs for swap transactions would also increase the extent of SEFs' jurisdiction over market participants' trading, which market participants may view as a disadvantage or an increased cost. If market participants react to this by using other

[991] To the extent that requiring SEFs to offer Order Books facilitates their eventual use, the proposed elimination of the minimum trading functionality under § 37.3 creates a potential decrease in future pre-trade price transparency. If SEFs decide to stop offering Order Books pursuant to this proposal, some swaps markets may be not be able to move onto an Order Book even if there is future interest from some market participants. This cost would be mitigated to the extent that SEFs can always reinstate their order books in response to customer demand or offer other execution methods that provide similar pre-trade price transparency benefits.

means of risk management in place of the swaps that are required to be traded on SEF, then their risk management processes may be more disadvantageous or costlier.

As noted above, the Commission anticipates that competitive pressures may drive SEFs to offer flexible execution methods, which may impose additional costs on SEFs. The Commission believes that these additional costs may be mitigated, as SEFs would have the option, under the proposal, of continuing their existing execution practices.

The Commission recognizes that the overall amount of pre-trade price transparency in swap transactions currently subject to the trade execution requirement may decline if the Order Book and RFQ-to-3 requirement under existing § 37.9 are eliminated. This potential reduction in pre-trade price transparency could reduce the liquidity of certain swaps trading on SEFs and increase the overall trading costs. The Commission believes that this increased cost may be most severe for smaller customers that trade infrequently, and therefore may not be aware of current swaps pricing without pre-trade price transparency.

The purpose of the § 37.9 requirement that transactions in swaps subject to the trade execution requirement be executed using an Order Book or an RFQ System is to ensure that all activity in these swaps benefit from a baseline amount of pre-trade price transparency, *i.e.*, knowledge of multiple bids and offers that may be available. While the proposal may result in a reduction of the benefits from the existing system, this cost may be mitigated because every SEF still has the option of offering an Order Book and continuing to offer market participants the ability to submit RFQs to multiple liquidity providers on the SEF. Accordingly, the Commission anticipates that market participants would not need to forgo the pre-trade transparency associated with these means of

execution. Further, the Commission notes that to the extent that SEFs and other market participants respond to the proposed approach by offering flexible execution methods, market participants should benefit by having the opportunity to choose an execution method with a more appropriate level of pre-trade transparency for their transactions and their swaps trading needs.

According to a Commission staff research paper[992] that analyzed SEF trading in index CDS[993] subject to the trade execution requirement, approximately 45 percent of the RFQs were sent to three liquidity providers and the remaining 55 percent were sent to four or more. The mean number of RFQ recipients was 4.12.[994] The Commission anticipates that all or most of the market participants making RFQs to four or more liquidity providers would continue to send RFQs to multiple participants, even absent a rule requiring them to do so. Some percentage of those market participants currently sending RFQs to exactly three liquidity providers would probably send requests to only one or two liquidity providers if they were allowed to, but the Commission is unable to estimate what percentage of market participants would choose to send RFQs to fewer liquidity providers. As noted, those market participants sending RFQs to only one liquidity provider would be forgoing pre-trade transparency, but would be doing so voluntarily.

The Commission notes that the cost of a potential decline in pre-trade price transparency may be offset by the possible benefits from greater liquidity by permitting SEFs to offer other execution methods in episodically liquid markets. Additional

[992] 2017 Riggs Study at 11.
[993] The Commission has not performed a similar analysis for IRS.
[994] The Commission understands that one of the two SEFs analyzed currently limits the number of liquidity providers receiving a single RFQ-to-five participants.

execution methods like auction systems, to the extent SEFs decide to offer them, and other potential execution methods may be offered in response to the proposal and could be used to facilitate pre-trade price transparency at lower costs, particularly if SEFs also offer indicative quotes or indicative market clearing prices to participants.[995]

Proposed § 37.201(a), which would require SEFs to disclose in their rulebook the protocols and procedures of execution methods they offer, including any discretion in facilitating trading and execution would impose administrative costs on SEFs. The Commission believes that those costs are similar to those imposed by existing § 37.201(a), which establishes similar disclosure requirements, but would be more tailored to existing SEF execution methods.

(2) Trade Execution Requirement and Elimination of MAT Process

The proposed elimination of § 37.10 and § 38.12 and the proposed interpretation of the trade execution requirement as codified under § 36.1(a) would likely require some market participants to onboard to a SEF or DCM, if they have not already done so, in order to continue trading swaps. The costs for a market participant to onboard, along with the time various market participants would have to join a SEF or DCM under the compliance schedule, and trade on a SEF, discussed above, are also relevant.

To the extent more swaps are traded on SEFs or DCMs as a result of the proposed interpretation of the trade execution requirement as set out under § 36.1(a), SEFs and DCMs may incur additional costs, as part of their normal course of business, to update their systems to accommodate the increased number of products listed. Because this

[995] The Commission is aware of existing periodic auction mechanisms that aim to aggregate the buy and sell interests for a given swap and to clear the market by displaying the market mid-price to the market participants and allowing them to transact on that price.

would be an expansion built on top of existing systems, the Commission does not expect the costs associated with this expansion to be substantial. Additionally, the Commission believes that the proposed exemptions for certain swaps from the trade execution requirement would not impose new costs on market participants or on SEFs.

The Commission expects there to be some cost to SEFs and DCMs related to the proposed Form TER requirement, where they would have to submit the specific relevant economic terms of the swaps they list for trading to the Commission (and posted on the web site) in a timely manner. These costs are discussed in relation to the Commission's analysis above of information collection burdens under the PRA that are affected by the proposed rules.

(3) Pre-Execution Communications and Block Trades

Under the proposal, pre-execution communications for swaps subject to the trade execution requirement would have to occur within the confines of a SEF and could not occur outside of the SEF's facilities. In practice, this would mean that pre-execution communications between dealers and their customers could not occur through non-SEF telephones, e-mail systems, instant messaging systems, or other means of communication outside of the SEF. SEFs would incur costs if they choose to set up telephone conference lines, proprietary instant messaging or email systems, or any other system within the SEF to facilitate pre-execution communications within the confines of the SEF.

SEFs could potentially use existing technology to facilitate pre-execution communications on SEF, thus mitigating some potential costs. The proposal could also impose costs on dealers and their customers since they commonly communicate via telephone or other systems today and may have to change their communication or trading

practices to comply with the proposed rule. The costs for market participants would be mitigated to the extent that SEFs elect to incur the costs of providing telephone or other systems for their market participants to use for pre-execution communications, but costs may then increase correspondingly for SEFs.

The proposed amendment to the block trade definition to require that counterparties that seek to execute swaps that are above the block trade size on a SEF must do so on a SEF's trading system or platform would cause these transactions to incur the costs of trading on a SEF as discussed above. To the extent market participants react to these costs by reducing their use of block trades, they may be disadvantaged, incur additional costs, or hinder the effectiveness of their risk management program.

(4) Impartial Access

The proposed changes to the impartial access requirement, which would not require an "all-to-all" market as envisioned by the current rules, may inhibit the ability of certain market participants to access certain trading markets and liquidity pools. Under the proposed changes, SEFs may be able to offer markets that feature levels of liquidity and competitive pricing that only a limited category of participants could access. For example, SEFs that desire to serve the dealer-to-dealer segment of the market may have access criteria that certain participants cannot meet, thus preventing those participants from onboarding and from providing bids and offers, which could be disadvantageous to those participants and otherwise reduce access to favorable prices and impede price competition. Although the proposed changes to impartial access would require a SEF to allow those who seek and are able to meet set criteria to participate on its trading system or platform, this approach may still permit SEFs to impose barriers to access.

Additionally, allowing different trading markets to operate and accommodate a limited set of market participants for similar or the same swaps may impose costs through information asymmetries. For example, a SEF that serves a dealer-to-dealer segment and a SEF that services a dealer-to-client segment may feature different pricing for certain standardized IRS. Participants in the dealer-to-client market, who do not have access to the pricing and volume information of these dealer-to-dealer SEFs, may not have beneficial pricing information available on the latter that would otherwise help to inform their trading. This may increase costs for those market participants with information disadvantages.

The Commission notes, however, that the current SEF market structure and participation have generally continued to develop along these traditional market segments, absent the proposed access criteria. Therefore, the Commission anticipates that costs to market participants may not change much from the current situation.

d. Section 15(a) Factors

(1) Protection of Market Participants and the Public

The Commission anticipates that the proposed interpretation of the trade execution requirement, which may result in an expanded scope of swaps being required to trade on SEFs, coupled with the proposed ban on pre-execution communications for swaps subject to the trade execution requirement away from the facility, would help improve the protection of market participants and the public by allowing SEFs to more effectively surveil their markets and prevent manipulation and disruption to the functioning of an orderly swaps market. The proposed rules are expected to facilitate more transactions on SEFs, ensure that such transactions are executed entirely on SEFs,

and facilitate more market participants trading on SEFs, effectively allowing SEFs to have direct access to more data and have direct visibility to a larger portion of the market.

The Commission anticipates that the proposed exemptions for certain swaps from the trade execution requirement should not materially affect the protection of market participants and the public. The proposed exemptions are intended to allow a limited number of swap transactions otherwise subject to the trade execution requirement to occur off-SEF where there is good reason to do so. These include transactions that involve end-users who are eligible for the end-user exception to both the clearing requirement and the trade execution requirement, transactions that are currently exempt under Part 50 from the clearing requirement, and transactions that cannot readily be executed on a registered SEF, even in light of the proposed rules allowing flexibility of execution methods.

The Commission believes that the proposed flexible execution methods should promote protection of market participants and the public by facilitating the trading of swaps on SEFs, including those swaps newly subject to the trade execution requirement. The Commission also believes that the proposed amendment to the block trade definition should help protect market participants and the public by moving block trades to SEFs with the associated protections described above. The proposal to prohibit pre-execution communications for transactions subject to the trade execution requirement away from the facility should help to ensure that the entire process of trading and executing a transaction would occur on SEF. Swaps traded on SEFs receive the protections associated with the SEF core principles and Commission regulations, including, among other things, monitoring of trading and prohibitions against manipulation and other

abusive trading practices. The Commission believes that proposed § 37.201(a), which would require SEFs to disclose in their rulebook the protocols and procedures of execution methods they offer, including any discretion in facilitating trading and execution, should help protect market participants and the public by ensuring that they are informed about how these various execution methods operate.

The elimination of the mandatory Order Book and RFQ System execution methods for Required Transactions may reduce the benefits associated with pre-trade price transparency. In the absence of pre-trade price transparency, a counterparty may not obtain swaps at current market prices. However, the Commission believes that the approach taken in the proposed rule should promote pre-trade price transparency in the swaps market by allowing execution methods that maximize participation and concentrate liquidity during times of episodic liquidity.

(2) Efficiency, Competitiveness, and Financial Integrity of Markets

The Commission anticipates that the proposed interpretation of the trade execution requirement, which may result in an expanded scope of swaps being required to trade on SEFs, should improve the efficiency and competitiveness of the swaps markets. Although SEFs and market participants may incur costs in trading an expanded scope of swaps on SEFs, the Commission expects that markets would become more efficient as a whole, since an increase in the number of market participants trading on SEFs should allow liquidity demanders to more efficiently locate liquidity providers and trade with them. These efficiency gains may be attenuated, however, if the costs of SEF trading are higher than expected or if market participants respond to the expanded trading requirement by reducing their use of swaps that are required to be traded on SEF.

The Commission believes competitiveness can also improve through more market participants trading on SEFs that offer a variety of trading mechanisms, some of which can be designed to improve competitiveness and liquidity formation in the market. To the extent these market participants did not have access to such trading mechanisms, they should benefit from increased competition and liquidity formation. Improvements in competiveness would be attenuated, however, if the increase in trading on SEFs is less than anticipated.

The Commission anticipates that the proposed exemptions from the trade execution requirement, as discussed above, may maintain the current efficiency of those trades and thus maintain the financial integrity of the counterparties. The Commission believes that the proposed exemptions are narrowly tailored and thus, should not materially affect the competitiveness of the swap markets.

The Commission believes that the proposed rules allowing flexible execution methods should enhance the efficiency and financial integrity of markets by providing an opportunity for SEFs to offer more execution methods that may be more efficient and cost-effective for their customers than those currently offered. The proposal to prohibit pre-execution communications for transactions subject to the trade execution requirement away from the facility should enhance the financial integrity of markets by helping to ensure that such communications receive the protections to financial integrity associated with SEF core principles, including Core Principle 7. Under the proposal, market participants should continue to have access to pre-trade price transparency, which should continue to promote competitive bid-ask spreads, *e.g.*, by submitting RFQs to multiple

liquidity providers or by using additional execution methods that should be just as good at promoting pre-trade price transparency as order books and RFQ systems.[996]

Additionally, the Commission's proposal to create and publish the trade execution requirement registry on its website should benefit market participants and increase efficiency by reducing uncertainty about whether a swap is required to be traded on a certain platform. Similarly, the Commission's proposal that a SEF publicly post its Form TER on its website also reinforces the efficiency benefit for market participants, albeit at the expense incurred by DCMs and SEFs related to Form TER filings, as discussed above.

The Commission believes that the proposed changes to impartial access may enhance the efficiency, competitiveness, and financial integrity of markets by allowing SEFs to develop trading platforms and fee structures that better reflect the underlying features of the products traded on the SEF and customer needs. This can facilitate competition between liquidity providers, leading to better pricing for all traders that participate in the relevant segment of the market. The proposed revision to the impartial access rule might impair competition by preventing some traders from providing or accessing liquidity on some SEFs or having access to the most up-to-date pricing information. Impaired access to liquidity or pricing information may result in some market participants transacting in swaps at uncompetitive terms.

[996] As noted above, however, to the extent that the Order Book and other methods of execution mandated by the current rule promote pre-trade price transparency, the proposed elimination of this mandate may impair competition if it reduces market participants' ability to observe pre-trade prices, and thereby lose insight into competitive conditions in the market.

(3) Price Discovery

The Commission believes that in general market participants should have access to better price discovery in more liquid markets under the proposed rule, because it should result in a higher number of products being traded on SEFs by an increased number of market participants. With increased transactions on SEFs, through an increase in number of products as well as in market participants, SEFs would offer more price points on the same or comparable products and potentially more bids and offers. This increased trading on SEFs may also offset any impairment to price discovery resulting from a loss in pre-trade price transparency from the elimination of the mandate to offer specified trading methods. The Commission expects all of these improvements to culminate in better and faster price discovery for market participants, although improvements in price discovery may be attenuated if the increase in trading on SEFs is less than anticipated.

While, as a general matter, the Commission believes that price discovery in swaps subject to the trade execution requirement should occur on SEFs, the Commission nevertheless believes that the proposed exemptions from the trade execution requirement should not materially impact price discovery in the U.S. swaps markets. Many of the transactions eligible for the exemptions, such as inter-affiliate trades, are not price-forming or involve end-users, while other eligible transactions in swaps that are only listed by Exempt SEFs cannot readily be traded on a registered SEF.

The Commission believes that the proposal to prohibit pre-execution communications for transactions subject to the trade execution requirement away from the facility should further price discovery on SEFs by helping to ensure that all

negotiations related to price discovery occur on SEFs. The proposed amendment to the block trade definition would also tend to encourage more price discovery on SEFs. The proposed flexible execution methods would provide SEFs an opportunity to develop innovative execution methods that could enhance the price discovery process.

To the extent that the revised impartial access rules lead to a less competitive market, the market also may suffer from reduced price discovery.

(4) Sound Risk Management Practices

The Commission believes the proposed expansion of the trade execution requirement may further sound risk management practices by requiring that a larger set of swap transactions are negotiated, arranged, and executed in a manner that is subject to the rules of a SEF and that those trades receive the protections associated with SEF core principles and Commission regulations.

The Commission anticipates that the proposed exemptions from the trade execution requirement should not significantly impair the furtherance of sound risk management practices because firms using the exemptions should continue to be able to move swap positions between affiliates and take advantage of the statutory end-user exception from the clearing requirement. Exempting certain transactions that cannot readily be executed on a SEF, such as package transactions involving new issuance bonds and transactions in swaps that are only listed by Exempt SEFs, should allow entities using these swaps to continue their sound risk management practices.

The Commission believes that the proposed rules enabling flexible execution methods and requiring that pre-execution communications for transactions subject to the trade execution requirement occur on-SEF may further sound risk management practices

by requiring that these trades are negotiated, arranged, and executed on a SEF and that these trades receive the protections associated with SEF core principles and Commission regulations. Similarly, the Commission believes that the proposed rules enabling flexible execution methods should promote trading on SEFs and increase the number of transactions receiving these protections, thereby facilitating greater choice by market participants in execution methods that better suit their risk management needs, including allowing market participants to reduce potential information leakage and front-running risks. These improvements may be attenuated if the increase in trading on SEFs is less than anticipated. The proposed amendment to the block trade definition may further sound risk management practices by requiring block trades to occur on SEFs, while still allowing reporting delays pursuant to Part 43, which may give liquidity providers time to hedge such block trades before they are reported.

(5) Other Public Interest Considerations

The Commission believes the proposed interpretation of the trade execution requirement and the proposed flexibility in execution methods would further the public interest consideration of promoting trading on SEFs as stated in CEA section 5h(e), while also continuing to provide market participants with access to the pre-trade price transparency offered by certain SEF execution methods. While the Commission is proposing to eliminate the minimum trading functionality requirement that SEFs offer an Order Book or other prescribed trading methods for all swap transactions, the Commission anticipates that market participants would still be able to realize pre-trade price transparency by sending RFQs to multiple market participants or using other

multiple-to-multiple execution methods offered by SEFs that seek to encourage transparency and concentrate liquidity formation.

The Commission believes that the proposal to prohibit pre-execution communications for transactions subject to the trade execution requirement away from the facility and the proposed amendment to the block trade definition should also further the public interest consideration of promoting trading on SEFs by moving additional trading activity to SEFs.

Request for Comment

The Commission requests comment on all aspects of the consideration of the costs and benefits of the provisions related to market structure and trade execution.

5. Compliance and SRO Responsibilities

a. Overview

(1) SEF Trading Specialists

The Commission is proposing to adopt regulations under § 37.201(c) that would categorize certain persons employed by a SEF as a "SEF trading specialist." The Commission proposes to define a SEF trading specialist as any natural person who, acting as an employee (or in a similar capacity) of a SEF, facilitates the trading or execution of swaps transactions (other than in a ministerial or clerical capacity), or who is responsible for direct supervision of such persons. The Commission proposes to require a SEF to ensure that its SEF trading specialists are not subject to a statutory disqualification under sections 8a(2) or 8a(3) of the Act, have met certain proficiency requirements, and undergo ethics training on a periodic basis. Proposed § 37.201(c) also would require a

SEF to establish standards of conduct for its SEF trading specialists, and to diligently supervise their activities.

Proposed § 37.201(c)(2) would prohibit a SEF from permitting a person who is subject to a statutory disqualification under section 8a(2) or 8a(3) of the Act to serve as a SEF trading specialist if the SEF knows, or in the exercise of reasonable care should know, of the statutory disqualification. There are certain exceptions for persons who have retained registration in other categories despite the disqualification.[997]

Proposed § 37.201(c)(3) would require a SEF to establish and enforce standards and procedures, including taking and passing an examination[998] to ensure that its SEF trading specialists have the proficiency and knowledge necessary to fulfill their responsibilities to the SEF as SEF trading specialists; and comply with applicable provisions of the Act, Commission regulations, and the rules of the SEF.

Proposed § 37.201(c)(4) would require a SEF to establish and enforce policies and procedures to ensure that its SEF trading specialists receive ethics training on a periodic basis.

Proposed § 37.201(c)(5) would require a SEF to establish and enforce policies and procedures that require its SEF trading specialists, in dealing with market participants

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[997] Specifically, the Commission proposes an exception to the prohibition under § 37.201(c)(2) for any person listed as a principal or registered with the Commission as an associated person of a futures commission merchant, retail foreign exchange dealer, introducing broker, commodity pool operator, commodity trading advisor, or leverage transaction merchant, or any person registered as a floor broker or floor trader, notwithstanding that such person is subject to a disqualification from registration under sections 8a(2) or 8a(3) of the Act. The Commission is proposing an additional exception to the requirement under § 37.201(c)(2) for any person otherwise subject to a disqualification from registration for whom a registered futures association ("RFA"), provides a notice stating that if the person applied for registration with the Commission as an associated person, the registered futures association would not deny the application on the basis of the statutory disqualification.

[998] Such an examination would be developed and administered by an RFA.

and fulfilling their responsibilities to the SEF, to satisfy standards of conduct as established by the SEF.

Finally, proposed § 37.201(c)(6) would require a SEF to diligently supervise the activities of its SEF trading specialists in facilitating trading on the SEF.

(2) Rule Compliance and Enforcement

(i) Definition of "Market Participant"

Proposed § 37.2(b) would define "market participant." Part 37 specifies that a SEF's jurisdiction applies to various market participants who may be involved in trading or executing swaps on its facility; to date, SEFs have been relying on preamble language describing a "market participant" provided in the SEF Core Principles Final Rule to determine the scope of jurisdiction. By clarifying and codifying the market participant definition in the part 37, the Commission would maintain the existing recordkeeping responsibilities of traders that meet the proposed definition, as well as the jurisdiction SEFs have with respect to those traders. For example, under § 37.404(b), a SEF is required to adopt rules that require its market participants to keep records of their trading, including records of their activity in any index or instrument used as a reference price, the underlying commodity, and related derivatives markets. In addition, a SEF is required to have means to obtain that information.

The key change to the proposed definition of market participant from the existing approach under part 37 is the exclusion of clients of asset managers or other similar situations. As noted above, "market participants" are subject to certain recordkeeping requirements, and under this definition, such clients would not be subject to these recordkeeping requirements.

(ii) Audit Trail and Surveillance Program

The Commission proposes a number of changes to the existing rules regarding SEF audit trail and surveillance programs. First, the Commission proposes amending the audit trail requirements by moving certain § 37.205(a) requirements to guidance to Core Principle 2 in Appendix B. This guidance would state that audit trail data should be sufficient to reconstruct all indications of interest, requests for quotes, orders, and trades. The Commission also proposes to remove the requirement to capture post-trade allocation information. Second, the Commission proposes to eliminate the prescriptive requirements that specify the nature and content of the original source documents under § 37.205(b)(1). Third, the Commission would replace § 37.205(c)'s audit trail enforcement requirement with an audit trail reconstruction requirement, which would be focused on verifying a SEF's ability to reconstruct audit trail data rather than enforcing audit trail requirements on market participants. Fourth, the Commission proposes amending § 37.203(d), § 37.205(b)(2), and § 37.205(b)(3) to relieve a SEF's obligation to conduct automated surveillance on orders that are not entered into an electronic trading system or platform, *e.g.*, orders entered by voice or certain other electronic communications, such as instant messaging and email.[999] Fifth, the Commission proposes amending § 37.203(d) to eliminate the enumerated capabilities that every automated surveillance system must have and to instead require that the automated surveillance system be able to detect and reconstruct potential trade practice violations.

[999] Sections 37.203(d), 37.205(b)(2), and 37.205(b)(3) require a SEF that offers any form of voice trading functionality, as a condition to its registration, to establish a voice audit trail surveillance program to ensure that it can reconstruct a sample of voice trades and review such trades for possible trading violations.

(iii) Compliance and Disciplinary Programs

The Commission proposes several amendments to the rules that address a SEF's compliance program. First, the Commission proposes to amend § 37.203(f)(1) to state that SEFs must establish and maintain procedures requiring compliance staff to conduct investigations, including the commencement of an investigation upon the receipt of a request from Commission staff or upon the discovery or receipt of information by the SEF that indicates the existence of a reasonable basis for finding that a violation may have occurred or will occur.[1000] Second, the Commission proposes eliminating existing § 37.203(f)(2)'s 12-month requirement for completing investigations and providing SEFs the ability instead to complete investigations in a timely manner taking into account the facts and circumstances of the investigation.[1001]

Third, the Commission proposes several amendments to the rules that address a SEF's disciplinary program. Proposed § 37.206(b) requires that a SEF administer its disciplinary program through one or more disciplinary panels, as currently allowed, or through its compliance staff. The Commission also proposes to simplify a SEF's disciplinary procedures by eliminating the following requirements: (1) existing § 37.206(c), which sets forth minimum requirements for a hearing, and (2) existing § 37.206(d)'s requirement that a disciplinary panel render a written decision promptly following a hearing, along with detailed items required to be included in the decision, and

[1000] The Commission proposes adding language in the guidance to Core Principle 2 in Appendix B stating that compliance staff should submit all investigation reports to the CCO or other compliance department staff responsible for reviewing such reports and determining next steps in the process, and that the CCO or other responsible staff should have reasonable discretion to decide whether to take any action, such as presenting the investigation report to a disciplinary panel for disciplinary action. 17 CFR part 37 app. B.
[1001] For purposes of § 37.203(f)(2), the Commission proposes to provide SEFs with reasonable discretion to determine the timely manner in which to complete investigations pursuant to the guidance to Core Principle 2 in Appendix B. 17 CFR part 37 app. B.

replacing it with guidance for proposed § 37.206(b) to specify that a SEF's rules should require the disciplinary panel to promptly issue a written decision following a hearing or the acceptance of a settlement offer. Consistent with the changes to § 37.206(b), the Commission proposes to eliminate paragraphs (a)(11)-(12) from the guidance to Core Principle 2 in Appendix B addressing § 37.206(b), which provides specific guidelines for a SEF's ability to provide rights of appeal to respondents and issue a final decision.

Additionally, proposed § 37.206(c) would establish certain requirements for warning letters that already apply to sanctions, and would allow more than one warning letter within a rolling 12-month period for entities, as well as for individuals for rule violations related to minor recordkeeping or reporting infractions. As a streamlining and conforming change, the Commission also proposes to eliminate the existing warning letter requirement from § 37.203(f)(5), and combine this requirement into proposed § 37.206(c).

(iv) Regulatory Service Provider

The Commission proposes several amendments to the rules that address a SEF's use of regulatory service providers. Proposed § 37.204(a) expands the scope of entities that may provide regulatory services to include any non-registered entity approved by the Commission. The Commission also proposes to combine and amend existing §§ 37.204(b)-(c), resulting in several changes to the supervision requirements of a regulatory services provider ("RSP"). First, proposed § 37.204(b) eliminates the requirement that the SEF hold regular meetings and conduct periodic reviews of the provider and instead allows SEFs to determine the necessary processes for supervising their RSP. Second, under proposed § 37.204(b) a SEF may allow its RSP to make substantive decisions,

provided that, at a minimum, the SEF is involved in such decisions. Third, the Commission proposes to eliminate the requirement under § 37.204(c) that a SEF document where its actions differ from the RSP's recommendations, deferring instead to the SEF and its RSP to mutually agree on the method it will use to document substantive decisions.

(3) Error Trade Policy

Proposed § 37.203(e) would require that SEFs establish and maintain rules and procedures that facilitate the resolution of error trades in a fair, transparent, consistent, and timely manner as opposed to the requirement in existing § 37.203(e) that SEFs have the authority to adjust trade prices or cancel trades in certain situations. The definition of "error trade" under § 37.203(e) would include any swap transaction executed on a SEF that contains an error in any term of the swap transaction, including price, size, or direction. However, this definition would not include a swap that is rejected from clearing for credit reasons, and a SEF's error policy would not apply.[1002] At a minimum, such error policy would have to provide the SEF with the authority to adjust an error trade's terms or cancel the error trade, and specify the rules and procedures for market participants to notify the SEF of an error trade, including any time limits for notification. The proposed rule would also impose the new requirement that a SEF notify all of its market participants, as soon as practicable of (i) any swap transaction that is under review pursuant to the SEF's error trade rules and procedures; (ii) a determination that the trade under review is or is not an error trade; and (iii) the resolution of any error trade, including any trade term adjustment or cancellation.

[1002] Consistent with proposed § 37.702(b)(1), a SEF would deem any swap that is rejected from clearing for credit reasons as void *ab initio*.

(4) Chief Compliance Officer

The Commission proposes several amendments to the chief compliance officer ("CCO") regulations. First, the Commission proposes to allow the senior officer[1003] of a SEF to have the same oversight responsibilities with respect to the CCO as the SEF's board of directors. Specifically, the Commission proposes to (i) amend existing § 37.1501(b)(1)(i) to allow a CCO to consult with either the board of directors or senior officer of the SEF as the CCO develops the SEF's policies and procedures; (ii) amend existing § 37.1501(c)(1)(iii)[1004] to allow a CCO to meet with either the senior officer of the SEF or the board of directors on an annual basis; (iii) amend existing § 37.1501(c)(1)(iv)[1005] to allow the CCO to provide self-regulatory program information to the SEF's senior officer or to the board of directors; and (iv) eliminate the restriction under existing § 37.1501(c)(3) that removal of the CCO requires approval of a majority of the board of directors or a senior officer if the SEF does not have a board of directors, and instead permit the board of directors or the senior officer to remove the CCO under § 37.1501(b)(3)(i).

Second, the Commission proposes to consolidate and amend existing §§ 37.1501(d)(5)-(6)[1006] to allow a CCO to identify noncompliance matters through "any means," in addition to the currently prescribed detection methods, and to clarify that the procedures followed to address noncompliance issues must be "reasonably designed" by the CCO to handle, respond, remediate, retest, and resolve noncompliance issues

[1003] As discussed below, the Commission proposes to define "senior officer" to mean the chief executive officer or other equivalent officer of the swap execution facility.
[1004] This requirement is in proposed § 37.1501(b).
[1005] This requirement is in proposed § 37.1501(b)(6).
[1006] This requirement is in proposed § 37.1501(c)(5).

identified by the CCO. The Commission also proposes to amend the CCO's duty to resolve conflicts of interest under existing § 37.1501(d)(2).[1007] The Commission proposes to refine the scope of the CCO's duty to address "reasonable steps" to resolve "material" conflicts of interest that may arise.

Third, the Commission is proposing certain amendments to the annual compliance report ("ACR") regulations in existing § 37.1501(e),[1008] that would eliminate duplicative or unnecessary information requirements and streamline existing requirements. The Commission proposes to eliminate existing § 37.1501(e)(2)(i), which requires an ACR to include a review of all of the Commission regulations applicable to a SEF and identify the written policies and procedures designed to ensure compliance with the Act and Commission regulations and eliminate certain specific content required under existing § 37.1501(e)(4).[1009] The Commission also proposes to amend existing § 37.1501(e)(5)[1010] to require a SEF to only discuss material noncompliance matters and explain the corresponding actions taken to resolve such matters, rather than describing all compliance matters. The Commission proposes to amend existing § 37.1501(e)(6)[1011] to limit a SEF CCO's certification of an ACR's accuracy and completeness to "all material respects" of the report. The Commission also proposes to streamline and reorganize the remaining ACR content requirements, including consolidating the CCO's required description of the SEF's policies and procedures under existing § 37.1501(e)(1)[1012] with the CCO's

[1007] This requirement is in proposed § 37.1501(c)(2).
[1008] This requirement is in proposed § 37.1501(d).
[1009] This requirement is in proposed § 37.1501(d)(3). The proposed eliminated provisions currently require a discussion of the SEF's compliance staffing and structure, a catalogue of investigations and disciplinary actions taken over the last year, and a review of disciplinary committee and panel performance.
[1010] This requirement is in proposed § 37.1501(d)(4).
[1011] This requirement is in proposed § 37.1501(d)(5).
[1012] This requirement is in proposed § 37.1501(d)(1).

required assessment of the effectiveness of these policies and procedures under existing § 37.1501(e)(2)(ii) and also consolidating the CCO's required narrative of any material changes made during the prior year with the CCO's required narrative of any forthcoming recommended changes and areas of improvement to the compliance program as required under existing § 37.1501(e)(3) and existing § 37.1501(e)(2)(iii),[1013] respectively.

Fourth, the Commission proposes several amendments to simplify the ACR submission procedures. The Commission proposes to amend existing § 37.1501(f)(2)[1014] to provide SEFs with an additional 30 days to file the ACR with the Commission, but no later than 90 calendar days after a SEF's fiscal year end. Additionally, the Commission proposes to eliminate the "substantial and undue hardship" standard required for filing ACR extensions and replace it with a "reasonable and valid" standard currently set forth in existing § 37.1501(f)(4).[1015] The Commission also proposes to clarify existing § 37.1501(f)(3)[1016] to provide that, as required for initial compliance reports, the CCO must submit an amended ACR to the SEF's board of directors or, in the absence of a board of directors, to the senior officer of the SEF, for review prior to submitting the amended ACR to the Commission.

In addition to these substantive changes, the Commission proposes a number of conforming, clarifying, and streamlining changes that would not impose new costs or result in new benefits and are not discussed in the cost and benefit sections below. The Commission proposes to eliminate the CCO's obligations to the regulatory oversight

[1013] This requirement is in proposed § 37.1501(d)(2).
[1014] This requirement is in proposed § 37.1501(e)(2).
[1015] This requirement is in proposed § 37.1501(e)(4).
[1016] This requirement is in proposed § 37.1501(e)(3).

committee ("ROC"), including existing § 37.1501(c)(1)(iii), which requires a quarterly meeting with the ROC, and existing § 37.1501(c)(1)(iv), which requires the CCO to provide self-regulatory program information to the ROC. The proposal would not impact SEFs as there is no requirement that a SEF have a ROC.

Additionally, the Commission proposes to consolidate existing §§ 37.1501(b)-(c) into proposed § 37.1501(b). The Commission proposes to eliminate existing § 37.1501(b)(1), which requires a SEF to designate a CCO, and existing § 37.1501(c)(2), which requires the CCO to report directly to the board of directors or the senior officer of the SEF, as these requirements are already contained under § 37.1500.

The Commission proposes to eliminate the requirement under existing § 37.1501(f)(1) that a SEF must document the submission of the ACR to the SEF's board of directors or senior officer in board minutes or some other similar written record. This requirement is already covered in the general recordkeeping requirements in proposed § 37.1501(f), which is existing § 37.1501(g).

The Commission proposes a non-substantive amendment to § 37.1501(a)(2) to define a "senior officer" as "the chief executive officer or other equivalent officer of the swap execution facility."[1017] In addition, proposed § 37.1501(f), currently set forth under § 37.1501(g), would require a SEF to keep records in a manner consistent with the recordkeeping requirements under §§ 37.1000-1001.

Finally, the Commission proposes a new acceptable practice to Core Principle 15 in Appendix B that would provide a non-exclusive list of factors that a SEF may consider

[1017] In the SEF Core Principles Final Rule, the Commission noted that it would not adopt a definition of "senior officer," but noted that the statutory term would only include the most senior executive officer of the legal entity registered as a SEF. *See* SEF Core Principles Final Rule at 33544.

when evaluating an individual's qualifications to be a CCO.[1018] The proposal would provide a safe harbor and not impose new obligations.

(5) Recordkeeping, Reporting, and Information-Sharing

(i) Equity Interest Transfer

The Commission is proposing to amend the existing notification requirements related to transfers of equity interest in a SEF. Proposed § 37.5(c)(1) would require a SEF to file a notice with the Commission regarding any transaction that results in the transfer of direct or indirect ownership of fifty percent or more of the equity interest of a SEF as opposed to only direct ownership transfers as currently required. Transfer of ownership in an "indirect" manner may occur through a transaction that involves the transfer of ownership of a SEF's direct parent or an indirect parent, and therefore, implicates effective change in ownership of the SEF's equity interest.

(ii) Confirmation and Trade Evidence Record

The Commission is proposing several amendments to the existing confirmation requirement under § 37.6(b).[1019] First, the Commission proposes § 37.6(b)(1)(ii)(B) to allow a SEF to issue a "trade evidence record" for uncleared swap transactions that are executed on its facility. As defined under proposed § 37.6(b)(1)(ii)(B), a trade evidence record means a legally binding written documentation that memorializes the terms of a swap transaction agreed upon by the counterparties and legally supersedes any conflicting term in any previous agreement that relates to the swap transaction between the counterparties. The trade evidence record, at a minimum, would be required to

[1018] 17 CFR part 37 app. B.

[1019] The Commission notes that the confirmation requirements in proposed § 37.6(b)(1)(i)(A) are not changing.

include the necessary terms to serve as a legally binding record of the transaction that supersedes any conflicting term in any previous agreements, but is not required to contain all of the terms, in particular relationship terms contained in underlying documentation between the counterparties.

Second, the Commission proposes § 37.6(b)(2)(i) to require a SEF to provide counterparties with a confirmation document or trade evidence record "as soon as technologically practicable" after the execution of the transaction on the SEF.

Third, the Commission proposes § 37.6(b)(2)(iii) to allow a SEF to issue a confirmation document or trade evidence record to the intermediary trading on behalf of a counterparty, provided that the SEF establish and enforce rules to require transmission of the document or record to the counterparty as soon as technologically practicable.

(iii) Information-Sharing

The Commission proposes to amend § 37.504 to generally allow a SEF to share information with third-parties as necessary to fulfill its self-regulatory and reporting responsibilities by eliminating the specifically enumerated list of entities with whom a SEF must share information.

(6) System Safeguards

The Commission proposes to move the requirement in existing § 37.205(b)(4) that a SEF must protect audit trail data from unauthorized alteration and accidental erasure or other loss to proposed § 37.1401(c). The Commission proposes a new § 37.1401(g) to

require SEFs to annually prepare and submit an up-to-date Exhibit Q (existing Exhibit V)[1020] to Form SEF ("Technology Questionnaire") for Commission staff.

b. Benefits

(1) SEF Trading Specialists

The Commission expects that SEF trading specialists would exercise a level of discretion and judgment in facilitating trading that is informed by their knowledge and understanding of the market and the products traded on it, and their communications with market participants. The role of SEF trading specialists and their use of discretion will likely increase under the Commission's proposed approach to allow SEFs to offer flexible execution methods and to expand the trade execution requirement. The dual and integral role that SEF trading specialists play in exercising that discretion—interacting with market participants, while facilitating fair, orderly, and efficient trading and overall market integrity—calls for a regulatory approach that aims to maintain market integrity and provide appropriate protections for market participants.

The Commission believes that establishing a new category of SEF personnel, "SEF trading specialists," and requiring SEFs to subject SEF trading specialists to fitness requirements, proficiency testing, standards of conduct for SEF trading, and ethics training, and to diligently supervise them, would enhance proficiency and professionalism among SEF trading specialists, and would promote market integrity and confidence of market participants. The Commission also believes that these requirements would increase protection of market participants and the public by promoting fair

[1020] The Commission proposes to renumber existing Exhibit V to Form SEF as proposed Exhibit Q to Form SEF. 17 CFR part 37 app. A.

dealing. Furthermore, diligent supervision of SEF trading specialists would increase compliance with legal and regulatory requirements and SEF rules.

Proposed § 37.201(c)(2)(i) would enhance protections for market participants by seeking to ensure that SEFs do not employ persons subject to a statutory disqualification as a SEF trading specialist, subject to the proposed exception as discussed below. Sections 8a(2) or 8a(3) of the Act set forth numerous bases upon which the Commission may refuse to register a person, including, without limitation, felony convictions, commodities or securities law violations, and bars or other adverse actions taken by financial regulators. The Commission believes that by restricting SEFs from permitting such persons from intermediating and facilitating SEF trading (except in a clerical or ministerial capacity), market participants and the public would be better protected from abusive and fraudulent trading practices. Moreover, given the role SEF trading specialists play in facilitating orderly and fair trading, the Commission believes that proposed § 37.201(c)(2)(i) would enhance market integrity and fairness, and the confidence of SEF market participants.

Proposed § 37.201(c)(2)(ii)(A) would allow SEFs to employ as a SEF trading specialist a person the National Futures Association ("NFA") has permitted to be listed as a principal or to register with the Commission based on the NFA's determination that the incident giving rise to the person's statutory disqualification is insufficiently serious, recent, or otherwise relevant to evaluating the person's fitness. Similarly, proposed § 37.201(c)(2)(ii)(B) would allow a SEF to employ as a SEF trading specialist a person subject to a statutory disqualification who provides a written notice from an RFA stating

that if the person were to apply for registration as an associated person, the RFA would not deny the application on the basis of the statutory disqualification.

Proposed § 37.201(c)(2)(ii) would benefit SEFs and their prospective SEF trading specialists by allowing SEFs to employ a person as a SEF trading specialist where the incident giving rise to the person's statutory disqualification is insufficiently serious, recent, or otherwise relevant to evaluating the person's fitness for registration with the Commission. The Commission believes that, where an RFA provides a notice that such circumstances are present, the benefits of the prohibition under § 37.201(c)(2)(i)—in particular the protection of market participants and the public and enhancing market integrity—are not implicated, and thus a SEF should be permitted to employ such persons as a SEF trading specialist.

Given the level of discretion SEF trading specialists exercise, the Commission believes that proposed § 37.201(c)(3)(i) would benefit market participants and the public by helping to ensure that SEF trading specialists have the requisite proficiency and knowledge to fulfill their responsibilities and to comply with the Act, Commission regulations, and SEF rules. The proficiency examination requirement under § 37.201(c)(3)(ii) would further ensure that all SEF trading specialists maintain a baseline level of proficiency. This would increase protection of market participants and better ensure that trading on SEFs is conducted in a fair, orderly, and efficient manner. The Commission expects the proposed requirements to enhance the confidence of market participants and the public in the integrity and fairness of SEF markets.

Proposed §§ 37.201(c)(4)-(6) would respectively require a SEF to ensure that SEF trading specialists receive ethics training on a periodic basis, subject SEF trading

specialists to standards of conduct in dealing with market participants and fulfilling their responsibilities, and diligently supervise the activities of its SEF trading specialists.

Overall, these proposed rules would promote public and market participants' confidence in the trading of swaps on SEFs and may bring additional volumes of trading and liquidity to SEFs.

(2) Rule Compliance and Enforcement

(i) Definition of "Market Participant"

The primary benefit of the rule change is an anticipated reduction in recordkeeping costs for clients of asset managers and SEFs.

(ii) Audit Trail and Surveillance Program

Many of the proposed changes to the audit trail and surveillance requirements described above are expected to result in savings in terms of compliance staff and resources for most SEFs. For example, SEFs that offer voice trading are currently required to conduct regular voice audit trail surveillance in lieu of the electronic analysis capability requirements of § 37.205(b)(3). These SEFs dedicate compliance staff and resources to establishing and conducting the voice audit trail surveillance programs, including contracting with the NFA for the performance of the reviews. However, under the proposed changes to § 37.203(d), § 37.205(b)(2), and § 37.205(b)(3), these SEFs would no longer be required to conduct regular automated surveillance on indications of interest, requests for quotes, and orders that are not entered into a SEF's electronic trading system or platform. Therefore, new SEFs would not incur the cost to implement this requirement and all SEFs would not incur the ongoing cost to maintain a regular voice audit trail surveillance program.

Additionally, eliminating § 37.205(c)'s requirement to enforce audit trail requirements through annual reviews should result in cost savings to all SEFs, as they would no longer need resources, either internal compliance staff or the NFA, to perform audit trail reviews.

However, the Commission proposes to replace these requirements with a requirement to perform audit trail reconstructions, which is expected to reduce some of the cost savings as described above.[1021] The proposed changes to the audit trail rules under § 37.205(a) are intended to address the current challenges SEFs face with respect to obtaining post-trade allocation information and conducting surveillance on orders that are not entered into an electronic trading system or platform. Similarly, proposed § 37.203(d) would no longer require SEF automated surveillance systems to have certain capabilities that they cannot perform.

(iii) Compliance and Disciplinary Programs

SEF compliance programs should benefit from the proposed changes related to conducting investigations. For example, changes proposed to § 37.203(f) seek to simplify the procedures for SEFs to conduct investigations and prepare investigation reports. Specifically, eliminating the 12-month requirement for completing investigations under § 37.203(f)(2), and replacing it instead with a general statement that permits SEFs to complete investigations "in a timely manner taking into account the facts and circumstances of the investigation" would provide SEFs with greater discretion to manage their workload, and allow them to prioritize their other compliance

[1021] The Commission also notes that some of the new costs associated with the reconstruction program requirement in proposed § 37.205(c) are offset by to the statutory mandate in Core Principle 4 that already requires a SEF to have methods for conducting comprehensive and accurate trade reconstructions.

responsibilities as needed. SEFs also may benefit from the additional clarity and flexibility provided in language related to investigation reports in the guidance to Core Principle 2 in Appendix B. The language states that compliance staff should submit all investigation reports to the CCO or other compliance department staff responsible for reviewing such reports and determining next steps in the process, and that the CCO or other responsible staff should have reasonable discretion to decide whether to take any action, such as presenting the investigation report to a disciplinary panel for disciplinary action.

SEFs may realize additional cost savings under the proposed changes to the disciplinary rules under § 37.206. Proposed § 37.206(b) would allow a SEF to administer its disciplinary program through not only one or more disciplinary panels as currently allowed, but also through its compliance staff. This proposed rule would provide SEFs with more flexibility to adopt a cost effective disciplinary structure that better suits their markets and market participants, while still effectuating the requirements and protections of Core Principle 2. The Commission anticipates that SEFs that choose to administer their disciplinary programs through their compliance staff would incur the greatest cost savings. These SEFs would not incur the cost associated with establishing or maintaining disciplinary panels.

Additionally, to the extent that a SEF chooses to administer its disciplinary programs through compliance staff, the SEF may no longer incur certain costs associated with conducting hearings or appeals, such as preparing materials and presentations for hearings before the disciplinary panel, or the time spent by SEF employees preparing written disciplinary decisions. A SEF also may benefit from increased efficiencies that

they can leverage from compliance staff's knowledge about the SEF and its trading practices to adjudicate matters more quickly than under the traditional disciplinary structure.

(iv) Regulatory Service Provider

A SEF may realize cost savings from the proposed changes under § 37.204. Expanding the scope of entities that may provide regulatory services under proposed § 37.204(a) to include any non-registered entity approved by the Commission may result in an increase in competition among RSPs, and reduce the overall cost of securing an RSP. Under the proposed changes to § 37.204(b), a SEF and its RSP may also mutually agree on the method it will use to document substantive decisions, rather than documenting every instance where the SEF's actions differ from the RSP's recommendations, which may reduce the administrative costs associated with documentation created and maintained by a SEF and its RSP. Providing SEFs with the option under proposed § 37.204(b) to allow their RSPs to make substantive decisions, should better enable an RSP to promptly intervene and take action, as it deems necessary. Finally, eliminating the requirement under § 37.204(c) that a SEF document where its actions differ from the RSP's recommendations, deferring instead to the SEF and its RSP to mutually agree on the method it will use to document substantive decisions, may encourage better communication among SEFs and its RSP.

(3) Error Trade Policy

The Commission believes that the proposed changes to the error trade rule would reduce the costs and risks associated with error trades and promote swaps market integrity and efficiency. When counterparties execute a trade that is an error trade, the

counterparties bear the costs and risks from being bound to terms to which they did not intend to assent. The proposed rule that requires error trades be resolved in a fair, transparent, and consistent manner would increase confidence that error trades would be corrected and that published swap data is an accurate indication of market supply and demand.

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. The proposed timeliness requirement should result in faster error resolution and lower the risk of costly market moves.

The proposed requirement that SEFs notify market participants that a swap transaction is under review pursuant to error trade rules and procedures, the determination that the trade under review is or is not an error trade, and the resolution of any error trade review should make markets more efficient. An error trade misinforms market participants when its price is different than the price would be if the trade had been executed non-erroneously. The notification requirement should allow market participants to make better informed decisions regarding supply and demand.

(4) Chief Compliance Officer

As discussed in the preamble, the Commission believes that some of the regulations implementing Core Principle 15 may be unnecessarily burdensome and inefficient. The proposed regulations are intended to address these issues.

The proposal to give the senior officer the same authority as the board of directors to oversee the CCO would provide SEFs with greater opportunity to structure the management and oversight of the CCO based on the SEF's particular corporate structure, size, and complexity. This could increase efficiency and reduce costs. Additionally, the quality of oversight of the CCO could improve if the senior officer is better positioned than the board of directors to provide day-to-day oversight of the CCO.

The proposal to permit the CCO to use any means to identify noncompliance issues is less prescriptive and should also increase efficiencies. The proposed amendment to § 37.1501(d) to refine the scope of the required information in a SEF's ACR should make the ACR process more efficient and reduce costs. For example, the proposed removal of § 37.1501(e)(2)(i) and certain specific content set forth under § 37.1501(e)(4) should reduce the amount of time that a CCO and his or her staff must

spend preparing the ACR. Proposed § 37.1501(d)(4), which would require that SEFs focus on describing material non-compliance matters, rather than describing all compliance matters, should streamline the ACR requirement and provide more useful information to the Commission. Additionally, the proposed clarification under § 37.1501(e)(3) that the CCO must submit an amended ACR to the SEF's board of directors or, in the absence of a board of directors, the senior officer of the SEF, should reduce the need for extensive follow-up discussions.

Finally, the proposal to allow SEFs more time to submit their ACRs should reduce the time and resource burden on the CCO and compliance department. This additional time should allow SEFs to fully complete their ACRs and meet their other end-of-year reporting obligations, such as the fourth quarter financial report. However, the Commission understands that those SEFs that already may rely on Commission staff no-action relief for an extra 30 days to complete the ACR may have availed themselves of the benefits associated with the extended reporting deadline.

(5) Recordkeeping, Reporting, and Information-Sharing

(i) Equity Interest Transfer

The Commission notes that an indirect transfer of a SEF's equity interest raises similar concerns as a direct transfer, notification of which is currently required under the existing requirement. Therefore, the Commission believes that proposed § 37.5(c)(1) would benefit market participants because the Commission would have the ability to more broadly identify and assess situations where an indirect equity interest transfer of a SEF could potentially impact its operational ability to comply with the SEF core principles and the Commission's regulations.

(ii) Confirmation and Trade Evidence Record

The Commission believes that the proposed "trade evidence record" approach in proposed § 37.6(b) should benefit both SEFs and market participants by decreasing the administrative costs to execute an uncleared swap on a SEF. Not only would a SEF not be required to expend time and resources to gather and maintain all of the underlying relationship documentation between all possible counterparties on its facility, but market participants would also not be required to expend time and resources in gathering and submitting this information to the SEF, including any amendments or updates to that documentation. Consistent with the bilateral nature of the underlying relationship documentation and current market practice outside of SEFs, counterparties to the transaction would be better able to devise their own confirmation documents by supplementing the information provided in the trade evidence record with additional terms that they have previously negotiated. Therefore, SEFs and counterparties should benefit from a documentation requirement that better reflects the nature of uncleared swap transactions. Moreover, the Commission believes this trade evidence record may encourage more uncleared swaps trading on SEFs where these trades can benefit from SEF oversight, and ultimately would increase the financial integrity of the swaps market. The Commission notes that to the extent that SEFs and market participants have relied on the existing no-action relief provided by Commission staff to avoid these costs by incorporating those terms by reference in a confirmation document, they have been availing themselves of the benefits from these reduced costs.

SEFs should also benefit from the proposed requirement that they transmit the confirmation document or the trade evidence record "as soon as technologically"

practicable after execution of the transaction rather than at the same time as execution. In particular, this approach should provide an opportunity for a SEF to develop protocols for transmitting this documentation in a manner that is adaptive to the type of execution method that is utilized to execute a transaction. Given the flexible methods of execution that the Commission proposes to allow for all swaps, this practical approach to transmitting documentation should not impede the development of trading systems or platforms. For example, a SEF that offers non-automated execution methods would not be required to ensure that post-trade processing protocols simultaneously transmit the confirmation or trade evidence record at the time of execution.

Further, SEFs and market participants should benefit from allowing an intermediary to receive a confirmation document or trade evidence record on behalf of the counterparties to the transaction. This approach should be more consistent with current market practice, such that intermediaries maintain the connectivity in trading on the SEF. Given that intermediaries are connected with and participating on the SEFs, but are acting on behalf of the counterparties, a SEF is able to transmit the documentation related to a swap transaction to the intermediary, who would then transmit that information to the ultimate counterparties.

(iii) Information-Sharing

The Commission believes that the proposed amendment to information-sharing requirements would benefit SEFs by providing a better opportunity to utilize third-party entities to fulfill their self-regulatory and reporting responsibilities at a lower cost. The proposed rule should increase the number of RSPs and likely increase the competition between these providers, which should both lower costs and improve the level of services

offered. The Commission anticipates that this benefit would be greater for smaller SEFs that otherwise would have difficulty operating economically due to the high fixed costs of some services.

(6) System Safeguards

The Commission has identified several potential benefits from the proposed changes to the system safeguards requirements. First, the proposed annual Technology Questionnaire filing requirement (in proposed Exhibit Q) should help the Commission maintain a current profile of the SEF's automated systems and be consistent with the provisions of existing § 37.1401(g)(4),[1022] which allows the Commission to request the results from a SEF's mandatory tests of its automated systems and business continuity-disaster recovery capabilities. The Commission believes that the proposed rule would reduce the need for additional information and document requests related to that existing requirement.[1023]

Second, the Commission believes an annually-updated Technology Questionnaire could expedite Systems Safeguards Examinations ("SSE"). For example, it could reduce a SEF's overall compliance-related burdens for SSEs by (i) reducing a SEF's effort to respond to SSE document requests by instead allowing a SEF to provide updated information and documents for sections of Exhibit Q that have changed since the last annual filing; and (ii) allowing SEFs to respond to an SSE document request by

[1022] Existing § 37.1401(g) generally requires a SEF to provide all other books and records requested by Commission staff in connection with Commission oversight of system safeguards pursuant to the Act or Commission regulations, or in connection with Commission maintenance of a current profile of the SEF's automated systems. 17 CFR 37.1401(g).

[1023] The current profile of a SEF's automated systems is also supported by the provision of timely advance notice of all material planned changes to automated systems that may impact the reliability, security, or adequate scalable capacity of such systems, and of planned changes to the SEF's program of risk analysis and oversight, as required by § 37.1401(f)(1)-(2). 17 CFR 37.1401(f)(1)-(2).

referencing Exhibit Q information and documents to the extent that they are still current, rather than resubmitting such information and documents. The Commission also notes that an annual update to Exhibit Q, which would be required concurrently with submission of the CCO annual compliance report, could provide information and documents potentially useful in preparing that annual report.

c. Costs

(1) SEF Trading Specialists

The Commission expects that SEFs and/or SEF trading specialists would incur additional costs to satisfy the fitness requirement in proposed § 37.201(c)(2). The Commission expects that SEFs would vet prospective SEF trading specialists to ensure that they are not subject to a statutory disqualification. Such vetting may include the completion by a prospective SEF trading specialist of a questionnaire regarding employment and criminal history. Additionally, SEFs may conduct criminal background checks through third-party service providers to ensure that SEF trading specialists are not subject to a statutory disqualification.

The costs of ensuring compliance with proposed § 37.201(c)(2)(i) may be mitigated where a SEF trading specialist is separately registered with the Commission in some other capacity (*e.g.*, as an associated person), in which case a SEF may reasonably rely on the person's registration status as evidence that the person is not subject to a statutory disqualification or that the person falls within the exception set forth in proposed § 37.201(c)(2)(ii)(A). In cases where a SEF relies on the exception in proposed § 37.201(c)(2)(ii)(B), the SEF (or the SEF trading specialist) would bear an additional cost of obtaining the required notice from an RFA.

The expected costs associated with the proficiency requirement in proposed § 37.201(c)(3)(i) would include the cost to a SEF of determining if a SEF trading specialist is sufficiently proficient (which can be accomplished by passing the examination, once it is available) and, if necessary, providing training to ensure that a SEF trading specialist possesses the requisite proficiency. In some cases, the cost of determining proficiency may be minimal; for example where the SEF trading specialist has an employment history that reflects the requisite knowledge and experience.

The expected costs associated with the proficiency examination requirement in proposed § 37.201(c)(3)(ii) would include a fee imposed by the RFA. This fee would likely be designed to, at a minimum, offset the costs of developing and administering the examination. Additional costs may include study, training, or other examination preparation, borne by a SEF trading specialist or by a SEF on behalf of the SEF trading specialist. As discussed above, once an examination for swaps proficiency is made available, compliance by a SEF with the examination requirement in proposed § 37.201(c)(3)(ii) would constitute compliance with the general proficiency requirement in proposed § 37.201(c)(3)(i). Thus, the cost associated with complying with proposed § 37.201(c)(3)(i) would be mitigated once an RFA-administered examination is made available.

As discussed in the proposed amendments to the guidance to Core Principle 2 in Appendix B, each SEF would have broad discretion in developing and implementing its ethics training program under proposed § 37.201(c)(4). Given this discretion, the costs to SEFs to comply with the ethics training requirement may vary widely from SEF to SEF.

Furthermore, the training needs of a SEF may vary according to the size, number of SEF trading specialists, and the level of their expertise and responsibilities within a SEF.

While the Commission believes that the requirements in proposed §§ 37.201(c)(5)-(6) would impose additional costs on SEFs, the Commission anticipates that the costs would vary from SEF to SEF. A SEF may utilize its existing compliance staff or may opt to add compliance staff in order to enforce its standards of conduct for SEF trading specialists and to meet the SEF's obligation to diligently supervise SEF trading specialists. Additional costs associated with these proposed requirements may include the costs of developing standards of conduct and policies and procedures designed to ensure that SEF trading specialists are diligently supervised.

(2) Rule Compliance and Enforcement

(i) Definition of "Market Participant"

By effectively moving clients of asset managers out of the category of market participant, the proposal potentially reduces SEFs' ability to monitor the positions of these clients, although SEFs would still be able to monitor the trading of the asset managers.[1024] Hence, the cost of the proposed change may be a reduction in the ability of SEFs to detect abusive practices to the extent that clients of asset managers are able to engage in such practices. However, these swap users, who typically give up their trading discretion, appear to be the least likely to engage in manipulative practices. For example, when a client gives complete trading discretion to an asset manager, the specifics of the

[1024] The proposed definition of "market participant" includes any person who accesses a SEF through direct access provided by a SEF; through access or functionality provided by a third-party; or through directing an intermediary, such as an asset manager, that accesses a swap execution facility on behalf of such person to trade on its behalf. A person who does not access a SEF in any of these ways, such as a client who does not direct the asset manager to trade on its behalf, would not be a market participant under the proposed definition. *See* proposed § 37.2(b).

asset manager's trading typically occurs without particular knowledge of the client—that is, they do not know the investment, whether any swap traded is occurring on a SEF, or even the identity of the SEF. Importantly, the asset managers who conduct trading on the SEF for the client remain subject to the SEF's record retention and other requirements. Hence, to the extent that an asset manager for a client is engaging in abusive trading practices on a SEF, a SEF's ability to investigate and prevent those practices should not be diminished.

(ii) Audit Trail and Surveillance Program

Without conducting automated surveillance on orders entered by voice or certain other electronic communications, such as instant messaging and email, SEFs may have a reduced ability to identify potential misconduct involving voice orders. However, the Commission recognizes that since SEFs currently do not have a cost-effective solution for performing such automated surveillance, the proposed rules do not provide lesser protections to market participants and the public. Regarding the requirement to capture post-trade allocation information, the Commission understands that SEFs currently cannot capture this information. As a result of capturing less audit trail data under the proposal, there may be possible costs in the form of reduced protections to market participants and the public. However, the Commission does not believe that the proposed rule is likely to meaningfully reduce protections to market participants and the public as compared to the current rules.

The Commission proposes to replace the audit trail enforcement requirement with the requirement to perform audit trail reconstructions.[1025] Since SEFs are currently required to reconstruct a sample of orders and trades under the voice audit trail surveillance program, the Commission does not anticipate that any SEFs subject to this program will incur any additional costs associated with performing audit trail reconstructions under proposed § 37.205(c). For SEFs that electronically capture audit trail data and do not have a voice component, the incremental cost of reconstructing trades should not be material, as their automated trade surveillance systems should already be capable of such reconstructions under § 37.203(d).

(iii) Compliance and Disciplinary Programs

The Commission is mindful that the proposed elimination of the 12-month requirement for completing investigations under § 37.203(f)(2) could lead to delays in completing disciplinary actions. However, the Commission notes that SEFs remain responsible for completing investigations in a "timely manner taking into account the facts and circumstances of the investigation." In addition, while many SEFs are likely to benefit from the proposed changes described above related to the disciplinary process, there may be accompanying costs. For example, a SEF's compliance staff may incur additional costs taking on the added responsibilities previously performed by a disciplinary panel.

The proposed changes to § 37.206 also permit SEFs to establish a disciplinary process that may provide respondents fewer procedural protections than are required

[1025] The Commission also notes that some of the new costs associated with the reconstruction program requirement under proposed § 37.205(c) are offset by to the statutory mandate in Core Principle 4 that currently requires a SEF to have methods for conducting comprehensive and accurate trade reconstructions.

under the current rules. However, the Commission notes that the guidance to Core Principle 2 in Appendix B states that a SEF's rules relating to disciplinary panel procedures should be fair, equitable, and publicly available. Competition and customer demand should ensure that SEFs maintain suitable disciplinary programs with sufficient protections.

(iv) Regulatory Service Provider

New RSPs may incur start-up costs associated with developing an automated trade surveillance system and establishing and maintaining sufficient compliance staff. However, the Commission would expect these costs to decrease once the RSP has established its program and as it gains experience providing regulatory services. RSPs may realize further reductions in these costs as they gain economies of scale by offering their services to multiple SEFs.

Eliminating the requirement that a SEF hold regular meetings and conduct periodic reviews of its RSP may lead to varying degrees of communication between a SEF and its RSP, but the Commission believes that most SEFs would seek to maintain regular communication with their RSPs, given that SEFs remain ultimately responsible for the performance of any regulatory services received, for compliance with their obligations under the Act and Commission regulations, and for the RSPs' performance on their behalf.

(3) Error Trade Policy

The Commission anticipates that SEFs would incur costs to establish and maintain rules and procedures that facilitate the resolution of error trades. As noted in the preamble, the proposed rule is intended to reflect error trade policies that generally exist

among SEFs so many SEFs should have policies that are at least partially compliant with the proposed rule and would not have to incur the full costs discussed below. The Commission understands that SEFs implemented these policies as an appropriate means to address error trades or to satisfy a condition set forth in no-action relief provided by Commission staff.

Proposed § 37.203(e)(2) would require that some SEFs incur the costs associated with establishing and maintaining rules and procedures that facilitate resolution of purported errors in a fair, transparent, consistent, and timely manner. Existing § 37.203(e) requires only that a SEF have the authority to resolve errors when necessary to mitigate certain market disrupting events. SEFs that do not currently have error trade policies, or whose policies are not compliant with proposed § 37.203(e)(2), would incur one-time costs to develop a compliant policy and ongoing costs to implement such policy.

To comply with the proposed § 37.203(e)(3) requirement that SEFs notify market participants of (i) any swap transaction that is under review pursuant to the SEF's error trade rules and procedures; (ii) a determination that the trade under review is or is not an error trade; and (iii) the resolution of any error trade, including any trade term adjustment or cancellation, some SEFs would have to incur costs to establish a means of communicating such information to market participants. The Commission believes that many SEFs would send notifications electronically to their market participants. All SEFs have the ability to communicate electronically with market participants. However, some SEFs may not be able to send electronic notifications "as soon as practicable" and could have to obtain and implement software to do so. SEFs would also incur costs each time a

notification is sent. The Commission believes that the ongoing cost would be minimal if the notification was sent electronically using a partially automated software system. However, some SEFs may send notifications to their market participants by other means.

The Commission does not believe the proposed error trade policy is likely to increase the risk that counterparties act carelessly and make more errors. As noted above, market participants may incur significant costs when they enter into error trades if they need to unwind hedge trades and execute new hedge trades. The Commission believes that these costs encourage market participants to implement best practices to avoid errors. The Commission also does not believe that the error trade policy is likely to increase the risk that counterparties attempt to use error trades to manipulate the market by entering into off-market transactions and then cancelling the trades after the market has moved. Since § 37.203(e) already requires that SEFs correct error trades, the proposed rule should not improve a market manipulation scheme's chances of success.

(4) Chief Compliance Officer

The proposed change to § 37.1501(b) to authorize the senior officer to oversee the CCO, could impair the independence of the CCO, and as a result the CCO's oversight of the SEF. However, the Commission believes that this risk is mitigated by the Commission's review of annual ACRs and examination programs.

The proposed amendments would eliminate requirements that the CCO identify noncompliance matters using only certain specified detection methods, design procedures that detect and resolve all possible noncompliance issues, and eliminate all potential conflicts of interest. These requirements would be replaced by more flexible standards, which could potentially allow for some impairment of a CCO's oversight of the SEF in

some circumstances. However, the Commission believes that the resulting costs (in the form of potential adverse consequences) would not be material because the proposed changes would now focus on material aspects of the compliance program, *e.g.*, material breaches and material conflicts of interest. The Commission believes that the proposal acknowledges that the focus should be placed on material compliance issues rather than all compliance issues.

The proposed change to § 37.1501(e) to reduce the information required in an ACR could make it more difficult for the Commission to assess a SEF's compliance and self-regulatory programs. However, the Commission does not anticipate that these changes would materially impact the Commission's assessment as it already receives or has access to such information from other sources. For example, the Commission approves a SEF's compliance staffing and structure as part of the SEF's registration or rule submission, and annual updates provide minimal additional information, at best. In addition, SEFs report finalized disciplinary actions to the NFA,[1026] and the Commission could access this information through its oversight of the NFA.

Finally, the proposal to give SEFs more time to submit their ACRs could delay the Commission in recognizing and addressing a SEF compliance issue. However, the Commission anticipates that such risk is mitigated to the extent that SEFs provide ACRs on the timeline set forth in the proposed rules. The Commission's experience with these SEFs has not indicated that this delayed reporting has adversely impacted its ability to recognize and address compliance issues in a timely manner.

[1026] *See* § 9.11 (stating that whenever an exchange decision pursuant to which a disciplinary action or access denial action is to be imposed has become final, the exchange must, within thirty days thereafter, provide written notice of such action to the person against whom the action was taken and notice to the National Futures Association). 17 CFR 9.11.

(5) Recordkeeping, Reporting, and Information-Sharing

(i) Equity Interest Transfer

The proposed additional requirement to notify the Commission of an indirect change in ownership would increase costs to a SEF, who would be required to provide notice in these instances. As part of that notification, a SEF may incur costs that are similar to those incurred when providing a notice of a direct change, including providing details of the proposed transaction and how the transaction would not adversely impact its ability to comply with the SEF core principles and the Commission's regulation, responding to any requests for supporting documentation from the Commission, and updating any ongoing changes to the transaction.[1027]

(ii) Confirmation and Trade Evidence Record

With respect to uncleared swaps, the proposed "trade evidence record" approach in proposed § 37.6(b) could reduce the financial integrity of transactions on SEFs compared to the current rule. There could be a greater risk of misunderstanding between the counterparties if they do not provide all the terms of a transaction at the time of execution. Even when parties reference agreements, confusion could arise from issues such as multiple versions of the agreement with the same labeling or missing sections. However, the Commission does not expect that this risk will materially reduce the integrity of the swaps market. The Commission notes that these agreements are usually relationship terms between counterparties that govern all trading in uncleared swaps and

[1027] The Commission previously identified the types of information that a SEF should provide as part of its notification, including (i) relevant agreement(s); (ii) associated changes to relevant corporate documents; (iii) a chart outlining any new ownership or corporate or organization structure, if available; and (iv) a brief description of the purpose and any impact of the equity interest transfer. SEF Core Principles Final Rule at 33490.

do not concern the terms of specific transactions. The Commission expects that, since it should generally be less extensive, the change should result in no increased costs.

The Commission also notes that to the extent that a SEF elects to not issue a confirmation document that includes or incorporates all of the terms of an uncleared swap transaction (including the trade evidence record), the counterparties to the swap may be subject to other Commission regulations that impose those burdens, and therefore, increased costs. For example, where one of the counterparties to an uncleared swap transaction is a swap dealer or major swap participant, § 23.501 requires that the swap dealer or major swap participant issue a confirmation for the transaction as soon as technologically practicable.[1028] The Commission, however, believes that such costs are likely to be mitigated by the reduced cost burdens § 37.6(b) otherwise currently imposes upon counterparties to an uncleared swap.

(iii) Information-Sharing

The Commission recognizes that permitting SEFs to share information with any third party to fulfill its self-regulatory obligations under proposed § 37.504 may increase the risk that the SEF's market participant information is misappropriated. These third party entities are not necessarily registered with the Commission and may lack the document security and compliance knowledge, to adequately protect market participant information. However, the Commission notes that a SEF would remain responsible for maintaining the security of this information, and would oversee their service providers to ensure compliance, to the extent feasible. Furthermore, the Commission intends to

[1028] 17 CFR 23.501(a).

continue to review SEFs' operations to ensure ongoing compliance (including the compliance of third-party service providers).

(6) System Safeguards

SEFs are currently required to file a Technology Questionnaire under existing Exhibit V to Form SEF for registration as a SEF. SEFs are likely to incur additional costs associated with annually updating this Questionnaire in proposed Exhibit Q under proposed § 37.1401(g). The Commission believes, however, that this cost may be minimal, as the Technology Questionnaire pertains to the SEF's operations and is information that a SEF should know for purposes of its compliance with Core Principle 14 and the Commission regulations. Further, the Commission believes that maintaining an annually updated Exhibit Q would limit SSE document requests and the effort required to respond to these requests and ad-hoc Commission system safeguards-related requests under proposed § 37.1401(h).

d. Section 15(a) Factors

(1) Protection of Market Participants and the Public

The Commission believes that the proposed amendments to the existing SEF requirements related to compliance and self-regulatory responsibilities are likely to increase professionalism in the swaps market, further promote an orderly trading environment and market integrity, and better enable the Commission to protect market participants and the public.

First, several of the requirements should help the Commission to determine whether a SEF's operations are compliant with the Act and the Commission's regulations. For example, requiring a SEF to additionally provide notice of any

transaction resulting in the transfer of indirect ownership of fifty percent or more of the SEF's equity interest under § 37.5(c)(1) would broaden the Commission's ability to review changes in ownership that may affect the SEF's operations. Accordingly, the Commission should be better able to assess whether such changes would adversely impact the SEF's operations or its ability to comply with the core principles or Commission's regulations, which are intended in part to protect market participants.

The Commission's proposed amendments to the ACR requirements under proposed § 37.1501(d) should also better enable the Commission to assess the effectiveness of a SEF's compliance or self-regulatory programs. The proposed amendments, among other things, would remove some of the existing content requirements that are duplicative and unnecessary, but require the ACR to include a description and self-assessment of the SEF's written policies. Removing information requirements, *e.g.*, requirements to review all Commission regulations applicable to a SEF and to identify the written policies and procedures enacted to foster compliance, may reduce the amount of information available to the Commission in an ACR to assess a SEF's compliance. However, the Commission has considered that, based on its experience with the existing requirements, this information may not enhance the usefulness of the ACR. Therefore, the Commission does not believe that the proposed amendments would negatively impact its ability to assess the SEF, which is intended, in part, to protect market participants.

The proposed requirement that a SEF annually update its response to the Questionnaire should facilitate the Commission's oversight of a SEF's systems safeguard program, and in turn, benefit the swaps markets by promoting more robust automated

systems and enhanced cybersecurity. This should decrease the likelihood of disruptions and market-wide closures, systems compliance issues, and systems intrusions. The receipt of an annually-updated response to Exhibit Q should further the protection of market participants and the public by helping to ensure that automated systems are available, reliable and secure; adequate in scalable capacity; and effectively overseen.

Second, the proposed requirements under § 37.201(c) should protect market participants and the public by mandating that SEF trading specialists meet fitness and proficiency standards, undergo periodic ethics training, and be subject to standards of conduct and diligent supervision by SEFs. The Commission expects that the proposed requirements should reduce abusive and fraudulent conduct and increase the professionalism of, and fair dealing by, SEF trading specialists who facilitate trading between SEF market participants. Furthermore, the proposed requirements should promote compliance with legal and regulatory obligations and SEF rules that are aimed at protecting market participants. These improvements may be attenuated if the costs of meeting the new standards reduce the number of SEF trading specialists.

Third, in addition to promoting the Commission's ability to assess a SEF's compliance with the Act and Commission regulations, some of the requirements should protect market participants and the public by improving a SEF's ability to detect potential rule violations. For example, the proposed amendments to § 37.203(f)(2) and § 37.206(b) would permit a SEF to determine the timeframe within which to complete an investigation and how to administer its disciplinary program, respectively. A SEF would be better able to prioritize its completion of investigations and disciplinary cases that have a greater impact on the SEF's markets, its market participants, and the public.

These benefits may be reduced if SEFs excessively delay investigations or do not prioritize appropriately. Furthermore, proposed § 37.204(b) should permit a SEF's RSP to make substantive decisions, which would allow an RSP to take action more promptly to protect the SEF's markets, market participants, and the public against misconduct, with a reduced risk of delay that could be incurred if the SEF was required to take action. There may be a risk of erroneous decisions or inappropriate delays by the RSP, however. By shifting existing § 37.205(c)'s focus from audit trail enforcement to audit trail reconstruction, proposed § 37.205(c) should enable a SEF to better detect inaccurate or incomplete audit trail data that could potentially impair the SEF's ability to conduct effective surveillance. As a whole, the Commission believes that the requirements as amended should continue to allow a SEF to better protect its markets, market participants, and the public by providing it with greater discretion to carry out these self-regulatory responsibilities.

The proposed changes to the existing audit trail requirements may reduce the scope of information that would be captured in a SEF's audit trail, but the Commission believes that these changes are not likely to materially affect the protection of market participants and the public. For example, the Commission proposes to eliminate the requirement that a SEF capture post-execution allocation information. The Commission notes that this information has generally not been captured because SEFs have operated under no-action relief, which was provided by Commission staff due to the general inability of SEFs to access this information. Thus, elimination of the requirement should not have a material effect.

The Commission believes that certain proposed amendments to current requirements reflect existing market realities, which preclude SEFs from complying with some of these requirements. In particular, the proposal would (i) move the requirement that audit trail data be sufficient to reconstruct indications of interest, requests for quotes, orders and trades, to the guidance to Core Principle 2 in Appendix B; and (ii) eliminate the requirement under existing § 37.205(b)(2) that a SEF's electronic history database include all indications of interest, requests for quotes, orders, and trades entered into a SEF's trading system or platform. Further, the proposed regulations would no longer require a SEF that offers a voice-based trading system or platform to maintain regular voice audit trail surveillance programs to reconstruct and review voice trades for possible trading violations. Notwithstanding the regulatory requirements in this area, the Commission emphasizes that SEF Core Principle 2 and its requirements remain and a SEF must still capture all audit trail data related to each of its offered execution methods that is necessary to reconstruct all trading on its facility, detect and investigate customer and market abuses, and take disciplinary action.

Fourth, the proposed requirements should protect market participants by promoting the integrity of the transactions executed on the SEF. For example, proposed § 37.203(e)—which would require a SEF to adopt policies to address and resolve error trades on its facility—should help to ensure that SEFs promptly address error trades to facilitate fair and equitable treatment between market participants on the SEF. To the extent that market participants better understand how a SEF addresses error trades and its approach for resolving such errors, these market participants should have more confidence in transacting on the SEF. Furthermore, the proposal should lead to SEFs

adopting more consistent approaches to addressing trading errors, which should better protect market participants from basing their trading on erroneous information provided in market data feeds. Additionally, the proposal should lead to market participants receiving more effective notice of potential and resolved errors, which should minimize the market harm from price misinformation, which can lead to price distortion and inefficiency in the market, and indirectly impact the public. The extent of these improvements may depend on the quality of error trade policies adopted by SEFs and the effectiveness of their implementation.

Fifth, the proposed requirements should continue to promote the legal certainty of transactions executed on the SEF. Proposed § 37.6(b)(1)(ii), which would require a SEF to provide the counterparties to an uncleared swap transaction with a "trade evidence record" that memorializes the terms of the swap transaction agreed upon between the counterparties on the SEF, specifies that such documentation must be legally binding and memorialize the terms of the transaction. The Commission notes that this approach differs from the existing no-action relief provided by Commission staff, under which SEFs have incorporated terms by reference in a confirmation for an uncleared swap that have been previously established via privately-negotiated underlying agreements. While the proposed requirement would limit the scope of terms and conditions that must be included in SEF-issued documentation for uncleared swaps, the Commission believes that this approach is not likely to diminish the protection of market participants. The trade evidence record would continue to serve as evidence of a legally-binding swap transaction between the counterparties, who would still have the ability to supplement the record with additional terms that they had already previously agreed upon.

The protection of market participants and the public may be adversely affected to the extent that risks noted in the discussion of the costs of the proposed amendments occur. For example, increased flexibility in the implementation of compliance programs may lead to a reduction of their effectiveness in some circumstances.

(2) Efficiency, Competitiveness, and Financial Integrity of Markets

The Commission believes that the proposed amendments to the SEF requirements listed above should further promote efficiency, competitiveness, and financial integrity of the swaps markets.

Requiring a SEF to adopt error trade policies under proposed § 37.203(e) should also promote efficiency and financial integrity on a SEF's markets. Although many SEFs currently maintain error trade policies as noted, the proposed rule should help to establish a more consistent and transparent approach to addressing and resolving error trades that should benefit market participants, including those that may rely on trading data derived from the SEF's trading activity. Accordingly, requiring SEFs to provide notification of potential errors and a pending review should mitigate the potential for subsequent trading based on an erroneous transaction that could create market distortions interfering with efficient and competitive markets. The requirement should encourage efficiency by minimizing the risk that the SEF's pricing information does not reflect existing market conditions, thereby increasing market participants' confidence to participate on the SEF's facility. The extent of these improvements may depend on the quality of error trade policies adopted by SEFs, and the effectiveness of their implementation.

The proposed amendments under Core Principle 2 would generally allow a SEF greater discretion to tailor its compliance program to identify and address rule violations

among its markets and market participants. The Commission believes that proposed § 37.203(f) and § 37.206 may improve a SEF's operational efficiency, and thereby the efficiency and integrity of its markets, by allowing a SEF to determine how to complete an investigation and take disciplinary action to address misconduct more efficiently. Further, proposed § 37.204(b), which would allow a SEF's RSP more leeway to make substantive decisions related to a SEF's compliance program, should also improve the efficiency and integrity of a SEF's operations by allowing the RSP to take action with less delay once it identifies misconduct among market participants. These efficiency gains may be reduced by inappropriate decisions made by RSPs. Additionally, the Commission believes that the audit trail reconstruction requirement under proposed § 37.205(c) should improve a SEF's ability to detect potential rule violations, and may thereby enhance the overall integrity of its markets.

The requirements in proposed §§ 37.201(c)(2)-(3) should enhance efficiency, competitiveness, and financial integrity of swap markets by helping to ensure that SEF trading specialists, who are responsible for facilitating orderly, efficient, and fair trading on SEFs, have better fitness and proficiency to do so. The requirements pertaining to ethics training and SEF standards of conduct in proposed §§ 37.201(c)(4)-(5) should better ensure that SEF trading specialists are more aware of applicable regulatory obligations and SEF rules aimed at maintaining efficiency, competiveness, and market integrity. These gains may not be as extensive if the costs of meeting these standards reduce the number of SEF trading specialists. The proposed supervision requirement under § 37.201(c)(6) should increase compliance by SEF trading specialists with its obligations.

The Commission believes that related amendments proposed under Core Principle 15 should also promote efficiency and integrity of a SEF's market by allowing a more streamlined compliance approach that does not require the board of directors to assume primary oversight responsibility for the CCO. This proposed approach should in many circumstances permit the CCO to more efficiently make changes to the regulatory program in response to potential trading violations, which should aid in protecting the financial integrity of the market. Furthermore, the proposal's focus of the CCO's duties on reasonably designed procedures to address noncompliance issues and material conflicts of interest should improve the CCO's efficiency by specifying that this is the appropriate standard. This increased efficiency should permit CCOs to better allocate resources to focus on detecting and deterring material rule violations, which otherwise may harm the market's efficiency, competitiveness, and integrity.

(3) Price Discovery

The Commission believes that the proposed amendments related to compliance and self-regulatory responsibilities should protect the price discovery functions provided by a SEF's trading system or platform. For example, the proposed amendments under Core Principle 2, which the Commission believes would allow a SEF to develop the most efficient approach to identify and address rule violations based on its markets and market participants, should help to facilitate orderly trading and promote integrity in the market. Price discovery may be impaired, however, if SEFs are less successful in addressing rule violations or have difficulty in maintaining orderly trading under the framework of the proposed rules. By promoting market integrity and orderly trading—particularly through identifying and resolving abusive trading practices in an efficient manner—the

Commission believes that a SEF's trading system or platform should be able to serve as a more robust mechanism for price discovery.

To the extent that SEF trading specialists facilitate the trading of swaps transactions, they may be active participants in the price discovery process. The proposed fitness, proficiency, and ethics rules would help ensure that SEF trading specialists perform these tasks ethically and competently, which should contribute to the smooth functioning of the price discovery process.

The Commission believes that requiring SEFs to adopt and maintain a formal error trade policy under proposed § 37.203(e) should similarly promote the SEF's ability to facilitate price discovery. The error trade policy should protect the price discovery process on the SEF's facility, and promote confidence in the prices market participants use to hedge risk. This may depend on the quality of the policy and the effectiveness of its implementation. If a SEF does not promptly address an error trade, market participants may mistakenly rely on inaccurate pricing information.

(4) Sound Risk Management Practices

The Commission believes that the proposed amendments related to compliance and self-regulatory responsibilities should promote sound risk management practices. The gains in this regard may depend on the quality and effective implementation of the policies and practices that SEFs would adopt under the proposed amendments.

The Commission notes that proposed § 37.203(e) is intended to encourage SEFs to implement and maintain error trade policies that reduce operational risks for market participants, and are therefore sound risk management policies. This proposed rule should reduce the harm to a market participant when it enters into an error trade, and

reduce harm to the market generally by decreasing the risk of reliance on pricing information from an error trade.

(5) Other Public Interest Considerations

The Commission has not identified any effects of the proposed rules identified above on other public interest considerations.

Request for Comment

The Commission requests comment on all aspects of the consideration of the costs and benefits of the provisions related to Compliance and SRO Responsibilities.

6. Design and Monitoring of Swaps

a. Overview

(1) Swaps Not Readily Susceptible to Manipulation

The Commission proposes to revise the guidance relating to how a SEF should demonstrate that a new swap contract is not readily susceptible to manipulation under § 37.301. The Commission proposes to adopt rules that would create an Appendix C to part 37 (and update the cross reference under § 37.301) and make conforming changes to the guidance found in Appendix B. The proposed revision to the guidance to Core Principle 3 in Appendix B would eliminate the explanatory guidance, which the Commission is proposing to address in the proposed guidance to Appendix C to part 37 and replace the existing Appendix B guidance's cross reference to sections of Appendix C to part 38 with a general reference to Appendix C to part 37. The guidance in Appendix C to part 38 partly focuses on futures products, which is not applicable in part 37. The proposed guidance is intended to clarify a SEF's obligations pursuant to Core Principle 3, and specifically addresses only swap contracts.

(2) Monitoring of Trading and Trade Processing

The proposed changes to the regulations implementing Core Principle 4 are intended to establish more practical trade monitoring requirements. First, the Commission proposes to amend existing § 37.401(c)[1029] to require that a SEF conduct real-time market monitoring of "trading activity" only on its own facility and in order to identify disorderly trading, any market or system anomalies, and instances or threats of manipulation, price distortion, and disruption. Second, the Commission proposes to amend existing § 37.401(a)[1030] to specify that a SEF has discretion to determine when (in place of the current requirement that it do so on an "ongoing basis") to collect and evaluate market participant's trading activity beyond its market, *i.e.*, as necessary to detect and prevent manipulation, price distortion, and, where possible, disruptions of the physical-delivery or cash-settlement processes. Third, the Commission proposes to eliminate the § 37.403(a) requirement that SEFs monitor the "pricing" of the reference price used to determine cash flows or settlement. Fourth, with regards to the § 37.404(b) requirement that a SEF require its market participants to keep records of their trading, the Commission proposes to eliminate the current information maintenance and collection exemption that permits SEFs to limit the application of the requirement for market participants to keep and provide records of their activity to only those market participants that conduct "substantial" trading on the SEF as set forth in the guidance to Core Principle 4 in Appendix B. Fifth, the Commission proposes to amend § 37.405 to state that a SEF must have risk control mechanisms to prevent and reduce market disruptions as well as price distortions only on its own facility, rather than on and off facility.

[1029] This requirement is in proposed § 37.401(a).
[1030] This requirement is in proposed § 37.401(b).

In addition to these substantive changes, the Commission proposes a number of clarifying and streamlining changes that would not result in any new costs or benefits and are not discussed below. The Commission proposes to partially incorporate existing § 37.203(e), which requires that a SEF conduct real-time market monitoring, into § 37.401(a),[1031] and to consolidate the trade reconstruction requirements under § 37.401(d) and § 37.406 into proposed § 37.401(d). The Commission proposes clarifying amendments to § 37.402 and § 37.403, regarding SEF monitoring obligations with respect to physical-delivery and cash-settled swaps, which would not impose new obligations.

b. Benefits

(1) Swaps Not Readily Susceptible to Manipulation

The Commission believes that SEFs should benefit from the swap focused discussion in proposed Appendix C to part 37. Similar to Appendix C to part 38, the guidance outlined in proposed Appendix C to part 37 would set forth information that should be provided to the Commission for new products and rule amendments under § 37.301, based on best practices developed over the past three decades by the Commission and other regulators. This guidance should provide greater efficiency for SEFs so that they do not have to try to apply to swaps products the futures-related provisions in Appendix C to part 38. The guidance would also likely reduce the time and costs that SEFs would incur in providing the appropriate information and should mitigate the need for extensive follow-up discussions with the Commission. In addition, it should reduce

[1031] The Commission notes that existing § 37.203(e) specifies that a SEF must conduct real-time market monitoring of all trading activity on its system(s) or platform(s) to identify "disorderly trading and any market or system anomalies." As discussed above, the Commission is proposing to eliminate this provision and establish these requirements under § 37.401(a) to streamline the existing regulations.

the amount of time it takes Commission staff to analyze whether a new product or rule amendment is in compliance with the CEA.

Furthermore, the proposed Appendix C to part 37 should not diminish the current benefits from the implementing regulations for Core Principle 3. The proposed Appendix C to part 37 should continue to aid SEFs to list contracts that are not readily susceptible to manipulation and should contribute to integrity and stability of the marketplace by giving traders more confidence that the prices associated with swaps reflect the true supply of and demand for the underlying commodities or financial instruments.

(2) Monitoring of Trading and Trade Processing

The Commission acknowledges that trading abuses may take place across trading platforms and markets. However, the Commission understands that the requirement that a SEF monitor the trading activity of its market participants, whether or not the activity occurs on the SEF's own platform, has in practice been highly costly and burdensome, and in some instances these costs and burdens effectively preclude compliance. Moreover, requiring every SEF to monitor trading on every other regulated trading facility is redundant and therefore provides little incremental benefit.

The Commission believes that the proposed regulations should substantially reduce these very high monitoring costs for SEFs with relatively little impact on the benefits of the regulation, as discussed above. Under the proposed regulations, a SEF would not have to monitor trading activity in real-time beyond its facility or the pricing of reference prices for cash-settled swaps, and would not have to collect and evaluate its market participants trading activity on an ongoing basis—only as needed to detect and prevent abusive trading practices. Accordingly, this should save SEF resources

Proposed § 37.401(a) and, for cash-settled swaps, the removal of existing § 37.403(a),[1032] would limit certain monitoring obligations to a SEF's facility, and should significantly reduce the hours that a SEF's employees and officers must spend reviewing both the SEF's market participants' trading activity off of its facility and also market data (including the pricing information as required under § 37.403(a)) from other exchanges, index providers, and over-the-counter ("OTC") trading. SEFs would not have to pay third party exchanges and providers for this market data and trading information because a SEF would no longer have to monitor trading beyond its facility (although it would still have to collect and evaluate market participant's trading data as needed per § 37.401(b)). As a practical matter, SEFs would also not have to establish and implement protocols to reformat third party data for import and use with the SEF's internal systems. While existing SEFs have already incurred cost to establish protocols to import third party data, there would be some savings for new SEFs because they would not have to develop protocols.

Furthermore, SEFs generally would no longer have to implement or maintain these protocols to import third party data. Consistent with these changes, proposed § 37.405 would require a SEF to maintain risk control mechanisms to prevent and reduce the potential risk of price distortions and market disruptions on its facility. A SEF would no longer have to incur costs to monitor other trading facilities and OTC trading for purposes of its risk controls. As noted above, since these other trading facilities also have risk control mechanisms, the benefits of requiring SEFs to monitor other trading facilities may be incremental.

[1032] The Commission notes that the proposed elimination of § 37.403(a) only creates a cost savings for a SEF's monitoring of cash-settled swap products.

Additionally, under proposed § 37.401(b), a SEF would only be required to collect and evaluate data on its market participant's activity that occurs away from the SEF to the extent that doing so is necessary to detect and prevent abusive trading practices. The cost for SEFs to collect market data should decrease because SEFs would no longer collect information on an ongoing basis. To the extent that SEFs were requesting that market participants provide trading data, market participants should also incur fewer costs. Furthermore, SEFs would no longer have to obtain trading data from third parties since all market participants would be required to provide trading data upon request under § 37.404(b), including those market participants that a SEF currently may not require to provide trading activity information to the SEF.[1033] These market participants that currently do not collect or provide trading data would incur some additional costs to provide such information. Overall, SEFs should be required to spend less money importing and analyzing its market participants' off-SEF trading, and market participants should incur less cost in exporting this data.

Consistent with these changes, proposed § 37.405 would require a SEF to maintain risk control mechanisms to prevent and reduce the potential risk of price distortions and market disruptions only on its facility. A SEF would no longer have to monitor or coordinate its risk controls with other SEFs and activity on the OTC market.

Notwithstanding these potential savings due to proposed §§ 37.401(a)-(b), § 37.405, and removal of existing § 37.403(a), the Commission understands that most SEFs have (in light of the infeasibility of compliance as discussed above) interpreted the

[1033] Section 37.404(b) and the associated guidance to Core Principle 4 in Appendix B permits a SEF to limit the application of the requirement for market participants to keep and provide records of their activity in the index or instrument used as a reference price, the underlying commodity, and related derivatives markets, to only those market participants that conduct substantial trading on its facility. 17 CFR part 37 app. B.

existing regulations to be less demanding than as described in the preamble to the part 37 SEF final rule, and, in practice, have implemented monitoring programs and risk controls that primarily focus on their respective facility. These SEFs may not realize a meaningful reduction in costs because they already have implemented many of these more limited monitoring programs and risk controls.

c. Costs

(1) Swaps Not Readily Susceptible to Manipulation

Compliance with the guidance in proposed Appendix C to part 37 should not impose any additional costs on SEFs or the market generally. SEFs submitting products for the Commission's certification under § 37.301 could incur some costs applying the guidance if the proposed Appendix C to part 37 prompted a SEF to increase the information that it provided when submitting a new swap product. However, the requested information set forth in proposed Appendix C to part 37 is intended to reflect the Commission's prior expectations. For example, the proposed Appendix C to part 37 includes a specific section for options on swap contracts that Appendix C to part 38 does not address. This newly created section is intended to be consistent with previous Commission expectations regarding contract design and transparency of option contract terms. The Commission currently requires that a SEF's product submission specify in an objective manner the following material option-specific terms of a swap (in addition to appropriately designing and sufficiently specifying the underlying swap's terms): (i) exercise method; (ii) exercise procedure; (iii) strike price provisions; (iv) automatic exercise provisions; (v) contract size; (vi) option expiration and last trading day; and (vii) option type and trading convention. SEFs have provided these option-specific terms in

their submissions for options on swap contracts. The Commission does not expect SEFs to incur any additional costs because of the guidance.

(2) Monitoring of Trading and Trade Processing

The proposed changes to the implementing regulations under Core Principle 4 could increase the chance that a SEF does not promptly identify abusive trading practices that occur away from its facility, but this risk is mitigated because every transaction occurring on a regulated platform such as a SEF or DCM would still be subject to monitoring. The narrowing of a SEF's monitoring obligations under § 37.401(a) may potentially cause the SEF to not identify an abusive trading practice occurring on another exchange or OTC market, possibly in coordination with trading on the SEF's facility.

As a mitigating factor, the Commission believes that a SEF should benefit from its monitoring staff focusing more on trading activity on its facilities and the SEF's obligation to collect and evaluate its market participants' trading activity off of the SEF. This refocusing of the monitoring staff's attention should better enable a SEF to more quickly identify and address abusive trading practices on its facility.

The removal of SEFs' monitoring obligations under § 37.403(a) may potentially cause a SEF to not identify an abusive trading practice occurring on a cash-settled swap's underlier, possibly in coordination with trading of the cash-settled swap on the SEF's facility. In practice, the Commission believes that the additional risk of a SEF failing to promptly identify abusive trading due to this proposed regulation is minimal because SEFs typically cannot access third parties' price-forming information, and SEFs would be challenged to analyze this third party information for abusive activities. Consequently,

the Commission does not anticipate that removing this requirement will materially impact SEFs current monitoring practices or effectiveness.[1034]

The reduction in trading information that SEFs have to analyze under proposed § 37.401(b) could limit a SEF's ability to identify an abusive trading practice occurring on another SEF or a DCM or OTC, possibly in coordination with trading on the SEF's facility. However, the Commission believes that under the proposed regulation, SEFs would still have the means to collect market participants' trading information and, in unusual situations when a SEF would benefit from additional information to identify abusive trading practices, the SEF would be able to request this information. Moreover, the other SEFs and DCMs would be required to monitor for abusive practices on their own facilities. Thus, requiring SEFs to monitor trading on other regulated trading facilities is redundant. The Commission believes that SEFs would be more efficient and effective if they were required only to ask for this information when needed.

The proposed changes to the risk control mechanisms under § 37.405 could increase the chance that abusive trading practices go unchecked. A SEF would no longer have to monitor or coordinate its risk controls with other SEFs and OTC trading, and a market participant may be able to attempt to engage in an abusive trading practice across exchanges and OTC due to this lack of coordination. The Commission believes that this risk is largely mitigated because every SEF and DCM would be required to have these mechanisms on their own facilities, and therefore the incremental detriment from removing this requirement should be minimal. The Commission believes that potential

[1034] The Commission notes that SEFs would continue to be obligated to monitor the continued appropriateness of the index or instrument and take appropriate actions where there is a threat of manipulation , price distortion, or market disruption pursuant to proposed § 37.403(b).

costs resulting from removing the requirement that SEFs monitor or have risk controls related to the OTC market are unlikely to be significant, since such monitoring and risk controls are not practicable. The OTC market is not required by the CEA or the Commission's regulations to have risk controls and it is not clear that risk controls in the OTC market are feasible. The Commission notes that in light of the Commission's proposed interpretation of the trade execution requirement, more swaps are likely to be traded on-SEF and thus subject to monitoring and risk controls. Moreover, SEFs would continue to have the ability to investigate and address abusive trading practices that are implemented across multiple trading facilities, and to request information on a market participant's trading activity.

d. Section 15(a) Factors

(1) Protection of Market Participants and the Public

The proposed guidance in Appendix C to part 37 and the monitoring requirements in proposed §§ 37.401-403 should not materially diminish a SEF's ability to protect market participants and the public. The proposed guidance in Appendix C to part 37 and the proposed amendments to §§ 37.402-403 are intended to provide additional clarity for SEFs to help ensure that a contract is not readily susceptible to manipulation, and to help ensure that SEFs are able to adequately collect information on market activity, including special considerations for physical-delivery contracts and cash-settled contracts. Proposed §§ 37.402-403 would require SEFs to take specific actions to address threats of manipulation, price distortion, or market disruption, and proposed § 37.405 would continue to require risk controls to prevent and reduce the potential risk of price distortions and market disruptions on the SEF.

The Commission does not believe that narrowing a SEF's monitoring obligation under proposed § 37.401(a) to trading activity on its facility, requiring a SEF to collect market participants' off facility trading information only when necessary to detect abusive trading activity per proposed § 37.401(b), eliminating the SEF's monitoring of the price formation information for underlying indexes currently set forth under § 37.403(a), or altering the risk control mechanisms under § 37.405 would meaningfully increase the risk that abusive trading practices go undetected. While there is a risk that abusive trading can lead to market disruptions and create distorted prices or systemic risks that could harm the economy and the public, the SEF's requirement to monitor its facility per § 37.401(a) and to collect additional trading information from market participants as necessary per § 37.401(b) should mitigate this risk. As a group, these rules should continue to protect market participants by helping to prevent price manipulation and trading abuses, as the proposed rules are designed to protect the public by creating an environment that fosters prices that reflect actual market conditions.

(2) Efficiency, Competitiveness, and Financial Integrity of the Markets

The proposed guidance in Appendix C to part 37 is intended to provide more tailored guidance, based on best practices for swaps, regarding what a SEF should consider when developing a swap or amending the terms and conditions of an existing swap. This tailored guidance should help the contracts listed by SEFs, as a whole, to be more reflective of the underlying cash market, thus providing for more efficient hedging of commercial risk.

Furthermore, proposed §§ 37.401-403 should require SEFs to continue to detect and promptly address violations and market anomalies, and ensure that prohibited

activities do not distort the swap market's prices. Therefore, the proposed modifications to SEF monitoring requirements should not materially diminish market confidence or reduce the market's ability to operate efficiently. Additionally, proposed § 37.405 should continue to deter rule violations by establishing conditions under which trading is paused or halted.

(3) Price Discovery

The Commission does not believe that the proposed rules would materially diminish a SEF's ability to implement an effective monitoring system of its facility to detect rule violations. Manipulation or other market disruptions interfere with the price discovery process by artificially distorting prices and preventing those prices from properly reflecting the fundamental forces of supply and demand. Although there is some risk, as discussed above, that modifications to the SEF's monitoring obligations may cause a SEF to not identify price manipulation, the Commission believes this risk is not material. These rules would continue to require that SEFs detect, and where possible prevent, such market mispricing, and detect disconnects between swaps and their related market prices, *e.g.*, between cash market prices and the prices of related futures and swaps. These rules should continue to promote confidence in the SEF's price discovery process and market participants' use of swaps to hedge risk.

(4) Sound Risk Management Practices

By following the best practices outlined in the proposed guidance in Appendix C to part 37 and the requirements of proposed §§ 37.402-403, a SEF should be able to minimize the susceptibility of a swap to manipulation or price distortion at the time it is developing the contract's terms and conditions. Performing this work early on should

enable a SEF to minimize risks to its clearinghouse and to market participants. Sound risk management practices rely upon execution of hedge strategies at market prices that are free of manipulation or other disruptions. These rules are designed to facilitate hedging at prices free of distortions that may be preventable by adequate controls.

Furthermore, proposed §§ 37.401-403 should continue to aid SEFs in deterring, detecting, and addressing operational risks posed by abusive trading practices or trading activities. These proposed rules are designed to limit the potential losses and costs to SEFs and market participants and promote sound risk management practices.

(5) Other Public Interest Considerations

The Commission has not identified any effects that these rules will have on other public interest considerations other than those enumerated above.

Request for Comment

The Commission requests comment on all aspects of the consideration of the costs and benefits of the provisions related to the Design and Monitoring of Swaps.

7. Financial Integrity of Transactions

a. Overview

In order to promote financial integrity of transactions, the Commission is proposing changes with respect to certain straight-through processing obligations under Core Principle 7 for SEFs and its implementing regulations and under § 39.12(b)(7) for derivatives clearing organizations ("DCO"). The Commission will discuss these changes

together in this section since these provisions interact to form the basis of the Commission's straight-through processing obligations for SEFs and DCOs.[1035]

Proposed § 37.701 would require a SEF to have an independent clearing agreement with each registered DCO or exempt DCO to which the SEF routes swaps for clearing, including in those instances where a SEF, pursuant to a service agreement with a third-party service provider, routes swaps through the SEF's third-party service provider to a DCO that maintains its own agreement with the third-party service provider, but not with the SEF.

Proposed § 37.702(b)(1) would require SEFs to coordinate with registered DCOs to develop rules and procedures that facilitate the "prompt, efficient, and accurate" processing and routing of swap transactions in accordance with § 39.12(b)(7)(i)(A).[1036] The Commission proposes to explicitly interpret the "prompt, efficient, and accurate" standard to establish a qualitative approach for swaps subject to manual post-execution affirmation to be routed to and received by the relevant DCO via a third-party affirmation hub that would account for existing market practices and technology, as well as current market conditions at the time of execution. The Commission notes that this proposed interpretation is in contrast to the Divisions' view discussed in the 2013 Staff STP Guidance, in which the Divisions interpreted the "prompt and efficient" standard in existing § 37.702(b)(2) to mean that swaps subject to manual post-execution affirmation

[1035] For example, the Commission promulgated § 37.702(b) and § 39.12(b)(7) along with other Commission regulations related to straight-through processing in the same Commission rulemaking. *See* Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 FR 21278 (Apr. 9, 2012) ("Timing of Acceptance for Clearing Final Rule").
[1036] *See* Section XII.B.—§ 37.702—General Financial Integrity. The proposal would renumber § 37.702(b)(2) to § 37.702(b)(1), delete existing § 37.702(b)(1), and amend the "prompt and efficient" standard to "prompt, efficient, *and accurate*" (emphasis added).

via a third-party affirmation hub should be routed to and received by the relevant DCO in no more than ten minutes after execution.[1037]

Proposed §§ 37.702(b)(2)-(3), respectively, would mandate that SEFs (i) require their market participants to identify a clearing member in advance for each counterparty on an order-by-order basis and (ii) facilitate pre-execution screening by each clearing FCM in accordance with the requirements of § 1.73 on an order-by-order basis. The Commission notes that this is consistent with the Divisions' view in the 2013 Staff STP Guidance that such requirements are corollary to a SEF's obligation to facilitate "prompt and efficient" transaction processing.[1038] Further, the Commission notes that pre-execution credit screening has become a fundamental component of the swaps clearing infrastructure as SEFs that list Required Transactions[1039] for trading or offer clearing for Permitted Transactions[1040] generally have already established these functionalities, at least in part, to comply with the Commission's regulations, to be consistent with the Divisions' views expressed in the 2013 Staff STP Guidance, or to adhere to existing industry practices.[1041]

[1037] The Commission understands that several aspects of straight-through processing requirements are rendered through the 2013 Staff STP Guidance and the 2015 Staff Supplementary Letter. The Commission also understands that certain aspects of the guidance may be unclear when read in conjunction with existing regulations. Therefore, the Commission seeks to provide greater clarity and certainty under the proposed framework with respect to the straight-through processing requirements for SEFs and DCOs through the proposed clarifications and amendments described herein.

[1038] *See* 2013 Staff STP Guidance at 3. The Commission further notes that it stated in the Timing of Acceptance for Clearing Final Rule, that the "parties would need to have clearing arrangement in place with clearing members in advance of execution" and that "[i]n cases where more than once DCO offered clearing services, the parties also would need to specify in advance where the trade should be sent for clearing." Timing of Acceptance for Clearing Final Rule at 21284.

[1039] 17 CFR 37.9(a)(1) (defining a Required Transaction as any transaction involving a swap that is subject to the trade execution requirement in section 2(h)(8) of the Act).

[1040] 17 CFR 37.9(c) (defining a Permitted Transaction as any transaction not involving a swap that is subject to the trade execution requirement in section 2(h)(8) of the Act).

[1041] In the 2013 Staff STP Guidance, the Divisions believed that pre-trade credit checks would make rejection from clearing for credit reasons a rare event. *See* 2013 Staff STP Guidance at 5. The

The Commission proposes to streamline the applicable straight-through processing provisions for registered DCOs by consolidating the existing requirements under §§ 39.12(b)(7)(ii)-(iii) into proposed § 39.12(b)(7)(ii) and would delete existing § 39.12(b)(7)(iii). Specifically, proposed § 39.12(b)(7)(ii) would establish a single AQATP standard that applies to all "*agreements*, contracts, *and transactions*" (emphasis added) regardless of whether a trade is (1) executed competitively or noncompetitively; (2) executed on, off, or pursuant to the rules of a DCM;[1042] or (3) a swap, futures contract, or option on a futures contract; and (4) would apply after *submission* to the DCO (*i.e.*, once the transaction is received by the DCO) rather than after *execution* in all circumstances.

In contrast, existing §§ 39.12(b)(7)(ii)-(iii) establish different standards that apply based on a transaction's characteristics. Existing § 39.12(b)(7)(ii) applies to (i) any contract, including futures, options on futures, and swaps, that is (ii) executed competitively, (iii) on or subject to the rules of a SEF or DCM, and (iv) the AQATP period applies after the trade's *execution* on the SEF or DCM (emphasis added). Existing § 39.12(b)(7)(iii) applies to any (i) swap (but not other products) that either is (ii) executed noncompetitively on or subject to the rules of a SEF or DCM or (iii) not executed on or subject to the rules of a SEF or DCM, and (iv) the AQATP period applies after *submission* to the DCO (emphasis added). Moreover, consistent with the views expressed by the Divisions in the 2013 Staff STP Guidance, the Commission proposes

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Commission notes that the proposed amendments to § 37.702(b) are generally consistent with the Divisions' views articulated in the 2013 Staff STP Guidance.

[1042] The Commission notes that it is proposing to eliminate the "pursuant to the rules" language, given the change to the block trade definition. *See supra* Section XXII.A.—§ 43.2—Definition—Block Trade; § 37.203(a)—Elimination of Block Trade Exception to Pre-Arranged Trading.

that registered DCOs must continue to accept or reject trades within ten seconds after submission under proposed § 39.12(b)(7)(ii)'s AQATP standard.

The Commission would also make several non-substantive amendments. First, to conform the changes throughout the part 37 proposal, all references under §§ 37.702-703 to "member" would be changed to "market participant."

Second, existing § 37.702(b)(2) requires SEFs to develop rules and procedures to facilitate the "prompt and efficient transaction processing" of swap transactions to the applicable DCO. To conform this requirement to existing § 39.12(b)(7)(i)(A), which requires each registered DCO to coordinate with a SEF or DCM to facilitate the "prompt, efficient, and accurate" processing of swaps for clearing, the Commission proposes to add the term "accurate" to the existing "prompt and efficient" standard for SEFs under § 37.702(b)(2).[1043] Proposed § 37.702(b)(1) would also apply to the "routing" of swap transactions; while the Commission believes that "processing" as used in existing § 37.702(b)(2) also encompasses the routing of swaps from a SEF to a DCO, the Commission proposes to explicitly include "routing" in the regulatory text for avoidance of doubt.[1044] As a result, existing § 37.702(b)(1), which required a SEF to have the "capacity to route transactions" to a DCO, would be deleted as unnecessary due to new proposed § 37.702(b)(1). As a conforming change to proposed § 37.702(b)(1), the Commission also proposes to add the term "routing" to § 39.12(b)(7)(i)(A). The Commission also proposes to specify under § 37.702(b)(1) that a SEF's obligation to

[1043] The Commission proposes to renumber § 37.702(b)(2) to § 37.702(b)(1).
[1044] Existing § 37.702(b)(1) requires SEFs to have the capacity to route transactions to the DCO in a manner acceptable to the DCO for purposes of clearing. Since proposed § 37.702(b)(3) would specify that SEFs must also work with DCOs to route transactions, existing § 37.702(b)(1) would become superfluous and would be deleted.

coordinate with DCOs should be in accordance with DCOs' obligations under existing § 39.12(b)(7)(i)(A).[1045]

Third, proposed § 37.702 would clarify that a SEF's obligations under § 37.702 apply only to registered DCOs, as opposed to exempt DCOs.

Fourth, proposed § 37.702(b) would specify that its requirements apply only to those transactions routed through a SEF to a registered DCO for clearing. The Commission believes that this change is helpful to clarify that § 37.702(b)'s requirements do not apply to those SEFs that do not facilitate the clearing of swaps executed on the SEF.

Fifth, proposed § 39.12(b)(7) would apply to all "agreements, contracts, and transactions," rather than "transactions" as currently provided, in order to conform with the statutory definition of "DCO" in section 1a(15) of the Act and general scope of product eligibility under § 39.12(b)(1) and would make conforming changes in proposed §§ 39.12(b)(7)(i)-(ii).

b. Benefits

Proposed § 37.701 is intended to interact with the other proposed changes in Core Principle 7 and § 39.12(b)(7) to strengthen the straight-through processing and routing of swaps from SEFs to DCOs, and increase market integrity. The Commission believes proposed § 37.701(b)'s requirement that a SEF have a direct clearing agreement with each DCO to which the SEF submits swaps for clearing would improve a SEF's ability to

[1045] Existing § 37.702(b)(2) requires SEFs to work with each DCO in accordance with the requirements of § 39.12(b)(7). The Commission's proposal would more specifically reference § 39.12(b)(7)(i)(A) (emphasis added), which establishes a corresponding obligation on DCOs to work with SEFs to develop rules to facilitate the "prompt, efficient, and accurate processing" of transactions in order to avoid any confusion with the application of the AQATP standard under existing §§ 39.12(b)(7)(ii)-(iii).

establish rules and procedures that better coordinate with a DCO's clearance and settlement processes to foster greater financial integrity of swaps sent to the DCO for clearing. Such an agreement also would instill more confidence in the ability of swap clearing through the SEF, as under the proposal the SEF should have the appropriate processes to facilitate swaps clearing. Further, 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.

The Commission believes that adopting proposed §§ 37.702(b)(2)-(3) would strengthen the straight-through processing and routing of swaps from SEFs to DCOs, and increase financial integrity of transactions by ensuring a consistent and timely clearing process. Specifically, proposed §§ 37.702(b)(2)-(3) should benefit transaction processing, routing, and clearing by codifying the straight-through processing requirement that SEFs must ensure that trades are efficiently routed to DCOs, reducing the time between execution and clearing. However, to the extent counterparties already comply with proposed §§ 37.702(b)(2)-(3) as a result of standard industry practices or as a result of adopting the Divisions' view discussed in the 2013 Staff STP Guidance, these benefits may already have been realized.[1046]

The Commission believes that its proposed qualitative interpretation of the "prompt, efficient, and accurate" standard in proposed § 37.702(b)(1), rather than a static bright-line standard such as the ten-minute standard discussed by the Divisions in the

[1046] As discussed above, in the 2013 Staff STP Guidance, the Divisions previously discussed their view that the straight-through processing requirements under § 37.702(b) require SEFs to have pre-execution credit screening in certain instances. *Id*. at 3.

2015 Supplementary Staff Letter, would benefit the marketplace by establishing a standard that is conducive to the broader array of swaps that would be subject to the expanded trade execution requirement, as well as the additional executed methods that would be permitted under the Commission's proposal.

The Commission's proposed qualitative interpretation of the "prompt, efficient, and accurate" standard should also help ensure that SEFs have time to use third-party affirmation hubs for all swap trades instead of merely those trades that can be routed through the affirmation hub for submission to the DCO within the prescribed time limit. The Commission believes that permitting the use of affirmation hubs benefits the marketplace in certain situations by providing an opportunity for counterparties to identify and correct potential error trades prior to routing these trades to a DCO for clearing, thereby reducing the number of error trades.

The Commission believes that streamlining and creating a single AQATP standard would benefit DCOs, SEFs, and clearing FCMs. The current bifurcation of the AQATP standard requires a DCO to ascertain the characteristics of a trade to determine whether the DCO's obligation to accept or reject a trade subject to AQATP begins after (1) the trade's execution for a trade that is executed competitively on a SEF or DCM (and therefore subject to § 39.12(b)(7)(ii)), or (2) the trade's submission to the DCO for a trade that was either executed non-competitively or on or subject to the rules of a SEF or DCM or executed bilaterally (and therefore subject to § 39.12(b)(7)(iii)). The Commission's proposal to streamline the AQATP standard should simplify the AQATP standard for DCOs, which in turn may lead to even more efficient trade processing,

routing, and clearing since these extra steps are being removed from the straight-through processing requirements.

c. Costs

Proposed § 37.701 would require those SEFs that do not currently have a direct clearing agreement with a DCO to clear swaps executed on the SEF to enter into such an agreement with an applicable DCO. This requirement could add a marginal cost related to reviewing and entering into such an agreement with the SEF's DCO.

With respect to the Commission's proposed qualitative interpretation of the "prompt, efficient, and accurate" standard in proposed § 37.702(b)(1), the 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.

However, the Commission believes this potential cost would be mitigated if, as the Commission expects will occur, market and technological developments enable processing and routing through third-party affirmation hubs to occur at increasingly shorter time intervals. The Commission also believes that there is an inherent incentive to confirm all trades in a timely manner, as a counterparty to the trade that has entered a

trade in its front office system and is trading on that information needs to ensure that trade is accurate, otherwise, it may be managing its portfolio with inaccurate information. Further, the Commission has set forth its expectation that under its proposed qualitative standard, transactions that can be reasonably affirmed on a fully automatic basis after execution should be affirmed in that manner.[1047] In such cases, the Commission believes that "prompt, efficient, and accurate" processing and routing would occur in a much shorter time frame, *e.g.*, less than the ten-minute time frame discussed in the 2015 Supplementary Staff Letter. Accordingly, the Commission would continue to monitor the post-trade affirmation timeframe and industry developments with respect to swap processing and routing to require that SEFs and DCOs comply with their applicable straight-through processing requirements.

Proposed § 37.702(b)(2) would require each market participant to identify a clearing FCM in advance of each trade for each counterparty. The Commission notes that market participants must already identify a clearing FCM, and so does not believe that the proposed requirement will impose a material cost since it would specify only that a market participant must identify its clearing FCM before the trade rather than after. Similarly, proposed § 37.702(b)(3) would require SEFs to provide pre-execution credit screening, which could impose a cost on some SEFs to establish a means of communicating with an FCM. While proposed §§ 37.702(b)(2)-(3) could impose costs by requiring SEFs to update their systems to facilitate these requirements, the Commission believes that SEFs generally already have established these functionalities as established market practices. Moreover, existing § 1.73 requires a clearing FCM to

[1047] The Commission notes that this statement is consistent with the views of the Divisions in the 2015 Supplementary Staff Letter. *Id.* at 3.

implement pre-execution risk controls. Consequently, the Commission believes that most SEFs already comply with proposed § 37.702(b)(3) since clearing FCMs otherwise would unlikely be able to comply with their § 1.73 obligations. Accordingly, costs imposed by proposed §§ 37.702(b)(2)-(3) likely have already been realized.[1048]

The Commission believes that the proposed consolidation of the AQATP standard would not impose any new cost on DCOs since the Commission is merely clarifying an AQATP standard in existing § 39.12(b)(7)(ii) to more accurately reflect when a DCO's AQATP obligation begins. The proposed ten-second AQATP standard could impose new costs by requiring DCOs to establish the ability to accept or reject trades for clearing within ten seconds. However, the Commission does not believe that the proposed interpretation of the AQATP standard would impose any material costs because it conforms to the industry standard and 99 percent of all trades are accepted or rejected from clearing within ten seconds or less.[1049] The proposed ten-second interpretation of the AQATP standard could dis-incentivize the development of an even quicker industry AQATP standard, resulting in the opportunity cost of the development of more efficient and faster straight-through processing. On the other hand, the ten-second standard could be too prescriptive, compared to the qualitative approach the Commission is taking with respect to the "prompt, efficient, and accurate" standard in the context of manual affirmation hubs, and certain execution methods such as voice execution, that may have a relatively higher error rate compared to other execution methods such as electronic

[1048] The Divisions' view in the 2013 Staff STP Guidance already stipulated that SEFs should adopt the practices that the Commission has proposed under §§ 37.702(b)(2)-(3). As a result, to the extent that SEFs have followed the Divisions' interpretation in the 2013 Staff STP Guidance, such costs already have been realized.
[1049] *See* 2015 Supplementary Staff Letter at 5.

trading, could reasonably require more than ten seconds under the AQATP standard. This issue could be exacerbated by new or innovative execution methods along with potentially new and complex swaps that the Commission anticipates may become more common on SEFs and DCMs under its proposed framework and that otherwise could benefit from more than ten seconds under the AQATP standard.

d. Section 15(a) Factors

(1) Protection of Market Participants and the Public

The Commission's proposal on the financial integrity of transactions and straight-through processing obligations should benefit market participants and the public by helping to ensure greater transparency and consistency of straight-through processing, which the Commission expects would result in market participants and the public having a better understanding of the relevant market structure. In turn, this could enable market participants and the public to make more informed choices and more readily identify and understand possible risks. The proposal would adopt and codify certain straight-through processing standards—rather than relying on industry practice or staff guidance—related to the processing and routing of swaps by SEFs, *i.e.*, the "prompt, efficient, and accurate" standard and the continued use of manual affirmation hubs and the clearing or rejection of trades by registered DCOs, *i.e.*, the ten-second AQATP standard. These requirements should help market participants and the public obtain greater transparency of market structure and potential risks related to timely trade processing and clearing. Similarly, although the Commission believes that its proposal is consistent with existing industry practices, by adopting and codifying these straight-through processing standards, the proposal should better protect market participants and the public by helping to ensure that

FCMs, SEFs, DCMs, and DCOs adhere to the applicable straight-through processing standards. As a result, the proposal would help ensure that market participants and the public continue to receive the related straight-through processing benefits.

(2) Efficiency, Competitiveness, and Financial Integrity of Markets

The AQATP standard reflects the Commission's belief that acceptance or rejection for clearing in close to real time is crucial for the efficient operation of trading venues, and the Commission's proposal is intended 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. In turn, this should promote market efficiency and the financial integrity of transactions by requiring these market participants to work together to process, route, and ultimately clear swap transactions as appropriate.

In recognizing that some trading venues may not be fully automated or may offer execution methods that either are not fully automated or that have a relatively higher error rate, such as voice execution, the Commission's proposal would explicitly permit the use of third-party affirmation hubs pursuant to proposed § 37.702(b) to assist counterparties in identifying and fixing any errors before routing to a DCO. Identifying errors before trades are cleared should enhance the financial integrity of markets by helping to ensure that cleared transactions reflect counterparties' expectations and thereby avoid costs associated with fixing any cleared error trades. However, the absence of a prescribed timeframe to confirm transactions may result in delayed resolution of trade errors.

Clarifying that a DCO must accept or reject a trade after submission to the DCO, *i.e.*, when the DCO receives the transaction, subject to the ten-second AQATP standard should facilitate a regulatory framework in which DCOs have access to reasonably available technology to provide their clearing customers with competitive and efficient timeframes to accurately accept or reject trades for clearing. The Commission's AQATP standard for DCOs' compliance will allow—and require—the timeframe for straight-through processing to continue to adapt with technological advancements and other cleared product developments.

Proposed § 37.702(b) and the Commission's related interpretation should promote efficiency by incorporating the use of third-party affirmation platforms, which provide an opportunity to identify error trades prior to clearing, pursuant to the "prompt, efficient, and accurate" standards. Similarly, proposed § 37.702(b) should promote financial integrity by reducing instances in which a DCO inadvertently clears an error trade, which may also possibly be reported to an SDR that would publish such trades to the public pursuant to the real-time reporting requirements under part 43 of the Commission's regulations. However, the Commission also recognizes that to the extent that market participants have adopted these practices, such as pre-execution screening by FCMs, these benefits may already have been realized.

(3) Price Discovery

The Commission does not believe the proposed changes will have a significant effect on price discovery. To the extent that the Commission's proposal is conducive to permitting new execution methods (*i.e.*, by establishing a qualitative standard for third-party manual affirmation hubs), the Commission believes that these changes could

improve price discovery. On the other hand, the absence of a prescribed timeframe to process and route transactions to a DCO may result in trades taking longer to clear than they otherwise would have with a prescribed timeframe, which may affect price discovery. However, as noted above, the Commission believes that the proposed standard is consistent with industry practice.

(4) Sound Risk Management Practices

The AQATP standard reflects the Commission's belief that acceptance or rejection for clearing in close to real time is crucial for effective risk management. The Commission believes that prudent risk management dictates that once a trade has been submitted to a clearing FCM or a DCO, the clearing FCM or DCO must accept or reject it as quickly as possible. The Commission's proposal would promote sound risk management practices by ensuring that all intended-to-be-cleared swaps are subject to straight-through processing on a SEF and that all trades submitted to a DCO are subject to a consistent AQATP standard.

(5) Other Public Interest Considerations

The Commission has not identified any other public interest considerations relevant to the proposal on financial integrity and straight-through processing obligations.

Request for Comment

The Commission requests comment on all aspects of the consideration of the costs and benefits of the proposal related to the financial integrity of transactions and straight-through processing obligations.

8. Financial Resources

a. Overview

The proposal would generally adopt Commission staff "Financial Resources Guidance,"[1050] with certain changes, as part of the proposed acceptable practices to Core Principle 13 in Appendix B to part 37 to provide additional guidance for SEFs when determining their financial obligations under proposed § 37.1301 and § 37.1303, including what costs a SEF may or may not include in its projected operating cost calculations.

Proposed § 37.1301(a) would require a SEF to maintain financial resources in an amount adequate to cover only those projected operating costs necessary to enable the SEF to comply with its core principle obligations under section 5h of the Act and any applicable Commission regulation for a one-year period, calculated on an ongoing basis. In contrast, existing § 37.1301(a) requires a SEF to maintain sufficient financial resources to cover all of its operations for a one-year period, calculated on an ongoing basis, regardless of whether such operating costs are necessary for the SEF to comply with its core principle or other applicable Commission regulations. The Commission would consolidate § 37.1301(c) with § 37.1301(a) and accordingly delete § 37.1301(c). Proposed § 37.1301(b) would permit a SEF to file a consolidated financial report if the SEF also operates as a DCO.

[1050] CFTC Letter No. 17-25 Division of Market Oversight Guidance on Calculating Projected Operating Costs by Designated Contract Markets and Swap Execution Facilities (Apr. 28, 2017).

Pursuant to existing § 37.1303, a SEF currently has reasonable discretion to determine its financial obligations under § 37.1301.[1051] The Commission would adopt Acceptable Practices to further clarify the costs that a SEF may or may not exclude in its reasonable discretion when determining its projected operating costs under § 37.1301(a). The proposed Acceptable Practices would generally be based upon the Financial Resources Guidance in which staff discussed the scope of a SEF's reasonable discretion for determining its obligations under § 37.1301 and § 37.1303. Specifically, the Financial Resources Guidance provides that a SEF may reasonably exclude from its projected operating costs certain expenses, including (1) costs attributable solely to sales, marketing, business development, or recruitment;[1052] (2) compensation and related taxes and benefits for SEF employees whose functions are not necessary to meet the SEF's regulatory responsibilities;[1053] (3) costs for acquiring and defending patents and trademarks for SEF products and related intellectual property; (4) magazine, newspaper, and online periodical subscription fees; (5) tax preparation and audit fees; (6) to the extent not covered by item (2) above, the variable commissions that a voice-based SEF may pay to its employee-brokers, calculated as a percentage of transaction revenue generated by the voice-based SEF; and (7) any non-cash costs, including depreciation and

[1051] Section 37.1303 provides that a SEF has reasonable discretion in determining the methodology used to compute its projected operating costs in order to determine the amount needed to meet its requirements under § 37.1301. Because the liquidity requirement in existing § 37.1305 is based upon a SEF's financial requirement under § 37.1301, the SEF's application of its reasonable discretion also implicitly determines its liquidity obligation under § 37.1305. The Commission proposes to renumber § 37.1303 to § 37.1304. Other than renumbering the provision and other conforming changes, such as including a reference to wind-down costs, the Commission is not proposing substantive changes to the provision.

[1052] The costs listed in this item (1) also include costs for travel, entertainment, events and conferences to the extent that such costs are not necessary.

[1053] For example, if a SEF requires a certain number of voice brokers to run its voice/hybrid platform but hires additional voice brokers to provide superior customer service, the SEF would only need to include the minimum number of voice brokers to run its voice-based or voice-assisted platform based on its current business volume, and taking into account any projected increase or decrease in business volume, in its projected operating cost calculations.

amortization. The Commission similarly would incorporate this list with certain conforming changes into the proposed Acceptable Practices as costs that the Commission believes may be reasonable for a SEF to exclude from its projected operating cost calculations.[1054] In addition to these enumerated items, the proposed Acceptable Practices additionally would provide that as long as a SEF offers more than one *bona fide* execution method, it may be a reasonable use of a SEF's discretion under proposed § 37.1304 to include the costs of only one of its *bona fide* execution methods in its projected operating costs calculations, while excluding the costs associated with its other execution methods.[1055]

Further, based on the Financial Resources Guidance, the proposed Acceptable Practices would clarify that in order to determine its obligations under proposed § 37.1301(a), a SEF may pro-rate, but not exclude, certain expenses in calculating projected operating costs.[1056] In pro-rating any of these expenses, however, a SEF would need to document, identify, and justify is decision to pro-rate such expenses.

[1054] In order to conform to the Commission's proposed change to § 37.1301(a), the Commission proposes to slightly alter the wording of item (2) to provide that a SEF may exclude the costs of a SEF's employees are not necessary to *comply with* the core principles set forth in § 5h of the Act and any applicable Commission regulations. (emphasis added). Similarly, the Financial Resources Guidance provides that a reasonable calculation of projected operating expenses must include all expenses necessary for a SEF to discharge its responsibilities as a SEF in compliance with the CEA, the Commission's regulations, and the SEF's rulebooks, which is consistent with existing § 37.1301(a). However, in order to conform with proposed § 37.1301(a), the proposed acceptable practices would instead provide that a SEF must include all expenses necessary for the SEF "to comply" with the core principles and any applicable Commission regulations.

[1055] For example, if a SEF offers both an Order Book and RFQ System, the SEF would be permitted to include the costs related to only one of the execution methods it offers (*e.g.*, if a SEF includes in its projected operating costs the costs associated with its Order Book, it may exclude the costs related to its RFQ System, or vice-versa). A *bona fide* method would refer to a method actually used by SEF participants and not established by a SEF on a *pro forma* basis for the purpose of complying with—or evading—the financial resources requirement. In contrast, under the current Financial Resources Guidance and Commission regulations, a SEF's projected operating costs generally must include all offered execution methods.

[1056] For example, a SEF would be permitted to pro-rate expenses that are shared with affiliates, *e.g.*, the costs of administrative staff or seconded employees that a SEF shares with affiliates. Further, a SEF would also be permitted to pro-rate expenses that are attributable in part to activities that are not required to

Proposed § 37.1303 would require a SEF to maintain liquid assets in an amount equal to the greater of (i) three-months' projected operating costs necessary to enable the SEF to comply with its core principle and applicable Commission regulations and (ii) the SEF's projected wind-down costs. In contrast, a SEF currently must maintain sufficient liquid assets to cover six-months' projected operating costs.[1057] As discussed above, the Commission proposes to adopt the Acceptable Practices to further clarify the costs that a SEF, based on its reasonable discretion, may or may not exclude from its projected operating costs when determining its financial obligations under proposed § 37.1303.

Since SEFs currently are not required to provide GAAP-compliant financial submissions, proposed § 37.1306(a) would require a SEF's quarterly financial submissions to conform to GAAP, or in the case of a non-U.S. domiciled SEF that is not otherwise required to prepare GAAP-compliant statements, to prepare its statements in accordance with either the International Financial Reporting Standards issued by the International Accounting Standards Board, or a comparable international standard that the Commission may accept in its discretion. Proposed § 37.1306(c) would provide that a SEF's quarterly financial statements must explicitly (i) identify all the SEF's expenses without any exclusions, (ii) identify all expenses and corresponding amounts that the SEF excluded or pro-rated when it determined its projected operating costs, (iii) explain why the SEF excluded or pro-rated any expenses, and (iv) identify and explain all costs necessary to wind down the SEF's operations. Section 37.1306(c)(1) currently requires SEFs to provide "[s]ufficient documentation" explaining how the SEF determined its

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comply with the SEF core principles, *e.g.*, costs of a SEF's office space to the extent it also houses personnel whose costs may be excludable under items (1) or (2).

[1057] The proposal would renumber § 37.1305 to § 37.1303.

financial resources obligations, and the Commission believes that the items specified in proposed § 37.1306(c) constitute such sufficient documentation and are already being provided by compliant SEFs. Proposed § 37.1306(d) would extend the deadline for a SEF's fourth quarter financial statement from sixty to ninety days after the end of such fiscal quarter to conform to the extended deadline for a SEF's annual compliance report. Proposed § 37.1306(e) would require a SEF to provide notice no later than forty-eight hours after it knows or reasonably should know it no longer meets its financial resources obligations.

b. Benefits

Proposed § 37.1301(a) is expected to reduce the total financial assets that most SEFs must maintain since a SEF would be required to maintain sufficient resources to cover only its operations necessary to comply with its core principle obligations and applicable Commission regulations rather than all of its operating costs as currently provided in existing § 37.1301(a). With respect to proposed § 37.1301(a), the proposed Acceptable Practices would provide further guidance regarding the scope of a SEF's reasonable discretion when determining the SEF's financial requirements under § 37.1301(a) to exclude certain expenses from its projected operating cost calculations, thereby reducing the amount of total financial assets that a SEF must maintain under proposed § 37.1301(a). T the extent that the proposed Acceptable Practices generally adopt the staff's existing Financial Resources Guidance, SEFs may also already have realized the benefits associated with reduced financial resources requirements. However, in addition to the expenses enumerated in the Financial Resources Guidance, the proposed Acceptable Practices also would clarify that when determining its financial

obligations under § 37.1301(a), as long as a SEF includes the costs of one *bona fide* execution method, a SEF could reasonably exclude from its projected operating costs the expenses associated with its other execution methods.[1058] As a result, the Commission anticipates that a SEF's projected operating costs related to a SEF's execution platforms would generally not be significantly more than the least costly *bona fide* execution method offered by the SEF, which the Commission notes could be in the millions of dollars for certain SEFs.[1059]

Proposed § 37.1301(b) could result in a marginal cost reduction since an entity would no longer be required to submit a separate financial submission for its affiliated SEF and DCO. However, the Commission believes that this would be a *de minimis* reduction.

Proposed § 37.1303's liquidity requirement would significantly reduce the amount of liquid financial assets that must be maintained by most SEFs. Currently, a SEF must maintain liquid financial assets equal to six-months' projected operating costs, while proposed § 37.1303 would require most SEFs to hold three-months' projected operating costs. As a result, proposed § 37.1303 generally would reduce the liquidity requirement for most SEFs by 50 percent.[1060] Similar to the discussion above under

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[1058] For example, if a SEF offers both an Order Book and RFQ System, the SEF would be permitted to include the costs related to only one of the execution methods it offers (*e.g.*, if a SEF includes in its projected operating costs the costs associated with its Order Book, it may exclude the costs related to its RFQ System, or vice-versa). A *bona fide* method would refer to a method actually used by SEF participants and not established by a SEF on a *pro forma* basis for the purpose of complying with—or evading—the financial resources requirement.

[1059] The Commission anticipates that SEFs that offer execution methods that are more costly for a SEF to maintain, such as voice-based or voice-assisted execution methods, are likely to see the greatest relative reduction in projected operating costs.

[1060] The Commission notes that the current liquidity requirement in existing § 37.1305 as well as proposed § 37.1303 permits a SEF to acquire a "committed line of credit" to satisfy the liquidity requirement. However, the Commission notes that most SEFs satisfy this requirement through maintaining liquid assets rather than obtaining a line of credit. Accordingly, as a practical matter, the Commission expects proposed

proposed § 37.1301(a), the proposed Acceptable Practices would broaden the reasonable discretion that a SEF has under proposed § 37.1304 for computing its projected operating costs to exclude certain expenses from its projected three-months' operating cost calculations, thereby reducing the amount of total financial assets that a SEF must maintain under proposed § 37.1303.[1061] In addition, a SEF currently must maintain liquid assets equal to six-months' operating costs even if the SEF's actual wind-down costs are greater. For certain SEFs with wind-down costs that exceed six-months' operating costs, proposed § 37.1303 would augment market integrity for such SEFs by requiring them to maintain additional liquid assets to cover their wind-down costs, even if the SEF's wind-down would exceed six-months, but in no event would a SEF be permitted to maintain less than three-months' operating costs.

The Commission believes that the proposal provides a SEF with greater flexibility in terms of establishing its financial resources. This, in turn, may lead to greater efficiencies in terms of financing and capital allocation and investment. However, the Commission acknowledges, as discussed below, this flexibility may increase the level of financial risk at the SEF.

Proposed §§ 37.1306(a) and (c) would benefit transparency and augment the Commission's oversight by requiring SEFs to provide standardized, GAAP-compliant financial submissions that explicitly identify any cost a SEF has excluded or pro-rated in determining its projected operating costs. In its experience conducting ongoing SEF

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§ 37.1303 to reduce the amount of liquid assets that a SEF must maintain. Moreover, the Commission notes that there would be additional associated costs if a SEF were to obtain a committed line of credit.

[1061] This assumes that a SEF's projected wind-down costs are less than the SEF's three-months' projected operating costs; otherwise, proposed § 37.1303 would require the SEF to maintain liquid financial resources in an amount equal to its wind-down costs.

oversight, Commission staff has devoted additional effort to obtain appropriate clarity and sufficient documentation from SEFs. Therefore, the Commission believes that clarifying the minimum documentation that a SEF must provide would mitigate the time and resources required both by staff in conducting its oversight and by SEFs in responding to staff's requests for additional information. Proposed § 37.1306(e) would benefit market integrity by ensuring that the Commission is aware of any non-compliance forty-eight hours after the SEF knows or reasonably should know that it fails to satisfy its financial resources obligations rather than when the SEF submits its quarterly financial statement under § 37.1306(a), increasing the Commission's ability to promptly respond.

c. Costs

Proposed § 37.1301(a) would reduce the amount of financial resources that a SEF must maintain to an amount that would enable the SEF to comply with its core principle obligations and applicable Commission regulations for a one-year period, calculated on an ongoing basis, rather than in an amount necessary to cover all of the SEF's operations as required under existing § 37.1301(a). The proposed Acceptable Practices further would clarify the costs that a SEF may exclude when determining its obligations under proposed § 37.1301(a). As a result, proposed § 37.1301(a) as contemplated in the proposed Acceptable Practices likely would induce SEFs to reduce the current level of total financial resources that they maintain under § 37.1301. In turn, this could decrease market participants' confidence and could harm a SEF's stability during adverse market conditions because the SEF may not have adequate financial resources to cover its costs. However, the Commission believes that the potential harm to a SEF's financial stability and to the market is minimal since proposed § 37.1301(a) addresses only the amount of a

SEF's total financial assets, which includes illiquid assets, rather than focusing only on a SEF's liquid assets. The Commission notes that illiquid assets are less important compared to the amount of liquid financial assets that a SEF must maintain under proposed § 37.1303 since it is more difficult for a SEF to timely liquidate its illiquid assets to cover its operating costs, especially during periods of market instability. Accordingly, the Commission believes a SEF's liquid financial assets, which the Commission addresses in proposed § 37.1303 below, is more important for sustaining a SEF's financial health and continuing operations.

Proposed § 37.1303 could require some SEFs to maintain additional liquid financial assets, compared to the current liquidity requirement, where a SEF's wind-down costs exceed six-months' operating costs. However, as explained above under the discussion of benefits, the Commission believes that most SEFs would not have wind-down costs that exceed six-months' operating costs. Accordingly, proposed § 37.1303 should not increase the liquidity requirement for most SEFs.

Proposed § 37.1304 would require a SEF to incur an additional marginal cost to calculate its wind-down costs, in addition to its projected operating costs as currently required, in order to determine its financial resources obligations under § 37.1301 and § 37.1303. The Commission estimates that this proposed change would impose an initial, minimal, one-time cost for each SEF related to determining the length of time and associated costs associated with an orderly wind down.

Proposed § 37.1306 would impose greater costs on a SEF. Specifically, proposed § 37.1306(a) would require a SEF to submit GAAP-compliant quarterly reports. Because GAAP-compliant financial statements generally require additional effort compared to

non-GAAP compliance financial statements, the Commission estimates that the proposed change would increase annual costs for each SEF to create GAAP-compliance financial report. However, the Commission does not believe that proposed § 37.1306(c) would increase costs. Under existing § 37.1306(c), a SEF must provide sufficient documentation explaining the methodology it used to compute its financial resources requirements; accordingly, proposed § 37.1306(c) is merely clarifying the type of information that is already required.[1062] Similarly, the Commission does not believe that proposed § 37.1306(e) would increase costs since a SEF currently is required to maintain continuous compliance with its financial resources obligations. By requiring a SEF to notify the Commission within 48 hours of non-compliance, rather than informing the Commission through a SEF's quarterly financial submission, proposed § 37.1306(e) could impose a *de minimis* cost to prepare a notice from a non-compliant SEF.

d. Section 15(a) Factors

(1) Protection of Market Participants and the Public

The Commission previously noted that the financial resources requirements protect market participants and the public by establishing uniform standards and a system of Commission oversight that ensures that trading occurs on a financially stable facility, which in turn, mitigates the risk of market disruptions, financial losses, and system problems that could arise from a SEF's failure to maintain adequate financial resources.[1063] In the event that a SEF must wind down its operations, proposed § 37.1303 would explicitly require a SEF to maintain sufficient liquid financial resources to conduct an orderly wind-down of its operations, or three-months' operating costs if greater than

[1062] *See* § 37.1306(c).
[1063] *See* Core Principles Final Rule at 33580.

the SEF's wind-down costs.[1064] The Commission believes that the proposed SEF financial requirements are better calibrated to the inherent risks of a SEF, which should not diminish the financial integrity of the SEF, but should result in greater efficiencies.

Moreover, a SEF would be required to provide notice under proposed § 37.1306(e) no later than forty-eight hours after it knows or reasonably should have known that it no longer satisfies its financial resources obligations, ensuring that the Commission can take prompt action to protect market participants and the public. In contrast, the Commission currently is notified of non-compliance in a SEF's quarterly financial statements. Lastly, a SEF would be required to submit GAAP-compliant quarterly financial submissions under proposed § 37.1306(c) that explicitly identify the costs a SEF has excluded or pro-rated in determining its projected operating costs. As a result, the Commission would more easily be able to compare SEFs' financial health and take pro-active steps to protect market participants and the public if the Commission identifies a SEF with weak financial health or the development of negative financial trends among SEFs that could endanger the market participants or the public.

(2) Efficiency, Competitiveness, and Financial Integrity of the Markets

Proposed § 37.1301(a) and § 37.1303, as further clarified through the proposed Acceptable Practices, together should benefit market efficiency by reducing capital costs since SEFs would no longer be required to maintain an excessive amount of financial resources. Accordingly, a SEF should be able to more efficiently allocate its financial resources, which in turn should encourage market growth and innovation. For example,

[1064] As the Commission previously noted, a SEF that has sufficient amounts of liquid financial resources would be better positioned to close out trading in a manner not disruptive to market participants or to members of the public who rely on SEF prices. *See* Core Principles Final Rule at 33580.

as noted above, in the case of proposed § 37.1303, the Commission expects that most SEFs would need to hold approximately 50 percent less liquid financial assets as reserve capital to cover operating costs. The current financial resources requirements dis-incentivize a SEF by imposing higher capital requirements if the SEF wishes to offer new or experimental technology, execution methods, or related products and services—especially if such business lines, products, or services are not expected to be immediately profitable or would have low margins.

The existing regulations may discourage a SEF from offering more capital intensive activities, such as execution methods that involve human brokers compared to fully electronic trading that are less capital intensive. Accordingly, the Commission believes that the proposed capital resources requirements would be more neutral with respect to a SEF's chosen technology and business model, and therefore should encourage a greater variety of execution methods and related services and products in the market place.

Reducing capital costs would promote the entry of new entrants into the market by reducing start-up costs and initial capital requirements, thereby further encouraging competition and innovation. The increase in competition and innovation could depend on the extent to which potential new entrants respond to this encouragement.

Proposed § 37.1306(e) should improve the financial integrity of markets by requiring a SEF to notify the Commission within 48 hours after it knows or reasonably should have known that it no longer satisfies its financial resources obligations, ensuring that the Commission can take prompt action to protect market integrity. Lastly, proposed § 37.1306(c) would improve SEF financial submissions by requiring GAAP-compliant

statements as well as clarifying that a SEF must explicitly identify any costs that it has exclude or pro-rated in determining its projected operating costs. These changes should improve the Commission's ability to conduct its oversight responsibilities to protect market integrity.

(3) Price Discovery

The Commission has not identified any effects of the proposed rules identified above on price discovery.

(4) Sound Risk Management Practices

By establishing specific standards with respect to how SEFs should assess and monitor the adequacy of their financial resources, the financial resources rules should promote sound risk management practices by SEFs. As noted above, proposed § 37.1303 would require a SEF to identify its wind-down costs and associated timing and ensure that it has sufficient liquid assets to maintain an orderly wind down. Similarly, proposed § 37.1306(c) would require a SEF to explain the basis of its determination for its estimate of its wind-down costs and timing. Proposed § 37.1307(e) would require a SEF to notify the Commission no later than 48 hours after it knows or reasonably should have known that it no longer satisfies its financial resources obligations. As a result, a SEF would be required to ensure that it maintains the necessary procedures to identify, and to notify the Commission of, any non-compliance.

(5) Other Public Interest Considerations

The Commission has not identified any effects that these rules will have on other public interest considerations other than those enumerated above.

Request for Comment

The Commission requests comment on all aspects of the consideration of the costs and benefits of the provisions related to SEF financial resources.

D. Antitrust Considerations

CEA section 15(b) requires the Commission to "take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of this Act, in issuing any order or adopting any Commission rule or regulation (including any exemption under section 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of this Act."[1065]

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requests comment on whether the proposal implicates any other specific public interest to be protected by the antitrust laws.

The Commission has considered the proposal to determine whether it is anticompetitive and does not anticipate that the proposal, viewed in its entirety, will have material anticompetitive effects or result in anticompetitive behavior. As described in detail in the preamble above, the proposal is expected to generally provide greater flexibility and competition in connection with swap trading on SEFs largely as a result of the proposed approach that would permit SEFs to offer a variety of innovative execution methods rather than being limited to specific, mandated execution methods. The

[1065] 7 U.S.C. 19(b).

Commission believes that such innovation is expected to promote greater competition between SEFs in order to attract additional trading and market participation.

The Commission also believes that achieving the SEF statutory goals of promoting trading on SEFs and pre-trade price transparency requires both (i) increasing the number of swaps that are subject to the trade execution requirement; and (ii) concurrently providing flexibility of execution methods. The Commission believes that requiring market participants to conduct a larger portion of their swaps trading on SEFs would, among other things, foster additional competition among a more concentrated number of market participants resulting in increased market efficiency and decreased transaction costs.

The Commission also notes that the proposal would enhance the available third party regulatory service providers that a SEF could hire to perform a variety of regulatory functions required of SEFs under the Act and Commission regulations. Specifically, as noted in the preamble, the Commission has proposed to expand the scope of entities that may provide regulatory services under § 37.204(a) to include any non-registered entity approved by the Commission. This proposed change is expected to potentially increase competition among existing and potential regulatory service providers and, thereby, reduce operating costs for SEFs, and mitigate barriers to entry for new SEFs.

Although the Commission does not anticipate that the proposal, viewed in its entirety, will have material anticompetitive effects or result in anticompetitive behavior, the Commission encourages comments on any aspect of the proposal that may be inconsistent with the antitrust laws or anticompetitive in nature. For example, the impartial access requirements proposed under § 37.202(a) would not require an all-to-all

market as envisioned by the current SEF rules, and therefore may inhibit the ability of certain market participants to access certain trading markets and liquidity pools. The Commission notes, however, that the current SEF market structure and participation patterns already have generally developed along these traditional lines, absent the proposed access criteria. The Commission underscores that its proposed changes to the impartial access requirements would require a SEF to allow access to prospective participants who are able to meet the SEF's participation criteria. As discussed in this proposal, although the Commission believes that this approach should prevent potential anticompetitive harms, it may still provide potential barriers to access.[1066] The Commission requests comment on whether and in what circumstances adopting the proposed rule could be anticompetitive.

Further, the Commission has preliminarily determined that the proposal serves the regulatory goals set forth in CEA section 5h(e) to promote trading on SEFs and pre-trade transparency in the swaps market. In addition, the Commission also preliminary believes that the proposal serves the general regulatory purpose in CEA section 3(b) to "promote responsible innovation and fair competition among boards of trade, other markets and market participants."[1067]

Although the Commission has not identified any less anticompetitive means to effectuate the purposes of CEA sections 5h(e) and 3(b) in connection with the SEF regulatory framework, nonetheless, the Commission requests comment on whether there

[1066] The Commission previously applied the impartial access requirement to ISVs on the basis that such types of vendors would provide various benefits to the market and market participants. SEF Core Principles Final Rule at 33,508 n.423. However, based on the Commission's experience and notwithstanding the existing impartial access requirement, ISVs have not established a significant level of participation on SEFs, nor have they achieved a broad level of adoption among market participants, absent the proposed access criteria. *See supra* VII.A.1.a.—§ 37.202(a)(1)—Impartial Access Criteria.

are other less anticompetitive means of achieving the relevant purposes of the Act. The Commission notes that it is not required to follow the least anticompetitive course of action.

List of Subjects

17 CFR Part 9

Administrative practice and procedure, Commodity exchanges, Commodity futures, Reporting and recordkeeping requirements.

17 CFR Part 36

Designated contract markets, Registered entities, Swap execution facilities, Swaps, Trade execution requirement.

17 CFR Part 37

Commodity futures, Registered entities, Registration application, Reporting and recordkeeping requirements, Swap execution facilities, Swaps.

17 CFR Part 38

Commodity futures, Designated contract markets, Registered entities, Reporting and recordkeeping requirements, Swaps, Trade execution requirement.

17 CFR Part 39

Consumer protection, Derivatives clearing organizations, Reporting and recordkeeping requirements, Risk management, Straight-through processing, Swaps.

17 CFR Part 43

Block trades, Consumer protection, Reporting and recordkeeping requirements, Swaps.

For the reasons stated in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR chapter I as follows:

PART 9 -- RULES RELATING TO REVIEW OF EXCHANGE DISCIPLINARY, ACCESS DENIAL OR OTHER ADVERSE ACTIONS

1. The authority citation for part 9 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6b-1, 6c, 7, 7a-2, 7b-3, 8, 9, 9a, 12, 12a, 12c, 13b, 16a, 18, 19, and 21.

2. Amend § 9.1 by:

a. Redesignating paragraph (c) as paragraph (d);

b. Redesignating paragraph (b)(4) as paragraph (c);

c. Revising paragraphs (b)(2), (b)(3), and newly redesignated paragraph (c).

The revisions read as follows:

§ 9.1 Scope of rules.

* * * * *

(b) * * *

(2) Except as provided in §§ 9.11(a), (b)(3)(i) through (v), (c), 9.12(a), and 9.13 (concerning the notice, effective date and publication of a disciplinary or access denial action), any summary action permitted under the rules of the swap execution facility imposing a minor penalty for the violation of rules relating to recordkeeping or reporting, or permitted under Core Principle 13, paragraph (a)(6) in appendix B to part 38 of this chapter imposing a minor penalty for the violation of exchange rules relating to decorum or attire, or relating to the timely submission of accurate records required for clearing or verifying each day's transactions or other similar activities; and

(3) Any exchange action arising from a claim, grievance, or dispute involving cash market transactions which are not a part of, or directly connected with, any transaction for the purchase, sale, delivery or exercise of a commodity for future delivery, a commodity option, or a swap.

(c) The Commission will, upon its own motion or upon motion filed pursuant to § 9.21(b), promptly notify the appellant and the exchange that it will not accept the notice of appeal or petition for stay of matters specified in paragraph (b) of this section. The determination to decline to accept a notice of appeal will be without prejudice to the appellant's right to seek alternate forms of relief that may be available in any other forum.

3. In § 9.2, revise paragraph (k) to read as follows:

§ 9.2 Definitions.

* * * * *

(k) *Summary action* means a disciplinary action resulting in the imposition of a penalty on a person for violation of rules of the exchange permitted under the rules of the swap execution facility for impeding the progress of a hearing; Core Principle 13, paragraph (a)(4) in appendix B to part 38 of this chapter (penalty for impeding progress of hearing); Core Principle 2, paragraph (a)(8) in appendix B to part 37 of this chapter (emergency disciplinary actions); Core Principle 13, paragraph (a)(7) in appendix B to part 38 of this chapter (emergency disciplinary actions); the rules of the swap execution facility for summary fines for violations of rules regarding recordkeeping or reporting; or Core Principle 13, paragraph (a)(6) in appendix B to part 38 of this chapter (summary

fines for violations of rules regarding timely submission of records, decorum, or other similar activities).

4. In § 9.11, revise paragraph (b)(2) to read as follows:

§ 9.11 Form, contents and delivery of notice of disciplinary or access denial action.

* * * * *

(b) * * *

(2) The written notice of a disciplinary action or access denial action provided to the person against whom the action was taken by a swap execution facility must be a copy of a written decision which includes the items listed in paragraphs (b)(3)(i) through (vi) of this section.

* * * * *

5. In § 9.12, revise paragraphs (a)(1) through (3) to read as follows:

§ 9.12 Effective date of disciplinary or access denial action.

(a) * * *

(1) As permitted by Core Principle 2, paragraph (a)(8) in appendix B to part 37 of this chapter (emergency disciplinary actions) or Core Principle 13, paragraph (a)(7) in appendix B to part 38 of this chapter (emergency disciplinary actions), the exchange reasonably believes, and so states in its written decision, that immediate action is necessary to protect the best interests of the marketplace;

(2) As permitted by the rules of the swap execution facility or Core Principle 13, paragraph (a)(4) in appendix B to part 38 of this chapter (hearings), the exchange determines, and so states in its written decision, that the actions of a person who is within the exchange's jurisdiction has impeded the progress of a disciplinary hearing;

(3) As permitted by the rules of the swap execution facility for recordkeeping or reporting violations or Core Principle 13, paragraph (a)(6) in appendix B to part 38 of this chapter (summary fines for violations of rules regarding timely submission of records, decorum, or other similar activities), the exchange determines that a person has violated exchange rules relating to decorum or attire, or timely submission of accurate records required for clearing or verifying each day's transactions or other similar activities; or

* * * * *

6. In § 9.24, revise paragraph (a)(2) to read as follows:

§ 9.24 Petition for stay pending review.

(a) * * *

(2) Within ten days after a notice of summary action has been delivered in accordance with § 9.12(b) to a person who is the subject of a summary action permitted by Core Principle 2, paragraph (a)(8) in appendix B to part 37 of this chapter (emergency disciplinary actions) or Core Principle 13, paragraph (a)(7) in appendix B to part 38 of this chapter (emergency disciplinary actions), that person may petition the Commission to stay the effectiveness of the summary action pending completion of the exchange proceeding.

* * * * *

7. Add part 36 to read as follows:

PART 36 -- TRADE EXECUTION REQUIREMENT

Sec.
36.1 Trade execution requirement.
36.2 Registry of registered entities listing swaps subject to the trade execution requirement.
36.3 Trade execution requirement compliance schedule.
Appendix A to Part 36 – Form TER

Authority: 7 U.S.C. 1a, 2, 5, 6, 6c, 7, 7a-2, 7b-3, 2a2, and 21, as amended by Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

§ 36.1 Trade execution requirement.

(a) Except as provided in this section, counterparties shall execute a transaction involving a swap subject to the clearing requirement of section 2(h)(1) of the Act on a designated contract market, a swap execution facility, or a swap execution facility that is exempt from registration under section 5h(g) of the Act, that lists the swap for trading.

(b) Paragraph (a) of this section does not apply to a swap transaction that is listed only by a swap execution facility that is exempt from registration under section 5h(g) of the Act.

(c) Paragraph (a) of this section does not apply to a swap transaction for which the clearing exception under section 2(h)(7) of the Act or the exceptions or exemptions under part 50 of this chapter have been elected, and the associated requirements met.

(d) Paragraph (a) of this section does not apply to a swap transaction that is executed as a component of a package transaction that includes a component transaction that is the issuance of a bond in a primary market.

(1) For purposes of this paragraph (d), a *package transaction* consists of two or more component transactions executed between two or more counterparties where:

(i) Execution of each component transaction is contingent upon the execution of all other components transactions; and

(ii) The component transactions are priced or quoted together as one economic transaction with simultaneous or near simultaneous execution of all components.

(2) [Reserved]

(e) Paragraph (a) of this section does not apply to a swap transaction that is executed between counterparties that have eligible affiliate counterparty status pursuant to § 50.52(a) of this chapter even if the eligible affiliate counterparties clear the swap transaction.

§ 36.2 Registry of registered entities listing swaps subject to the trade execution requirement.

(a) *Registry*. The Commission shall publish and maintain on its website a list that specifies the swaps that are subject to the trade execution requirement under section 2(h)(8) of the Act as set forth in § 36.1 and the designated contract markets and swap execution facilities where such swaps are listed for trading.

(b) *Required filing*. A designated contract market or swap execution facility shall file electronically to the Commission a complete Form TER set forth in appendix A to this part for each swap, or any group, category, type or class of swaps that it lists for trading and is subject to or becomes subject to the clearing requirement of section 2(h)(1) of the Act, as follows:

(1) For any swap, or any group, category, type or class of swaps subject to the clearing requirement of section 2(h)(1) of the Act, to be listed for trading, a designated contract market or a swap execution facility shall submit a complete Form TER or amend its Form TER concurrently with the submission of a product listing pursuant to § 40.2 or § 40.3 of this chapter;

(2) For any swap, or any group, category, type or class of swaps currently listed for trading and subject to the clearing requirement of section 2(h)(1) of the Act, a

designated contract market or a swap execution facility shall submit a complete Form TER ten business days prior to the effective date of this rule in the *Federal Register*; or

(3) For any swap, or any group, category, type or class of swaps that a designated contract market or a swap execution facility lists for trading that subsequent to listing is determined to become subject to the clearing requirement of section 2(h)(1) of the Act, the designated contract market or the swap execution facility shall submit a complete Form TER or amend its Form TER ten business days prior to the effective date of the same swap, or same group, category, type or class of swaps becoming subject to the clearing requirement.

(c) *Required posting.* A designated contract market and a swap execution facility shall publicly post the most recent version of its Form TER on its website pursuant to the timeline in paragraph (b) of this section. If any information reported on Form TER, or in any amendment thereto, is or becomes inaccurate for any reason, the designated contract market or the swap execution facility shall promptly file an amendment on Form TER updating such information.

§ 36.3 Trade execution requirement compliance schedule.

(a) *Definitions.* For the purposes of this section:

Category 1 entity means a swap dealer; a security-based swap dealer; a major swap participant; or a major security-based swap participant.

Category 2 entity means a commodity pool; a private fund as defined in section 202(a) of the Investment Advisers Act of 1940; or a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act of 1956.

(b) For swaps subject to the requirements of section 2(h)(8) of the Act prior to the effective date of this rule, counterparties must continue to comply with the requirements of section 2(h)(8) of the Act.

(c) *Schedule for compliance.* Upon the effective date of this rule, the following schedule for compliance with the trade execution requirement under section 2(h)(8) of the Act as set forth in § 36.1 shall apply with respect to swaps that on the effective date of this rule in the *Federal Register* become subject to the requirements of section 2(h)(8) of the Act:

(1) *Category 1 entities.* A Category 1 entity must comply with the requirements of section 2(h)(8) of the Act as set forth in § 36.1 no later than ninety (90) days from the effective date of this rule in the *Federal Register* when it executes a swap transaction with another Category 1 entity or a non-Category 1 entity that voluntarily seeks to execute the swap on a swap execution facility, designated contract market, or swap execution facility that is exempt from registration under section 5h(g) of the Act.

(2) *Category 2 entities.* A Category 2 entity must comply with the requirements of section 2(h)(8) of the Act as set forth in § 36.1 no later than one hundred and eighty (180) days from the effective date of this rule in the *Federal Register* when it executes a swap transaction with another Category 2 entity, a Category 1 entity, or other counterparties that voluntarily seek to execute the swap on a swap execution facility, designated contract market, or swap execution facility that is exempt from registration under section 5h(g) of the Act.

(3) *Other counterparties.* All other counterparties must comply with the requirements of section 2(h)(8) of the Act as set forth in § 36.1 no later than two hundred and seventy (270) days from the effective date of this rule in the *Federal Register*.

(d) Nothing in this rule shall be construed to prohibit any person from voluntarily complying with the requirements of section 2(h)(8) of the Act as set forth in § 36.1 sooner than required under the implementation schedule provided under paragraph (c) of this section.

(e) *Future compliance schedules.* After the effective date of this rule and upon the issuance of additional clearing requirement determinations under section 2(h)(2) of the Act that a swap, or any group, category, type or class of swaps is required to be cleared, the Commission shall determine the appropriate schedule for compliance with the trade execution requirement under section 2(h)(8) of the Act as set forth in § 36.1 for that swap, group, category, type or class of swap.

Appendix A to Part 36 – Form TER

COMMODITY FUTURES TRADING COMMISSION

FORM TER

LISTED SWAPS SUBJECT TO THE TRADE EXECUTION REQUIREMENT

INSTRUCTIONS

Intentional misstatements or omissions of material fact may constitute federal criminal violations (7 U.S.C. 13 and 18 U.S.C. 1001).

DEFINITIONS

Unless the context requires otherwise, all terms used in this Form TER have the same meaning as in the Commodity Exchange Act, as amended ("CEA" or "Act"), and in the General Rules and Regulations of the Commodity Futures Trading Commission ("Commission") thereunder (17 CFR chapter I).

GENERAL INSTRUCTIONS

1. This Form TER, which includes instructions, is to be filed with the Commission by a designated contract market ("DCM") or swap execution facility ("SEF") for a swap or a group, category, type, or class of swaps, that is subject to or that becomes subject to the clearing requirement of section 2(h)(1) of the Act that the DCM or SEF lists for trading.

2. Individuals' names, except the executing signature, shall be given in full (Last Name, First Name, Middle Name).

3. Signatures on all copies of the Form TER filed with the Commission can be executed electronically. If this Form TER is filed by a corporation, it shall be signed in the name of the corporation by a principal officer duly authorized; if filed by a limited liability company, it shall be signed in the name of the limited liability company by a manager or member duly authorized to sign on the limited liability company's behalf; if filed by a partnership, it shall be signed in the name of the partnership by a general partner duly authorized; if filed by an unincorporated organization or association which is not a partnership, it shall be signed in the name of such organization or association by the managing agent, *i.e.*, a duly authorized person who directs or manages or who participates in the directing or managing of its affairs.

4. If any item is inapplicable, indicate by "none," "not applicable," or "N/A," as appropriate.

5. The Commission may determine that additional information is required from the DCM or SEF in order to process its filing. **A Form TER that is not prepared and executed in compliance with applicable requirements and instructions**

may be returned as not acceptable for filing. Acceptance of this Form TER, however, shall not constitute a finding that the Form TER has been filed as required or that the information submitted is true, current, or complete.

6. The information submitted on this Form TER will be published and maintained on the Commission's website and be available for inspection by any interested person.

AMENDMENTS

1. When filing this Form TER for purposes of amending a prior filing pursuant to § 36.2 of the Commission's regulations (17 CFR 36.2), a DCM or SEF must file a complete form that is marked to show changes as applicable.

2. Amendments shall be signed on behalf of the DCM or SEF by a duly authorized representative.

WHERE TO FILE

This Form TER must be filed electronically with the Secretary of the Commission in the manner specified by the Commission.

COMMODITY FUTURES TRADING COMMISSION

FORM TER

LISTED SWAPS SUBJECT TO THE TRADE EXECUTION REQUIREMENT

Registered Entity Identifier Code *(optional)*:

_____

Organization:

_____

Filing as a: ___ DCM ___ SEF

☐ If this is an **INITIAL** filing of Form TER, complete in full and check here.

☐ If this is an **AMENDMENT** to a previously filed Form TER, complete in full, list all items that are amended and check here.

SIGNATURES

The DCM or SEF has duly caused this Form TER or amendment to be signed on its behalf by the undersigned, hereunto duly authorized, this ____ day of _____, 20___. The undersigned represents hereby that all information contained herein is true, current, and complete. It is understood that all required items are considered integral parts of this Form TER and that the submission of any amendment represents that all unamended items remain true, current, and complete as previously filed.

_____

Name of DCM or SEF

_____

Signature of Duly Authorized Person

_____

Print Name and Title of Signatory

GENERAL INFORMATION – EXHIBIT INSTRUCTIONS

1. The following Exhibit(s) must be filed with the Commission for each swap, or any group, category, type, or class of swaps that the DCM or SEF lists for trading that is subject to the clearing requirement under section 2(h)(1) of the Act as set forth in § 50.4 of the Commission's regulations (17 CFR 50.4).

2. An Exhibit must be labeled and include the information as specified in this Form TER. The following tables are the required template and must be reproduced for each contract listing, as appropriate.

EXHIBIT A-1 – INTEREST RATES

1. Attach as **Exhibit A-1**, the interest rate contracts the DCM or SEF lists for trading that are subject to the clearing requirement.

Product Class/Specification	
Currency	
Floating Rate Index	
Stated Termination Date Range	
Optionality	
Dual Currencies	
Conditional Notional Amounts	

EXHIBIT A-2 – CREDIT

2. Attach as **Exhibit A-2**, the credit contracts the DCM or SEF lists for trading that are subject to the clearing requirement.

Product Class/Specification	
Reference Entities	
Region	
Indices	
Tenor	
Applicable Series	
Tranched	

8. Revise part 37 to read as follows:

PART 37 -- SWAP EXECUTION FACILITIES

Subpart A – General Provisions

Sec.
37.1 Scope.
37.2 Applicable provisions and definitions.
37.3 Requirements and procedures for registration.
37.4 Procedures for implementing rules.
37.5 Provision of information relating to a swap execution facility.
37.6 Enforceability.
37.7 Boards of trade operating both a designated contract market and a swap execution facility.

Subpart B – Compliance with Core Principles

Sec.
37.100 Core Principle 1 – Compliance with core principles.
37.101 [Reserved]

Subpart C – Compliance with Rules

Sec.
37.200 Core Principle 2 – Compliance with rules.
37.201 Requirements for swap execution facility execution methods.
37.202 Access requirements.
37.203 Rule enforcement program.
37.204 Regulatory services provided by a third party.
37.205 Audit trail.
37.206 Disciplinary procedures and sanctions.

Subpart D – Swaps Not Readily Susceptible to Manipulation

Sec.
37.300 Core Principle 3 – Swaps not readily susceptible to manipulation.
37.301 General requirements.

Subpart E – Monitoring of Trading and Trade Processing

Sec.
37.400 Core Principle 4 – Monitoring of trading and trade processing.
37.401 General requirements.
37.402 Additional requirements for physical-delivery swaps.
37.403 Additional requirements for cash-settled swaps.
37.404 Ability to obtain information.
37.405 Risk controls for trading.
37.406 Regulatory service provider.
37.407 Additional sources for compliance.

Subpart F – Ability to Obtain Information

Sec.

37.500 Core Principle 5 – Ability to obtain information.

37.501 Establish and enforce rules.

37.502 Provide information to the Commission.

37.503 Information-sharing.

37.504 Prohibited use of data collected for regulatory purposes.

Subpart G – Position Limits or Accountability

Sec.

37.600 Core Principle 6 – Position limits or accountability.

37.601 [Reserved].

Subpart H – Financial Integrity of Transactions

Sec.

37.700 Core Principle 7 – Financial integrity of transactions.

37.701 Required clearing.

37.702 General financial integrity.

37.703 Monitoring for financial soundness.

Subpart I – Emergency Authority

Sec.

37.800 Core Principle 8 – Emergency authority.

37.801 Additional sources for compliance.

Subpart J – Timely Publication of Trading Information

Sec.

37.900 Core Principle 9 – Timely publication of trading information.

37.901 General requirements.

Subpart K – Recordkeeping and Reporting

Sec.

37.1000 Core Principle 10 – Recordkeeping and reporting.

37.1001 Recordkeeping.

Subpart L – Antitrust Considerations

Sec.

37.1100 Core Principle 11 – Antitrust considerations.

37.1101 Additional sources for compliance.

Subpart M – Conflicts of Interest

Sec.

37.1200 Core Principle 12 – Conflicts of interest.

37.1201 [Reserved].

Subpart N – Financial Resources

Sec.
37.1300 Core Principle 13 – Financial resources.
37.1301 General requirements.
37.1302 Types of financial resources.
37.1303 Liquidity of financial resources.
37.1304 Computation of costs to meet financial resources requirement.
37.1305 Valuation of financial resources.
37.1306 Reporting to the Commission.
37.1307 Delegation of authority.

Subpart O – System Safeguards
Sec.
37.1400 Core Principle 14 – System safeguards.
37.1401 Requirements.

Subpart P – Designation of Chief Compliance Officer
Sec.
37.1500 Core Principle 15 – Designation of chief compliance officer.
37.1501 Chief compliance officer.

Appendix A to Part 37 – Form SEF
Appendix B to Part 37 – Guidance on, and Acceptable Practices in, Compliance with Core Principles
Appendix C to Part 37 – Demonstration of Compliance that a Swap Contract is Not Readily Susceptible to Manipulation

Authority: 7 U.S.C. 1a, 2, 5, 6, 6c, 7, 7a-2, 7b-3 and 12a, as amended by Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

Subpart A – General Provisions

§ 37.1 Scope.

The provisions of this part shall apply to every swap execution facility that is registered or is applying to become registered as a swap execution facility under section 5h of the Commodity Exchange Act ("the Act").

§ 37.2 Applicable provisions and definitions.

(a) *Applicable provisions.* A swap execution facility shall comply with the requirements of this part and all other applicable Commission regulations, including § 1.60 of this chapter and any related definitions and cross-referenced sections.

(b) *Definitions.* For the purposes of this part, *market participant* means 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.

§ 37.3 Requirements and procedures for registration.

(a) *Requirements for registration.* 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 any swap, regardless of whether such swap is subject to the trade execution requirement under section 2(h)(8) of the Act as set forth in § 36.1 of this chapter, with more than one other market participant on the system or platform shall register the facility as a swap execution facility under this part or as a designated contract market under part 38 of this chapter.

(b) *Procedures for registration*—(1) *Application for registration.* An applicant requesting registration as a swap execution facility shall:

(i) File electronically a complete Form SEF as set forth in appendix A to this part, or any successor forms, and all information and documentation described in such forms with the Secretary of the Commission in the form and manner specified by the Commission;

(ii) Provide to the Commission, upon the Commission's request, any additional information and documentation necessary to review an application; and

(iii) Obtain a legal entity identifier code for the purpose of identifying the swap execution facility pursuant to part 45 of this chapter.

(2) *Request for confidential treatment*. (i) An applicant requesting registration as a swap execution facility shall identify with particularity any information in the application that will be subject to a request for confidential treatment pursuant to § 145.9 of this chapter.

(ii) Section 40.8 of this chapter sets forth those sections of the application that will be made publicly available, notwithstanding a request for confidential treatment pursuant to § 145.9 of this chapter.

(3) *Amendment of application for registration*. An applicant amending a pending application for registration as a swap execution facility shall file an amended Form SEF electronically with the Secretary of the Commission in the manner specified by the Commission.

(4) *Effect of incomplete application*. If an application is incomplete pursuant to paragraph (b)(1) of this section, the Commission shall notify the applicant that its application will not be deemed to have been submitted for purposes of the Commission's review.

(5) *Commission review period*. The Commission shall review an application for registration as a swap execution facility pursuant to the 180-day timeframe and procedures specified in section 6(a) of the Act.

(6) *Commission determination.* (i) The Commission shall issue an order granting registration upon a Commission determination, in its own discretion, that the applicant has demonstrated compliance with the Act and the Commission's regulations applicable to swap execution facilities. If deemed appropriate, the Commission may issue an order granting registration subject to conditions.

(ii) The Commission may issue an order denying registration upon a Commission determination, in its own discretion, that the applicant has not demonstrated compliance with the Act and the Commission's regulations applicable to swap execution facilities.

(c) *Amendment of an order of registration.* (1) A swap execution facility requesting an amendment to an order of registration shall electronically file such request with the Secretary of the Commission in the form and manner specified by the Commission.

(2) A swap execution facility shall provide to the Commission, upon the Commission's request, any additional information and documentation necessary to review a request to amend an order of registration.

(3) The Commission shall issue an amended order of registration upon a Commission determination, in its own discretion, that the swap execution facility would maintain compliance with the Act and the Commission's regulations upon amendment to the order. If deemed appropriate, the Commission may issue an amended order of registration subject to conditions.

(4) The Commission may decline to issue an amended order based upon a Commission determination, in its own discretion, that the SEF would not continue to

maintain compliance with the Act and the Commission's regulations upon amendment to the order.

(d) *Reinstatement of dormant registration.* A dormant swap execution facility as defined in § 40.1 of this chapter may reinstate its registration under the procedures of paragraph (b) of this section. The applicant may rely upon previously submitted materials if such materials accurately describe the dormant swap execution facility's conditions at the time that it applies for reinstatement of its registration.

(e) *Request for transfer of registration.* (1) A swap execution facility seeking to transfer its registration from its current legal entity to a new legal entity as a result of a corporate change shall file a request for approval to transfer such registration with the Secretary of the Commission in the form and manner specified by the Commission.

(2) *Timeline for filing a request for transfer of registration.* A swap execution facility shall file a request for transfer of registration as soon as practicable prior to the anticipated corporate change.

(3) *Required information.* The request for transfer of registration shall include the following:

(i) The underlying documentation that governs the corporate change;

(ii) A description of the corporate change, including the reason for the change and its impact on the swap execution facility, including its governance and operations, and its impact on the rights and obligations of market participants;

(iii) A discussion of the transferee's ability to comply with the Act, including the core principles applicable to swap execution facilities, and the Commission's regulations thereunder;

(iv) The governing documents adopted by the transferee, including a copy of any constitution, articles or certificate of incorporation, organization, formation, or association with all amendments thereto, partnership or limited liability agreements, and any existing bylaws, operating agreement, or rules or instruments corresponding thereto;

(v) The transferee's rules marked to show changes from the current rules of the swap execution facility;

(vi) A representation by the transferee that it:

(A) Will be the surviving entity and successor-in-interest to the transferor swap execution facility and will retain and assume the assets and liabilities of the transferor, except if otherwise indicated in the request;

(B) Will assume responsibility for complying with all applicable provisions of the Act and the Commission's regulations promulgated thereunder, including all self-regulatory responsibilities except if otherwise indicated in the request; and

(C) Will notify market participants of all changes to the transferor's rulebook prior to the transfer, including those changes that may affect the rights and obligations of market participants, and will further notify market participants of the concurrent transfer of the registration to the transferee upon Commission approval and issuance of an order permitting this transfer.

(4) *Commission determination.* Upon review of a request for transfer of registration, the Commission, as soon as practicable, shall issue an order either approving or denying the request.

(f) *Request for withdrawal of application for registration.* An applicant for registration as a swap execution facility may withdraw its application submitted pursuant

to paragraph (b) of this section by filing a withdrawal request electronically with the Secretary of the Commission. Withdrawal of an application for registration shall not affect any action taken or to be taken by the Commission based upon actions, activities, or events occurring during the time that the application was pending with the Commission.

(g) *Request for vacation of registration.* A swap execution facility may request that its registration be vacated under section 7 of the Act by filing a vacation request electronically with the Secretary of the Commission. Vacation of registration shall not affect any action taken or to be taken by the Commission based upon actions, activities, or events occurring during the time that the swap execution facility was registered by the Commission.

(h) *Delegation of authority.* The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, upon consultation with the General Counsel or the General Counsel's delegate, authority to notify an applicant seeking registration that its application is incomplete and that it will not be deemed to have been submitted for purposes of the Commission's review, and to notify an applicant seeking registration under section 6(a) of the Act that its application is materially incomplete and the running of the 180-day period is stayed. The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

§ 37.4 Procedures for implementing rules.

(a) Any rule, except for swap product terms and conditions, submitted as part of a swap execution facility's application for registration shall be considered for approval by the Commission at the time the Commission issues the swap execution facility's order of registration.

(b) Any rule, except for swap product terms and conditions, submitted as part of an application to reinstate the registration of a dormant swap execution facility, as defined in § 40.1 of this chapter, shall be considered for approval by the Commission at the time the Commission approves the dormant swap execution facility's reinstatement of registration.

§ 37.5 Provision of information relating to a swap execution facility.

(a) *Request for information.* Upon the Commission's request, a swap execution facility shall file with the Commission information related to its business as a swap execution facility in the form and manner and within the time period as the Commission specifies in its request.

(b) *Demonstration of compliance.* Upon the Commission's request, a swap execution facility shall file with the Commission a written demonstration, containing supporting data, information, and documents that it is in compliance with its obligations under the Act and the Commission's regulations as the Commission specifies in its request. The swap execution facility shall file such written demonstration in the form and manner and within the time period as the Commission specifies in its request.

(c) *Equity interest transfer*—(1) *Equity interest transfer notification.* A swap execution facility shall file with the Commission a notification of each transaction involving the direct or indirect transfer of fifty percent or more of the equity interest in

the swap execution facility. The Commission may, upon receiving such notification, request that the swap execution facility provide supporting documentation of the transaction.

(2) *Timing of notification.* The equity interest transfer notice described in paragraph (c)(1) of this section shall be filed electronically with the Secretary of the Commission at its Washington, DC headquarters at *submissions@cftc.gov* and the Division of Market Oversight at *DMOSubmissions@cftc.gov,* at the earliest possible time but in no event later than the open of business ten business days following the date upon which a firm obligation is made to transfer, directly or indirectly, fifty percent or more of the equity interest in the swap execution facility.

(3) *Certification.* Upon a transfer, whether directly or indirectly, of an equity interest of fifty percent or more in a swap execution facility, the swap execution facility shall file electronically with the Secretary of the Commission at its Washington, DC headquarters at *submissions@cftc.gov* and the Division of Market Oversight at *DMOSubmissions@cftc.gov,* a certification that the swap execution facility meets all of the requirements of section 5h of the Act and the Commission regulations adopted thereunder, no later than two business days following the date on which the equity interest of fifty percent or more was acquired.

(d) *Delegation of authority.* The Commission hereby delegates, until it orders otherwise, the authority set forth in this section to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time. The Director may submit to the Commission for its consideration any matter that

has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

§ 37.6 Enforceability.

(a) *Enforceability of transactions.* A swap transaction executed on a swap execution facility shall not be void, voidable, subject to rescission, otherwise invalidated, or rendered unenforceable as a result of:

(1) A violation by the swap execution facility of the provisions of section 5h of the Act or this part;

(2) Any Commission proceeding to alter or supplement a rule, term, or condition under section 8a(7) of the Act or to declare an emergency under section 8a(9) of the Act; or

(3) Any other proceeding the effect of which is to:

(i) Alter or supplement a specific term or condition or trading rule or procedure; or

(ii) Require a swap execution facility to adopt a specific term or condition, trading rule or procedure, or to take or refrain from taking a specific action.

(b) *Swap documentation*—(1) *Legally binding documentation*—(i) *Cleared swaps.* (A) A swap execution facility shall provide a confirmation document to each counterparty to a cleared swap transaction that is executed on the swap execution facility.

(B) *Confirmation document* means a legally binding written documentation (electronic or otherwise) that memorializes the agreement to all terms of a swap transaction and legally supersedes any previous agreement (electronic or otherwise) that relates to the swap transaction between the counterparties.

(ii) *Uncleared swaps.* (A) A swap execution facility shall provide a trade evidence record to each counterparty to an uncleared swap transaction that is executed on the swap execution facility.

(B) *Trade evidence record* means a legally binding written documentation (electronic or otherwise) that memorializes the terms of a swap transaction agreed upon by the counterparties and legally supersedes any conflicting term in any previous agreement (electronic or otherwise) that relates to the swap transaction between the counterparties.

(2) *Requirements for swap documentation.* (i) A swap execution facility shall issue the confirmation document or trade evidence record to the counterparties as soon as technologically practicable after the execution of the swap transaction on the swap execution facility.

(ii) Specific customer identifiers for accounts included in bunched orders involving swap transactions need not be included in a confirmation document or a trade evidence record provided by a swap execution facility if the applicable requirements of § 1.35(b)(5) of this chapter are met.

(iii) The swap execution facility may issue the confirmation document or trade evidence record to the person acting as an intermediary on behalf of the counterparty to the swap transaction. The swap execution facility shall establish and enforce rules that require such intermediary to send the confirmation document or trade evidence record to the respective counterparty as soon as technologically practicable upon receipt of the confirmation document or trade evidence record from the swap execution facility.

§ 37.7 Boards of trade operating both a designated contract market and a swap execution facility.

(a) An entity that intends to operate both a designated contract market and a swap execution facility shall separately register the two entities pursuant to the designated contract market designation procedures set forth in part 38 of this chapter and the swap execution facility registration procedures set forth in this part.

(b) A board of trade, as defined in section 1a(6) of the Act, that operates both a designated contract market and a swap execution facility and that uses the same electronic trade execution system for executing and trading swaps on the designated contract market and on the swap execution facility shall clearly identify to market participants for each swap whether the execution or trading of such swaps is taking place on the designated contract market or on the swap execution facility.

Subpart B – Compliance with Core Principles

§ 37.100 Core Principle 1 – Compliance with core principles.

(a) *In general.* To be registered, and maintain registration, as a swap execution facility, the swap execution facility shall comply with—

(1) The core principles described in section 5h of the Act; and

(2) Any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5) of the Act.

(b) *Reasonable discretion of a swap execution facility.* Unless otherwise determined by the Commission by rule or regulation, a swap execution facility described in paragraph (a) of this section shall have reasonable discretion in establishing the

manner in which the swap execution facility complies with the core principles described in section 5h of the Act.

§ 37.101 [Reserved]

Subpart C – Compliance with Rules

§ 37.200 Core Principle 2 – Compliance with rules.

A swap execution facility shall:

(a) Establish and enforce compliance with any rule of the swap execution facility, including the terms and conditions of the swaps traded or processed on or through the swap execution facility and any limitation on access to the swap execution facility;

(b) 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 provide market participants with impartial access to the market and to capture information that may be used in establishing whether rule violations have occurred;

(c) Establish rules governing the operation of the facility, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the facility, including block trades; and

(d) Provide by its rules that when a swap dealer or major swap participant enters into or facilitates a swap that is subject to the mandatory clearing requirement of section 2(h) of the Act, the swap dealer or major swap participant shall be responsible for compliance with the mandatory trading requirement under section 2(h)(8) of the Act.

§ 37.201 Requirements for swap execution facility execution methods.

(a) *Required swap execution facility rules.* A swap execution facility shall establish rules governing the operation of the swap execution facility that specify:

(1) The protocols and procedures for trading and execution, including entering, amending, cancelling, or executing orders for each execution method;

(2) The manner or circumstances in which the swap execution facility may exercise discretion in facilitating trading and execution for each execution method; and

(3) The sources and methodology for generating any market pricing information provided to facilitate trading and execution for each execution method.

(b) *Pre-execution communications.* A swap execution facility shall establish rules governing the operation of the swap execution facility that specify a prohibition on engaging in any communications away from the swap execution facility regarding any swap subject to the trade execution requirement of section 2(h)(8) of the Act as set forth in § 36.1 of this chapter.

(1) Counterparties to a swap that is subject to the trade execution requirement of section 2(h)(8) of the Act as set forth in § 36.1 of this chapter may engage in communications away from the swap execution facility if the swap is executed as a component of a package transaction that includes a component transaction that is not subject to section 2(h)(8) of the Act as set forth in § 36.1 of this chapter. For purposes of this paragraph (b)(1), a package transaction consists of two or more component transactions executed between two or more counterparties where:

(i) Execution of each component transaction is contingent upon the execution of all other components transactions; and

(ii) The component transactions are each priced or quoted together as part of one economic transaction with simultaneous or near simultaneous execution of all components.

(2) [Reserved]

(c) *SEF trading specialist*—(1) *Definition*. For purposes of this part, the term *SEF trading specialist* means any natural person who, acting as an employee (or in a similar capacity) of a swap execution facility, facilitates the trading or execution of swaps transactions (other than in a ministerial or clerical capacity), or who is responsible for direct supervision of such persons.

(2) *Fitness*. (i) No 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.

(ii) The prohibition set forth in paragraph (c)(2)(i) of this section shall not apply to:

(A) Any person listed as a principal or registered with the Commission as an associated person of a futures commission merchant, retail foreign exchange dealer, introducing broker, commodity pool operator, commodity trading advisor, or leverage transaction merchant, or any person registered as a floor broker or floor trader, notwithstanding that such person is subject to a disqualification from registration under sections 8a(2) or 8a(3) of the Act; or

(B) Any person otherwise subject to a disqualification from registration under sections 8a(2) or 8a(3) of the Act for whom a registered futures association provides a

notice stating that, if the person applied for registration with the Commission as an associated person, the registered futures association would not deny the application on the basis of the statutory disqualification.

(3) *Proficiency requirements.* (i) A swap execution facility shall establish and enforce standards and procedures to ensure that its SEF trading specialists have the proficiency and knowledge necessary to:

(A) Fulfill their responsibilities to the swap execution facility as SEF trading specialists; and

(B) Comply with applicable provisions of the Act, the Commission's regulations, and the rules of the swap execution facility.

(ii) *Qualification testing.* A swap execution facility shall require any person serving as a SEF trading specialist to demonstrate that:

(A) Such person has taken and passed any examination for swaps proficiency developed and administered by a registered futures association; and

(B) There is no continuous two-year period subsequent to such person passing a swaps proficiency examination during which the person has not served as a SEF trading specialist.

(iii) Compliance with the qualification testing requirements under paragraph (c)(3)(ii) of this section shall constitute compliance with the proficiency requirements under paragraph (c)(3)(i) of this section.

(4) *Ethics training.* A swap execution facility shall establish and enforce policies and procedures to ensure that its SEF trading specialists receive ethics training on a periodic basis.

(5) *Standards of conduct*. A swap execution facility shall establish and enforce policies and procedures that require its SEF trading specialists in dealing with market participants and fulfilling their responsibilities to the swap execution facility to satisfy standards of conduct as established by the swap execution facility.

(6) *Duty to supervise*. A swap execution facility shall diligently supervise the activities of its SEF trading specialists in the facilitation of trading and execution on the swap execution facility.

(7) *Additional sources for compliance*. A swap execution facility may refer to the guidance and/or acceptable practices in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.201.

§ 37.202 Access requirements.

(a) *Impartial access to markets, market services, and execution methods*. (1) A swap execution facility shall establish rules specifying impartial access criteria for its markets, market services, and execution methods, including any indicative quote screens or any similar pricing data displays. Such impartial access criteria shall be transparent, fair, and non-discriminatory and applied to all or similarly situated market participants.

(2) A swap execution facility shall establish fee structures and fee practices that are fair and non-discriminatory to market participants.

(b) *Limitations on access*. A swap execution facility shall establish and impartially enforce rules governing any decision to deny, suspend, permanently bar, or otherwise limit market participants' access to the swap execution facility, including when such decisions are made as part of a disciplinary or emergency action taken by the swap execution facility. The swap execution facility shall maintain documentation of any

decision to deny, suspend, permanently bar, or otherwise limit access of a market participant to the swap execution facility.

(c) *Eligibility*. A swap execution facility shall require its market participants to provide the swap execution facility with written confirmation (electronic or otherwise) of their status as eligible contract participants, as defined by the Act and Commission regulations, prior to obtaining access.

(d) *Jurisdiction*. Prior to granting any market participant access to its facilities, a swap execution facility shall require that the market participant consent to its jurisdiction.

§ 37.203 Rule enforcement program.

(a) *Abusive trading practices prohibited*. A swap execution facility shall prohibit abusive trading practices on its markets by market participants. Swap execution facilities that permit intermediation shall prohibit customer-related abuses including, but not limited to, trading ahead of customer orders, trading against customer orders, accommodation trading, and improper cross trading. Specific trading practices that shall be prohibited include front-running, wash trading, pre-arranged trading, fraudulent trading, money passes, and any other trading practices that a swap execution facility deems to be abusive. A swap execution facility shall also prohibit any other manipulative or disruptive trading practices prohibited by the Act or by the Commission pursuant to Commission regulation.

(b) *Authority to collect information*. A swap execution facility shall have the authority to collect information required to be kept by persons subject to the swap execution facility's recordkeeping rules.

(c) *Compliance staff and resources.* A swap execution facility shall establish and maintain sufficient compliance staff and resources to ensure that it can fulfill its self-regulatory obligations under the Act and Commission regulations.

(d) *Automated trade surveillance system.* A swap execution facility shall maintain an automated trade surveillance system capable of detecting and reconstructing potential trade practice violations. Any trade executed by voice or by entry into a swap execution facility's electronic trading system or platform and any order entered into an electronic trading system or platform shall be loaded and processed into the automated trade surveillance system no later than 24 hours after the completion of the trading day on which such trade was executed or such order was entered.

(e) *Error trade policy*—(1) *Definition.* As used in this paragraph (e), the term *error trade* means any swap transaction executed on a swap execution facility that contains an error in any term of the swap transaction, including price, size, or direction.

(2) A swap execution facility shall establish and maintain rules and procedures that facilitate the resolution of error trades in a fair, transparent, consistent, and timely manner. Such rules and procedures shall:

(i) Provide the swap execution facility with the authority to adjust trade terms or cancel trades; and

(ii) Specify the rules and procedures for market participants to notify the swap execution facility of an error trade, including any time limits for notification.

(3) A swap execution facility shall, as soon as practicable, provide notice to all market participants of:

(i) Any swap transaction that is under review by the swap execution facility pursuant to error trade rules and procedures;

(ii) Any determination by the swap execution facility that a swap transaction under review is or is not an error trade; and

(iii) The resolution of any error trade, including any trade term adjustment or trade cancellation.

(4) The requirements of paragraph (e) of this section shall not preclude the swap execution facility from establishing non-reviewable ranges.

(f) *Investigations*—(1) *Procedures.* A swap execution facility shall establish and maintain procedures that require its compliance staff to conduct investigations, including the commencement of an investigation upon the receipt of a request from Commission staff or upon the discovery or receipt of information by the swap execution facility that indicates a reasonable basis for finding that a violation may have occurred or will occur.

(2) *Timeliness.* Each investigation shall be completed in a timely manner, taking into account the facts and circumstances of the investigation.

(3) *Investigation reports.* Compliance staff shall prepare a written investigation report to document the conclusion of each investigation. The investigation report shall include the reason the investigation was initiated; a summary of the complaint, if any; the relevant facts; compliance staff's analysis and conclusions; and a recommendation as to whether disciplinary action should be pursued.

(g) *Additional sources for compliance.* A swap execution facility may refer to the guidance and/or acceptable practices in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.203.

§ 37.204 Regulatory services provided by a third party.

(a) *Use of regulatory service provider permitted.* A swap execution facility may choose to contract with a registered futures association or another registered entity, as such terms are defined under the Act, or any non-registered entity (collectively, "regulatory service providers"), for the provision of services to assist in complying with the Act and Commission regulations thereunder, as approved by the Commission. Any swap execution facility that chooses to contract with a regulatory service provider shall ensure that such provider has the capabilities and resources necessary to provide timely and effective regulatory services, including adequate staff and automated surveillance systems. A swap execution facility shall at all times remain responsible for the performance of any regulatory services received, for compliance with the swap execution facility's obligations under the Act and Commission regulations, and for the regulatory service provider's performance on its behalf.

(b) *Duty to supervise regulatory service provider.* A swap execution facility that elects to use the service of a regulatory service provider shall retain sufficient compliance staff and resources to supervise the quality and effectiveness of the regulatory services provided on its behalf. A swap execution facility shall determine the necessary processes for a swap execution facility to supervise such provider. Such processes shall include, at a minimum, the swap execution facility's involvement in all substantive decisions, such as decisions involving:

(1) The adjustment or cancellation of trades;

(2) Whether or not to issue disciplinary charges; and

(3) Denials of access to the swap execution facility for disciplinary reasons. Such decisions shall be documented as agreed upon by the swap execution facility and its regulatory service provider.

(c) *Delegation of authority.* The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, the authority to approve any regulatory service provider chosen by a swap execution facility for the provision of regulatory services. The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

§ 37.205 Audit trail.

(a) *Audit trail required.* A swap execution facility shall capture and retain all audit trail data necessary to reconstruct all trading on its facility, detect and investigate customer and market abuses, and take appropriate disciplinary action. An acceptable audit trail shall also permit the swap execution facility to track a customer order from the time of receipt through execution on the swap execution facility.

(b) *Elements of an acceptable audit trail program*—(1) *Original source documents.* A swap execution facility's audit trail shall include original source documents. Original source documents include unalterable, sequentially-identified records on which trade execution information is originally recorded, whether recorded manually or electronically.

(2) *Transaction history database.* A swap execution facility's audit trail program shall include an electronic transaction history database. An adequate transaction history

database includes a history of any trade executed by voice or by entry into a swap execution facility's electronic trading system or platform and any order entered into its electronic trading system or platform, including any order modification and cancellation.

(3) *Electronic analysis capability*. A swap execution facility's audit trail program shall include electronic analysis capability with respect to all audit trail data in the transaction history database. Such electronic analysis capability shall ensure that the swap execution facility has the ability to reconstruct any trade executed by voice or by entry into a swap execution facility's electronic trading system or platform and any order entered into its electronic trading system or platform, and identify possible trading violations with respect to both customer and market abuse.

(c) *Audit trail reconstruction*. A swap execution facility shall establish a program to verify its ability to comprehensively and accurately reconstruct all trading on its facility in a timely manner.

§ 37.206 Disciplinary procedures and sanctions.

(a) *Enforcement staff*. A swap execution facility shall establish and maintain sufficient enforcement staff and resources to effectively and promptly enforce possible rule violations within the disciplinary jurisdiction of the swap execution facility.

(b) *Disciplinary program*. A swap execution facility shall establish a disciplinary program to enforce its rules. A swap execution facility shall administer its disciplinary program through one or more disciplinary panels or its compliance staff. Notwithstanding the requirements of § 37.2, if a swap execution facility elects to administer its disciplinary program through its compliance staff, the requirements of § 1.64(c)(4) of this chapter shall not apply to such compliance staff. Any disciplinary

panel or appellate panel established by a swap execution facility shall meet the composition requirements of applicable Commission regulations, and shall not include any member of the swap execution facility's compliance staff or any person involved in adjudicating any other stage of the same proceeding.

(c) *Warning letters and sanctions.* (1) All warning letters and sanctions imposed by a swap execution facility or its disciplinary panels shall be commensurate with the violations committed and shall be clearly sufficient to deter recidivism or similar violations by other market participants. All such warning letters and sanctions (including summary fines and sanctions imposed pursuant to an accepted settlement offer) shall take into account the respondent's disciplinary history. In the event of demonstrated customer harm, any sanction shall also include full customer restitution, except where the amount of restitution or to whom it should be provided cannot be reasonably determined.

(2) A swap execution facility's compliance staff or disciplinary panel may not issue more than one warning letter to the same individual found to have committed the same rule violation within a rolling twelve-month period, except for rule violations related to minor recordkeeping or reporting infractions.

(d) *Additional sources for compliance.* A swap execution facility may refer to the guidance and/or acceptable practices in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.206.

Subpart D – Swaps Not Readily Susceptible to Manipulation

§ 37.300 Core Principle 3 – Swaps not readily susceptible to manipulation.

The swap execution facility shall permit trading only in swaps that are not readily susceptible to manipulation.

§ 37.301 General requirements.

To demonstrate to the Commission compliance with the requirements of § 37.300, a swap execution facility shall, at the time it submits a new swap contract in advance to the Commission pursuant to part 40 of this chapter, provide the applicable information as set forth in appendix C to this part, Demonstration of Compliance that a Swap Contract is Not Readily Susceptible to Manipulation.

Subpart E – Monitoring of Trading and Trade Processing

§ 37.400 Core Principle 4 – Monitoring of trading and trade processing.

The swap execution facility shall:

(a) Establish and enforce rules or terms and conditions defining, or specifications detailing:

(1) Trading procedures to be used in entering and executing orders traded on or through the facilities of the swap execution facility; and

(2) Procedures for trade processing of swaps on or through the facilities of the swap execution facility; and

(b) Monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.

§ 37.401 General requirements.

A swap execution facility shall:

(a) Conduct real-time market monitoring of all trading activity on the swap execution facility to identify disorderly trading, any market or system anomalies, and instances or threats of manipulation, price distortion, and disruption;

(b) Collect and evaluate data on its market participants' trading activity away from its facility, including trading in the index or instrument used as a reference price, the underlying commodity for its listed swaps, or in related derivatives markets, as necessary to detect and prevent manipulation, price distortion, and, where possible, disruptions of the physical-delivery or cash-settlement processes;

(c) Monitor and evaluate general market data as necessary to detect and prevent manipulative activity that would result in the failure of the market price to reflect the normal forces of supply and demand; and

(d) Have the ability to comprehensively and accurately reconstruct all trading activity on its facility for the purpose of detecting instances or threats of manipulation, price distortion, and disruptions.

§ 37.402 Additional requirements for physical-delivery swaps.

For a physical-delivery swap listed on the swap execution facility, the swap execution facility shall:

(a) Monitor the swap's terms and conditions as it relates to the underlying commodity market by reviewing the convergence between the swap's price and the price of the underlying commodity and make a good-faith effort to resolve conditions that are interfering with convergence or notify the Commission of such conditions; and

(b) Monitor the availability of the supply of the commodity specified by the delivery requirements of the swap and make a good-faith effort to resolve conditions that

threaten the adequacy of supplies or the delivery process or notify the Commission of such conditions.

§ 37.403 Additional requirements for cash-settled swaps.

(a) For cash-settled swaps listed on the swap execution facility where the reference price is formulated and computed by the swap execution facility, the swap execution facility shall monitor the continued appropriateness of its methodology for deriving that price and take appropriate action, including amending the methodology, where there is a threat of manipulation, price distortion, or market disruption.

(b) For cash-settled swaps listed on the swap execution facility where the reference price relies on a third-party index or instrument, the swap execution facility shall monitor the continued appropriateness of the index or instrument and take appropriate action, including selecting an alternate index or instrument for deriving the reference price, where there is a threat of manipulation, price distortion, or market disruption.

§ 37.404 Ability to obtain information.

(a) A swap execution facility shall maintain access to sufficient information to assess whether trading in swaps that it lists, in the index or instrument used as a reference price, or in the underlying commodity for its listed swaps is being used to affect prices on its market.

(b) A swap execution facility shall have rules that require its market participants to keep records of their trading, including records of their activity in the index or instrument used as a reference price, the underlying commodity, and related derivatives

markets, and make such records available, upon request, to the swap execution facility or, if applicable, to its regulatory service provider, and the Commission.

§ 37.405 Risk controls for trading.

The swap execution facility shall establish and maintain risk control mechanisms to prevent and reduce the potential risk of price distortions and market disruptions on its facility, including, but not limited to, market restrictions that pause or halt trading under market conditions prescribed by the swap execution facility.

§ 37.406 Regulatory service provider.

A swap execution facility shall comply with the regulations in this subpart through a dedicated regulatory department or by contracting with a regulatory service provider pursuant to § 37.204.

§ 37.407 Additional sources for compliance.

A swap execution facility may refer to the guidance and/or acceptable practices in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.400.

Subpart F – Ability to Obtain Information

§ 37.500 Core Principle 5 – Ability to obtain information.

The swap execution facility shall:

(a) Establish and enforce rules that will allow the facility to obtain any necessary information to perform any of the functions described in section 5h of the Act;

(b) Provide the information to the Commission on request; and

(c) Have the capacity to carry out such international information-sharing agreements as the Commission may require.

§ 37.501 Establish and enforce rules.

A swap execution facility shall establish and enforce rules that will allow the swap execution facility to have the ability and authority to obtain sufficient information to allow it to fully perform its operational, risk management, governance, and regulatory functions and any requirements under this part.

§ 37.502 Provide information to the Commission.

A swap execution facility shall provide information in its possession to the Commission upon request, in a form and manner that the Commission approves.

§ 37.503 Information-sharing.

A swap execution facility shall share information as required by the Commission or as appropriate to fulfill its self-regulatory and reporting responsibilities. Appropriate information-sharing agreements can be established or the Commission can act in conjunction with the swap execution facility to carry out such information sharing.

§ 37.504 Prohibited use of data collected for regulatory purposes.

A swap execution facility shall not use for business or marketing purposes, nor permit such use of, any proprietary data or personal information it collects or receives, from or on behalf of any person, for the purpose of fulfilling its regulatory obligations; *provided, however,* that a swap execution facility may use or permit the use of such data or information for business or marketing purposes if the person from whom it collects or receives such data or information clearly consents to the use of such data or information in such manner. A swap execution facility shall not condition access to its markets or market services on a person's consent to the swap execution facility's use of proprietary data or personal information for business or marketing purposes.

Subpart G – Position Limits or Accountability

§ 37.600 Core Principle 6 – Position limits or accountability.

(a) *In general.* To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, a swap execution facility that is a trading facility shall adopt for each of the contracts of the facility, as is necessary and appropriate, position limitations or position accountability for speculators.

(b) *Position limits.* For any contract that is subject to a position limitation established by the Commission pursuant to section 4a(a) of the Act, the swap execution facility shall:

(1) Set its position limitation at a level no higher than the Commission limitation; and

(2) Monitor positions established on or through the swap execution facility for compliance with the limit set by the Commission and the limit, if any, set by the swap execution facility.

§ 37.601 [Reserved]

Subpart H – Financial Integrity of Transactions

§ 37.700 Core Principle 7 – Financial integrity of transactions.

The swap execution facility shall establish and enforce rules and procedures for ensuring the financial integrity of swaps entered on or through the facilities of the swap execution facility, including the clearance and settlement of the swaps pursuant to section 2(h)(1) of the Act.

§ 37.701 Required clearing.

(a) Transactions executed on the swap execution facility that are required to be cleared under section 2(h)(1)(A) of the Act or are voluntarily cleared by the counterparties shall be cleared through a Commission-registered derivatives clearing organization, or a derivatives clearing organization that the Commission has determined is exempt from registration.

(b) A swap execution facility shall have an independent clearing agreement with each Commission-registered derivatives clearing organization, or derivatives clearing organization that the Commission has determined is exempt from registration, to which the swap execution facility submits a swap for clearing.

§ 37.702 General financial integrity.

A swap execution facility shall provide for the financial integrity of its transactions:

(a) By establishing minimum financial standards for its market participants, which shall, at a minimum, require that each market participant qualifies as an eligible contract participant as defined in section 1a(18) of the Act;

(b) For transactions routed through a swap execution facility to a registered derivatives clearing organization for clearing:

(1) By coordinating with each registered derivatives clearing organization to which the swap execution facility submits transactions for clearing, in the development of rules and procedures to facilitate prompt, efficient, and accurate processing and routing of transactions to registered derivatives clearing organizations in accordance with the requirements of § 39.12(b)(7)(i)(A) of this chapter;

(2) By requiring that each market participant identify a clearing member in advance for each counterparty on an order-by-order basis; and

(3) By facilitating pre-execution screening by each clearing futures commission merchant in accordance with the requirements of § 1.73 of this chapter on an order-by-order basis.

§ 37.703 Monitoring for financial soundness.

A swap execution facility shall monitor its market participants to ensure that they continue to qualify as eligible contract participants as defined in section 1a(18) of the Act.

Subpart I – Emergency Authority

§ 37.800 Core Principle 8 – Emergency authority.

The swap execution facility shall adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, as is necessary and appropriate, including the authority to liquidate or transfer open positions in any swap or to suspend or curtail trading in a swap.

§ 37.801 Additional sources for compliance.

A swap execution facility may refer to the guidance and/or acceptable practices in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.800.

Subpart J – Timely Publication of Trading Information

§ 37.900 Core Principle 9 – Timely publication of trading information.

(a) *In general.* The swap execution facility shall make public timely information on price, trading volume, and other trading data on swaps to the extent prescribed by the Commission.

(b) *Capacity of swap execution facility.* The swap execution facility shall be required to have the capacity to electronically capture and transmit trade information with respect to transactions executed on the facility.

§ 37.901 General requirements.

With respect to swaps traded on or through a swap execution facility, each swap execution facility shall:

(a) Report specified swap data as provided under parts 43 and 45 of this chapter; and

(b) Meet the requirements of part 16 of this chapter.

Subpart K – Recordkeeping and Reporting

§ 37.1000 Core Principle 10 – Recordkeeping and reporting.

(a) *In general.* A swap execution facility shall:

(1) 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 Commission for a period of five years;

(2) Report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines to be necessary or appropriate for the Commission to perform the duties of the Commission under the Act; and

(3) Keep any such records relating to swaps defined in section 1a(47)(A)(v) of the Act open to inspection and examination by the Securities and Exchange Commission.

(b) *Requirements.* The Commission shall adopt data collection and reporting requirements for swap execution facilities that are comparable to corresponding requirements for derivatives clearing organizations and swap data repositories.

§ 37.1001 Recordkeeping.

A swap execution facility shall maintain records of all activities relating to the business of the facility, in a form and manner acceptable to the Commission, for a period of at least five years. A swap execution facility shall maintain such records, including a complete audit trail for all swaps executed on the swap execution facility, investigatory files, and disciplinary files, in accordance with the requirements of § 1.31 and part 45 of this chapter.

Subpart L – Antitrust Considerations

§ 37.1100 Core Principle 11 – Antitrust considerations.

Unless necessary or appropriate to achieve the purposes of the Act, the swap execution facility shall not:

(a) Adopt any rules or take any actions that result in any unreasonable restraint of trade; or

(b) Impose any material anticompetitive burden on trading or clearing.

§ 37.1101 Additional sources for compliance.

A swap execution facility may refer to the guidance and/or acceptable practices in appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.1100.

Subpart M – Conflicts of Interest

§ 37.1200 Core Principle 12 – Conflicts of interest.

The swap execution facility shall:

(a) Establish and enforce rules to minimize conflicts of interest in its decision-making process; and

(b) Establish a process for resolving the conflicts of interest.

§ 37.1201 [Reserved]

Subpart N – Financial Resources

§ 37.1300 Core Principle 13 – Financial resources.

(a) *In general.* The swap execution facility shall have adequate financial, operational, and managerial resources to discharge each responsibility of the swap execution facility.

(b) *Determination of resource adequacy.* The financial resources of a swap execution facility shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the swap execution facility to cover the operating costs of the swap execution facility for a one-year period, as calculated on a rolling basis.

§ 37.1301 General requirements.

(a) A swap execution facility shall maintain financial resources on an ongoing basis that are adequate to enable it to comply with the core principles set forth in section 5h of the Act and any applicable Commission regulations. Financial resources shall be considered adequate if their value exceeds the total amount that would enable the swap execution facility to cover its projected operating costs necessary for the swap execution

facility to comply with section 5h of the Act and applicable Commission regulations for a one–year period, as calculated on a rolling basis pursuant to § 37.1304.

(b) An entity that operates as both a swap execution facility and a derivatives clearing organization shall also comply with the financial resource requirements of § 39.11 of this chapter. In lieu of filing separate reports under § 37.1306(a) and § 39.11(f) of this chapter, such an entity may file a single report in accordance with § 39.11 of this chapter.

§ 37.1302 Types of financial resources.

Financial resources available to satisfy the requirements of § 37.1301 may include:

(a) The swap execution facility's own capital, meaning its assets minus its liabilities calculated in accordance with generally accepted accounting principles in the United States; and

(b) Any other financial resource deemed acceptable by the Commission.

§ 37.1303 Liquidity of financial resources.

The financial resources allocated by the swap execution facility to meet the ongoing requirements of § 37.1301 shall include unencumbered, liquid financial assets (*i.e.*, cash and/or highly liquid securities) equal to at least the greater of three months of projected operating costs, as calculated on a rolling basis, or the projected costs needed to wind down the swap execution facility's operations, in each case as determined under § 37.1304. If a swap execution facility lacks sufficient unencumbered, liquid financial assets to satisfy its obligations under this section, the swap execution facility may satisfy

this requirement by obtaining a committed line of credit or similar facility in an amount at least equal to such deficiency.

§ 37.1304 Computation of costs to meet financial resources requirement.

A swap execution facility shall each fiscal quarter, make a reasonable calculation of its projected operating costs and wind-down costs in order to determine its applicable obligations under § 37.1301 and § 37.1303. The swap execution facility shall have reasonable discretion in determining the methodologies used to compute such amounts. The Commission may review the methodologies and require changes as appropriate.

§ 37.1305 Valuation of financial resources.

No less than each fiscal quarter, a swap execution facility shall compute the current market value of each financial resource used to meet its obligations under § 37.1301 and § 37.1303. Reductions in value to reflect market and credit risk ("haircuts") shall be applied as appropriate.

§ 37.1306 Reporting to the Commission.

(a) Each fiscal quarter, or at any time upon Commission request, a swap execution facility shall provide a report to the Commission that includes:

(1) The amount of financial resources necessary to meet the requirements of § 37.1301 and § 37.1303, computed in accordance with the requirements of § 37.1304, and the market value of each available financial resource, computed in accordance with the requirements of § 37.1305; and

(2) Financial statements, including the balance sheet, income statement, and statement of cash flows of the swap execution facility.

(i) The financial statements shall be prepared in accordance with generally accepted accounting principles in the United States, prepared in English, and denominated in U.S. dollars.

(ii) The financial statements of a swap execution facility that is not domiciled in the United States, and is not otherwise required to prepare financial statements in accordance with generally accepted accounting principles in the United States, may satisfy the requirement in paragraph (a)(2)(i) of this section if such financial statements are prepared in accordance with either International Financial Reporting Standards issued by the International Accounting Standards Board, or a comparable international standard as the Commission may otherwise accept in its discretion.

(b) The calculations required by paragraph (a) of this section shall be made as of the last business day of the swap execution facility's applicable fiscal quarter.

(c) With each report required under paragraph (a) of this section, the swap execution facility shall also provide the Commission with sufficient documentation explaining the methodology used to compute its financial requirements under § 37.1301 and § 37.1303. Such documentation shall:

(1) Allow the Commission to reliably determine, without additional requests for information, that the swap execution facility has made reasonable calculations pursuant to § 37.1304; and

(2) Include, at a minimum:

(i) A total list of all expenses, without any exclusion;

(ii) All expenses and the corresponding amounts, if any, that the swap execution facility excluded or pro-rated when determining its operating costs, calculated on a

rolling basis, required under § 37.1301 and § 37.1303, and the basis for any determination to exclude or pro-rate any such expenses;

(iii) Documentation demonstrating the existence of any committed line of credit or similar facility relied upon for the purpose of meeting the requirements of § 37.1303 (*e.g.*, copies of agreements establishing or amending a credit facility or similar facility); and

(iv) All costs that a swap execution facility would incur to wind down the swap execution facility's operations, the projected amount of time for any such wind-down period, and the basis of its determination for the estimation of its costs and timing.

(d) The reports and supporting documentation required by this section shall be filed not later than 40 calendar days after the end of the swap execution facility's first three fiscal quarters, and not later than 90 calendar days after the end of the swap execution facility's fourth fiscal quarter, or at such later time as the Commission may permit, in its discretion, upon request by the swap execution facility.

(e) A swap execution facility shall provide notice to the Commission no later than 48 hours after it knows or reasonably should have known that it no longer meets its obligations under § 37.1301 or § 37.1303.

§ 37.1307 Delegation of authority.

(a) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, authority to:

(1) Determine whether a particular financial resource under § 37.1302 may be used to satisfy the requirements of § 37.1301;

(2) Review and make changes to the methodology used to compute projected operating costs and wind-down costs under § 37.1304 and the valuation of financial resources under § 37.1305;

(3) Request reports, in addition to those required in § 37.1306, or additional documentation or information under § 37.1306(a), (c), and (e); and

(4) Grant an extension of time to file fiscal quarter reports under § 37.1306(d).

(b) The Director may submit to the Commission for its consideration any matter that has been delegated in this section. Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

Subpart O – System Safeguards

§ 37.1400 Core Principle 14 – System safeguards.

The swap execution facility shall:

(a) Establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk, through the development of appropriate controls and procedures, and automated systems, that:

(1) Are reliable and secure; and

(2) Have adequate scalable capacity;

(b) Establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for:

(1) The timely recovery and resumption of operations; and

(2) The fulfillment of the responsibilities and obligations of the swap execution facility; and

(c) Periodically conduct tests to verify that the backup resources of the swap execution facility are sufficient to ensure continued:

(1) Order processing and trade matching;

(2) Price reporting;

(3) Market surveillance; and

(4) Maintenance of a comprehensive and accurate audit trail.

§ 37.1401 Requirements.

(a) A swap execution facility's program of risk analysis and oversight with respect to its operations and automated systems shall address each of the following categories of risk analysis and oversight:

(1) *Enterprise risk management and governance.* This category includes, but is not limited to: Assessment, mitigation, and monitoring of security and technology risk; security and technology capital planning and investment; board of directors and management oversight of technology and security; information technology audit and controls assessments; remediation of deficiencies; and any other elements of enterprise risk management and governance included in generally accepted best practices;

(2) *Information security.* This category includes, but is not limited to, controls relating to: Access to systems and data (including least privilege, separation of duties, account monitoring and control); user and device identification and authentication; security awareness training; audit log maintenance, monitoring, and analysis; media protection; personnel security and screening; automated system and communications protection (including network port control, boundary defenses, encryption); system and information integrity (including malware defenses, software integrity monitoring);

vulnerability management; penetration testing; security incident response and management; and any other elements of information security included in generally accepted best practices;

(3) *Business continuity-disaster recovery planning and resources*. This category includes, but is not limited to: Regular, periodic testing and review of business continuity-disaster recovery capabilities, the controls and capabilities described in paragraphs (c), (d), and (k) of this section; and any other elements of business continuity-disaster recovery planning and resources included in generally accepted best practices;

(4) *Capacity and performance planning*. This category includes, but is not limited to: Controls for monitoring the swap execution facility's systems to ensure adequate scalable capacity (including testing, monitoring, and analysis of current and projected future capacity and performance, and of possible capacity degradation due to planned automated system changes); and any other elements of capacity and performance planning included in generally accepted best practices;

(5) *Systems operations*. This category includes, but is not limited to: System maintenance; configuration management (including baseline configuration, configuration change and patch management, least functionality, inventory of authorized and unauthorized devices and software); event and problem response and management; and any other elements of system operations included in generally accepted best practices;

(6) *Systems development and quality assurance*. This category includes, but is not limited to: Requirements development; pre-production and regression testing; change management procedures and approvals; outsourcing and vendor management; training in

secure coding practices; and any other elements of systems development and quality assurance included in generally accepted best practices; and

(7) *Physical security and environmental controls.* This category includes, but is not limited to: Physical access and monitoring; power, telecommunication, and environmental controls; fire protection; and any other elements of physical security and environmental controls included in generally accepted best practices.

(b) In addressing the categories of risk analysis and oversight required under paragraph (a) of this section, a swap execution facility shall follow generally accepted standards and best practices with respect to the development, operation, reliability, security, and capacity of automated systems.

(c) A swap execution facility shall maintain a business continuity-disaster recovery plan and business continuity-disaster recovery resources, emergency procedures, and backup facilities sufficient to enable timely recovery and resumption of its operations and resumption of its ongoing fulfillment of its responsibilities and obligations as a swap execution facility following any disruption of its operations. Such responsibilities and obligations include, without limitation: Order processing and trade matching; transmission of matched orders to a derivatives clearing organization for clearing, where appropriate; price reporting; market surveillance; and maintenance of a comprehensive audit trail protected from alteration, accidental erasure, or other loss. A swap execution facility's business continuity-disaster recovery plan and resources generally should enable resumption of trading and clearing of swaps executed on the swap execution facility during the next business day following the disruption. A swap execution facility shall update its business continuity-disaster recovery plan and

emergency procedures at a frequency determined by an appropriate risk analysis, but at a minimum no less frequently than annually.

(d) A swap execution facility satisfies the requirement to be able to resume its operations and resume its ongoing fulfillment of its responsibilities and obligations during the next business day following any disruption of its operations by maintaining either:

(1) Infrastructure and personnel resources of its own that are sufficient to ensure timely recovery and resumption of its operations and resumption of its ongoing fulfillment of its responsibilities and obligations as a swap execution facility following any disruption of its operations; or

(2) Contractual arrangements with other swap execution facilities or disaster recovery service providers, as appropriate, that are sufficient to ensure continued trading and clearing of swaps executed on the swap execution facility, and ongoing fulfillment of all of the swap execution facility's responsibilities and obligations with respect to such swaps, in the event that a disruption renders the swap execution facility temporarily or permanently unable to satisfy this requirement on its own behalf.

(e) A swap execution facility shall notify Commission staff promptly of all:

(1) Electronic trading halts and material system malfunctions;

(2) Cyber security incidents or targeted threats that actually or potentially jeopardize automated system operation, reliability, security, or capacity; and

(3) Activations of the swap execution facility's business continuity-disaster recovery plan.

(f) A swap execution facility shall provide Commission staff timely advance notice of all material:

(1) Planned changes to automated systems that may impact the reliability, security, or adequate scalable capacity of such systems; and

(2) Planned changes to the swap execution facility's program of risk analysis and oversight.

(g) A swap execution facility shall annually prepare and submit to the Commission an up-to-date Exhibit Q to Form SEF—Program of Risk Analysis and Oversight Technology Questionnaire—in appendix A to this part. The annual filing shall be submitted electronically to the Commission not later than 90 calendar days after the end of the swap execution facility's fiscal year. The swap execution facility shall file Exhibit Q with the annual financial report and the annual compliance report pursuant to § 37.1306(d) and § 37.1501(e)(2), respectively.

(h) As part of a swap execution facility's obligation to produce books and records in accordance with § 1.31 of this chapter, Core Principle 10 (Recordkeeping and Reporting), and § 37.1000 and § 37.1001, a swap execution facility shall provide to the Commission the following system safeguards-related books and records, promptly upon the request of any Commission representative:

(1) Current copies of its business continuity-disaster recovery plans and other emergency procedures;

(2) All assessments of its operational risks or system safeguards-related controls;

(3) All reports concerning system safeguards testing and assessment required by this chapter, whether performed by independent contractors or by employees of the swap execution facility; and

(4) All other books and records requested by Commission staff in connection with Commission oversight of system safeguards pursuant to the Act or Commission regulations, or in connection with Commission maintenance of a current profile of the swap execution facility's automated systems.

(5) Nothing in this paragraph (h) shall be interpreted as reducing or limiting in any way a swap execution facility's obligation to comply with § 1.31 of this chapter, Core Principle 10 (Recordkeeping and Reporting), or § 37.1000 or § 37.1001.

(i) A swap execution facility shall conduct regular, periodic, objective testing and review of its automated systems to ensure that they are reliable, secure, and have adequate scalable capacity. It shall also conduct regular, periodic testing and review of its business continuity-disaster recovery capabilities. Such testing and review shall include, without limitation, all of the types of testing set forth in this paragraph (i).

(1) *Definitions.* As used in paragraph (i):

Controls means the safeguards or countermeasures employed by the swap execution facility in order to protect the reliability, security, or capacity of its automated systems or the confidentiality, integrity, and availability of its data and information, and in order to enable the swap execution facility to fulfill its statutory and regulatory responsibilities.

Controls testing means assessment of the swap execution facility's controls to determine whether such controls are implemented correctly, are operating as intended,

and are enabling the swap execution facility to meet the requirements established by this section.

Enterprise technology risk assessment means a written assessment that includes, but is not limited to, an analysis of threats and vulnerabilities in the context of mitigating controls. An enterprise technology risk assessment identifies, estimates, and prioritizes risks to swap execution facility operations or assets, or to market participants, individuals, or other entities, resulting from impairment of the confidentiality, integrity, and availability of data and information or the reliability, security, or capacity of automated systems.

External penetration testing means attempts to penetrate the swap execution facility's automated systems from outside the systems' boundaries to identify and exploit vulnerabilities. Methods of conducting external penetration testing include, but are not limited to, methods for circumventing the security features of an automated system.

Internal penetration testing means attempts to penetrate the swap execution facility's automated systems from inside the systems' boundaries, to identify and exploit vulnerabilities. Methods of conducting internal penetration testing include, but are not limited to, methods for circumventing the security features of an automated system.

Key controls means those controls that an appropriate risk analysis determines are either critically important for effective system safeguards or intended to address risks that evolve or change more frequently and therefore require more frequent review to ensure their continuing effectiveness in addressing such risks.

Security incident means a cyber security or physical security event that actually jeopardizes or has a significant likelihood of jeopardizing automated system operation, reliability, security, or capacity, or the availability, confidentiality or integrity of data.

Security incident response plan means a written plan documenting the swap execution facility's policies, controls, procedures, and resources for identifying, responding to, mitigating, and recovering from security incidents, and the roles and responsibilities of its management, staff and independent contractors in responding to security incidents. A security incident response plan may be a separate document or a business continuity-disaster recovery plan section or appendix dedicated to security incident response.

Security incident response plan testing means testing of a swap execution facility's security incident response plan to determine the plan's effectiveness, identify its potential weaknesses or deficiencies, enable regular plan updating and improvement, and maintain organizational preparedness and resiliency with respect to security incidents. Methods of conducting security incident response plan testing may include, but are not limited to, checklist completion, walk-through or table-top exercises, simulations, and comprehensive exercises.

Vulnerability testing means testing of a swap execution facility's automated systems to determine what information may be discoverable through a reconnaissance analysis of those systems and what vulnerabilities may be present on those systems.

(2) *Vulnerability testing.* A swap execution facility shall conduct vulnerability testing of a scope sufficient to satisfy the requirements set forth in paragraph (k) of this section.

(i) A swap execution facility shall conduct such vulnerability testing at a frequency determined by an appropriate risk analysis.

(ii) Such vulnerability testing shall include automated vulnerability scanning, which shall follow generally accepted best practices.

(iii) A swap execution facility shall conduct vulnerability testing by engaging independent contractors or by using employees of the swap execution facility who are not responsible for development or operation of the systems or capabilities being tested.

(3) *External penetration testing.* A swap execution facility shall conduct external penetration testing of a scope sufficient to satisfy the requirements set forth in paragraph (k) of this section.

(i) A swap execution facility shall conduct such external penetration testing at a frequency determined by an appropriate risk analysis.

(ii) A swap execution facility shall conduct external penetration testing by engaging independent contractors or by using employees of the swap execution facility who are not responsible for development or operation of the systems or capabilities being tested.

(4) *Internal penetration testing.* A swap execution facility shall conduct internal penetration testing of a scope sufficient to satisfy the requirements set forth in paragraph (k) of this section.

(i) A swap execution facility shall conduct such internal penetration testing at a frequency determined by an appropriate risk analysis.

(ii) A swap execution facility shall conduct internal penetration testing by engaging independent contractors or by using employees of the swap execution facility

who are not responsible for development or operation of the systems or capabilities being tested.

(5) *Controls testing.* A swap execution facility shall conduct controls testing of a scope sufficient to satisfy the requirements set forth in paragraph (k) of this section.

(i) A swap execution facility shall conduct controls testing, which includes testing of each control included in its program of risk analysis and oversight, at a frequency determined by an appropriate risk analysis. Such testing may be conducted on a rolling basis.

(ii) A swap execution facility shall conduct controls testing by engaging independent contractors or by using employees of the swap execution facility who are not responsible for development or operation of the systems or capabilities being tested.

(6) *Security incident response plan testing.* A swap execution facility shall conduct security incident response plan testing sufficient to satisfy the requirements set forth in paragraph (k) of this section.

(i) A swap execution facility shall conduct such security incident response plan testing at a frequency determined by an appropriate risk analysis.

(ii) A swap execution facility's security incident response plan shall include, without limitation, the swap execution facility's definition and classification of security incidents, its policies and procedures for reporting security incidents and for internal and external communication and information sharing regarding security incidents, and the hand-off and escalation points in its security incident response process.

(iii) A swap execution facility may coordinate its security incident response plan testing with other testing required by this section or with testing of its other business continuity-disaster recovery and crisis management plans.

(iv) A swap execution facility may conduct security incident response plan testing by engaging independent contractors or by using employees of the swap execution facility.

(7) *Enterprise technology risk assessment*. A swap execution facility shall conduct enterprise technology risk assessment of a scope sufficient to satisfy the requirements set forth in paragraph (k) of this section.

(i) A swap execution facility shall conduct enterprise technology risk assessment at a frequency determined by an appropriate risk analysis. A swap execution facility that has conducted an enterprise technology risk assessment that complies with this section may conduct subsequent assessments by updating the previous assessment.

(ii) A swap execution facility may conduct enterprise technology risk assessments by using independent contractors or employees of the swap execution facility who are not responsible for development or operation of the systems or capabilities being assessed.

(j) To the extent practicable, a swap execution facility shall:

(1) Coordinate its business continuity-disaster recovery plan with those of the market participants it depends upon to provide liquidity, in a manner adequate to enable effective resumption of activity in its markets following a disruption causing activation of the swap execution facility's business continuity-disaster recovery plan;

(2) Initiate and coordinate periodic, synchronized testing of its business continuity-disaster recovery plan with those of the market participants it depends upon to provide liquidity; and

(3) Ensure that its business continuity-disaster recovery plan takes into account the business continuity-disaster recovery plans of its telecommunications, power, water, and other essential service providers.

(k) *Scope of testing and assessment*. The scope for all system safeguards testing and assessment required by this part shall be broad enough to include the testing of automated systems and controls that the swap execution facility's required program of risk analysis and oversight and its current cybersecurity threat analysis indicate is necessary to identify risks and vulnerabilities that could enable an intruder or unauthorized user or insider to:

(1) Interfere with the swap execution facility's operations or with fulfillment of its statutory and regulatory responsibilities;

(2) Impair or degrade the reliability, security, or adequate scalable capacity of the swap execution facility's automated systems;

(3) Add to, delete, modify, exfiltrate, or compromise the integrity of any data related to the swap execution facility's regulated activities; or

(4) Undertake any other unauthorized action affecting the swap execution facility's regulated activities or the hardware or software used in connection with those activities.

(l) *Internal reporting and review*. Both the senior management and the Board of Directors of a swap execution facility shall receive and review reports setting forth the

results of the testing and assessment required by this section. A swap execution facility shall establish and follow appropriate procedures for the remediation of issues identified through such review, as provided in paragraph (m) of this section, and for evaluation of the effectiveness of testing and assessment protocols.

(m) *Remediation.* A swap execution facility shall identify and document the vulnerabilities and deficiencies in its systems revealed by the testing and assessment required by this section. The swap execution facility shall conduct and document an appropriate analysis of the risks presented by such vulnerabilities and deficiencies, to determine and document whether to remediate or accept the associated risk. When the swap execution facility determines to remediate a vulnerability or deficiency, it must remediate in a timely manner given the nature and magnitude of the associated risk.

Subpart P – Designation of Chief Compliance Officer

§ 37.1500 Core Principle 15 – Designation of chief compliance officer.

(a) *In general.* Each swap execution facility shall designate an individual to serve as a chief compliance officer.

(b) *Duties.* The chief compliance officer shall:

(1) Report directly to the board or to the senior officer of the facility;

(2) Review compliance with the core principles in this subsection;

(3) In consultation with the board of the facility, a body performing a function similar to that of a board, or the senior officer of the facility, resolve any conflicts of interest that may arise;

(4) Be responsible for establishing and administering the policies and procedures required to be established pursuant to this section;

(5) Ensure compliance with the Act and the rules and regulations issued under the Act, including rules prescribed by the Commission pursuant to section 5h of the Act; and

(6) Establish procedures for the remediation of noncompliance issues found during compliance office reviews, look backs, internal or external audit findings, self-reported errors, or through validated complaints.

(c) *Requirements for procedures.* In establishing procedures under paragraph (b)(6) of this section, the chief compliance officer shall design the procedures to establish the handling, management response, remediation, retesting, and closing of noncompliance issues.

(d) *Annual reports*—(1) *In general.* In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of:

(i) The compliance of the swap execution facility with the Act; and

(ii) The policies and procedures, including the code of ethics and conflict of interest policies, of the swap execution facility.

(2) *Requirements.* The chief compliance officer shall:

(i) Submit each report described in paragraph (d)(1) of this section with the appropriate financial report of the swap execution facility that is required to be submitted to the Commission pursuant to section 5h of the Act; and

(ii) Include in the report a certification that, under penalty of law, the report is accurate and complete.

§ 37.1501 Chief compliance officer.

(a) *Definitions.* For purposes of this part, the term—

Board of directors means the board of directors of a swap execution facility, or for those swap execution facilities whose organizational structure does not include a board of directors, a body performing a function similar to a board of directors.

Senior officer means the chief executive officer or other equivalent officer of the swap execution facility.

(b) *Chief compliance officer*—(1) *Authority of chief compliance officer.* (i) The position of chief compliance officer shall carry with it the authority and resources to develop, in consultation with the board of directors or senior officer, the policies and procedures of the swap execution facility and enforce such policies and procedures to fulfill the duties set forth for chief compliance officers in the Act and Commission regulations.

(ii) The chief compliance officer shall have supervisory authority over all staff acting at the direction of the chief compliance officer.

(2) *Qualifications of chief compliance officer.* (i) The individual designated to serve as chief compliance officer shall have the background and skills appropriate for fulfilling the responsibilities of the position.

(ii) No individual disqualified from registration pursuant to sections 8a(2) or 8a(3) of the Act may serve as a chief compliance officer.

(3) *Appointment and removal of chief compliance officer.* (i) Only the board of directors or the senior officer may appoint or remove the chief compliance officer.

(ii) The swap execution facility shall notify the Commission within two business days of the appointment or removal, whether interim or permanent, of a chief compliance officer.

(4) *Compensation of the chief compliance officer.* The board of directors or the senior officer shall approve the compensation of the chief compliance officer.

(5) *Annual meeting with the chief compliance officer.* The chief compliance officer shall meet with the board of directors or senior officer of the swap execution facility at least annually.

(6) *Information requested of the chief compliance officer.* The chief compliance officer shall provide any information regarding the self-regulatory program of the swap execution facility as requested by the board of directors or the senior officer.

(c) *Duties of chief compliance officer.* The duties of the chief compliance officer shall include, but are not limited to, the following:

(1) Overseeing and reviewing compliance of the swap execution facility with section 5h of the Act and any related rules adopted by the Commission;

(2) Taking reasonable steps, in consultation with the board of directors or the senior officer of the swap execution facility, to resolve any material conflicts of interest that may arise;

(3) Establishing and administering written policies and procedures reasonably designed to prevent violations of the Act and the rules of the Commission;

(4) Taking reasonable steps to ensure compliance with the Act and the rules of the Commission;

(5) Establishing procedures reasonably designed to handle, respond, remediate, retest, and resolve noncompliance issues identified by the chief compliance officer through any means, including any compliance office review, look-back, internal or external audit finding, self-reported error, or validated complaint;

(6) Establishing and administering a compliance manual designed to promote compliance with the applicable laws, rules, and regulations and a written code of ethics for the swap execution facility designed to prevent ethical violations and to promote honesty and ethical conduct by personnel of the swap execution facility;

(7) Supervising the self-regulatory program of the swap execution facility with respect to trade practice surveillance; market surveillance; real-time market monitoring; compliance with audit trail requirements; enforcement and disciplinary proceedings; audits, examinations, and other regulatory responsibilities (including taking reasonable steps to ensure compliance with, if applicable, financial integrity, financial reporting, sales practice, recordkeeping, and other requirements); and

(8) Supervising the effectiveness and sufficiency of any regulatory services provided to the swap execution facility by a regulatory service provider in accordance with § 37.204.

(d) *Preparation of annual compliance report*. The chief compliance officer shall, not less than annually, prepare and sign an annual compliance report that covers the prior fiscal year. The report shall, at a minimum, contain:

(1) A description and self-assessment of the effectiveness of the written policies and procedures of the swap execution facility, including the code of ethics and conflict of interest policies to reasonably ensure compliance with the Act and applicable Commission regulations;

(2) Any material changes made to compliance policies and procedures during the coverage period for the report and any areas of improvement or recommended changes to the compliance program;

(3) A description of the financial, managerial, and operational resources set aside for compliance with the Act and applicable Commission regulations;

(4) Any material non-compliance matters identified and an explanation of the corresponding action taken to resolve such non-compliance matters; and

(5) A certification by the chief compliance officer that, to the best of his or her knowledge and reasonable belief, and under penalty of law, the annual compliance report is accurate and complete in all material respects.

(e) *Submission of annual compliance report and related matters*—(1) *Furnishing the annual compliance report prior to submission to the Commission.* Prior to submission to the Commission, the chief compliance officer shall provide the annual compliance report for review to the board of directors of the swap execution facility or, in the absence of a board of directors, to the senior officer of the swap execution facility. Members of the board of directors and the senior officer shall not require the chief compliance officer to make any changes to the report.

(2) *Submission of annual compliance report to the Commission.* The annual compliance report shall be submitted electronically to the Commission not later than 90 calendar days after the end of the swap execution facility's fiscal year. The swap execution facility shall concurrently file the annual compliance report with the fourth quarter financial report pursuant to § 37.1306.

(3) *Amendments to annual compliance report*. (i) Promptly upon discovery of any material error or omission made in a previously filed annual compliance report, the chief compliance officer shall file an amendment with the Commission to correct the material error or omission. The chief compliance officer shall submit the amended

annual compliance report to the board of directors, or in the absence of a board of directors, to the senior officer of the swap execution facility, pursuant to paragraph (e)(1) of this section.

(ii) An amendment shall contain the certification required under paragraph (d)(5) of this section.

(4) *Request for extension.* A swap execution facility may request an extension of time to file its annual compliance report from the Commission. Reasonable and valid requests for extensions of the filing deadline may be granted at the discretion of the Commission.

(f) *Recordkeeping.* The swap execution facility shall maintain all records demonstrating compliance with the duties of the chief compliance officer and the preparation and submission of annual compliance reports consistent with §§ 37.1000 and 37.1001.

(g) *Delegation of authority.* The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, the authority to grant or deny a request for an extension of time for a swap execution facility to file its annual compliance report under paragraph (e)(4) of this section. The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

Appendix A to Part 37 – Form SEF

COMMODITY FUTURES TRADING COMMISSION

FORM SEF

SWAP EXECUTION FACILITY
APPLICATION OR AMENDMENT TO APPLICATION FOR REGISTRATION

REGISTRATION INSTRUCTIONS

Intentional misstatements or omissions of material fact may constitute federal criminal violations (7 U.S.C. 13 and 18 U.S.C. 1001) or grounds for disqualification from registration.

DEFINITIONS

Unless the context requires otherwise, all terms used in this Form SEF have the same meaning as in the Commodity Exchange Act, as amended ("Act"), and in the General Rules and Regulations of the Commodity Futures Trading Commission ("Commission") thereunder (17 CFR chapter I).

For the purposes of this Form SEF, the term "Applicant" shall include any applicant for registration as a swap execution facility or any applicant amending a pending application.

GENERAL INSTRUCTIONS

1. This Form SEF, which includes instructions, a Cover Sheet, and required Exhibits (together, "Form SEF"), is to be filed with the Commission by all Applicants, pursuant to section 5h of the Act and the Commission's regulations thereunder. Applicants may prepare their own Form SEF, but must follow the format prescribed herein. Upon the filing of an application for registration in accordance with the instructions provided herein, the Commission will publish notice of the filing and afford interested persons an opportunity to submit written comments concerning such application. No application for registration shall be effective unless the Commission, by order, grants such registration.

2. Individuals' names, except the executing signature, shall be given in full (Last Name, First Name, Middle Name).

3. Signatures on all copies of the Form SEF filed with the Commission can be executed electronically. If this Form SEF is filed by a corporation, it shall be signed in the name of the corporation by a principal officer duly authorized; if filed by a limited liability company, it shall be signed in the name of the limited liability company by a manager or member duly authorized to sign on the limited liability company's behalf; if filed by a partnership, it shall be signed in the name of the partnership by a general partner duly authorized; if filed by an unincorporated organization or association which is not a partnership, it shall be signed in the name of such organization or

association by the managing agent, *i.e.*, a duly authorized person who directs or manages or who participates in the directing or managing of its affairs.

4. If this Form SEF is being filed as an application for registration, all applicable items must be answered in full. If any item is inapplicable, indicate by "none," "not applicable," or "N/A," as appropriate.

5. Under section 5h of the Act and the Commission's regulations thereunder, the Commission is authorized to solicit the information required to be supplied by this Form SEF from any Applicant seeking registration as a swap execution facility. Disclosure by the Applicant of the information specified in this Form SEF is mandatory prior to the start of the processing of an application for registration as a swap execution facility. The information provided in this Form SEF will be used for the principal purpose of determining whether the Commission should grant or deny registration to an Applicant. The Commission may determine that additional information is required from an Applicant in order to process its application. **A Form SEF that is not prepared and executed in compliance with applicable requirements and instructions may be returned as not acceptable for filing. Acceptance of this Form SEF, however, shall not constitute a finding that the Form SEF has been filed as required or that the information submitted is true, current, or complete**.

6. Except in cases where confidential treatment is requested by the Applicant and granted by the Commission pursuant to the Freedom of Information Act and the rules of the Commission thereunder, information supplied on this Form SEF will be included in the public files of the Commission and will be available for inspection by any interested person.

APPLICATION AMENDMENTS

1. An Applicant amending a pending application for registration as a swap execution facility shall file an amended Form SEF electronically with the Secretary of the Commission in the manner specified by the Commission.

2. When filing this Form SEF for purposes of amending a pending application, an Applicant must re-file the entire Cover Sheet, amended if necessary, include an executing signature, and attach thereto revised Exhibits or other materials marked to show any amendments. The submission of an amendment to a pending application represents that the remaining items and Exhibits that are not amended remain true, current, and complete as previously filed.

WHERE TO FILE

This Form SEF must be filed electronically with the Secretary of the Commission in the manner specified by the Commission.

COMMODITY FUTURES TRADING COMMISSION

FORM SEF

SWAP EXECUTION FACILITY
APPLICATION OR AMENDMENT TO APPLICATION FOR REGISTRATION

COVER SHEET

_____

Exact name of Applicant as specified in charter

_____

Address of principal executive offices

☐ If this is an **APPLICATION** for registration, complete in full and check here.

☐ If this is an **AMENDMENT** to a pending application, complete in full, list all items that are amended and check here.

_____

_____

_____

GENERAL INFORMATION

1. Name under which the business of the swap execution facility is or will be conducted, if different than name specified above (include acronyms, if any):

   _____

2. If name of swap execution facility is being amended, state previous swap execution facility name:

   _____

3. Contact information, including mailing address if different than address specified above:

   _____
   Number and Street

   _____
   City State Country Zip Code

   _____
   Main Phone Number Fax

   _____
   Website URL E-mail Address

4. List of principal office(s) and address(es) where swap execution facility activities are/will be conducted:

Office **Address**

_____

_____

_____

5. If the Applicant is a successor to a previously registered swap execution facility, please complete the following:

   a. Date of succession

   _____

   b. Full name and address of predecessor registrant

   _____
   Name

   _____
   Number and Street

   _____
   City State Country Zip Code

   _____
   Main Phone Number Website URL

BUSINESS ORGANIZATION

6. Applicant is a:

☐ Corporation
☐ Partnership
☐ Limited Liability Company
☐ Other form of organization (specify)

_____

7. Date of incorporation or formation:

_____

8. State of incorporation or jurisdiction of organization:

_____

9. Date of fiscal year end of organization:
_____

10. The Applicant agrees and consents that the notice of any proceeding before the Commission in connection with this application may be given by sending such notice by certified mail to the person named below at the address given.

_____
Print Name and Title

_____
Name of Applicant

_____
Number and Street

_____
City State Zip Code

SIGNATURES

11. The Applicant has duly caused this application or amendment to be signed on its behalf by the undersigned, hereunto duly authorized, this _____ day of _____, 20_____. The Applicant and the undersigned represent hereby that all information contained herein is true, current, and complete. It is understood that all required items and Exhibits are considered integral parts of this Form SEF and that the submission of any amendment represents that all unamended items and Exhibits remain true, current, and complete as previously filed.

_____
Name of Applicant

_____
Signature of Duly Authorized Person

_____
Print Name and Title of Signatory

COMMODITY FUTURES TRADING COMMISSION

FORM SEF

SWAP EXECUTION FACILITY
APPLICATION OR AMENDMENT TO APPLICATION FOR REGISTRATION

EXHIBIT INSTRUCTIONS

The following Exhibits must be filed with the Commission by each Applicant applying for registration as a swap execution facility pursuant to section 5h of the Act and the Commission's regulations thereunder. The Exhibits must be labeled according to the items specified in this Form SEF.

The application must include a Table of Contents listing each Exhibit required by this Form SEF and indicating which, if any, Exhibits are inapplicable. For any Exhibit that is inapplicable, next to the Exhibit letter specify "none," "not applicable," or "N/A," as appropriate. The Table of Contents must indicate whether each item submitted for each Exhibit required by this Form SEF is subject to a request for confidential treatment.

If an Applicant seeks confidential treatment of any Exhibit or a portion of any Exhibit, the Applicant must mark such Exhibit with a prominent stamp, typed legend, or other suitable form of notice on each page or portion of each page stating "Confidential Treatment Requested by [Applicant]." If marking each page is impracticable under the circumstances, a cover sheet prominently marked "Confidential Treatment Requested by [Applicant]" should be provided for each group of records submitted for which confidential treatment is requested. Each of the records transmitted in this manner shall be individually marked with an identifying number and code so that they are separately identifiable. An Applicant must also file a confidentiality request in a form and manner specified with the Secretary of the Commission.

LIST OF EXHIBITS

EXHIBITS — BUSINESS ORGANIZATION

1. Attach as **Exhibit A:**

    a. The name of any person who owns ten percent or more of the Applicant's stock or who, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the management or policies of the Applicant.

    b. The full name and address of each such person and attach a copy of the agreement or, if there is none written, describe the agreement or basis upon which such person exercises or may exercise such control or direction.

2. Attach as **Exhibit B,** a list of the present officers, directors, governors (and, in the case of an Applicant that is not a corporation, the members of all standing committees, grouped by committee), or persons performing functions similar to any of the foregoing, of the swap execution facility or of any entity that performs the regulatory activities of the Applicant, indicating for each:
    a. Name
    b. Title
    c. Dates of commencement and termination of present term of office or position
    d. Length of time each present officer, director, or governor has held the same office or position
    e. Brief account of the business experience of each officer and director over the last five years
    f. Any other business affiliations in the derivatives or securities industry
    g. For directors, list any committees on which they serve and any compensation received by virtue of their directorship
    h. A description of:
        (1) Any order of the Commission with respect to such person pursuant to section 5e of the Act;
        (2) Any conviction or injunction against such person within the past ten years;
        (3) Any disciplinary action with respect to such person within the last five years;
        (4) Any disqualification under sections 8b and 8d of the Act;
        (5) Any disciplinary action under section 8c of the Act; and
        (6) Any violation pursuant to section 9 of the Act.

3. Attach as **Exhibit C:**

    a. A copy of the constitution, articles of incorporation, formation, or association with all amendments thereto, partnership or limited liability agreements, and existing by-laws, operating agreement, committee charter, rules or instruments corresponding thereto, as applicable, of the Applicant.

    b. A narrative that sets forth the fitness standards for the Board of Directors and its composition including the number and percentage of public directors.

    c. A certificate of good standing dated within one week of the date of this Form SEF.

4. Attach as **Exhibit D:**

    a. A narrative or graphic description of the organizational structure of the Applicant. Include a list of the legal names of all affiliates of the Applicant and indicate the general nature of the affiliation. Note: If the swap execution facility activities of the Applicant are or will be conducted primarily by a division, subdivision, or other separate entity within the Applicant, corporation, or organization, describe the relationship of such entity within the overall organizational structure and attach as Exhibit D a description only as it applies to the division, subdivision, or separate entity, as applicable.

b. Provide any relevant jurisdictional information, including any and all jurisdictions in which the Applicant and any affiliated entity engaged in financial services or markets activities, including, but not limited to, trading, clearing, or reporting of swaps are doing business; registration status, including pending applications (*e.g.*, country, regulator, registration category, date of registration); and nature of the business. Provide the address for legal service of process for each jurisdiction, which cannot be a post office box.

5. Attach as **Exhibit E:**

   a. A narrative or graphic description of the personnel structure that specifies the reporting lines and identifies the name and position for each officer, manager, and supervisor employed by or seconded to the Applicant for the operation of the Applicant as a swap execution facility. The narrative or graphic description of the personnel should identify the reporting line and estimated number of positions within any other category of non-management and non-supervisory employees employed by or seconded to the Applicant or the division, subdivision, or other separate entity within the Applicant.

   b. Provide a description of the duties as well as the background, skills, and any other qualifications necessary for each officer, manager, supervisor, and any other category of non-management and non-supervisory employees employed by or seconded to the Applicant or the division, subdivision, or other separate entity within the Applicant.

6. Attach as **Exhibit F**, a brief description of any material pending legal proceeding(s), other than ordinary and routine litigation incidental to the business, to which the Applicant or any of its affiliates is a party or to which any of its or their property is the subject. Include the name of the court or agency where the proceeding(s) are pending, the date(s) instituted, the principal parties involved, a description of the factual basis alleged to underlie the proceeding(s), and the relief sought. Include similar information as to any proceeding(s) known to be contemplated by the governmental agencies.

EXHIBITS — FINANCIAL INFORMATION

7. Attach as **Exhibit G:**

   a. The following financial statements: balance sheet, income statement, statement of cash flows, and all notes or schedules thereto, as of the most recent fiscal year of the Applicant. If the Applicant is a newly-formed entity and does not have these financial statements, then the Applicant should provide *pro forma* financial statements for a six-month operating period. If any financial statements certified by an independent public accountant are available, the Applicant should submit those statements with this Exhibit G. The financial statements shall be prepared in accordance with generally accepted accounting principles in the United States and denominated in U.S. dollars. Applicants not domiciled in the United States, and not otherwise required to prepare financial statements in accordance with generally

accepted accounting principles in the United States, may prepare their financial statements in accordance with either the International Financial Reporting Standards issued by the International Accounting Standards Board, or a comparable international standard the Commission may otherwise accept in its discretion.

b. A narrative with appropriate financial calculations demonstrating:
   (1) That the value of the financial resources of the Applicant exceeds the total amount that would enable the Applicant to cover its operating costs for a period of at least one year, calculated on a rolling basis that would enable it to comply with the core principles set forth in section 5h of the Act and the Commission's regulations;
   (2) That the Applicant has unencumbered, liquid financial assets (*i.e.*, cash and/or highly liquid securities) equal to at least the greater of three months operating costs or the cost to wind-down operations as a swap execution facility; and
   (3) The methodology by which the Applicant has computed the current market value of each financial resource used to meet its regulatory obligations pursuant to § 37.1301 and § 37.1303 of the Commission's regulations (17 CFR 37.1301 and 37.1303) and indicate any reductions in value which reflect market and credit risk as appropriate.

c. Documentation demonstrating the existence of any committed lines of credit or similar facility relied upon for the purpose of meeting the requirements of § 37.1303 of the Commission's regulations (17 CFR 37.1303) (*e.g.*, copies of agreements establishing or amending a credit facility or similar facility).

d. A list of the Applicant's expenses which itemizes any costs excluded or pro-rated in determining the operating costs of the Applicant for a one-year period on a rolling basis. Provide an explanation of the basis for the Applicant's determination to exclude or pro-rate expenses.

e. An itemized list of all costs that the Applicant would incur to wind-down the operations of the Applicant as a swap execution facility, the projected amount of time of any such wind-down period, and an explanation of the basis by which the Applicant has determined such estimated costs and time.

8. Attach as **Exhibit H:**

a. A complete list of all dues, fees, and other charges to be imposed by or on behalf of the Applicant. Identify the service or services provided for each of these dues, fees, and other charges. Identify any market maker programs, other incentive programs, or any other discount on dues, fees, or other charges to be imposed by the Applicant.

b. A description of the basis, methods, and any factors used in determining the level and structure of the dues, fees, and other charges listed in paragraph (a) of this item.

EXHIBITS — COMPLIANCE

9. Attach as **Exhibit I,** a regulatory compliance chart with citations to the Applicant's relevant rules, policies, and procedures that describe the manner in which the Applicant is able to comply with each core principle. The Applicant must provide an explanation of any novel issues for which compliance with a core principle is not self-evident, including an explanation of how that item satisfies the core principles.

10. Attach as **Exhibit J,** a copy of the Applicant's rules (as defined in § 40.1 of the Commission's regulations, 17 CFR 40.1) and any technical manuals, other guides, or instructions for users of the Applicant, including minimum financial standards for market participants. Include rules on publication of daily trading information pursuant to the requirements of part 16 of the Commission's regulations (17 CFR part 16). The Applicant should include an explanation and any other form of documentation that would be helpful to explain or demonstrate how the documentation provided in this Exhibit J supports the Applicant's compliance with the core principles.

11. Attach as **Exhibit K,** a copy of any compliance manual and any other documents that describe with specificity the manner in which the Applicant will conduct trade practice, market, and financial surveillance and maintain trading data.

12. Attach as **Exhibit L,** executed or executable copies of all user agreements, including, but not limited to, on-boarding documentation, regulatory data usage consent agreements, intermediary documentation, and arrangements for alternative dispute resolution. Provide a narrative of the legal, operational, and technical requirements for users to directly or indirectly access the Applicant's facility.

13. Attach as **Exhibit M,**

    a. A list of the swap data repositories to which the Applicant will report data related to swaps and the respective asset classes for which the Applicant will report data related to swaps for each Commission-registered swap data repository.

    b. An executed copy of all agreements regarding the reporting of data related to swaps between the Applicant and each Commission-registered swap data repository to which the Applicant will report data related to swaps.

    c. A representation from each Commission-registered swap data repository that states that the Applicant has satisfactorily completed all legal, technical, and operational requirements, including all necessary testing, to enable the Commission-registered swap data repository to reliably accept swap reporting data from the Applicant.

14. Attach as **Exhibit N,** which is required only for an Applicant that seeks to offer swaps for trading that may be cleared through a clearing organization,

a. A list of the (1) Commission-registered derivatives clearing organizations and (2) derivatives clearing organizations that the Commission has determined are exempt from registration, to which the Applicant will submit swap transactions for clearing. The list shall identify the asset classes for which the Applicant will submit swap transactions for clearing.

b. A representation that clearing members of each (1) Commission-registered derivatives clearing organization and (2) derivatives clearing organization that the Commission has determined is exempt from registration, will guarantee all swap transactions submitted by the Applicant for clearing.

c. An executed copy of the clearing agreement and any related documentation for each (1) Commission-registered derivatives clearing organization and (2) derivatives clearing organization that the Commission has determined is exempt from Commission registration, that will clear swap transactions submitted by the Applicant.

d. A representation from each Commission-registered derivatives clearing organization and derivatives clearing organization that the Commission has determined is exempt from registration that will clear swap transactions for the Applicant, that states that the Applicant has satisfactorily completed all legal, technical, and operational requirements, including all necessary testing, to enable such clearing organization to reliably accept swap transactions from the Applicant.

15. Attach as **Exhibit O,** executed or executable copies of any agreements or contracts entered into or to be entered into by the Applicant, including third-party regulatory service provider agreements that enable the Applicant to comply with applicable core principles that are not otherwise attached within Exhibits L, M, N, or Q. For each agreement, identify the services that will be provided and the core principles addressed by such agreement.

16. Attach as **Exhibit P,** an explanation regarding the operation of the Applicant's trading system(s) or platform(s) and the manner in which the system(s) or platform(s) satisfy any Commission rules, interpretations, or guidelines regarding a swap execution facility's execution methods, including the requirements in § 37.201(a) of the Commission's regulations (17 CFR 37.201(a)). Where possible, this explanation should include screenshots of the Applicant's trading system(s) or platform(s).

EXHIBITS — OPERATIONAL CAPABILITY

17. Attach as **Exhibit Q,** information responsive to the Program of Risk Analysis and Oversight Technology Questionnaire. This questionnaire focuses on information pertaining to the Applicant's program of risk analysis and oversight. Main topic areas include: information security; business continuity-disaster recovery planning and resources; capacity and performance planning; systems operations; systems development and quality assurance; and physical security and environmental controls. The questionnaire will be available on the Commission's website.

PROGRAM OF RISK ANALYSIS AND OVERSIGHT TECHNOLOGY QUESTIONNAIRE

Provide all relevant documents responsive to the information requests listed within each area below. In addition to the specific documents requested, provide any other policies, procedures, standards or guidelines, plans, independent assessments (including internal audits), test results, and representations that will assist the Commission in assessing the compliance of trading platform and related supporting systems with the applicable SYSTEM SAFEGUARDS CORE PRINCIPLE. The Systems Safeguards Core Principle require exchanges to (1) establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk, through the development of appropriate controls and procedures, and the development of automated systems, that are reliable, secure, and have adequate scalable capacity;[1] (2) establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for the timely recovery and resumption of operations and the fulfillment of the responsibilities and obligations of the exchange; and (3) periodically conduct tests to verify that backup resources are sufficient to ensure continued order processing and trade matching, transmission of matched orders to a designated clearing organization for clearing, price reporting, market surveillance, and maintenance of a comprehensive and accurate audit trail.

1. Organizational Structure, System Description, Facility Locations, and Geographic Distribution of Staff and Equipment per the following:

    a. Provide high-level organization charts and staffing level information for all groups that are directly involved in supporting the development, operation, and maintenance of the systems, including systems development, quality assurance, system operations, event management, market operations, network and telecommunications, information security, capacity planning, contingency planning (including disaster recovery), market surveillance, and trade practice investigation; include a brief biography with applicable certifications for each key IT staff leader.

    b. Describe or provide a diagram showing the locations of all facilities that house the staff described above and the equipment on which your systems operate. Indicate the nature of the facilities (*e.g.*, headquarters, primary and backup data centers, primary and backup market operations centers, etc.), and a description of your rationale for the distribution of staff and system components across those facilities.

[1] An exchange's program of risk analysis and oversight with respect to its operations and automated systems shall address each of the following categories: (1) Enterprise risk management and governance; (2) Information security; (3) Business continuity-disaster recovery planning and resources, including pandemic planning; (4) Capacity and performance planning; (5) System operations (including configuration management, event management, and incident response); (6) Systems development and quality assurance (including security controls requirements, software change management, and outsourcing); and (7) Physical security and environmental controls. *See* 17 CFR 37.1401.

c. Provide a high-level application flow diagram and the specific information requested below for all systems that perform and support trading, price reporting, regulatory reporting, market surveillance, and trade practice investigation:

1) System description and overview.
2) A logical diagram of the software components, including the following information for each component:
   a) Name;
   b) Functional description; and
   c) Upstream and downstream feeds.
3) Provide a logical security architecture and description.
4) A representative physical diagram of the hardware components (servers and communications equipment) that exist at both the primary and backup data centers, and for each representative hardware component, provide the following information:
   a) Device type (*e.g.*, switch, server, SAN, etc.);
   b) Device O/S;
   c) Functional description;
   d) Internal redundancies (*e.g.*, power supplies, RAID); and
   e) External redundancies (*e.g.*, mirroring, clustering).
5) A physical diagram of the network topology within and between data centers and external entities, and for each connection provide the following information:
   a) Purpose(s) of connection;
   b) Type and bandwidth of each connection; and
   c) Identification of carrier.

2. Enterprise Risk Management and Governance. Describe your Enterprise Risk Management program as it relates to IT and your entity's approach for assessing and managing the risks associated with technology and cybersecurity, including procedures for risk escalation, adjudication, mitigation, and acceptance; include the following:

   a. Provide a copy of your most recent annual Enterprise Technology Risk Assessment and Enterprise Risk Assessment.

   b. Include a description of Board of Directors and/or Board Committee involvement in oversight of system safeguards and cybersecurity.

   c. Provide a list of Board of Directors and Board Committee members, indicating for each: name, title, and description of any system safeguards and cyber security experience.

   d. Provide copies of all system safeguards-related materials provided to the Board of Directors or applicable Board Committees for the four most recent meetings.

   e. Provide copies of Board of Directors and Board Committee meeting minutes regarding system safeguards from the four most recent meetings.

f. Describe the process by which the Board is kept apprised of the status of systems safeguards related initiatives and assessments, including any escalation procedures or trigger points that automatically require Board notification and involvement.

g. Describe any ongoing education or training that Board members receive regarding systems safeguards, including cybersecurity. If a third party consultant is used in matters of system safeguards and cybersecurity risk, include the name, title and applicable qualifications for each consultant.

h. Describe your internal audit program, including:

1) Organizational structure of internal audit;
2) Audit staff qualifications and use of external staff;
3) Controls that ensure independence;
4) Process for development of IT audit plan, including prioritization and allocation of audit resources;
5) Follow up and resolution of IT audit findings and recommendations and quality assurance reviews of the internal audit program and processes; and
6) Provide the results of the most recent quality assurance review.

i. Submit the system evaluation documentation and information requested below for each of the following systems safeguard categories: (1) risk management; (2) systems development methodology; (3) information security; (4) system operations; (5) capacity and performance planning; (6) physical security and environmental controls, including data centers; and (7) business continuity and disaster recovery.

1) Provide your most recent audit or other risk assessment documents for each category, including complete reports (not only executive summaries), management's responses, and mitigation plans and results for addressing findings;
2) Describe your plans and schedule for ongoing independent audits, other risk assessments, and tests for each category;
3) Describe how you periodically assess compliance with applicable policies and procedures for each category.

j. Outsourcing and Vendor Management

1) Provide a copy of each service agreement currently in place for any IT services provided by a third party.
2) Describe your process for pre-contract due diligence and screening of IT service providers.
3) Describe your process for monitoring the performance of service agreements, including roles and responsibilities, scope and frequency of review, and remediation of identified deficiencies.

4) Describe inclusion of vendor relationships and outsourced systems in your ongoing risk management process.
5) Describe any information systems security testing and ongoing monitoring you may require and/or conduct of vendors.
6) Provide a list of all vendors who have any sort of connection or access to your systems and describe how you manage and mitigate the risks to your systems posed by this access on an ongoing basis.
7) Provide a list of critical service providers (those without whose functioning your entity cannot function).
8) Describe all testing you perform or participate in jointly with each of your critical service providers.
9) Describe how you ensure that you are notified of all significant changes to the systems, operations, management, or physical resources of your critical service providers.

3. Information Security

a. Provide documentation (policies, standards, guidelines) that attests to the development of and adherence to an ongoing information security program.

b. Describe your background investigation program's controls and procedures to include credit checking for the following:
   1) Pre-assignment of personnel to sensitive roles; and
   2) Recurring periodic investigations for staff in sensitive roles.

c. Provide information regarding security awareness training and education:

   1) Describe the security awareness training provided to system users, including periodic refresher training.
   2) Identify the roles of personnel that have significant system security or system development responsibilities and describe the security training they are required to complete.

d. Provide information regarding the access controls and procedures that are used to ensure the identification, authorization, and authentication of system users and any third-party service providers.

e. Provide information regarding the procedures that are used to ensure proper account management, including:

   1) Establishing, changing, reviewing, and removing accounts (including emergency and other temporary accounts);
   2) Password complexity and life cycle standards; and
   3) Maintaining user awareness of the authorized uses of the system.

f. Provide information regarding the administrative procedures (such as adherence to least privilege and separation of duties concepts) and automated systems that will be employed to prevent and detect the unauthorized use of the system.

g. Provide information (including specific products used, guidelines for use, and roles and responsibilities) regarding the use and management of safeguards and security tools used to protect the critical data and system components, including:

1) Encryption and data compression (data at-rest and in-transit);
2) Denial of service protection;
3) Firewalls;
4) Routers;
5) DMZs and network segmentation;
6) Intrusion detection;
7) Event logging and log analysis, including:
   a) Scope of log coverage (*e.g.*, production/development; servers/firewalls);
   b) Focus of event details captured (e.g., unauthorized activities, system issues);
   c) Monitoring of system logging alerts (*e.g.*, log failure alert); and
   d) Frequency and level of log review, analysis, and reporting.
8) Virus protection;
9) Encryption and control of portable mobile devices;
10) Encryption and control of portable external media (*e.g.*, USB drives, optical media, external hard drives, etc.);
11) Data Loss Prevention (DLP) tools; and
12) Ongoing testing of the efficacy of safeguards and security tools for the areas enumerated above.

h. Provide policies, guidelines, and procedures for authorization and use of remote access capabilities to manage the system, including hardware and software tools that protect the information and system while using those capabilities. In your response, also address policies, guidelines or procedures governing third party access to your systems.

i. Provide information about your procedures for sanitization, destruction, and disposal of equipment and media.

j. Provide information regarding the manual and automated processes in place to facilitate the capture and secure storage of all records relating to the business of the facility, including a complete audit trail, for a period of five years.[2]

1) Identify the specific audit trail information captured.
2) Describe the controls that provide for reliable collection of audit information, including those that ensure sufficient capacity and alerting of audit failures.
3) For each copy of the audit trail information, describe the processes that protect the information from accidental and deliberate alteration or destruction prior to its planned disposal. Include information about:

[2] *See* 17 CFR 37.205 and 37.1001.

a) Access controls (physical and logical);
b) Environmental controls (*e.g.*, fire protection) provided at storage locations;
c) Schedule and procedures for secure movement of information;
d) Retention period; and
e) Distance between storage locations.

k. Provide information about your security incident response program, including:

1) Staffing;
2) Roles and responsibilities;
3) Training;
4) Procedures (including detection, analysis, containment, and recovery);
5) Communication/notification and reporting, including notification of appropriate regulators, law enforcement, and appropriate information sharing organizations; and
6) Testing of security incident response procedures.

l. Describe your cybersecurity threat intelligence capabilities, including:

1) Staffing (in-house and outsourced services);
2) Roles and responsibilities;
3) Training;
4) Intelligence gathering and analysis methodology;
5) Dissemination of intelligence within the organization and with appropriate information sharing organizations, and
6) Evaluating intelligence for tactical and strategic action.

m. Describe your participation in any information sharing organizations, *e.g.*, FS-ISAC.

4. Business Continuity and Disaster Recovery ("BC-DR"). Provide the following information:

a. A description of your DR sites, including the following information for each site:
1) State of readiness (hot, warm, cold);
2) Whether a commercial or self-managed site; and
3) Distance from production site.

b. A description of the public infrastructure (*e.g.*, water, electric, etc.) supporting each of your BC-DR sites, including redundancy, resilience, and physical security.

c. A list of the mission-critical systems that each BC-DR site will support on a routine, non-disaster basis, and a description of your reasons for this overall data center strategy.

d. A list of the mission-critical systems that each of your BC-DR sites will support in the event of a disaster.

e. Copies of all agreements, including service level agreements, with third parties to provide services in support of your BC-DR plans.

f. A description of your strategy for ensuring the availability of essential software and data, including security and testing of backups.

g. A description of your recovery point objective ("RPO"), and a description or assessment of your maximum potential data loss in the event of a disaster, including loss of in-transit data.

h. A description of your strategy for staffing DR sites in the event of a disaster, including a pandemic.

i. A description of any plans or capabilities for remote management and operation of your primary or DR sites in the event that they become inaccessible but remain functional. Include information regarding the systems security controls that will be applied to internal and third party (including service provider) users.

j. Briefing materials for senior management regarding BC-DR and pandemic plans.

k. BC-DR and pandemic training materials prepared for employees.

l. A description of your procedures for ensuring the currency and availability to team members of essential documentation.

m. Your technology-related BC-DR plans, including roles and responsibilities, staffing assignments, recovery procedures, test plans, external dependencies and any pandemic plans.

n. Your emergency communications plan, including emergency contact information.

o. A description of external communications and reporting regarding BC-DR events, including notification of customers and appropriate regulators.

p. A description of how your BC-DR plan is coordinated with members' BC-DR plans.

q. A description of your strategy for testing your DR sites, including frequency, types of tests, and scope of staff and market participant involvement.

r. A copy of the most recent SSAE16 Type II reports for each of your data centers, including, if applicable, any actions taken to remediate findings in the report.

s. Documentation from the three most recent operational tests conducted with respect to your DR sites, including the test plan, the results report, and the mitigation plan and results.

t. Documentation from your participation in the most recent industry wide test relating to BC-DR matters, including the test plan, the results report, and the mitigation plan and results.

u. A description of any instances of activation of your BC-DR plans, including the results report and the mitigation plan and results.

v. Explain your recovery time objective ("RTO") for each of the following:

1) Ability to meet the "next day" resumption of trading regulatory requirement.
2) Completed clearing of transactions executed prior to disruption.
3) Resumption of clearing of new transactions.
4) Resumption of market surveillance.
5) Access to audit trail information and resumption of trade practice surveillance.
6) Redirection to a secondary data center (when needed).

w. Explain your successfully tested recovery time capability for resuming fulfillment of your responsibilities and obligations as an exchange. Please provide test results.

5. Capacity Planning and Testing

a. Provide the capacity levels and associated performance (*i.e.*, response time) for each of the following system activities, including target, average daily, historical high, and system stress-tested sustained and peak levels:

1) Simultaneous workstation sessions;
2) Market participant transactions;
3) Trade matches;
4) Quote vendor transactions; and
5) Data mirroring transactions.

b. Describe any formal process you employ for the ongoing review of capacity and performance levels.

c. Describe current system bottlenecks, and the methods in which they are monitored.

d. Describe at what levels the addition of new system resources would be triggered to ensure adequate capacity and performance.

e. Describe the methods by which additional capacity and performance resources could be activated in an emergency situation and state how long those processes would take.

6. System Operations

a. Configuration management for hardware and software
Provide information regarding the controls and procedures that will be used to ensure:

1) Consistent inventory maintenance;
2) Adherence to standards for baseline configuration, including hardening;
3) Pre-installation testing and authorization;
4) Processes that ensure minimal configuration drift between primary and backup environments; and
5) Post-installation monitoring and testing.

b. System change management for hardware and software
Provide information regarding the controls and procedures that will be used to ensure the reliability of system software, including:

1) Testing;
2) Independent review for quality assurance;
3) Approval for production installation;
4) Processes that ensure minimal configuration drift between primary and backup environments;
5) Post-change monitoring, including testing to confirm planned vs. actual system configuration;
6) Separation of duties;
7) Controls in place to ensure quality, consistency, and security of code developed by third party developers; and
8) Controlled access to code libraries.

c. Patch management program
Provide information regarding the controls and procedures that will be used to ensure the timely application of essential patches, including:

1) Staffing;
2) Awareness;
3) Analysis of required patching to operational systems and any impact to computing environments;
4) Testing and Approval;
5) Emergency patch processes and procedures, including notification, analysis, testing, approval, and implementation;
6) Implementation and fallback procedures; and
7) Communication and reporting.

d. Password scanning
Provide information about any internal password scanning you perform, including:

1) Frequency of use;
2) Tools used;
3) Scope; and
4) Follow-up.

e. Event and problem management
Provide information regarding the controls and procedures that will be used to ensure the timely notification about operational events and resolution of operational problems, including:

1) Staffing;
2) Roles and responsibilities;
3) Use of monitoring systems;
4) Tracking and escalation;
5) Resolution; and
6) Internal and external reporting, including notification of appropriate regulators.

7. Systems Development Methodology

a. Describe your process, including roles and responsibilities, for identifying and approving functional, security, and capacity/performance requirements.

b. Describe your software change management process, including quality assurance and issue tracking and resolution.

1) Provide information regarding the testing methodology, including management controls, used to verify the system's ability to perform as intended (regarding functionality, security, and capacity and performance requirements).
2) Provide copies of current representative samples of your test results documentation.
3) Identify what group is responsible for recording, correcting, and retesting errors, and detail their procedures for those activities.

c. Describe the documentation required during the development of new software and as part of the software release package for installation, operation, and maintenance.

d. Describe the controls in place for promotion of application software into the production environment, including approval, access controls, and post-implementation monitoring.

8. Physical Security and Environmental Controls

a. Provide information regarding the physical security controls used in the communications and central computer facilities to protect system components and critical infrastructure. In your response, please address:

1) Perimeter and external building controls and monitoring, including:
   a) Lights;
   b) Cameras;
   c) Motion detectors;
   d) Guards;
   e) Fences, gates, and other barriers; and
   f) Building entrances, including loading docks.
2) Internal building controls and monitoring, including:
   a) Engineering and physical security staffing, including shift coverage, minimum qualifications and training;
   b) Metal detectors;
   c) Door locks;
   d) Visitor controls, including scheduling, identification, logbooks, and escort requirements;
   e) Compartmentalization of computing, communications, and building infrastructure equipment;
   f) Cameras, video recording, and monitoring stations;
   g) Access authorization and review procedures; and
   h) Mail and package handling procedures.

b. Provide copies of any internal or third party physical security assessments conducted for each of your operating locations.

c. Describe plans for third party physical security assessments for each of your operating locations.

d. Provide information regarding the environmental controls used in the communications and central computer facilities to ensure reliable availability of system components and critical infrastructure. Address redundancy, monitoring, maintenance, and testing of:

1) Electrical supply, including:
   a) Sources and paths of commercial power;
   b) Generators (and associated on-site fuel supply and fuel delivery contracts);
   c) Power distribution units;
   d) Uninterruptible Power Supply units; and
   e) Emergency shutoff controls.

2) Cooling equipment, including:
   a) HVAC units;
   b) Air handlers;
   c) Chillers; and
   d) Other associated items such as water supply and humidifiers.
3) Fire control equipment, including:
   a) Smoke and heat detection;
   b) Fire suppression; and
   c) Water damage protection.

e. Provide copies of any recent third party assessments of your communications and central computer facilities, including results and plans for remediation of any findings made.

f. Provide information regarding any Single Point of Failure reviews or assessments made of your communications, data center, and cloud infrastructure; including but not limited to carrier line diversity, points of presence, and oversight of changes.

9. Testing Program

a. Provide information regarding your use of internal and third party vulnerability scanning and testing to identify and eliminate vulnerabilities in the configuration of your computing and communications equipment. Address each of the following:

   1) Scope of testing;
   2) Frequency of use;
   3) Methodology and tools;
   4) Distribution of reports;
   5) Remediation of findings by severity or risk posed; and
   6) Tracking of mitigation activities, including notification of senior management or the Board.

b. Provide the results of the two most recent internal or third party vulnerability scans (for our assessment of progress made), including complete reports (not only summaries), management's responses, and mitigation plans and results for addressing findings.

c. Provide information regarding your use of internal and third party external and internal penetration testing to identify and eliminate vulnerabilities in the architecture and configuration of your computing and communications equipment. Address each of the following:

   1) Scope of testing;
   2) Frequency of use;
   3) Methodology and tools;
   4) Distribution of reports;

5) Remediation of findings by severity or risk posed; and
6) Tracking of mitigation activities, including notification of senior management or the Board.

d. Provide the results of the two most recent internal or third party penetration tests (for our assessment of progress made), including complete reports (not only summaries), management's responses, and mitigation plans and results for addressing findings.

e. Describe your program of periodic controls testing, including:

1) Selection of controls, including determination of key controls;
2) Frequency, scope, and schedule of testing;
3) Use of any third party assessors; and
4) Escalation, follow up and resolution of findings.
5) Provide representative samples of any periodic control testing.

f. Provide the results of your most recently performed Security Incident Response Plan test.

Appendix B to Part 37 – Guidance on, and Acceptable Practices in, Compliance with Core Principles

1. This appendix provides guidance on complying with core principles, both initially and on an ongoing basis, to maintain registration under section 5h of the Act and this part. Where provided, guidance is set forth in paragraph (a) following the relevant heading and can be used to demonstrate to the Commission compliance with the selected requirements of a core principle of this part. The guidance for the core principle is illustrative only of the types of matters a swap execution facility may address, as applicable, and is not intended to be used as a mandatory checklist. Addressing the issues set forth in this appendix would help the Commission in its consideration of whether the swap execution facility is in compliance with the selected requirements of a core principle; provided however, that the guidance is not intended to diminish or replace, in any event, the obligations and requirements of applicants and swap execution facilities to comply with the regulations provided under this part.

2. Where provided, acceptable practices meeting selected requirements of core principles are set forth in paragraph (b) following the guidance. Swap execution facilities that follow specific practices outlined in the acceptable practices for a core principle in this appendix will meet the selected requirements of the applicable core principle; provided however, that the acceptable practice is not intended to diminish or replace, in any event, the obligations and requirements of applicants and swap execution facilities to comply with the regulations provided under this part. The acceptable practices are for illustrative purposes only and do not state the exclusive means for satisfying a core principle.

Core Principle 1 of section 5h of the Act—Compliance with Core Principles

(A) *In general.* To be registered, and maintain registration, as a swap execution facility, the swap execution facility shall comply with – the core principles described in section 5h of the Act; and any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5) of the Act.

(B) *Reasonable discretion of swap execution facility.* Unless otherwise determined by the Commission by rule or regulation, a swap execution facility described in paragraph (A) shall have reasonable discretion in establishing the manner in which the swap execution facility complies with the core principles described in section 5h of the Act.

(a) *Guidance.* [Reserved]

(b) *Acceptable Practices.* [Reserved]

Core Principle 2 of section 5h of the Act—Compliance with Rules

A swap execution facility shall:

(A) Establish and enforce compliance with any rule of the swap execution facility, including the terms and conditions of the swaps traded or processed on or through the swap execution facility and any limitation on access to the swap execution facility;

(B) 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 provide market participants with impartial access to the market and to capture information that may be used in establishing whether rule violations have occurred;

(C) Establish rules governing the operation of the facility, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the facility, including block trades; and

(D) Provide by its rules that when a swap dealer or major swap participant enters into or facilitates a swap that is subject to the mandatory clearing requirement of section 2(h) of the Act, the swap dealer or major swap participant shall be responsible for compliance with the mandatory trading requirement under section 2(h)(8) of the Act.

(a) *Guidance*. (1) *Ethics training*. (i) Section 37.201(c)(4) requires a swap execution facility to ensure that its SEF trading specialists receive ethics training on a periodic basis. Such training should help SEF trading specialists be aware, and remain abreast, of, their continuing obligations with respect to the rules, policies, and procedures of the swap execution facility, as well as the applicable provisions of the Act and Commission regulations thereunder.

(ii) Ethics training for SEF trading specialists should account for the level and nature of SEF trading specialists' responsibilities within a swap execution facility. The training should address topics such as an explanation of applicable laws and regulations and the rules, policies, and procedures of the swap execution facility; how to act honestly and fairly and with due skill, care, and diligence in furtherance of the interests of market participants and the integrity of the market; protection of confidential information; and avoidance, proper disclosure, and handling of conflicts of interest. Such ethics training should also seek to ensure that SEF trading specialists remain current with regard to the ethical ramifications of new developments with respect to evolving technology, trading practices, products, and other relevant changes.

(iii) A swap execution facility, at its discretion, may develop and implement its own ethics training program or utilize a program offered by a third-party provider, or may implement some combination thereof. Third-party providers may include independent persons, firms, or industry associations. No specific format or class training is required, as the needs of a swap execution facility may vary according to its size and number of personnel that are SEF trading specialists. A swap execution facility may utilize electronic media, such as video presentations, internet-based transmissions, and interactive software programs as part of its ethics training program. A swap execution facility should ascertain the credentials of any provider of ethics training or training materials and should ensure that such persons have the appropriate level of industry experience and knowledge, including with respect to the swap execution facility's rules, policies, procedures, and operations.

(iv) A swap execution facility may determine the frequency and duration of ethics training but such frequency and duration should promote a corporate culture of high ethical and professional conduct and a continuous awareness of industry standards and practices.

(2) *Investigations – Timeliness.* A swap execution facility has reasonable discretion to determine the timely manner in which to complete investigations under § 37.203(f)(2).

(3) *Investigations – Investigation reports.* A swap execution facility's compliance staff should submit all investigation reports to the Chief Compliance Officer or other compliance department staff responsible for reviewing such reports and determining the next steps in the process. The Chief Compliance Officer or other responsible staff should

have reasonable discretion to decide whether to take any action, such as presenting the investigation report to a disciplinary panel for disciplinary action.

(4) *Audit trail required.* A swap execution facility's audit trail data should be sufficient to reconstruct all indications of interest, requests for quotes, orders, and trades within a reasonable period of time and to provide evidence of any violations of the rules of the swap execution facility.

(5) *Audit trail reconstruction.* An effective audit trail reconstruction program should annually review an adequate sample of executed and unexecuted orders and trades from each execution method offered by the swap execution facility to verify the swap execution facility's ability to comprehensively and accurately reconstruct trading in a timely manner. A swap execution facility should have reasonable discretion to determine the meaning of adequate sample as used in this paragraph.

(6) *Enforcement staff.* A swap execution facility's enforcement staff should not include either members of the swap execution facility or persons whose interests conflict with their enforcement duties. A member of the enforcement staff should not operate under the direction or control of any person or persons with trading privileges at the swap execution facility.

(7) *Disciplinary panel procedures.* The rules of a swap execution facility governing the requirements that apply to the adjudication of a matter by a swap execution facility disciplinary panel should be fair, equitable, and publicly available. Such rules should require the disciplinary panel to promptly issue a written decision following a hearing or the acceptance of a settlement offer.

(8) *Emergency disciplinary actions.* A swap execution facility may impose a sanction, including suspension, or take other summary action against a person or entity subject to its jurisdiction upon a reasonable belief that such immediate action is necessary to protect the best interest of the marketplace.

(9) *Warning letters and sanctions.* A swap execution facility should have reasonable discretion to determine when to issue warning letters and apply sanctions under § 37.206(c)(1).

(b) *Acceptable Practices.* [Reserved]

Core Principle 3 of section 5h of the Act—Swaps Not Readily Susceptible to Manipulation

The swap execution facility shall permit trading only in swaps that are not readily susceptible to manipulation.

(a) *Guidance.* Guidance in appendix C to this part—"Demonstration of Compliance that a Swap Contract is Not Readily Susceptible to Manipulation"—may be used as guidance in meeting this core principle for both new product listings and existing listed contracts.

(b) *Acceptable Practices.* [Reserved]

Core Principle 4 of section 5h of the Act—Monitoring of Trading and Trade Processing

The swap execution facility shall:

(A) Establish and enforce rules or terms and conditions defining, or specifications detailing:

(1) Trading procedures to be used in entering and executing orders traded on or through the facilities of the swap execution facility; and

(2) Procedures for trade processing of swaps on or through the facilities of the swap execution facility; and

(B) Monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.

(a) *Guidance.* The swap execution facility should have rules in place that allow it to intervene to prevent and reduce disorderly trading and disruptions. Once threatened or actual disorderly trading or disruption is detected, the swap execution facility should take steps to prevent the disorderly trading or disruption, or reduce its severity.

(1) *General requirements.* Real-time monitoring for disorderly trading and market or system anomalies is the most effective, but the swap execution facility's program may also be acceptable if some of the monitoring is accomplished on a T+1 basis. The monitoring of trading should use automated alerts to detect disorderly trading and any market or system anomalies, including abnormal price movements and unusual trading volumes in real-time and instances or threats of manipulation, price distortion, and disruptions on at least a T+1 basis. The T+1 detection and analysis should incorporate any additional data that becomes available on a T+1 basis, including the trade reconstruction data. In some cases, a swap execution facility may demonstrate that its manual processes are effective. The swap execution facility should act promptly to

address the conditions that are causing price distortions or disruptions, including, when appropriate, changes to contract terms.

(2) *Physical-delivery swaps.* For a physical-delivery swap listed on the swap execution facility, the swap execution facility should monitor for conditions that may cause the swap to become susceptible to manipulation, price distortion, or market disruptions, including: conditions influencing the convergence between the swap's price and the price of the underlying commodity such as the general availability of the commodity specified by the swap, the commodity's characteristics, and the delivery locations; and if available, information related to the size and ownership of deliverable supplies. Price convergence refers to the process whereby the price of a physically-delivered swap converges to the spot price of the underlying commodity, as the swap nears expiration. The hedging effectiveness of a physically-delivered swap depends in part upon the extent to which the swap price reliably converges to the comparable cash market price, or to a predictable differential to the comparable cash market price.

(3) *Ability to obtain information.* The swap execution facility should be able to obtain position and trading information directly from the market participants that conduct trading on its facility.

(4) *Risk controls for trading.* In developing and implementing an acceptable program for preventing and reducing the potential risk of price distortions and market disruptions, a swap execution facility should establish and maintain appropriate trading risk controls, in addition to pauses and halts. Risk controls should be adapted to the unique characteristics of the swap execution facility's trading system or platform and the swap contracts listed for trading and should be designed to avoid price distortions and

market disruptions without unduly interfering with that market's price discovery function. The swap execution facility may choose from among controls that include: pre-trade limits on order size, price collars or bands around the current price, message throttles, and daily price limits, or design other types of controls, as well as clear order-cancellation policies. Within the specific array of controls that are selected, the swap execution facility should set the parameters for those controls, so that the specific parameters are reasonably likely to serve the purpose of preventing price distortions and market disruptions. If a swap is fungible with, linked to, or a substitute for other swaps on the swap execution facility or contracts on other trading venues, such risk controls should, to the extent practicable, be coordinated with any similar controls placed on those other swaps or contracts. If a swap is based on the level of an equity index, such risk controls should, to the extent practicable, be coordinated with any similar controls placed on national security exchanges.

(b) *Acceptable Practices.* [Reserved]

Core Principle 5 of section 5h of the Act—Ability to Obtain Information

The swap execution facility shall:

(A) Establish and enforce rules that will allow the facility to obtain any necessary information to perform any of the functions described in section 5h of the Act;

(B) Provide the information to the Commission on request; and

(C) Have the capacity to carry out such international information-sharing agreements as the Commission may require.

(a) *Guidance.* If position and trading information is available through information-sharing agreements with other trading venues or a third-party regulatory

service provider, the swap execution facility should cooperate, to the extent practicable, in such information-sharing agreements.

(b) *Acceptable Practices.* [Reserved]

Core Principle 6 of section 5h of the Act—Position Limits or Accountability

(A) *In general.* To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, a swap execution facility that is a trading facility shall adopt for each of the contracts of the facility, as is necessary and appropriate, position limitations or position accountability for speculators.

(B) *Position limits.* For any contract that is subject to a position limitation established by the Commission pursuant to section 4a(a) of the Act, the swap execution facility shall:

(1) Set its position limitation at a level no higher than the Commission limitation; and

(2) Monitor positions established on or through the swap execution facility for compliance with the limit set by the Commission and the limit, if any, set by the swap execution facility.

(a) *Guidance.* [Reserved]

(b) *Acceptable Practices.* [Reserved]

Core Principle 7 of section 5h of the Act—Financial Integrity of Transactions

The swap execution facility shall establish and enforce rules and procedures for ensuring the financial integrity of swaps entered on or through the facilities of the swap execution facility, including the clearance and settlement of the swaps pursuant to section 2(h)(1) of the Act.

(a) *Guidance.* [Reserved]

(b) *Acceptable Practices.* [Reserved]

Core Principle 8 of section 5h of the Act—Emergency Authority

The swap execution facility shall adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, as is necessary and appropriate, including the authority to liquidate or transfer open positions in any swap or to suspend or curtail trading in a swap.

(a) *Guidance.*

(1) A swap execution facility should have rules that authorize it to take certain actions in the event of an emergency, as defined in § 40.1(h) of this chapter. A swap execution facility should have the authority to intervene as necessary to maintain markets with fair and orderly trading and to prevent or address manipulation or disruptive trading practices, whether the need for intervention arises exclusively from the swap execution facility's market or as part of a coordinated, cross-market intervention. A swap execution facility should have the flexibility and independence to address market emergencies in an effective and timely manner consistent with the nature of the emergency, as long as all such actions taken by the swap execution facility are made in good faith to protect the integrity of the markets. However, the swap execution facility should also have rules that allow it to take market actions as may be directed by the Commission, including actions that the Commission requires the swap execution facility to take as part of a coordinated, cross-market intervention. Additionally, in situations where a swap is traded on more than one platform, emergency action should be taken as directed or agreed to by the Commission or the Commission's staff. A swap execution facility's rules should include

procedures and guidelines for decision-making and implementation of emergency intervention that avoid conflicts of interest and include alternate lines of communication and approval procedures to address emergencies associated with real time events. To address perceived market threats, the swap execution facility should have rules that allow it to take emergency actions, including imposing or modifying position limits, imposing or modifying price limits, imposing or modifying intraday market restrictions, ordering the fixing of a settlement price, extending or shortening the expiration date or the trading hours, suspending or curtailing trading in any contract, or altering any contract's settlement terms or conditions, or, if applicable, providing for the carrying out of such actions through its agreements with its third-party provider of clearing or regulatory services.

(2) A swap execution facility should promptly notify the Commission of its exercise of emergency action, explaining its decision-making process, the reasons for using its emergency authority, and how conflicts of interest were minimized, including the extent to which the swap execution facility considered the effect of its emergency action on the underlying markets and on markets that are linked or referenced to the contracts traded on its facility, including similar markets on other trading venues. Information on all regulatory actions carried out pursuant to a swap execution facility's emergency authority should be included in a timely submission of a certified rule pursuant to part 40 of this chapter.

(b) *Acceptable Practices.* [Reserved]

Core Principle 9 of section 5h of the Act—Timely Publication of Trading Information

(A) *In general.* The swap execution facility shall make public timely information on price, trading volume, and other trading data on swaps to the extent prescribed by the Commission.

(B) *Capacity of swap execution facility.* The swap execution facility shall be required to have the capacity to electronically capture and transmit trade information with respect to transactions executed on the facility.

(a) *Guidance.* [Reserved]

(b) *Acceptable Practices.* [Reserved]

Core Principle 10 of section 5h of the Act—Recordkeeping and Reporting

(A) *In general.* A swap execution facility shall:

(1) 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 Commission for a period of five years;

(2) Report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines to be necessary or appropriate for the Commission to perform the duties of the Commission under the Act; and

(3) Keep any such records relating to swaps defined in section 1a(47)(A)(v) of the Act open to inspection and examination by the Securities and Exchange Commission.

(B) *Requirements.* The Commission shall adopt data collection and reporting requirements for swap execution facilities that are comparable to corresponding requirements for derivatives clearing organizations and swap data repositories.

(a) *Guidance.* [Reserved]

(b) *Acceptable Practices.* [Reserved]

Core Principle 11 of section 5h of the Act—Antitrust Considerations

Unless necessary or appropriate to achieve the purposes of the Act, the swap execution facility shall not:

(A) Adopt any rules or take any actions that result in any unreasonable restraint of trade; or

(B) Impose any material anticompetitive burden on trading or clearing.

(a) *Guidance.* An entity seeking registration as a swap execution facility may request that the Commission consider under the provisions of section 15(b) of the Act, any of the entity's rules, including trading protocols or policies, and including both operational rules and the terms or conditions of products listed for trading, at the time of registration or thereafter. The Commission intends to apply section 15(b) of the Act to its consideration of issues under this core principle in a manner consistent with that previously applied to contract markets.

(b) *Acceptable Practices.* [Reserved]

Core Principle 12 of section 5h of the Act—Conflicts of Interest

The swap execution facility shall:

(A) Establish and enforce rules to minimize conflicts of interest in its decision-making process; and

(B) Establish a process for resolving the conflicts of interest.

(a) *Guidance.* [Reserved]

(b) *Acceptable Practices.* [Reserved]

Core Principle 13 of section 5h of the Act—Financial Resources

(A) *In general.* The swap execution facility shall have adequate financial, operational, and managerial resources to discharge each responsibility of the swap execution facility.

(B) *Determination of resource adequacy.* The financial resources of a swap execution facility shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the swap execution facility to cover the operating costs of the swap execution facility for a one-year period, as calculated on a rolling basis.

(a) *Guidance.* [Reserved]

(b) *Acceptable Practices.*

(1) *Reasonable calculation of projected operating costs.* In connection with a swap execution facility calculating its projected operating costs, the Commission has determined that a reasonable calculation should include all expenses necessary for the swap execution facility to comply with the core principles set forth in section 5h of the Act and any applicable Commission regulations. This calculation should be based on the swap execution facility's current level of business and business model, and should take into account any projected modification to its business model (*e.g.,* the addition or subtraction of business lines or operations or other changes), and any projected increase or decrease in its level of business over the next 12 months. The Commission believes, however, that it may be reasonable for a swap execution facility to exclude the following expenses ("excludable expenses") from its projected operating cost calculations:

(i) Costs attributable solely to sales, marketing, business development, product development, or recruitment and any related travel, entertainment, event, or conference costs;

(ii) Compensation and related taxes and benefits for swap execution facility personnel who are not necessary to ensure that the swap execution facility is able to comply with the core principles set forth in section 5h of the Act and any applicable Commission regulations;

(iii) If a swap execution facility offers two or more *bona fide* execution methods (*e.g.*, it offers both an electronic central limit order book and voice execution via voice brokers), the swap execution facility may include the costs related to at least one of the execution methods that it offers, and may exclude the costs related to the other execution method(s) that it offers (*i.e.*, if a swap execution facility includes in its projected operating costs the costs associated with its central limit order book, it may exclude the costs related to its voice execution service, or vice-versa). A *bona fide* method here refers to a method actually used by the SEF's market participants and not established by a SEF on a *pro forma* basis for the purpose of complying with—or evading—Core Principle 13.

(iv) Costs for acquiring and defending patents and trademarks for swap execution facility products and related intellectual property;

(v) Magazine, newspaper, and online periodical subscription fees;

(vi) Tax preparation and audit fees;

(vii) To the extent not covered by paragraphs (b)(1)(ii) or (iii) above, the variable commissions that a voice-based swap execution facility may pay to its SEF trading

specialists (as defined under § 37.201(c)), calculated as a percentage of transaction revenue generated by the voice-based swap execution facility. Unlike fixed salaries or compensation, such variable commissions are not payable unless and until revenue is collected by the swap execution facility; and

(viii) Any non-cash costs, including depreciation and amortization.

(2) *Pro-rated expenses.* The Commission recognizes that, in the normal course of a swap execution facility's business, there may be an expense (*e.g.*, typically related to overhead) that is only partially attributable to a swap execution facility's ability to comply with the core principles set forth in section 5h of the Act and any applicable Commission regulations; accordingly, such expense may need to be only partially attributed to the swap execution facility's projected operating costs. For example, if a swap execution facility's office rental space includes marketing personnel and compliance personnel, the swap execution facility may exclude the pro-rated office rental expense attributable to the marketing personnel. In order to pro-rate an expense, a swap execution facility should:

(i) Maintain sufficient documentation that reasonably shows the extent to which an expense is partially attributable to an excludable expense;

(ii) Identify any pro-rated expense in the financial reports that it submits to the Commission pursuant to § 37.1306; and

(iii) Sufficiently explain why it pro-rated any expense. Common allocation methodologies that can be used include actual use, headcount, or square footage. A swap execution facility may provide documentation, such as copies of service agreements,

other legal documents, firm policies, audit statements, or allocation methodologies to support its determination to pro-rate an expense.

(3) *Expenses allocated among affiliates.* The Commission recognizes that a swap execution facility may share certain expenses with affiliated entities, such as parent entities or other subsidiaries of the parent. For example, a swap execution facility may share employees (including employees on secondment from an affiliate) that perform similar tasks for the affiliated entities or may share office space with its affiliated entities. Accordingly, the Commission believes that it would be reasonable, for purposes of calculating its projected operating costs, for a swap execution facility to pro-rate any shared expense that the swap execution facility pays for, but only to the extent that such shared expense is actually attributable to the affiliate and for which the swap execution facility is reimbursed. Similarly, a reasonable calculation of a swap execution facility's projected operating costs must include the pro-rated amount of any expense paid for by an affiliated entity to the extent that the shared expense is attributable to the swap execution facility. In order to pro-rate a shared expense, the swap execution facility should:

(i) Maintain sufficient documentation that reasonably shows the extent to which the shared expense is attributable to and paid for by the swap execution facility and/or affiliated entity;

(ii) Identify any shared expense in the financial reports that it submits to the Commission; and

(iii) Sufficiently explain why it pro-rated any shared expense. A swap execution facility may provide documentation, such as copies of service agreements, other legal

documents, firm policies, audit statements, or allocation methodologies, that reasonably shows how expenses are attributable to, and paid for by, the swap execution facility and/or its affiliated entities to support its determination to pro-rate an expense.

Core Principle 14 of section 5h of the Act—System Safeguards

The swap execution facility shall:

(A) Establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk, through the development of appropriate controls and procedures, and automated systems, that:

(1) Are reliable and secure; and

(2) Have adequate scalable capacity;

(B) Establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for:

(1) The timely recovery and resumption of operations; and

(2) The fulfillment of the responsibilities and obligations of the swap execution facility; and

(C) Periodically conduct tests to verify that the backup resources of the swap execution facility are sufficient to ensure continued:

(1) Order processing and trade matching;

(2) Price reporting;

(3) Market surveillance; and

(4) Maintenance of a comprehensive and accurate audit trail.

(a) *Guidance.*

(1) *Risk analysis and oversight program.* In addressing the categories of its risk analysis and oversight program, a swap execution facility should follow generally accepted standards and best practices with respect to the development, operation, reliability, security, and capacity of automated systems.

(2) *Testing.* A swap execution facility's testing of its automated systems and business continuity-disaster recovery capabilities should be conducted by qualified, independent professionals. Such qualified independent professionals may be independent contractors or employees of the swap execution facility, but should not be persons responsible for development or operation of the systems or capabilities being tested.

(3) *Coordination.* To the extent practicable, a swap execution facility should:

(i) Coordinate its business continuity-disaster recovery plan with those of the market participants it depends upon to provide liquidity, in a manner adequate to enable effective resumption of activity in its markets following a disruption causing activation of the swap execution facility's business continuity-disaster recovery plan;

(ii) Initiate and coordinate periodic, synchronized testing of its business continuity-disaster recovery plan with those of the market participants it depends upon to provide liquidity; and

(iii) Ensure that its business continuity-disaster recovery plan takes into account such plans of its telecommunications, power, water, and other essential service providers.

(b) *Acceptable Practices.* [Reserved]

Core Principle 15 of section 5h of the Act—Designation of Chief Compliance Officer

(A) *In general.* Each swap execution facility shall designate an individual to serve as a chief compliance officer.

(B) *Duties.* The chief compliance officer shall:

(1) Report directly to the board or to the senior officer of the facility;

(2) Review compliance with the core principles in this subsection;

(3) In consultation with the board of the facility, a body performing a function similar to that of a board, or the senior officer of the facility, resolve any conflicts of interest that may arise;

(4) Be responsible for establishing and administering the policies and procedures required to be established pursuant to this section;

(5) Ensure compliance with the Act and the rules and regulations issued under the Act, including rules prescribed by the Commission pursuant to section 5h of the Act; and

(6) Establish procedures for the remediation of noncompliance issues found during compliance office reviews, look backs, internal or external audit findings, self-reported errors, or through validated complaints.

(C) *Requirements for procedures.* In establishing procedures under paragraph (B)(6) of this section, the chief compliance officer shall design the procedures to establish the handling, management response, remediation, retesting, and closing of noncompliance issues.

(D) *Annual reports.*

(1) *In general.* In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of:

(i) The compliance of the swap execution facility with the Act; and

(ii) The policies and procedures, including the code of ethics and conflict of interest policies, of the swap execution facility.

(2) *Requirements.* The chief compliance officer shall:

(i) Submit each report described in clause (1) with the appropriate financial report of the swap execution facility that is required to be submitted to the Commission pursuant to section 5h of the Act; and

(ii) Include in the report a certification that, under penalty of law, the report is accurate and complete.

(a) *Guidance.* [Reserved]

(b) *Acceptable Practices.*

(1) *Qualifications of chief compliance officer.* In determining whether the background and skills of a potential chief compliance officer are appropriate for fulfilling the responsibilities of the role of the chief compliance officer, the swap execution facility has the discretion to base its determination on the totality of the qualifications of the potential chief compliance officer, including, but not limited to, compliance experience, related career experience, training, and any other relevant factors to the position. A swap execution facility should be especially vigilant regarding potential conflicts of interest when appointing a chief compliance officer.

Appendix C to Part 37 – Demonstration of Compliance that a Swap Contract is Not Readily Susceptible to Manipulation

The swap execution facility shall permit trading only in swaps that are not readily susceptible to manipulation.

(a) *Guidance for cash-settled swaps.*

(1) *General provision.* In general, a cash-settled swap contract is an agreement to exchange a series of cash flows over a period of time based on some reference price,

which could be a single price, such as an absolute level or a differential, or a price index calculated based on multiple observations. Such a reference price may be reported by the swap execution facility itself or by an independent third party. When listing a swap contract for trading, a swap execution facility shall ensure the swap contract's compliance with Core Principle 3, focusing on the reference price used to determine the exchanges of cash flows. A swap execution facility should either (i) calculate its own reference price, using suitable and well-established acceptable methods; or (ii) carefully select a reliable third-party index.

(2) *Reference price susceptibility to manipulation.* A swap execution facility must specify the reference price used for its swap contract and determine that the reference price is not readily susceptible to manipulation pursuant to SEF Core Principle 3. Accordingly, any reference price that is used in establishing the swap contract's cash settlement price should be assessed for its reliability as an indicator of cash market values in the underlying commercial market. Documentation demonstrating that the reference price is a reliable indicator of market values and conditions and is widely recognized by industry/market agents should be provided. Such documentation may be in various forms, including carefully documented interviews with principal market trading agents, pricing experts, marketing agents, etc. Additionally, careful consideration should be given to the potential for manipulation or distortion, when using the reference price to establish the swap's cash settlement price. The cash-settlement calculation should involve appropriate computational procedures that eliminate or reduce the impact of potentially unrepresentative data (*i.e.*, outliers).

(i) Where a swap execution facility itself generates the reference price, the swap execution facility should establish calculation procedures that safeguard against potential attempts to artificially influence the price. For example, if the reference price is derived by the swap execution facility based on a survey of cash market sources, then the swap execution facility should maintain a list of such reputable sources with knowledge of the cash market. In addition, the sample of sources polled should be representative of the cash market, and the poll should be conducted at a time when trading in the cash market is active and include the most liquid markets.

(ii) Where an independent, private-sector third party calculates the reference price, the swap execution facility should verify that the third party utilizes business practices that minimize the opportunity or incentive to manipulate the cash-settlement price series. Such safeguards may include lock-downs, prohibitions against derivatives trading by its employees, or public dissemination of the names of sources and the price quotes they provide. Because a cash-settled swap contract may create an incentive to manipulate or artificially influence the underlying commercial market from which the cash-settlement price is derived or to exert undue influence on the cash-settlement computation in order to profit on a derivative position in that commodity, a swap execution facility should, whenever practicable, enter into an information-sharing agreement with the third-party provider which would enable the swap execution facility to better detect and prevent manipulative behavior. A swap execution facility should also consider the need for a licensing agreement that will ensure the swap execution facility's rights to the use of the price series to settle the listed contract.

(3) *Contract terms and conditions.* An acceptable specification of the terms and conditions of a cash-settled swap contract would include, but may not be limited to, rules that address, as appropriate, the following criteria and comply with the associated standards:

(i) *Commodity characteristics.* The terms and conditions of a cash-settled swap contract should describe or define all of the economically significant characteristics or attributes of the commodity underlying the contract.

(ii) *Contract size and trading unit*. For standardized swap contracts, the contract size or size range should be clearly defined and consistent with customary transactions in the cash market. A swap execution facility may opt to set the swap contract size smaller than that of standard cash market transactions. For non-standardized swap contracts, a swap execution facility may allow the contract size or size range to be negotiable.

(iii) *Cash settlement procedure.* A cash settlement price should be an accurate and reliable indicator of prices in the underlying cash market. A cash settlement price also should be acceptable to commercial users of the cash-settled swap contract. A swap execution facility should fully document that a settlement price is accurate, reliable, widely regarded by industry/market participants. To the extent possible, the cash settlement price series of the swap should be based on reference prices that are publicly available on a timely basis. A swap execution facility should make the cash settlement price, as well as any other supporting information that is appropriate for release to the public, available to the public when cash settlement is conducted. If the cash settlement price is based on reference prices that are obtained from non-public sources (*e.g.*, cash market surveys conducted by the swap execution facility or by third parties on behalf of

the swap execution facility), then a swap execution facility should make available to the public the cash settlement price as well as any other supporting information that is appropriate or feasible to make available to the public.

(iv) *Minimum price fluctuation (minimum tick).* For standardized swap contracts, the minimum price increment (tick) should be set at a level that is consistent with cash market transactions for the underlying commodity. For non-standardized swap contracts, a swap execution facility may choose to not specify a minimum price increment (tick).

(v) *Intraday market restrictions.* A swap execution facility may have intraday market restrictions that pause or halt trading in the event of extraordinary price moves that may result in distorted prices. If a swap execution facility adopts such restrictions, they should not be unduly restrictive of trading. For swap contracts based on security indexes, intraday price limits and trading halts should be coordinated with circuit breakers of national security exchanges.

(vi) *Last trading day.* If a swap execution facility chooses to allow trading to occur through the determination of a settlement price, then the swap execution facility should demonstrate that swap trading would not distort the settlement price calculation. For standardized swap contracts, specification of the last trading day should take into consideration whether the volume of transactions underlying the cash settlement price would be unduly limited by the occurrence of holidays or traditional holiday periods in the cash market. For non-standardized swap contracts, a swap execution facility may allow the last trading day to be negotiable.

(b) *Guidance for physically-settled swaps.*

(1) *General definition.* A physically-settled swap contract is any swap agreement, as defined in section 1a(47) of the Act, that may result in physical settlement. Generally, these are agreements where the primary intent is to transfer the financial risk associated with the underlying commodity and not primarily to make or take delivery of the commodity.

(2) *Estimating deliverable supplies.* A swap execution facility should estimate the deliverable supply for which a swap contract is not readily susceptible to manipulation. The estimate of deliverable supply should be adequate to ensure that the swap contract is not readily susceptible to price manipulation. In general, the term "deliverable supply" means the quantity of the commodity meeting the swap contract's delivery specifications that reasonably can be expected to be readily available to short traders and salable by long traders at its market value in normal cash marketing channels at the swap contract's delivery points during the specified delivery period, barring abnormal movement in interstate commerce. For a non-financial physically-settled swap contract, this estimate should include all available supply that meets the swap contract's specifications and can be delivered at prevailing market prices via the delivery procedures set forth in the swap contract. Among this eligible supply, the estimate of deliverable supply can consist of:

(i) Commercially available imports;

(ii) Product which is in storage at the delivery point(s) specified in the swap contract; and

(iii) Product which is available for sale on a spot basis within the marketing channels that normally are tributary to the delivery point(s). Furthermore, an estimate of deliverable supply should exclude quantities that at current price levels are not

economically obtainable or deliverable or were previously committed for long-term agreements. The size of commodity supplies that are committed to long-term agreements may be estimated by consulting with market participants. However, if the estimated deliverable supply that is committed for long-term agreements, or significant portion thereof, can be demonstrated by the swap execution facility to be consistently and regularly made available to the spot market for shorts to acquire at prevailing economic values, then those "available" supplies committed for long-term contracts may be included in the swap execution facility's estimate of deliverable supply for that commodity. To the extent possible and that data resources permit, deliverable supply estimates should be constructed such that the data reflect the market defined by the swap contract's terms and conditions, and should be formulated, whenever possible, with government or publicly available data. All deliverable supply estimates should be fully defined, have all underlying assumptions explicitly stated, and have documentation of all data/information sources in order to permit estimate replication by Commission staff.

(iv) *Accounting for variations in deliverable supplies.* To assure the availability of adequate deliverable supplies, a swap contract's terms and conditions should assess adequately the potential range of deliverable supplies and account for variations in the patterns of production, consumption, and supply over a period of at least three years. This assessment also should consider seasonality, growth, and market concentration in the production/consumption of the underlying cash commodity. Patterns of variations in the deliverable supply are more apparent when deliverable supply estimates are calculated on a monthly basis and when such monthly estimates are provided for at least the most recent three years for which data resources permit. For commodities with

seasonal supply or demand characteristics, the deliverable supply analysis should include that period when potential supplies typically are at their lowest levels. In addition, consideration should be given to the relative roles of producers, merchants, and consumers in the production, distribution, and consumption of the cash commodity and whether the underlying commodity exhibits a domestic or international export focus. Careful consideration also should be given to the quality of the cash commodity, the movement or flow of the cash commodity in normal commercial channels, and any external factors or regulatory controls that could affect the price or supply of the cash commodity.

(3) *Contract terms and conditions.* For a swap contract that is settled by physical delivery, the terms and conditions of the contract should conform to the most common commercial practices and conditions in the cash market for the commodity underlying the swap contract. The terms and conditions should be designed to avoid any impediments to the delivery of the commodity so as to promote convergence between the value of the swap contract and the cash market value of the commodity at the expiration of the swap contract. An acceptable specification of terms and conditions would include, but may not be limited to, rules that address, as appropriate, the following criteria and comply with the associated standards:

(i) *Quality standards.* The terms and conditions of a swap contract should describe or define all of the economically significant characteristics or attributes of the commodity underlying the contract. In particular, the quality standards should be described or defined so that such standards reflect those used in transactions in the commodity in normal cash marketing channels. Documentation establishing that the

quality standards of the swap contract's underlying commodity comply with those accepted/established by the industry, by government regulations, and/or by relevant laws should also be submitted. For any particular swap contract, the specific attributes that should be enumerated depend upon the individual characteristics of the underlying commodity. These may include, for example, the following items: grade, quality, purity, weight, class, origin, growth, issuer, originator, maturity window, coupon rate, source, hours of trading, etc. If the terms of the swap contract provide for the delivery of multiple qualities of a specific attribute of the commodity having different cash market values, then a "par" quality should be specified with price differentials applicable to the "non-par" qualities that reflect discounts or premiums commonly observed or expected to occur in the cash market for that commodity.

(ii) *Delivery points and facilities.* Delivery point/area specifications should provide for delivery at a single location or at multiple locations where the underlying cash commodity is normally transacted or stored and where there exists a viable cash market(s). If multiple delivery points are specified and the value of the commodity differs between these locations, a swap contract's terms should include price differentials that reflect usual and observed differences in value between the different delivery locations. If the price relationships among the delivery points are unstable and a swap execution facility chooses to adopt fixed locational price differentials, such differentials should fall within the range of commonly observed or expected commercial price differences. In this regard, any price differentials should be supported with cash price data for the delivery location(s) for a period of three years. The price differential should be updated periodically to reflect prevailing market conditions. The terms and conditions

of a swap contract also should specify, as appropriate, any conditions the delivery facilities and/or delivery facility operators should meet in order to be eligible for delivery. Specification of any requirements for delivery facilities also should consider the extent to which ownership of such facilities is concentrated and whether the level of concentration would be susceptible to manipulation of the swap contract's prices. Physically-settled swap contracts also should specify appropriately detailed delivery procedures that describe the responsibilities of deliverers, receivers, and any required third parties in carrying out the delivery process. Such responsibilities could include allocation between buyer and seller of all associated costs such as load-out, document preparation, sampling, grading, weighing, storage, taxes, duties, fees, drayage, stevedoring, demurrage, dispatch, etc. Required accreditation for third-parties also should be detailed. These procedures should seek to minimize or eliminate any impediments to making or taking delivery by both deliverers and takers of delivery to help ensure convergence of the cash price and swap price.

(iii) *Delivery period and last trading day*. An acceptable specification of the delivery period would allow for sufficient time for deliverers to acquire the deliverable commodity and make it available for delivery, considering any restrictions or requirements imposed by the swap execution facility. For standardized swap contracts, specification of the last trading day for expiring swap contracts should consider whether adequate time remains after the last trading day to allow for delivery on the contract. For non-standardized swap contracts, a swap execution facility may allow the delivery period to be negotiable.

(iv) *Contract size and trading unit*. Generally, swap contract sizes and trading units for standardized contracts should be determined after a careful analysis of relevant cash market trading practices, conditions, and deliverable supply estimates, so as to ensure that the underlying commodity market and available supply sources are able to support the contract sizes and trading units at all times. For non-standardized swap contracts, a swap execution facility may allow the contract sizes and trading units to be negotiable.

(v) *Delivery pack*. The term "delivery pack" refers to the specific cash market packaging standards (*e.g.*, product may be delivered in burlap or polyethylene bags stacked on wooden pallets) or non-quality related standards regarding the composition of commodity within a delivery unit (*e.g.*, product must all be imported from the same country or origin). An acceptable specification of the delivery pack or composition of a swap contract's delivery unit should reflect, to the extent possible, specifications commonly applied to the commodity traded or transacted in the cash market.

(vi) *Delivery instrument*. An acceptable specification of the delivery instrument (*e.g.*, warehouse receipt, depository certificate or receipt, shipping certificate, bill of lading, in-line transfer, book transfer of securities, etc.) would provide for its conversion into the cash commodity at a commercially-reasonable cost. Transportation terms (*e.g.*, FOB, CIF, freight prepaid to destination) as well as any limits on storage or certificate daily premium fees should be specified. These terms should reflect cash market practices and the customary provision for allocating delivery costs between buyer and seller.

(vii) *Inspection provisions*. Any inspection/certification procedures for verifying compliance with quality requirements or any other related delivery requirements (*e.g.*,

discounts relating to the age of the commodity, etc.) should be specified in the swap contract's rules. An acceptable specification of inspection procedures would include the establishment of formal procedures that are consistent with procedures used in the cash market. To the extent that formal inspection procedures are not used in the cash market, an acceptable specification would contain provisions that assure accuracy in assessing the commodity, that are available at a low cost, that do not pose an obstacle to delivery on the swap contract and that are performed by a reputable, disinterested third party or by qualified swap execution facility employees. Inspection terms also should detail which party pays for the service, particularly in light of the possibility of varying inspection results.

(viii) *Delivery months.* Delivery months should be established based on the risk management needs of commercial entities as well as the availability of deliverable supplies in the specified months.

(ix) *Minimum price fluctuation (minimum tick).* For standardized swap contracts, the minimum price increment (tick) should be set at a level that is in line with cash market transactions for the underlying commodity. For non-standardized swap contracts, a swap execution facility may choose to not specify a minimum price increment (tick).

(x) *Maximum price fluctuation limits.* A swap execution facility may adopt price limits to (1) reduce or constrain price movements in a trading day that may not be reflective of true market conditions but might be caused by traders overreacting to news and (2) provide a "cooling-off" period for swap market participants to respond to bona fide changes in market supply and demand fundamentals that would lead to large cash and swap price changes. If price limit provisions are adopted, the limits should be set at

levels that are not overly restrictive in relation to price movements in the cash market for the commodity underlying the swap contract.

(c) *Guidance for options on swap contracts.*

The Commission believes that, provided the underlying swap complies with the relevant guidance in this Appendix C, any specification of the following terms would be acceptable; the primary requirement is that such terms be specified in an objective manner in the option contract's rules:

(1) Exercise method;

(2) Exercise procedure;

(3) Strike price provisions;

(4) Automatic exercise provisions;

(5) Contract size;

(6) Option expiration and last trading day; and (vii) option type and trading convention; and

(7) For non-standardized swap contracts, a swap execution facility may allow these contract terms to be negotiable.

(d) *Guidance for options on physicals contracts.*

(1) Under the Commission's regulations, the term "option on physicals" refers to option contracts that do not provide for exercise into an underlying futures contract. Upon exercise, options on physicals can be settled via physical delivery of the underlying commodity or by a cash payment. Thus, options on physicals raise many of the same issues associated with trading in other types of swap contracts such as the adequacy of deliverable supplies or acceptability of the cash settlement price series. In this regard, an

option that is cash settled based on the settlement price of a futures contract or a swap contract would be considered an "option on physicals" and the futures or swap settlement price would be considered the cash price series.

(2) In view of the above, acceptable practices for the terms and conditions of options on physicals contracts include, as appropriate, those practices set forth above for physical-delivery or cash-settled swap contracts plus the practices set forth for options on swap contracts.

PART 38 – DESIGNATED CONTRACT MARKETS

9. The authority citation for part 38 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6c, 6d, 6e, 6f, 6g, 6i, 6j, 6k, 6l, 6m, 6n, 7, 7a-2, 7b, 7b-1, 7b-3, 8, 9, 15, and 21, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376.

§§ 38.11 and 38.12 [Removed and reserved]

10. Remove and reserve §§ 38.11 and 38.12.

PART 39 – DERIVATIVES CLEARING ORGANIZATIONS

11. The authority citation for part 39 continues to read as follows:

Authority: 7 U.S.C. 2, 7a-1, and 12a; 12 U.S.C. 5464; 15 U.S.C. 8325.

12. In § 39.12, revise paragraph (b)(7) to read as follows:

§ 39.12 Participant and product eligibility.

* * * * *

(b) * * *

(7) *Time frame for clearing*—(i) *Coordination with markets and clearing members.* (A) Each derivatives clearing organization shall coordinate with each designated contract market and swap execution facility that lists for trading a product that

is cleared by the derivatives clearing organization in developing rules and procedures to facilitate prompt, efficient, and accurate processing and routing of all agreements, contracts, and transactions submitted to the derivatives clearing organization for clearing.

(B) Each derivatives clearing organization shall coordinate with each clearing member that is a futures commission merchant, swap dealer, or major swap participant to establish systems that enable the clearing member, or the derivatives clearing organization acting on its behalf, to accept or reject each agreement, contract, or transaction submitted to the derivatives clearing organization for clearing by or for the clearing member or a customer of the clearing member as quickly as would be technologically practicable if fully automated systems were used.

(ii) *Agreements, contracts, and transactions submitted for clearing to a derivatives clearing organization.* Each derivatives clearing organization shall have rules that provide that the derivatives clearing organization will accept or reject for clearing all agreements, contracts, and transactions as quickly after submission to the derivatives clearing organization as would be technologically practicable if fully automated systems were used. The derivatives clearing organization shall accept all agreements, contracts, and transactions:

(A) For which the executing parties have clearing arrangements in place with clearing members of the derivatives clearing organization;

(B) For which a derivatives clearing organization has been identified as the intended clearinghouse; and

(C) That satisfy the criteria of the derivatives clearing organization, including, but not limited to, applicable risk filters; provided that such criteria are non-discriminatory

across trading venues and are applied as quickly as would be technologically practicable if fully automated systems were used.

* * * * *

PART 43 – REAL-TIME PUBLIC REPORTING

13. The authority citation for part 43 continues to read as follows:

Authority: 7 U.S.C. 2(a), 12a(5) and 24a, as amended by Pub. L. 111–203, 124 Stat. 1376 (2010).

14. Revise § 43.2 to read as follows:

§ 43.2 Definitions.

As used in this part:

Act means the Commodity Exchange Act, as amended, 7 U.S.C. 1 et seq.

Affirmation means the process by which parties to a swap verify (orally, in writing, electronically or otherwise) that they agree on the primary economic terms of a swap (but not necessarily all terms of the swap). Affirmation may constitute "execution" of the swap or may provide evidence of execution of the swap, but does not constitute confirmation (or confirmation by affirmation) of the swap.

Appropriate minimum block size means the minimum notional or principal amount for a category of swaps that qualifies a swap within such category as a block trade or large notional off-facility swap.

As soon as technologically practicable means as soon as possible, taking into consideration the prevalence, implementation and use of technology by comparable market participants.

Asset class means a broad category of commodities including, without limitation, any "excluded commodity" as defined in section 1a(19) of the Act, with common

characteristics underlying a swap. The asset classes include interest rate, foreign exchange, credit, equity, other commodity and such other asset classes as may be determined by the Commission.

Block trade means a publicly reportable swap transaction that:

(1) Involves a swap that is listed on a registered swap execution facility or designated contract market;

(2) Is executed on a registered swap execution facility or occurs away from a designated contract market's trading system or platform and is executed pursuant to that designated contract market's rules;

(3) Has a notional or principal amount at or above the appropriate minimum block size applicable to such swap; and

(4) Is reported subject to the rules and procedures of the registered swap execution facility or designated contract market and the rules described in this part, including the appropriate time delay requirements set forth in § 43.5.

Business day means the twenty-four hour day, on all days except Saturdays, Sundays and legal holidays, in the location of the reporting party or registered entity reporting data for the swap.

Business hours mean the consecutive hours of one or more consecutive business days.

Cap size means, for each swap category, the maximum notional or principal amount of a publicly reportable swap transaction that is publicly disseminated.

Confirmation means the consummation (electronic or otherwise) of legally binding documentation (electronic or otherwise) that memorializes the agreement of the

parties to all terms of a swap. A confirmation shall be in writing (electronic or otherwise) and shall legally supersede any previous agreement (electronic or otherwise) relating to the swap.

Confirmation by affirmation means the process by which one party to a swap acknowledges its assent to the complete swap terms submitted by the other party to the swap. If the parties to a swap are using a confirmation service vendor, complete swap terms may be submitted electronically by a party to such vendor's platform and the other party may affirm such terms on such platform.

Economically related means a direct or indirect reference to the same commodity at the same delivery location or locations, or with the same or a substantially similar cash market price series.

Embedded option means any right, but not an obligation, provided to one party of a swap by the other party to the swap that provides the party holding the option with the ability to change any one or more of the economic terms of the swap as those terms previously were established at confirmation (or were in effect on the start date).

Executed means the completion of the execution process.

Execution means an agreement by the parties (whether orally, in writing, electronically, or otherwise) to the terms of a swap that legally binds the parties to such swap terms under applicable law. Execution occurs simultaneous with or immediately following the affirmation of the swap.

Futures-related swap means a swap (as defined in section 1a(47) of the Act and as further defined by the Commission in implementing regulations) that is economically related to a futures contract.

Large notional off-facility swap means an off-facility swap that has a notional or principal amount at or above the appropriate minimum block size applicable to such publicly reportable swap transaction and is not a block trade as defined in § 43.2.

Major currencies mean the currencies, and the cross-rates between the currencies, of Australia, Canada, Denmark, New Zealand, Norway, South Africa, South Korea, Sweden, and Switzerland.

Non-major currencies mean all other currencies that are not super-major currencies or major currencies.

Novation means the process by which a party to a swap transfers all of its rights, liabilities, duties and obligations under the swap to a new legal party other than the counterparty to the swap. The transferee accepts all of the transferor's rights, liabilities, duties and obligations under the swap. A novation is valid as long as the transferor and the remaining party to the swap are given notice, and the transferor, transferee and remaining party to the swap consent to the transfer.

Off-facility swap means any publicly reportable swap transaction that is not executed on or pursuant to the rules of a registered swap execution facility or designated contract market.

Other commodity means any commodity that is not categorized in the other asset classes as may be determined by the Commission.

Physical commodity swap means a swap in the other commodity asset class that is based on a tangible commodity.

Public dissemination and publicly disseminate means to publish and make available swap transaction and pricing data in a non-discriminatory manner, through the

Internet or other electronic data feed that is widely published and in machine-readable electronic format.

Publicly reportable swap transaction means:

(1) Unless otherwise provided in this part—

(i) Any executed swap that is an arm's-length transaction between two parties that results in a corresponding change in the market risk position between the two parties; or

(ii) Any termination, assignment, novation, exchange, transfer, amendment, conveyance, or extinguishing of rights or obligations of a swap that changes the pricing of the swap.

(2) Examples of executed swaps that do not fall within the definition of publicly reportable swap may include:

(i) Internal swaps between one-hundred percent owned subsidiaries of the same parent entity; and

(ii) Portfolio compression exercises.

(3) These examples represent swaps that are not at arm's length and thus are not publicly reportable swap transactions, notwithstanding that they do result in a corresponding change in the market risk position between two parties.

Real-time public reporting means the reporting of data relating to a swap transaction, including price and volume, as soon as technologically practicable after the time at which the swap transaction has been executed.

Reference price means a floating price series (including derivatives contract prices and cash market prices or price indices) used by the parties to a swap or swaption to determine payments made, exchanged or accrued under the terms of a swap contract.

Remaining party means a party to a swap that consents to a transferor's transfer by novation of all of the transferor's rights, liabilities, duties and obligations under such swap to a transferee.

Reporting party means the party to a swap with the duty to report a publicly reportable swap transaction in accordance with this part and section 2(a)(13)(F) of the Act.

Super-major currencies mean the currencies of the European Monetary Union, Japan, the United Kingdom, and United States.

Swaps with composite reference prices mean swaps based on reference prices that are composed of more than one reference price from more than one swap category.

Transferee means a party to a swap that accepts, by way of novation, all of a transferor's rights, liabilities, duties and obligations under such swap with respect to a remaining party.

Transferor means a party to a swap that transfers, by way of novation, all of its rights, liabilities, duties and obligations under such swap, with respect to a remaining party, to a transferee.

Trimmed data set means a data set that has had extraordinarily large notional transactions removed by transforming the data into a logarithm with a base of 10, computing the mean, and excluding transactions that are beyond four standard deviations above the mean.

Unique product identifier means a unique identification of a particular level of the taxonomy of the product in an asset class or sub-asset class in question, as further described in § 43.4(f) and appendix A to this part. Such unique product identifier may

combine the information from one or more of the data fields described in appendix A to this part.

Widely published means to publish and make available through electronic means in a manner that is freely available and readily accessible to the public.

Issued in Washington, DC, on November 6, 2018, by the Commission.

Christopher Kirkpatrick,

Secretary of the Commission.

NOTE: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Swap Execution Facilities and Trade Execution Requirement – Commission Voting Summary, Chairman's Statement, and Commissioners' Statements

Appendix 1 – Commission Voting Summary

On this matter, Chairman Giancarlo and Commissioners Quintenz, Behnam, and Stump voted in the affirmative. Commissioner Berkovitz voted in the negative.

Appendix 2 – Statement of Chairman J. Christopher Giancarlo

I start by referencing an important White Paper written in 1970 by a young graduate student in economics at UC Berkeley. That White Paper, entitled, "Preliminary Design for an Electronic Market," written for the Pacific Commodity Exchange, was the world's first written conceptualization of a fully electronic, for-profit futures exchange.

The White Paper was written by Dr. Richard Sandor. That White Paper has now been republished in a new book by Dr. Sandor.[1] In it, he recounts how his idea lay mostly dormant through the 1970s to mid-1980s before being slowly developed, in fits and starts, first in Europe in the 1990s and then in the United States in the 2000s. His book notes that electronic execution of futures products with continuous liquidity has become almost ubiquitous today, while other exchange traded asset classes with more episodic liquidity, like options and swaps, continue to trade by voice.

What I found fascinating in Dr. Sandor's recounting of this five-decade long evolution from trading pits to electronic trading of futures was the absence of any grand plan behind the transformation. Instead, it was a series of incremental commercial developments and technology innovations. At all times, the impetus was the demands of market participants and the response of market operators to reduce trading costs and transaction friction. At no time, did government step in and say, "Henceforth, all futures trading shall be on electronic exchanges." Instead, market evolution happened because a good idea was coupled with capable technology and mutual commercial interest with enough time to catch on and gain traction.

Before I joined the Commission, I spent a decade and a half at a leading operator of swaps marketplaces. We launched many innovative electronic platforms still in use today. Some of the platforms caught right on with our customers, others did not. Yet, we designed all of them to increase efficiency and reduce trading friction. It was just that

[1] Sandor, Richard L., "*Electronic Trading & Blockchain: Yesterday, Today and Tomorrow,*" 2018, World Scientific Publishing Co. Pte. Ltd.

sometimes our competitors designed better or cheaper ones or just simply got the timing right.

The point is that the design of trading platforms and the evolution of market structure is best done by platform operators, through trial and error, customer demand, commercial response and technological innovation. Regulators will never be close enough to the heartbeat of the markets, the spark of technology or the cost of development to prescribe the optimal design of trading platforms or business methods. Regulators can never know which trading methods will work best in the full range of market conditions, from low to extreme volatility.

Congress understood this. That is why Title VII of Dodd-Frank permits Swap Execution Facilities (SEFs) to conduct their activities through "any means of interstate commerce," not "such means that may be chosen by regulators."

Once regulators step in and dictate who serves who with what type of service, we are picking winners and losers. We are simply not authorized, nor are we competent, to act in this way. If we do, the winners will invariably be those with the most persuasive voices and best lobbyists.

Congress knew that swaps are not traded by retail participants, but for sophisticated, institutional traders. Wall Street banks, hedge funds, prop shops and large energy companies have the wherewithal to demand the transaction services they need without regulators holding their hands. And the platform operators are not public utilities, but seasoned competitors. If there is money to be made, trading efficiencies to be achieved, customers to be served or costs to be saved, they will find them. If there is a better mousetrap to be built, they will build it.

Unfortunately, the CFTC did not listen to Congress. Contrary to provisions of Dodd-Frank that permit SEFs to operate by "any means of interstate commerce," the current SEF rules constrain swaps trading to two methods of execution – request-for-quote or order book. While swaps not subject to the trade execution mandate can utilize other methods, SEFs must nevertheless provide an order book for such permitted transactions. All other "required" transactions have to be executed exclusively on one of those two options. Further, the rules incorporate a number of practices from futures markets that are antithetical to swaps trading, such as the 15 second "cross" and execution of block trades off platform. Additionally, the SEF core principles are interpreted in ways that are not conducive to environments in which swaps liquidity is formed and price discovery is conducted.

One effect of this approach has been to incentivize the shift of swaps price discovery and liquidity formation away from SEFs to introducing brokers (or "IBs"). SEFs have turned into booking engines for trades formulated elsewhere, often on IBs. Yet, IBs are not appropriate vehicles to formulate swaps transactions. The intended purpose of IBs in the CFTC's regulatory framework is to solicit orders for futures transactions, not swaps. Moving swaps price discovery and liquidity formation away from SEFs to IBs is not what Congress intended in Dodd-Frank. The goal was to have the entire process of swaps liquidity formation, price discovery and trade execution take place on licensed SEF platforms. IBs are not subject to conduct and compliance requirements appropriate for swaps trading. Their employees are not required to pass exams for proficiency in serving institutional market participants in over-the-counter swaps markets but they are for retail customers who are prohibited from trading swaps.

Another effect of the current approach is the paucity of platform innovation and new platform operators competing for market share. The stagnation has allowed a few incumbents to consolidate and dominate market share. According to one large swaps trader, "the biggest disappointment of SEFs is that nothing has really changed. I'm still trading the same way today as I was 10 years ago."[2] And, yet, the current rules were supposed to have caused as much as a hundred firms to register as SEFs.[3]

I have written a few white papers of my own. I have called for revising our current restrictions on SEF activity and allowing flexible methods of execution for swaps transactions using any means of interstate commerce, exactly as Congress intended.[4]

Today's proposal does just that. It will allow SEFs to innovate to meet customer demand and operate trading environments that are more salutatory to the more episodic nature of swaps liquidity. At the same time, it will make the "made available for trading" determination synonymous with the clearing determination to include all swaps subject to the clearing requirement and listed by a SEF or DCM. This is meant to bring the full range of liquidity formation, price discovery and trade execution on SEFs for a broader range of swaps products.

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[2] Robert Mackenzie Smith, "*SEF reforms could distort new, sounder benchmark rates,"* Risk.net, 19 Oct. 2016, at: *https://www.risk.net/derivatives/6049931/sef-reforms-could-distort-new-sounder-benchmark-rates*.

[3] Christopher Doering & Roberta Rampton, "*US May See 100 New Swaps Execution Entities: Broker,"* Reuters, Oct. 12, 2010, at: *https://www.reuters.com/article/us-financial-regulation-sefs/u-s-may-see-100-new-swap-execution-entities-broker-idUSTRE69B69020101012*.

[4] Commissioner J. Christopher Giancarlo, *Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank*, Jan. 29, 2015, *http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf*; ("2015 SEF White Paper"); and *Swaps Regulation Version 2.0: An Assessment of the Current Implementation of Reform and Proposals for Next Steps*, April 26, 2018.

The promotion of swaps trading on SEFs brings "daylight to the marketplace" by subjecting a much broader range of swaps products to SEF record keeping, regulatory supervision and oversight, just as Congress intended.

It is said that if CFTC mandates for minimum trading functionality go away, so will the current degree of electronic execution in the market. Sorry, but that is a naïve concern. Those electronic SEF platforms that are successful provide too much competitive advantage and cost efficiency and sunk costs to be shut down simply because they are no longer subject to a regulatory mandate. No firm is going to give up electronic trading market share and profitability and increase trading friction because regulation suddenly becomes less prescriptive.

A word about "impartial access," Dodd-Frank requires SEFs to have rules to provide market participants with "impartial access" to the market *and* permits SEFs to establish rules regarding any limitation on access.

"Impartial access" means just that, "impartial". It does not mean that SEFs must serve every type of market participant in an all-to-all environment. If it did, then Congress would not have allowed SEFs to establish rules for limitation of access.

The new proposal would establish what is meant by "impartial access". The proposal will generally define "impartial" as transparent, fair and non-discriminatory as applied to all similarly situated market participants in a fair and non-discriminatory manner based on objective, pre-established requirements.

Today's proposal would also enhance the professionalism of SEF personnel who exercise discretion by adopting proficiency requirements and conduct standards suitable for swaps. Furthermore, the proposal adopts rule changes in a number of places where

staff has previously issued guidance or no-action relief from the current rules, thereby increasing regulatory clarity and certainty.

We have approached today's proposal with the principle that the CFTC engage its international counterparts with respect and due consideration. The staff of the CFTC and I have made every effort to ensure that non-U.S. authorities had the opportunity to review and discuss the 2015 SEF White Paper that set out the concepts underlying today's proposal. Based on that outreach, I see no reason why today's proposal would be viewed as inconsistent with the regulatory systems of other G20 jurisdictions. We certainly welcome further dialogue with them. In fact, today's proposal is entirely consistent with, and anticipated by, recent discussions with foreign authorities about the CFTC's SEF regime, including the equivalence agreement for swaps trading platforms with the European Commission that EC Vice President Dombrovskis and I announced one year ago here in this room. That agreement, which focused on an outcomes-based approach toward EU equivalence and CFTC exemptions, was made by both parties with full knowledge and understanding of the changes advocated in the 2015 SEF White Paper and presented to us today.

Let me briefly address today's request for comment on the practice of name give up in swaps markets. There are a range of perspectives on this market practice. I have an open mind as to the advisability of restrictions on the practice and what form a rule would take, if at all. I look forward to comments and hearing more about the current impact of this practice in the marketplace.

One final point: today's proposal will invariably be slammed by opponents of change as a "rollback" of Dodd-Frank. Any such characterization would be disingenuous.

Those who examine my record know that I have been a consistent supporter of the swaps reforms embodied in Title VII of the Dodd-Frank Act. In fact, of the current five Commissioners, I may have been the first to publicly state my support for Title VII.[5] And, I have not waivered since. Congress got Title VII right. There, I said it again.

My support for the Title VII reforms – swaps clearing, swap dealer registration and requirements, trade reporting and regulated swaps execution – is not based on academic theory or political ideology. It is based on fifteen years of commercial experience. Done right, the reforms are good for American markets.

So is today's proposal. It is not a rollback, but a policy improvement, a step forward, to enhance swaps market health and vitality that is true to Congressional intent and purpose. I trust that market participants and interested parties will fairly consider it with the good faith with which it is presented. I look forward to a broad and active discussion.

In closing, I compliment the DMO staff for putting together a balanced rule proposal and request for comment. I would like to commend them for their many hours of hard work, the quality of the written proposal and their thoughtfulness and engagement throughout.

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[5] *Wholesale Markets Brokers' Association, Americas, Commends Historic US Financial legislation,* Jul. 21 2010, available at: *http://www.lexissecuritiesmosaic.com/gateway/CFTC/Speech/01_WMBAA-Dodd-Frank-Law-press-release-final123.pdf.*

You know, it is satisfying to see how an old White Paper, with ample time and reflection, can become a formal proposal, an arrow hitting its mark.

I look forward to the public's comments, healthy discussion, and a final rule in 2019.

Appendix 3 – Supporting Statement of Commissioner Brian D. Quintenz

I will vote in favor of issuing today's proposed rule and the request for comment reforming the regulatory regime of swap execution facilities (SEFs). The Chairman has shown great thought leadership and transparency in consistently and fully articulating his vision for swaps trading rules that would create a more cohesive, liquid swap marketplace. Today's proposal represents a significant step toward executing that vision. I look forward to hearing from market participants about how these broad reforms will work collectively to impact SEF trading dynamics and liquidity formation. Mr. Chairman, I know this day has been a long time coming, and I congratulate you and the Division of Market Oversight for all of your and their tireless work on this proposed rule.

Appendix 4 – Concurring Statement of Commissioner Rostin Behnam

Introduction

Today, the Commission votes to issue proposed rules that would constitute an overhaul of the existing framework for swap execution facilities (SEFs). Given the breadth and complexity of the proposed rules before us, the process of public comment is particularly important. I look forward to receiving input from market participants and the public who would be impacted, in any way, by a reworking of the SEF rules.

Background

As we consider the goals and therefore the direction of any SEF reform, I think it is very important that we first review how we got where we are today. Prior to the 2008 financial crisis, swaps were largely exempt from regulation and traded exclusively over-the-counter, rather than on a regulated exchange.[1] Lack of transparency in the over-the-counter swaps market contributed to the financial crisis because both regulators and market participants lacked the visibility necessary to identify and assess swaps market exposures and counterparty relationships.[2] In the aftermath of the financial crisis, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 (Dodd-Frank Act).[3] The Dodd-Frank Act largely incorporated the international financial reform initiatives for over-the-counter derivatives laid out at the 2009 G20 Pittsburgh Summit aimed at improving transparency, mitigating systemic risk, and protecting against market abuse.[4] Title VII of the Dodd-Frank Act amended the Commodity Exchange Act (CEA or Act) to establish a comprehensive new swaps regulatory framework that includes the registration and oversight of a new registered entity – SEFs. A key goal of Title VII of the Dodd-Frank Act is to bring greater pre-trade and post-trade transparency to the swaps market. The concept of transparency runs

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[1] *See* Commodity Futures Modernization Act of 2000, Public Law 106-554, 114 Stat. 2763 (2000).

[2] *See* The Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (Official Government Edition), at 299, 352, 363-364, 386, 621 n. 56 (2011), *available at https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.*

[3] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

[4] G20, *Leaders' Statement, The Pittsburgh Summit* (Sept. 24-25, 2009) at 9, *available at https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf.*

throughout Title VII – starting with the title itself: the "Wall Street *Transparency* and Accountability Act of 2010."[5]

As part of the Dodd-Frank effort to provide more transparency, in 2013 the Commission adopted the part 37 rules in order to implement a regulatory framework for SEFs.[6] In so doing, the Commission emphasized that "[pre-trade] transparency lowers costs for investors, consumers, and businesses; lowers the risks of the swaps market to the economy; and enhances market integrity to protect market participants and the public."[7]

The relatively young SEF framework has in many ways been a success. There are currently 25 registered SEFs.[8] Trading volume on SEF has been steadily growing each year.[9] The Commission's work to promote swaps trading on SEFs has resulted in increased liquidity, while adding pre-trade price transparency and competition.[10]

This is not to say that the SEF rules were perfect from the start and would not benefit from some targeted changes. Most SEFs operate under multiple no-action letters granted by the Division of Market Oversight. While the purpose of this form of targeted relief was often to smooth the implementation of the SEF framework, codifying or

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[5] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, title VII, Section 701, 124 Stat. 1376 (2010).

[6] Core Principles and Other Requirements for Swap Execution Facilities, 78 FR 33476 (Jun. 4, 2013).

[7] *Id.* at 33477.

[8] *See Trading Organizations – Swap Execution Facilities (SEF)*, CFTC.GOV, *https://sirt.cftc.gov/SIRT/SIRT.aspx?Topic=SwapExecutionFacilities (last visited Nov. 4, 2018)*.

[9] *See FIA SEF Tracker*, FIA.ORG, *https://fia.org/node/1901/* (last visited Nov. 4, 2018).

[10] *See* Bank of England Staff Working Paper No. 580, Centralized Trading, Transparency and Interest Rate Swap Market Liquidity: Evidence from the Implementation of the Dodd-Frank Act (May 2018), pp. 2-4, 18-24, *available at https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2018/centralized-trading-transparency-and-interest-rate-swap-market-liquidity-update*.

eliminating the need for existing no-action relief would provide market participants with greater legal certainty.

The current SEF rules have not brought as much trading onto SEFs as intended or envisioned. We can improve upon that. Currently, the Commission has a regulatory process for SEFs to demonstrate through a multi-factor analysis that a swap has been made-available-to-trade, or "MAT,"[11] meaning that it is required to trade on a SEF or DCM. The current process has resulted in relatively few MAT determinations and, after an initial flurry of submissions for the most standardized and liquid products, no further submissions have been made. I believe that addressing the MAT process could bring more activity on SEF, bringing pre-trade transparency to more products without dismantling the aspects of the SEF rules that are working currently.

Notice of Proposed Rulemaking (NPRM)

While I believe targeted reforms could bring more products onto SEFs, increase transparency, and lower costs for market participants, today's NPRM is far from targeted, and in some instances may represent a regulatory overreach. I therefore have a number of very serious concerns with the NPRM's approach and its far-ranging alterations. First, the NPRM violates the clear language of the Act, which states that one of the major goals of the SEF regulatory regime is to promote pre-trade transparency in the swaps market. As discussed below, the NPRM does exactly the opposite. Second, in addition to reducing transparency, the proposed rule also increases limitations on access to SEFs. The NPRM purports to increase choice and flexibility for SEFs; however, it simultaneously allows SEFs to limit choice and flexibility for market participants. Third,

[11] *See* 17 C.F.R. 37.10, 38.12.

as commenters and the Commission think about the NPRM, I think it is also important to consider whether we would be creating a new registration scheme that adds significant costs for market participants, while failing to address the fixable issues that exist in the market today.

Pre-trade Transparency

Section 1a(50) of the Act defines a 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 . . .."[12] Section 5h(e) of the Act states that "[t]he goal of this section is to promote trading of swaps on swap execution facilities *and to promote pre-trade transparency in the swaps market*."[13] The existing SEF rules establish two methods of execution for required transactions: the central limit order book (CLOB) and the Request for Quote (RFQ) system.[14] These methods were chosen specifically because they provide pre-trade transparency.

I am concerned that the NPRM goes too far by allowing, literally, any means of execution. The NPRM's preamble states that the approach "*should* also promote pre-trade transparency in the swaps market by allowing execution methods that maximize participation and concentrate liquidity . . .." This simply cannot be true. Absent a clear standard of what constitutes pre-trade transparency, it is fairly easy to envision an execution method that would not provide pre-trade transparency – one need look no further than the over-the-counter system that preceded the financial crisis. But this is

[12] 7 U.S.C. 1a(50).

[13] 7 U.S.C. 7b-3(e).

[14] *See* 17 C.F.R. § 37.9.

more than a case of what the Commission *should* or *should not* do. The statute is clear. The Commission must "promote pre-trade transparency in the swaps market." Today's NPRM would not do that.

That is not to say that expanding methods of execution – in a more limited and targeted way – is a bad idea or violates the Act. There are likely other execution methods that fit within section 1a(50) and would promote pre-trade transparency. I look forward to hearing from commenters as to what those methods might be, and debating with my fellow Commissioners as to whether they are appropriate within the confines of congressional intent and ultimately the Act.

Made Available to Trade

As I mentioned earlier, the MAT process is seemingly broken. The Commission stopped receiving MAT submissions after an initial set of submissions for the most standardized and liquid swaps contracts.[15] The Commission has not received any MAT submissions or made any MAT determinations since 2014.[16] This is not what the Commission envisioned in promulgating the Made Available to Trade rule.[17] The solution posited today is, in a sense, a simple, elegant one. The NPRM states that the phrase "makes the swap available to trade" in CEA section 2h(8) should be interpreted to mean that "once the clearing requirement applies to a swap, then the trade execution requirement applies to that swap upon any single SEF or DCM listing the swap for

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[15] *See* CFTC, Industry Oversight, Industry Filings, Swaps Made Available to Trade Determination, *https://sirt.cftc.gov/sirt/sirt.aspx?Topic=%20SwapsMadeAvailableToTradeDetermination*.

[16] *Id*.

[17] *See* Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available to Trade, Swap Transaction Compliance and Implementation Schedule, and Trade Execution Requirement Under the Commodity Exchange Act, 78 FR 33606 (Jun. 4, 2013).

trading." This would take both the SEF and the Commission out of the determination process.

My concern, however, is that there may be products that are more appropriately traded off SEF. In addition, tying the trade execution requirement to the clearing requirement could have unintended consequences – it could actually discourage voluntary central clearing.

I look forward to hearing from commenters regarding the appropriate interpretation of the term "made available to trade", including how to improve the existing process.

Impartial Access

One of the most troubling aspects of the NPRM is that it would alter the Commission's interpretation of "impartial access" under SEF Core Principle 2. Core Principle 2 of the Act requires SEFs to establish and enforce participation rules that "provide market participants with impartial access to the market."[18] Current Commission regulation 37.202(a) states that a SEF "shall provide *any* eligible contract participant . . . with impartial access to its market(s) and market services." (emphasis added). The Commission was clear in the preamble to the existing rules that "the purpose of the impartial access requirement is to prevent a SEF's owners from using discriminatory access requirements as a competitive tool" against certain eligible contract participants.[19] The current rule provides that a SEF can restrict access based on disciplinary history or

[18] 7 U.S.C. 7b-3(f)(2).

[19] *Supra* note 7 at 33508.

financial or operational soundness, if objective, pre-established criteria are used. What a SEF cannot do is restrict access to certain types of participants.

Today's NPRM would roll back this interpretation, leaving the term "impartial access" an empty shell. The proposed rule would "allow SEFs to serve different types of market participants or have different access criteria for different execution methods." This is exactly the type of discrimination that the "impartial access" provision in the Act was intended to prevent.

I believe that *all* market participants should have impartial access to a SEF whose access criteria is applied in a fair and non-discriminatory manner. Rather than erecting new barriers to participation, we should focus on applying our existing regulations as they are clearly written. It seems to me that impartial access theoretically would go hand-in-hand with the proposed widening of SEF execution methods. Instead, the Commission seems to be bending over backwards to be impartial regarding SEFs' modes of execution, while allowing the SEFs themselves to discriminate. This threatens to take us back to the world as it was pre-Dodd-Frank and pre-financial crisis, undermining some of the key successes of the existing SEF regulatory regime regarding transparency and market access.

Registration/Costs

I would like to turn for a minute to the potential costs to market participants – and the Commission – from this proposed rule. Currently, there are 25 registered SEFs.[20] The Proposal will drastically increase the number of SEFs – likely by multiples. In the

[20] *See Trading Organizations – Swap Execution Facilities (SEF)*, CFTC.GOV, *https://sirt.cftc.gov/SIRT/SIRT.aspx?Topic=SwapExecutionFacilities (last visited Nov. 4, 2018)*.

cost benefit considerations to the NPRM, the Commission estimates that approximately 40-60 swaps broking entities, including interdealer brokers, and one single-dealer aggregator platform would need to register as a SEF. That is the universe that we know – the market as we understand it to exist today. There could be more – perhaps many more – entities that will fall under the expanded registration requirements. Just as importantly, we do not know how these new rules will incentivize SEFs – whether they will lead to consolidation or myriad SEFs with myriad methods of execution.

The new registration regime, and the many changes that come along with it, will result in substantial costs all around: to both existing SEFs and new SEF registrants, and to their participants. I note with some concern that, while the preamble provides a laundry list of what rule changes will result in costs, there is no effort to quantify them. Operating or participating in a regulated market comes with costs; but, these incremental costs are offset, in part, by the benefits of having access to a transparent, safe market ecosystem that demands accountability and punishes wrongdoers. I do not mean to suggest anything else. However, as the Commission proceeds with this NPRM, I am hopeful that the best, most cost effective regulatory solutions will prevail as the Commission seeks to improve and advance the health and vibrancy of the SEF marketplace.

Comment Period

I also want to quickly raise a non-substantive concern, but one that may greatly impact the substance of the NPRM. The comment period for the proposal is only 75 days. As I have stated previously, this rulemaking is complex and impacts a wide range of market participants in fundamental ways. There are 105 numbered questions for

commenters in the NPRM's preamble, in addition to general requests for comment. I think it is very important that we give market participants time to carefully consider the proposed rule and make reasoned comments. Recent proposed rules that raised complex issues, like the capital rule and Reg AT, had 90 day comment periods followed by extensions of at least an additional 60 days.[21] The original part 37 notice of proposed rulemaking ultimately had open comment periods totaling 90 days, and market participants had 7 months between publication of the notice of proposed rulemaking and the end of the final comment period.[22] Today's NPRM deserves careful consideration, both from the public and from the Commission, and I hope that the Commission will give market participants the time they need to respond thoughtfully and thoroughly.

Name Give Up Request For Comment

Before I conclude, I would like to turn briefly to the name give-up request for comment that is before us as well, as it is inextricably tied to the SEF NPRM. Post-trade name give-up also relates to the issue of impartial access, which I discussed earlier. While today's SEF NPRM reworks the SEF rules generally, the NPRM does not address the long standing practice of disclosing the identity of each swap counterparty to the other after a trade has been matched anonymously. Instead, the Commission is voting to issue a request for comment seeking public comment on the practice. While I appreciate the desire to be measured and thoughtful on this issue, I fear that not taking a view at this

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[21] Capital Requirements of Swap Dealers and Major Swap Participants, 81 FR 91252 (proposed Dec. 16, 2016), and Capital Requirements of Swap Dealers and Major Swap Participants, 82 FR 13971 (March 16, 2017) (extending comment period an additional 60 days); Regulation Automated Trading, 80 FR 78824 (proposed Dec. 17, 2015), Regulation Automated Trading, 81 FR 85334 (proposed Nov. 25, 2016), and Regulation Automated Trading, 82 FR 8502 (Jan. 26, 2017).

[22] Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR 25274 (May 4, 2011), *available at https://www.gpo.gov/fdsys/pkg/FR-2011-05-04/pdf/2011-10884.pdf.*

time in the proposal may function as an endorsement of the status quo. The request for comment puts name give-up on a slower track than the rest of the rule. Any rule to address the issue will now be well behind the process for the rest of the SEF rules.

Conclusion

As outlined above, I have numerous concerns about this NPRM, both in terms of what the Commission *should* do as policy makers, and in terms of what the Commission *can* do under the law. Congress was clear in the Dodd-Frank Act – the Commission is tasked with bringing greater pre-trade transparency to the swaps market. Today's NPRM not only fails to advance pre-trade transparency, it actually undermines pre-trade transparency that has been achieved through our existing regulations. In addition to the few issues I raise today, the NPRM's changes also demand thoughtful deliberation on equally important issues related to cross-border implications, investigations, audit trails, recordkeeping, and disciplinary hearings to name just a few.

As I read through the NPRM, I noticed a common thread that naturally aims to shift the current part 37 regime to a less prescriptive, and more principles based regime. The frequent weaving of words into the text of the NPRM like, *defer, flexible, reasonable, and discretion* stand as a clear declaration of where this proposal's authors want it to go. I have long been a proponent of sensible principles based regulation. I believe our markets, and more importantly this agency, are strongly rooted in a principles based regulatory regime. However, like the words of this NPRM, I have woven my own thoughts on striking the right balance between principles based and rules based regulation. Principles based regulation certainly does not mean an absence of rules—or the absence of supervision.

In remarks I delivered in February of this year, I stated, "…[w]hile I strongly oppose any roll backs of Dodd-Frank initiatives, I believe a principles-based approach to implementation can be suitable in certain instances. A principles-based approach provides greater flexibility, but more importantly focuses on thoughtful consideration, evaluation, and adoption of policies, procedures, and practices as opposed to checking the box on a predetermined, one-size-fits-all outcome. However, the best principles-based rules in the world will not succeed absent: (1) clear guidance from regulators; (2) adequate means to measure and ensure compliance; and (3) willingness to enforce compliance and punish those who fail to ensure compliance with the rules."[23]

If the Commission was voting on a final rule today, my vote would be no. However, I fully recognize that our existing part 37 rules are not perfect. Bringing more activity on SEF is a laudable goal, both from a policy perspective and because Congress has tasked the Commission with doing so. I will support today's proposed rule because I believe that it is important that we hear from market participants regarding what aspects of the NPRM will improve the regulatory framework for SEFs, while staying within our responsibilities under the law.

[23] Rostin Behnam, Commissioner, U.S. Comm. Fut. Trading Comm'n, Remarks of Rostin Behnam before FIA/SIFMA Asset Management Group, Asset Management Derivatives Forum 2018, Dana Point, California (Feb. 8, 2018), *https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam2*.

Appendix 5 – Dissenting Statement of Commissioner Dan M. Berkovitz

I. Summary of Dissenting Views

I respectfully dissent from the Commodity Futures Trading Commission's ("CFTC" or "Commission") notice of proposed rulemaking regarding Swap Execution Facilities and Trade Execution Requirement (the "Proposal"). This Proposal would reduce competition and diminish price transparency in the swaps market, which will lead to higher costs for end users and increase systemic risks.

The Proposal would abandon the commitments the United States made at the G20 Summit in Pittsburgh in 2009 to trade standardized swaps on exchanges or electronic trading platforms and is contrary to Congressional direction in the Dodd-Frank Act and the Commodity Exchange Act ("CEA") reflecting those commitments. It would retreat from the progress made by the Commission and the financial industry in implementing those reforms.

The Proposal would reduce competition by cementing the oligopoly of the largest bank dealers as the main source of liquidity and pricing in the swaps markets. It would diminish transparency by removing the requirement that highly liquid swaps be traded through competitive methods of trading. By reducing competition and diminishing price transparency, the Proposal would increase systemic risks and lead to higher swaps prices for commercial and financial end-users. Ultimately, the millions of Americans who indirectly participate in the swaps market through their investments in retirement accounts, pension plans, home mortgages, and mutual funds will pay that higher cost. Finally, the Proposal would provide SEFs with too much discretion to set their own rules and in so doing, weaken regulatory oversight and enforcement capabilities.

II. Major Flaws in the Proposal

The evidence is clear that the Dodd-Frank reforms, including the Commission's swap execution regulations, have led to more competition, greater liquidity, more electronic trading, better price transparency, and lower prices for swaps that are required to be traded on regulated platforms. Numerous academic studies and reports by market consultants have documented these benefits.[1] The Proposal ignores this evidence and analysis.

The Proposal would jettison the regulatory foundation for the way swap execution facilities ("SEFs") currently operate. It would delete the requirement that swaps that are subject to the trade execution mandate ("Required Transactions") be traded either on Order Book or by a request for quote from at least three market participants ("RFQ-3"). This would undermine the Congressional directive in the Dodd-Frank Act that for Required Transactions, a SEF provide multiple participants with "the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system."[2] Consequently, the Proposal would lead to less price transparency and less competition.

The Proposal also would gut the impartial access requirement in the Dodd-Frank Act. The statute requires SEFs to establish rules that "provide market participants with impartial access to the market."[3] Authorizing discrimination based on the type of entity will permit the largest bank-dealers to establish and maintain exclusive pools of liquidity for themselves. By denying other market participants access to the most favorable prices

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[1] *See infra* section II.

[2] 7 U.S.C. 1a(50).

[3] 7 U.S.C. 7b-3(f)(2)(B)(i).

in the dealer-to-dealer market, bank dealers can prevent others from cost-effectively competing with them for customers. Eliminating competition will result in higher prices for customers. Permitting large banks and dealers to discriminate in this manner is inconsistent with sound economic principles underpinning competitive markets and the CEA's impartial access requirement.

In pursuit of the goal of "flexibility" for SEF markets, the Proposal deletes, reverses, or waters down many key trading, access, and compliance requirements for SEFs. The wide latitude that would be granted to SEFs as to how swaps may be traded, who may trade them, the oversight of the marketplace, and the conduct of the brokers looks very much like the "light-touch" approach to regulation that was discredited by the financial crisis.

Seven years ago, as the Commission was formulating the current regulations, very little data was available on swap trading and pricing. But now, after six years of experience with those regulations, we have an extensive amount of data, collected by SEFs and swap data repositories. The Commission should base its regulatory decisions on this data and the studies and literature that have analyzed this data and demonstrated the benefits of the current swap trading requirements.

Unfortunately, the Proposal does not consider the available data and market studies that demonstrate the current RFQ-3 system is working well to provide highly competitive prices and low transaction costs. For example, the Proposal ignores the following studies and conclusions:

- **CFTC economists' study (2018).**[4] This study, conducted by four CFTC economists, concluded: "Judged from our evidence, SEF-traded index CDS market seems to be working well after Dodd-Frank—dealers' response rates are high, the vast majority of customer orders result in trades, and customers' transaction costs are low."[5] With respect to the most liquid CDS index swaps, the CFTC economists found that "the average transaction cost is statistically and economically close to zero."[6]

- **Bank of England Staff Working Paper (2018).**[7] This Bank of England paper concluded that the CFTC's trade execution mandate, including the RFQ-3 requirement, has led to a "sharp increase in competition between swap dealers" in dealer-to-customer transactions for interest rate swaps subject to the mandate.[8] The study concluded that this competition had led to "a substantial reduction in execution costs," amounting "to daily savings in execution costs of as much as $3-$6 million for end-users of USD swaps."[9]

- **Study of "Market Structure and Transaction Costs of Index CDSs" (2017).**[10] This study found that prices customers obtained in the dealer-to-customer

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[4] Lynn Riggs (CFTC), Esen Onur (CFTC), David Reiffen (CFTC) & Haoxiang Zhu (MIT, NBER, and CFTC), *Swap Trading after Dodd-Frank: Evidence from Index CDS* (Jan. 26, 2018) ("CFTC Economist Study").

[5] *Id*. at 50.

[6] *Id*. at 43.

[7] Evangelos Benos, Richard Payne & Michalis Vasios, *Centralized trading, transparency and interest rate swap market liquidity: evidence from the implementation of the Dodd-Frank Act*, Bank of England Staff Working Paper No. 580 (May 2018) ("Bank of England Study").

[8] *Id*. at 31.

[9] *Id*. The authors explain that during this period these EUR-mandated swaps were not traded on SEFs due to the fragmentation of the EUR swaps market. *Id*. at 28.

[10] Pierre Collin-Dufresne, Benjamin Junge & Anders B. Trolle, *Market Structure and Transaction Costs of Index CDSs* (Sept. 12, 2017) ("Collin-Dufresne, Junge, and Trolle Study").

market through the RFQ system often were better than the prices that were available on the interdealer Order Book.[11] "[O]ur results show that the current market structure delivers very low transaction costs. . . .[12]

The Proposal conjectures that novel "flexible methods of execution" will benefit the trading of all swaps. The Proposal, however, does not identify any trading methodology that can provide lower costs than the RFQ-3 method as applied to interest rate swaps and index CDS subject to the current trade execution mandate. In discarding the trading requirements for Required Transactions to bring more swaps onto SEFs, the Proposal throws the baby out with the bathwater.

Today, a small number of large dealers provide liquidity to the swaps market. Five very large banks were party to over 60 percent of interest rate swap transactions.[13] Liquidity in highly standardized swaps is fragmented between a dealer-to-dealer market and a dealer-to-customer market. There are no non-dealers in the dealer-to-dealer market. This high degree of reliance on a few large bank dealers to supply liquidity to all swaps market participants presents systemic risks as well as other types of risk that arise in highly concentrated markets.

One of the fundamental purposes of the CEA is to "promote responsible innovation and fair competition among boards of trade, other markets and market participants."[14] It is the CFTC's mission, and incumbent upon this agency in carrying out that mission, to ensure that there is fair competition among all market participants. This

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[11] *Id*. at 38.

[12] *Id*. at 6.

[13] *Quantifying Interest Rate Swap Order Book Liquidity*, Greenwich Associates, Q1 2016 ("Greenwich Report"), at 8.

[14] 7 U.S.C. 5(b).

means ensuring no market participant or limited group of participants has excessive market power. Market structure and price competition should develop in the interest of all market participants, rather than in the interest of just a few of the largest banks. The Commission should strive to remove the existing barriers to broader participation and fair competition in the swaps markets. In my view, the Proposal seeks to perpetuate existing barriers.

III. Targeted Reforms to Consider

The current system is not perfect; there are flaws that should be addressed. But the evidence is clear that the current system has provided substantial benefits over the unregulated system that existed prior to the financial crisis and the Dodd-Frank reforms. The Proposal would return the swaps market to the dealer-dominated, trade-however-you-want system heavily reliant on voice brokers that existed prior to the financial crisis. At the G20 Summit in Pittsburgh in 2009, the United States made an international commitment to move away from the dealer-dominated, voice-brokered approach and Congress expressly rejected the dealer-dominated, flexible approach when it adopted the Dodd-Frank Act.

My sense from working with and talking to swap market participants is that many do not see a need for a major overhaul of the swaps regulatory framework. The benefits of the current system are due not just to the regulations, but also are the result of major efforts and investments by market participants and operators of SEFs in electronic trading technology and personnel. Many market participants do not want to deal with another round of costs and uncertainties that wholesale regulatory changes will generate. They believe the current system is working, despite its flaws. They prefer that we consider

more targeted reforms to address specific issues with the current system, rather than scrap the current system entirely. They do not want to face the possibility that the Commission will continue to engage in a repetitive cycle of de-regulation and re-regulation.

Rather than completely rewrite the SEF regulatory structure, and turn our back on the progress made in transparency and competition, I favor a more limited, data-based approach to build on our progress and improve upon the current structure. This could be accomplished by removing some of the unnecessary barriers to greater participation on SEFs. Banks and other swap dealers play a critical role in providing liquidity. We need them to participate. However, a highly concentrated dealer oligopoly is not a prerequisite for sufficient liquidity. We should seek ways to bring in more sources of liquidity and competition. Robust competition leads to healthier markets and improves the overall welfare of all market participants.

I support the goal of bringing more types of swaps onto the SEF trading environment. I could support a more narrow approach to achieve this goal that does not undermine the progress that has been made to date.

I am not persuaded that we should continue to have two separate pools of liquidity in the swaps market for all types of swaps, regardless of liquidity characteristics—one in which the dealers trade amongst themselves, and another in which the dealers trade with customers. Perhaps we should look for ways to consolidate rather than separate the swaps markets.

Specifically, I support considering the following regulatory measures to improve competition in the swaps market:

- **Abolish Name Give-Up.** The Commission should prohibit the practice of name give-up for cleared swaps. On many platforms that provide anonymous trading, the identity of a counterparty is provided to the dealer after the completion of a trade. Name give-up is a major deterrent to non-dealers seeking to participate on dealer-only platforms as it provides the dealers with valuable information about a counterparty's positions. Name give-up is a relic of the pre-Dodd Frank era when most swaps were not cleared and the identity of the counterparty was necessary to manage credit risks.

- **Expand Floor Trader registration.** The Commission should amend the floor trader provision in the swap dealer definition to remove overly restrictive conditions. This would permit a wider range of proprietary traders to provide liquidity and compete with large bank dealers on price.

- **Revise capital requirements.** The Commission should work with the prudential regulators to ensure that capital requirements do not unduly restrict the availability of clearing services by futures commission merchants ("FCMs"). The current capital requirements have had the unintended consequences of discouraging FCMs from providing additional clearing services to the cleared swaps market.

- **Enable average pricing.** The Commission should work with market participants and facilities to enable buy-side firms to obtain average pricing for buy-side swap trades. Although average pricing is available for futures, it currently is not available for swaps, which limits the direct participation of buy-side asset managers on SEFs.

We should explore these and other ways to increase competition in the swaps market rather than retreat from the progress that has been made. What follows is a more

detailed explanation of how the current regulatory system has improved the swaps market and how the Proposal would undermine those improvements.

IV. Specific Concerns with the Proposal

The Proposal raises the following specific concerns:

- Less competition
- Less transparency
- Higher prices for end-users
- Diminished CFTC supervision and enforcement abilities

A. Less competition, less transparency, and higher prices

The first three concerns—higher prices, less competition, and less transparency—arise from the repeal of two critical and inter-related provisions of the current regulations.

Elimination of Order Book/RFQ-3. The Dodd-Frank Act sets forth a Rule of Construction that the goal of the SEF regulations is "to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market."[15] A key requirement facilitating the statutory goal of pre-trade price transparency is that all Required Transactions must be traded by Order Book or RFQ-3.[16] Under RFQ-3, a customer must request quotes from at least three dealers prior to entering into a transaction. In this manner, dealers must compete on price.

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[15] 7 U.S.C. 7b-3(e).

[16] 17 CFR 37.9. In the 2013 rulemaking adopting the current SEF regulations, the Commission explained the rationale for this requirement: "[T]he Commission believes that an RFQ System, as defined in § 37.9, operating in conjunction with a SEF's minimum trading functionality (*i.e.*, Order Book) is consistent with the SEF definition and promotes the goals provided in [CEA Section 5h(e), 7 U.S.C. 7b-3(e)], which are to: (1) Promote the trading of swaps on SEFs and (2) promote pre-trade price transparency in the swaps market. The Commission notes that the RFQ System definition requires SEFs to provide market participants the ability to access multiple market participants, but not necessarily the entire market, in conformance with the SEF definition." Core Principles and Other Requirements for Swap Execution Facilities ("2013 SEF Rulemaking"), 78 FR 33476, 33496 (June 4, 2013).

The Proposal would delete the Order Book/RFQ-3 requirement, even for swaps already traded on SEFs and subject to the trade execution requirement. Instead, the Proposal states that "a SEF may utilize 'any means of interstate commerce' for purposes of execution and communication, including, but not limited to, the mail, internet, email and telephone."[17]

Authorizing discrimination; eviscerating impartial access. Next, the Proposal flips on its head the impartial access requirement. CEA section 5h(f)(2)(B)(i) requires a SEF to "provide market participants with impartial access to the market."[18] Under existing Commission Regulation 37.202, which implements this statutory provision, any SEF criteria governing access must be "impartial, transparent, and applied in a fair and non-discriminatory manner."[19] In the 2013 SEF rulemaking, the Commission explicitly rejected a proposed interpretation that would permit SEFs to discriminate against types of market participants. "[T]he Commission believes that the impartial access requirement of Core Principle 2 does not allow a SEF to limit access to its trading systems or platforms to certain types of [eligible contract participants ("ECPs")] or [independent software vendors ("ISVs")] as requested by some commenters. The Commission notes that the rule states 'impartial' criteria and not 'selective' criteria as recommended by some commenters."[20]

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[17] Notice of proposed rulemaking, Swap Execution Facilities and Trade Execution Requirement ("Proposal"), section IV.I.4.b.

[18] 7 U.S.C. 7b-3(f)(2)(B)(i).

[19] 17 CFR 37.202(a)(1).

[20] 2013 SEF Rulemaking, 78 FR at 33508. The Commission also stated that "the purpose of the impartial access requirements is to prevent a SEF's owners or operators from using discriminatory access requirements as a competitive tool against certain ECPs or ISVs." *Id.*

The Proposal would replace this critical requirement and allow each SEF to establish exclusionary criteria determining what *types* of market participants are "similarly situated market participants" that are allowed to trade on the SEF (let's call this what it is, the "Discriminatory Access Provision"). This approach flips the statutory "impartial access" requirement on its head by empowering SEFs to build limited liquidity pools for a select few market participants such as the dealers seeking to hedge with each other.

Under the Discriminatory Access Provision, it is reasonable to expect that the large bank swap dealers would encourage discriminatory SEF participation criteria such that only large bank swap dealers would be "similarly situated market participants" able to participate in dealer-to-dealer liquidity pools. Proprietary trading firms and smaller dealers provide competition to the large banks in pricing swaps, and are one major reason customers are able to obtain favorable prices through the current RFQ process. If discrimination is permitted, these other types of firms would not be able to use the dealer-to-dealer market to effectively hedge or offset trades with customers, and therefore would not be able to compete with the large bank swap dealers in the dealer-to-customer market. In this manner, the Discriminatory Access Provision would result in a significant loss of competition in the dealer-to-customer market, which ultimately would result in higher prices for end users.[21]

If the current trade execution requirement is repealed, dealers also could establish single-dealer platforms and call them SEFs to siphon liquidity away from the RFQ

[21] It is unclear under the Proposal what happens to market participants subject to the SEF trading requirements who are not given access to a SEF because of the Discriminatory Access Provision.

platforms. The dealers wield significant market power in the swaps market. Five dealers currently account for nearly two-thirds of the interest rate swap market, which is the largest swap product category.[22] Although SEFs that currently offer RFQ-3 functionality might continue to do so even if the requirement is repealed, once the customers are no longer required to use that functionality, the dealers could undermine the effectiveness of the RFQ process by offering incentives to trade on single-dealer platforms or voice-brokered SEFs. This outcome would reduce liquidity for the RFQ platforms. In the long run, draining liquidity from RFQ-3 platforms to single-dealer or voice-brokered systems will result in less direct competition between dealers, less transparency, and higher costs for customers.[23]

The Proposal asserts that all-to-all markets are "inimical" to "fundamental" swaps trading features.[24] The Proposal also states that "market participants have rarely used Order Books to trade swaps on SEFs," and that "this low level of swaps trading on Order Books is attributable to an Order Book's inability to support the broad and diverse range of products traded in the swaps market that trade episodically, rather than on a continuous

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[22] Greenwich Report at 8. One market participant has commented on the ability of the dealers to determine market structure through the exercise of their market power:

> "There is no commercial explanation for having a market that is not open to a lot more people. It just doesn't make any sense. But the ability of people to enforce change outside the incumbent dealers is very limited," says the expert. "The part that frustrates me more than anything is pretending that the leverage of the incumbent dealers over this market isn't real. When I hear people talk about the natural market evolution, I would contend that progress has been 100% prevented to date."

Robert Mackenzie Smith, *US swap trading overhaul may reinforce market split, users warn*, Risk.net, Mar. 21, 2018, *https://www.risk.net/derivatives/5440516/us-swap-trading-overhaul-may-reinforce-market-split-users-warn*.

[23] In the equities market, the forced transition away from a market centered around multiple dealers improved prices substantially. *See, e.g.*, Michael J. Barclay, William G. Christie, Jeffrey H. Harris, Eugene Kandel & Paul H. Schultz, *The Effects of Market Reform on the Trading Costs and Depths of Nasdaq Stocks*, Journal of Finance, Vol. 54, Issue 1, at 1-2 (1999) ("Our results indicate that quoted and effective spreads fell dramatically without adversely affecting market quality.").

[24] Proposal at section VII.A.1.a.

basis."[25] Following a brief discussion of why the Order Book is unsuitable for *some* swaps, the Proposal states that the Order Book should be eliminated for *all* swaps: "[B]ased in part on its experience, the Commission proposes to eliminate the minimum trading functionality requirement and the regulatory Order Book definition."[26]

Similarly, the Proposal eliminates the RFQ requirement because it states that this method of execution may be unsuitable for some additional types of swaps that are currently traded off SEF. "[T]he Commission believes that [Order Book and RFQ-3] would not be suitable for the broad swath of the swaps market that would become newly subject to the trade execution requirement."[27]

This reasoning is flawed. From the proposition that an Order Book may be unsuitable for *some* episodically traded swaps, it does not follow that an Order Book is unsuitable for *all* swaps, even highly liquid ones. Nor does it follow from the proposition that the RFQ process may be unsuitable for *some* swaps that it should be removed for *all* swaps. Yet this flawed logic appears to be the rationale for the elimination of both the Order Book and RFQ-3 functionality requirements, even for highly liquid standardized swaps.[28]

RFQ-3 has improved competition and lowered trading costs. Empirical evidence demonstrates that the Order Book/RFQ-3 and impartial access requirements for

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[25] *Id*. at section IV.C.2.

[26] *Id*.

[27] Proposal at section IV.I.4.b.

[28] In the Cost-Benefit Considerations, the Proposal acknowledges that "the overall amount of pre-trade price transparency in swap transactions currently subject to the trade execution requirement may decline if the Order Book and RFQ-to-3 requirement[s are] eliminated. This potential reduction in pre-trade price transparency could reduce the liquidity of certain swaps trading on SEFs and increase the overall trading costs." Proposal at section XXIII.C.

standardized, highly liquid cleared swaps have increased competition and transparency and brought low trading costs to swap markets. The Bank of England Study found that the RFQ-3 requirement significantly improved liquidity for U.S. dollar interest rate swaps, which reduced swap execution costs for end-users by an estimated $3 to $6 million *per day* relative to Euro swaps, which were not traded pursuant to the trade execution mandate.[29]

The Bank of England Study also assessed the impact of the SEF trading mandate on dealer market power.[30] The study found that, prior to the SEF trading mandate, 28 percent of customers for US and Euro interest rate swaps that became subject to the mandate dealt with only a single dealer, and over 50 percent of customers dealt with three or fewer dealers.[31] After the SEF trading requirements went into effect, those percentages dropped to 8 percent and 20 percent, respectively.[32] The study states that "[w]ith the improvements in pre-trade transparency, customer search costs have fallen and it has become easier for customers to trade with the dealer showing the best price."[33]

Other studies have found similar results. Collin-Dufresne, Junge, and Trolle compared the prices on the Order Books used in the interdealer market with the prices generated in the dealer-to-customer market through the RFQ system. The authors found

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[29] Bank of England Study at 31. As discussed further below, the Proposal appears to consider liquidity solely in terms of total volume of trades. The Bank of England Study measures liquidity using various price dispersion measures complemented by a price impact measure and a bid-ask spread. *See id*. at 4. This measure of liquidity better assesses how liquidity affects efficient execution, pricing, and timing of trading.

[30] *Id*. at section 5.

[31] *Id*. at 26.

[32] *Id*.

[33] *Id*.

that prices customers obtained in the dealer-to-customer market through the RFQ system often were better than the prices that were available on the interdealer Order Book.[34]

Economists in the CFTC's Office of Chief Economist examined data regarding the customer trading of index CDS on the Bloomberg and Tradeweb SEFs, which are the leading SEFs for dealer-to-customer trading.[35] The CFTC economists found that very little customer trading occurred on the Central Limit Order Book ("Clob") of either facility, but rather that most of the trading occurred either by RFQ or by request-for-streaming ("RFS").[36] Focusing on customer trading through the RFQ mechanism, the CFTC economists found that, on average, a customer requests quotes from 4.1 dealers and gets back 3.6 responses.[37]

The CFTC economists concluded that the current regulatory structure is working well: "Judged from our evidence, SEF-traded index CDS market seems to be working well after Dodd-Frank—dealers' response rates are high, the vast majority of customer orders result in trades and customers' transaction costs are low."[38] Specifically, the CFTC economists found that transaction costs were low for index CDS contracts:

> The transaction costs of on-the-run CDX.NA.IG and iTraxx Europe have a mean around 0.2 bps and a standard deviation of 1.4 bps, so the average transaction cost is statistically and economically close to zero. For on-the-run CDX.NA.HY and iTraxx Crossover, the average costs are larger, at about 0.5 and 1.1 bps, but again not significant compared to their standard

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[34] Collin-Dufresne, Junge, and Trolle Study at 38.

[35] The study reports that, according to the SEF Tracker, at the time of the study, Bloomberg held a market share of 71% and Tradeweb held a market share of 13.6%. CFTC Economist Study at 2.

[36] Under RFS, customers ask multiple dealers to send indicative quotes in a continuous manner, and can respond to one of them by proposing to trade at the dealers' quote.

[37] *Id*. at 17. The study also found that customers are more likely to request quotes from dealers with whom they have a clearing or pre-existing trading relationship, although customers realize small actual price benefits from requesting quotes from relationship dealers. *Id*. at 5.

[38] *Id*. at 50.

> deviations of about 2.6 and 3.5 bps. The first off-the-run contracts have comparable average transaction costs but a much higher standard deviation due to the relatively few number of trades in these contracts.[39]

Market participants have expressed similar concerns about removing the Order Book/RFQ-3 and impartial access requirements. One senior executive at a trading firm recently stated that the SEF regulations have helped halve the bid-offer spread in US dollar swaps and increased price competition. "My fear is we take too big a step back from having the competitive pricing in the market," he said. "It is still a dealer-controlled market and if the biggest dealers simply say: 'Great, I don't have to put a competitive price on the screen anymore, and if someone wants my most competitive price then you've got to pick up the phone again,' I don't want to take that step backwards."[40]

Similarly, the CEO of one SEF cautioned, "[o]ne of the risks of this concept of 'any means of interstate commerce' is you have benchmarks and fixings that rely on better liquidity coming in from liquid Clobs. You wouldn't want to go backwards in that respect."[41]

In 2016, Greenwich Associates reported that "the buy side feels the executions they are receiving under the current paradigm are sufficient, if not excellent."[42] Greenwich Associates noted that, for many asset managers, sending a request for quote to three market participants and selecting the best-priced response (no matter how many

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[39] *Id*. at 43.

[40] Robert Mackenzie Smith, *Sef reforms could distort new, sounder benchmark rates*, Risk.net, Oct. 19, 2018, *https://www.risk.net/derivatives/6049931/sef-reforms-could-distort-new-sounder-benchmark-rates* (remarks of Stephen Berger, Managing Director, Government and Regulatory Policy, Citadel).

[41] *Id*. (remarks of Scott Fitzpatrick, Chief Executive Officer, Tradition SEF).

[42] Greenwich Report at 7.

respond) "has long been considered an appropriate approach to achieving best execution."[43]

The Proposal does not reference any of these findings or views of market participants. In contrast to these data-based empirical studies regarding the benefits of the current regulatory system, the Proposal speculates—without any evidentiary support—that the "flexibility" afforded by the elimination of the Order Book/RFQ-3 requirement *may* provide various benefits. For example, the Proposal asserts "SEFs would have broader latitude to innovate and develop new and different methods of execution tailored to their markets."[44] The Proposal further opines that these new, flexible methods "*could be* more efficient," "*may* lead to reduced costs and increased transparency," and "*may* provide opportunities for new entrants in the SEF market."[45]

However, the Proposal provides no factual basis for any of these hypothetical benefits. In light of the very low execution costs that have been documented for interest rate and index CDS swaps traded through RFQ-3, it is difficult to understand why RFQ-3 should be eliminated, at least for the swaps to which is currently applies.

Effect of expanded trading mandate on liquidity. The overriding rationale for the Proposal is to attract greater liquidity formation to SEFs. The Proposal seeks to accomplish this goal by expanding the SEF trading requirement to include all mandatorily cleared swaps for which SEF trading exists, with several exceptions. Although the Proposal would expand the trade execution mandate in this manner, it also would eliminate the Order Book/RFQ-3 requirements and provide effectively unlimited

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[43] *Id*. at 11.

[44] Proposal at section XXIII.C.4.b(1) (emphasis added).

[45] *Id*.

flexibility as to the trading methods for all swaps subject to the expanded trading mandate. The Proposal broadly asserts, without providing any evidentiary support, that the expanded trading mandate will improve liquidity and pre-trade price transparency and reduce market fragmentation.

In asserting that the expanded execution mandate will increase on-SEF liquidity, the Proposal appears to measure liquidity solely in terms of volume. But volume does not equal liquidity. It is not apparent how simply moving this volume from off SEF to being traded within a SEF will have any effect on other traditional measures of liquidity, such as cost of transaction or price dispersion. Indeed, the only difference is that the swaps would be traded on SEF, but by the same people and using the same methods that they now use to trade them off SEF. It is not apparent how this would lead to any greater price transparency or lower costs.

How many and what types of swaps would be brought onto SEFs under the expanded trading mandate? The Proposal presents little data to answer this question. One approach would be to assume that all swap transactions that are currently subject to clearing would become subject to the expanded trading mandate under the Proposal. This amount may be significantly larger than the actual result because many swaps subject to clearing may not be easily traded on SEF. But by comparing this amount to the amount of swaps currently traded on SEF, we can estimate an upper bound on the incremental increase in on-SEF trading resulting from the Proposal.

The Proposal notes that an estimated 57% of the notional amount of interest rate swaps are being traded on SEF, and that 85% are subject to the clearing requirement. Accordingly, an upper bound of about 28% of interest rate swaps could be moved on SEF

under the Proposal.[46] This estimate is consistent with a recent estimate provided by Clarus that approximately two-thirds of the fixed/float USD interest rate swap market is traded on SEF.[47] Examining the one-third of interest rate swaps that are being traded off SEF, Clarus found that "[g]enerally speaking, everything off-SEF is bespoke."[48]

Again, it is not apparent how moving the trading of bespoke swaps from being traded by introducing brokers ("IBs") outside a SEF to being traded by swap trading specialists inside a SEF will have any effect on the prices of those bespoke swaps. It is even less apparent how the trading of these bespoke swaps within a SEF will have any impact upon the trading of the highly liquid standardized swaps already being traded within a SEF under the RFQ-3 methodology. In fact, eliminating RFQ-3 for those liquid swaps could raise the prices for those swaps, and in turn may also negatively impact pricing for less liquid swaps, because most interest rate swaps—including bespoke swaps—are priced in part on a standard rate curve developed from prices for liquid swaps at various point along the curve.

Other impacts from excessive flexibility and discretion. The Proposal establishes an overly flexible approach that allows each SEF to self-determine how it will operate in almost every respect. Among other areas, a SEF would use discretion (a word used over 150 times in the Proposal) to tailor policies and procedures regarding trading procedures and rules, access, pre-execution communication, personnel oversight and

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[46] Using the same method, available data from ISDA indicates that only about 4-5% of index CDS that are currently subject to mandatory clearing are not currently traded on SEF. *See* SwapsInfo Full Year 2017 and Fourth Quarter 2017 Review, ISDA, at 13-14 (Feb. 2018).

[47] *What is Left Off-SEF*, Clarus Financial Technology (Mar. 16, 2016), *https://www.clarusft.com/what-is-left-off-sef/*.

[48] *Id*.

ethics training, SEF compliance requirements, trading surveillance, error trade policies, record keeping, trade documentation, internal investigations and enforcement, setting fees, financial resource requirements, and supervision of third party services. Most of these changes would loosen current regulatory requirements.

Documentation of executed swaps would no longer be required at the time of execution, but as soon as technologically possible. The Proposal acknowledges that creating flexibility for execution methods and trading technology makes simultaneous documentation "impracticable."[49] In other words, moving away from electronic trading back to telephones will delay the time within which counterparties receive full confirmation of price and terms, preventing precision in the time of pricing, creating a higher likelihood of errors, and leading to less pre-trade price transparency.

Many of the changes in the Proposal would allow the SEF to exercise discretion in brokering trades and establishing rules to facilitate broking away from electronic platforms. The Proposal explains that one of the reasons for granting the SEF greater discretion is to allow voice-broking to occur directly within the SEF.

Traditional introducing broking, by its nature, is slower and less transparent at establishing prices as compared to electronic trading. As a broker calls around to multiple dealers for prices, the broker might make trade adjustments over time and prices from one call to the next may change. As time passes, prices may become stale, even within seconds. Dealers and other liquidity providers will add a cushion to the spread to account for this delay. This means that as the length of time increases between when a quote is first received and when the trade is executed and the price is reported, spreads

[49] Proposal at section IV.F.2.b.

become wider and pricing becomes less transparent. For certain trades, such as block trades, timing delays in price transparency might be appropriate for reasons related to the unique nature of each trade. However, we should not be adopting regulations that would degrade the current level of transparency for liquid swaps that are being efficiently traded using an Order Book or RFQ system.

Similarly, the Proposal would allow extensive pre-trade negotiation for all swaps so long as the SEF defines it into the SEF's trading rules. Pre-trade negotiation may be appropriate for certain bespoke or large sized swaps. However, to create flexibility in SEF trading methods, the Proposal would allow SEFs to include pre-trade negotiations for any and all types of swaps including standardized swaps currently traded electronically. However, the Proposal would allow SEFs to include pre-trade negotiations for more liquid, standardized swaps for which pre-trade price transparency is better achieved through electronic trading, as explained in the studies discussed above.

In addition, the Proposal would allow SEF trading specialists, when acting as brokers, to exercise discretion in sharing different market information with different market participants. The Proposal acknowledges that this "trading discretion exercised by SEF trading specialists may affect the manner in which market participants are treated on a facility."[50] The Proposal suggests that this is somehow "consistent with impartial access" because it facilitates more trading. More likely, this greater degree of sanctioned discretion—the extent of which is largely left up to the SEFs to determine—would lead to unfair treatment of different market participants and less pre-trade price transparency because SEF trading specialists can decide who gets what information pre-trade.

[50] Proposal at section VII.A.1.a(1)(iii).

The statements above should not be interpreted as critical of intermediary broking services. These services provide important options for trading and pricing certain types of swaps, such as bespoke swaps, package trades, and block sizes. Rather, my concern is that these important services and the professionals who provide them may become less regulated, and that they will become intermediaries for transactions that are required to be traded electronically.

B. Diminished Oversight and Enforcement

I am also concerned that this Proposal waters down the robust, and uniform, standards of conduct and supervision to which it currently holds SEFs, IBs, associated persons ("APs") of IBs, and other market participants. This could lead to SEFs reducing their focus on compliance, require the Commission to take on an enhanced oversight role, and constrain the Commission's ability to investigate and prosecute abusive trade practices involving SEFs.

As previously discussed, this Proposal grants extensive discretion to SEFs to create rules governing their operations and does away with some of the specific compliance and recordkeeping obligations currently required by the regulations governing SEFs, set forth in Part 37 of the Commission's Regulations.[51] The Proposal suggests that providing SEFs with greater flexibility to tailor their compliance and oversight programs will mitigate compliance challenges that SEFs have encountered in implementing part 37, yet fails to describe in any detail those challenges.[52] On the other hand, we know that our current system of oversight provides market participants and

[51] 17 CFR Part 37.

[52] Proposal at section I.C.

regulatory authorities with uniform and descriptive standards of conduct and compliance procedures. Enumerating these standards (1) prevents a race to the bottom, in which market participants pare back their policies and procedures to the bare minimum, and (2) provides the registrant and the Commission with the tools they need to successfully enforce compliance with those standards.

As an example, the Proposal would remove the requirement set forth in Regulation 37.203(c) that a SEF establish and maintain sufficient compliance staff and resources to (i) conduct specific monitoring, including audit trail reviews, trade practice and market surveillance, and real-time market monitoring; (ii) address unusual market or trading events; and (iii) complete investigations in a timely manner. Rather, the Proposal would only require that the SEF establish and maintain sufficient compliance staff and resources to ensure that it can fulfill its self-regulatory obligations under the CEA and Commission Regulations. Without specific requirements on what compliance resources are needed, each SEF will be free to determine what level of resources is sufficient for such a broad mandate. In essence, the SEF need not map its compliance resources to specific compliance tasks. Additionally, experience has shown that conducting oversight and examinations of the sufficiency of a registrant's compliance resources is more difficult to undertake on a standard and fair basis across registrants when each one has a different view of what resources will meet the generalized requirement.

As another example, the Proposal eliminates the specific requirements that a SEF establish an annual audit trail review and related enforcement program, and retain certain categories of documents currently required by Regulation 37.205. The Proposal assumes, however that "SEFs would continue to fulfill their information collection burdens in a

manner similar to the status quo."[53] If the expectation is that SEFs will continue to comply with the current requirements, then why is it necessary to remove or weaken them? Many still view the compliance function as a cost center. It is unrealistic to assume that we can remove many of the specific conduct and recordkeeping obligations and expect that market participants will continue to comply, when competitive market pressures will drive the allocation of resources elsewhere. Moreover, market participants have dedicated significant resources to developing these compliance policies and systems, and changing them without sufficient justification does not make practical sense.

As a final example, the Proposal removes some of the specific requirements in Regulation 37.204 for oversight of third-party regulatory services. SEFs would no longer be required to conduct regular meetings with, and periodic reviews of, service providers or provide records of such oversight to the Commission. Instead, SEFs are given broad latitude to determine the necessary processes to supervise these providers. When registrants delegate critical functions to third-party providers, it is imperative that the registrant maintain diligent supervision over the provider's handling of these functions.[54] In my view, the Proposal does not provide satisfactory reasons for removing these unambiguous requirements, considering that doing so could hamper the Commission's ability hold SEFs accountable for supervising third-party providers.

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[53] Proposal at section XXIII.B.1.f.

[54] *See, e.g.*, *In re AMP Global Clearing LLC*, CFTC No. 18-10, 2018 WL 898755 (Feb. 12, 2018) (consent order) (charging registrant with failing to supervise diligently its information technology provider's implementation of registrant's information systems security program); *In re Tillage Commodities, LLC*, No. 17-27, 2017 WL 4386853 (Sept. 28, 2017) (consent order) (charging registrant with failing to supervise diligently its fund administrator's operation of the registrant's bank account containing participant funds).

Equally concerning is the sweeping change the Proposal makes to the way in which SEFs and their employees and agents will be registered, and in turn, the Commission's oversight of their conduct. Under the current system, swaps broking entities that meet the definition of an IB must be registered with the Commission as such. The individuals who are involved in soliciting or accepting orders at IBs, or involved in supervising such individuals, must register as APs of IBs. As NFA members, IBs and APs are not only subject to the applicable Commission Regulations, but are also subject to uniform rules governing swaps brokering, trade practices, reporting, minimum financial requirements, proficiency testing, training standards, and supervision. In addition, NFA monitors IBs' swaps broking activity and compliance with all applicable statutes and rules. In furtherance of that responsibility, NFA conducts periodic examinations of swap IB member firms and has the ability to discipline IBs and APs where appropriate.

Under the Proposal, which limits the activity that can be conducted off SEF, IBs will need to register with the Commission as SEFs to continue to broker swaps transactions. Given that the majority of IBs engaging in swap transactions on SEF are affiliated with SEFs, it is likely that many of these entities, or their employees, will merge into or join the affiliated SEF. We can also expect to see the formation of new SEFs, which presumably would not be required to register as IBs.[55] SEFs and SEF employees would be free to withdraw their IB and AP registrations and memberships with NFA,

[55] The Proposal is not clear on whether an existing IB that now must register as a SEF, but continues to primarily conduct phone broking and other IB-related activities, and continues to meet the IB definition, would need to be dually registered.

leaving a regulatory vacuum with no self-regulatory organization oversight. Already strained Commission resources inevitably would need to fill that void.

Further, the Proposal creates an entirely new category of persons: the SEF trading specialist. As proposed, SEF trading specialists will perform "core functions" that facilitate swaps trading and execution, including negotiating trade terms, arranging bids and offers, and discussing market color with market participants, or directly supervising a person who engages in such functions. In fact, the Proposal notes that broadening the SEF registration and trade execution requirements would increase the level of discretion that these SEF employees and agents would exercise in connection with swaps trading. However, despite these key, customer-facing functions, SEF trading specialists would not be required to register with the Commission.

For this reason, I am also concerned that the Proposal would weaken the supervisory function within the SEF. Regulation 166.3 imposes a duty on all Commission registrants who act in a supervisory capacity, including APs, to diligently supervise the activities of employees and agents relating to their business as a Commission registrant.[56] However, if the SEF is not registered as an IB, and its employees are thereby not registered as APs, the SEF employees themselves will have no duty to supervise under Regulation 166.3. The Proposal imposes a separate duty on SEFs to supervise the activities of its SEF trading specialists "in the facilitation of trading and execution on the swap execution facility."[57] Critically, however, that duty runs only to

[56] 17 CFR 166.3.

[57] Proposal at section VI.A.3.f. Unlike Regulation 166.3, which applies to all activities relating to a registrant's business, the language "in facilitation of trading and execution on the swap execution facility" is susceptible to various interpretations and could considerably narrow the conduct that is required to be supervised.

the SEF as an entity and not to its employees, including the SEF trading specialists. As a result, SEF trading specialists or other SEF employees with supervisory duties cannot be held individually liable for failure to supervise under any Commission regulation if they are not duly registered as APs of IBs. Individual accountability is an important tool in incentivizing corporate responsibility and I think it must be preserved.

Finally, in at least one instance, the flexibility afforded to SEFs to establish a code of conduct for their SEF trading specialists is in direct conflict with the supervision rules applicable to all registrants under Regulation 166.3. The Proposal states that a SEF's Code of Conduct "*may* provide" that, among other things, a SEF trading specialist "not engage in fraudulent, manipulate, or disruptive conduct."[58] However, Regulation 166.3 requires that Commission registrants establish and maintain meaningful procedures for detecting and deterring fraud and other prohibited conduct by their employees and agents.[59] This could create another potential gap in our supervisory structure that could weaken the Commission's enforcement capabilities.

V. Conclusion

This Proposal is a fundamental overhaul of the SEF regulatory regime. The changes create a trading system that is so flexible that all swaps traded on SEFs—including the most liquid—could be traded the same way they were before the Dodd-Frank reforms were adopted. The Proposal would allow the largest dealers to establish

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[58] *Id*. at section VI.A.3.e (emphasis added).

[59] *See, e.g.*, *CFTC v. Sidoti*, 178 F.3d 1132, 1137 (11th Cir. 1999); *Sansom Refining Co. v. Drexel Burnham Lambert, Inc.*, CFTC No. 82-R448, 1990 WL 10830742 (Feb. 16, 1990) (registrant has "a duty to develop procedures for the 'detection and deterrence of possible wrongdoing by its agents.'"). Moreover, various provisions of the CEA and Commission Regulations prohibit fraudulent and manipulative conduct, so adequate supervision necessarily dictates that entities and supervisors monitor for this conduct. *See, e.g.*, 7 U.S.C. 6b, 9.

separate dealer-to-dealer liquidity pools through exclusionary access criteria. Competition would be reduced and price transparency diminished. This is not what Congress intended when it passed the Dodd-Frank Act.

I am open to appropriate, targeted amendments to the regulations, several of which I have suggested above. However, empirical studies have shown that the existing SEF regulations have made great progress in achieving the statutory goals of promoting on-SEF trading and pre-trade price transparency. With respect to the swaps markets that are working and providing low costs to the buy side and end users, we should live by the adage, "if it ain't broke, don't fix it."

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