6351-01-P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 36, 37, and 43

RIN 3038-AE94

Swap Execution Facility Requirements and Real-Time Reporting Requirements

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission ("Commission" or "CFTC") proposes to amend certain parts of its regulations relating to the execution of package transactions on swap execution facilities ("SEFs"); the execution of block trades on SEFs; and the resolution of error trades on SEFs. These matters are currently the subject of relief in certain no-action letters from Commission staff.

DATES: Comments must be received on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments, identified by RIN 3038-AE94, 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. Submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *https://www.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"),[1] a petition for confidential treatment of the exempt information may be submitted according to the procedures established in the Commission's regulations, 17 CFR 145.9.

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse, or remove any or all of your submission from *https://www.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 FOIA.

FOR FURTHER INFORMATION CONTACT: Roger Smith, Special Counsel, (202) 418-5344, *rsmith@cftc.gov*, Division of Market Oversight, Commodity Futures Trading Commission, 525 West Monroe Street, Suite 1100, Chicago, Illinois 60661, or Michael Penick, Senior Economist, (202) 418-5279, *mpenick@cftc.gov*, Office of the Chief Economist, Commodity Futures Trading Commission, Three Lafayette Centre, 1151 21st Street, NW, Washington, DC 20581.

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[1] 5 U.S.C. 552.

SUPPLEMENTARY INFORMATION:

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I.   Background

    A. Parts 37 and 43 of the Commission's Regulations

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") amended the Commodity Exchange Act ("CEA" or "Act") by adding section 5h, which establishes registration requirements and core principles for swap execution

facilities ("SEFs").[2] The Commission implemented section 5h by adopting regulations

that establish various trading requirements for swaps traded on SEFs[3] and articulating,

where appropriate, guidance and acceptable practices. In particular, the Commission

promulgated part 37 of its regulations to implement section 5h of the CEA and set forth

the registration and operational requirements for SEFs.[4] Among those are requirements

in part 37 specifying minimum trading functionality that a SEF must offer to participants

for all listed swaps, *i.e.*, an "order book," as defined in § 37.3 ("Order Book");[5]

specifying the types of systems or platforms that a SEF must offer for swaps trading,

including swaps subject to the trade execution requirement under CEA section 2(h)(8);[6]

and setting forth other relevant regulations applicable to the fifteen core principles with

which a SEF must comply to obtain and maintain registration with the Commission.

Commission regulation 37.9 prescribes the methods of execution that a SEF must

offer to market participants to execute swap transactions on the SEF. In particular, § 37.9

defines "Required Transactions" as swaps subject to the trade execution requirement.

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[2] 7 U.S.C. 7b-3.

[3] The Dodd-Frank Act also added to the CEA certain provisions related to the trading of swaps on designated contract markets ("DCMs"). Given that almost all platform trading of swaps in the U.S. occurs on SEFs, the Commission is not at this time proposing to amend any regulatory requirements pertaining to DCMs within part 38 of the Commission's regulations.

[4] Core Principles and Other Requirements for Swap Execution Facilities, 78 FR 33476 (June 4, 2013) (hereinafter "SEF Core Principles Final Rule").

[5] 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. *See* 17 CFR 37.3(a)(3).

[6] CEA section 2(h)(8) requires that transactions involving swaps subject to the CEA section 2(h)(1) clearing requirement be executed on or pursuant to the rules of a DCM or SEF, or a SEF that is exempt from registration, unless no DCM or SEF makes such swaps available to trade ("MAT") or such swaps qualify for the clearing exception under CEA section 2(h)(7) (the "trade execution requirement"). *See* 7 U.S.C. 2(h)(8).

Section 37.9 also requires a SEF to offer, as required methods of execution, 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 transactions.[7] 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.[8] The Commission's regulations specify additional

requirements that correspond to the use of an Order Book or RFQ System to execute

Required Transactions.[9]

Pursuant to section 727 of the Dodd-Frank Act, the Commission also established

a regulatory framework for the real-time public reporting of swap transaction and pricing

data, including swap block trades within CEA section 2(a)(13).[10] Part 43 of the

Commission's regulations implements section 727 of the Dodd-Frank Act by, among

other things, defining the requisite criteria for when a publicly reportable swap

transaction will be classified as a block trade, including the requirement that the swap

transaction "occur[] away" from a SEF's trading system or platform, but pursuant to the

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[7] 17 CFR 37.9(a). With the exception of block trades, as defined in § 43.2 of the Commission's regulations, Required Transactions must be executed on a SEF's Order Book or RFQ System. *See* 17 CFR 37.9(a)(2)(i).

[8] 17 CFR 37.9(c).

[9] For example, 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. *See* 17 CFR 37.9(b).

[10] 7 U.S.C. 2(a)(13).

SEF's rules and procedures.[11] Part 43 also sets forth the procedures for calculating

appropriate minimum block sizes for each swap asset class[12] and specifying the public

reporting delays available for such trades.[13]

B. Summary of Proposed Changes to Parts 36, 37, and 43

During the implementation of parts 37 and 43, market participants and SEFs

identified certain operational and compliance burdens related to various requirements.

To mitigate these burdens, Commission staff issued to SEFs and market participants

time-limited no-action relief from certain provisions of the CEA and the Commission's

regulations.[14] Based on this implementation experience, the Commission believes it may

be appropriate to amend the current SEF regulatory framework to address the following

issues, which have been identified in staff no-action letters:[15]

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[11] 17 CFR 43.2.

[12] 17 CFR 43.6.

[13] 17 CFR 43.5(d).

[14] As defined in § 140.99(a)(2) of the Commission's regulations, a no-action letter is a written statement issued by a Division stating that it will not recommend enforcement action to the Commission for failure to comply with a specific provision of the Act or a Commission rule, regulation, or order. A no-action letter represents only the issuing Division's position and binds only that Division. 17 CFR 140.99(a)(2).

[15] In November 2018, the Commission issued a comprehensive proposal to amend the SEF regulatory framework. *See generally* Swap Execution Facilities and Trade Execution Requirement, 83 FR 61946 (Nov. 30, 2018) ("2018 SEF Proposal"). Among other things, the 2018 SEF Proposal addresses existing relief under various no-action letters as part of the proposal's holistic approach to amending the SEF regulatory framework. Given the complex, expansive, and comprehensive nature of the 2018 SEF Proposal, however, the Commission continues to evaluate it. Therefore, the Commission is proposing rules herein independent of that proposal. To be clear, this rule proposal does not supersede the 2018 SEF Proposal in any way.
Further, while the proposals and rationales contained herein are, in some cases, identical or similar to the proposals and rationales used in the 2018 SEF Proposal, the Commission believes the context surrounding these two proposals distinguishes them in application and scope. While the Commission received comments on the 2018 SEF Proposal, the Commission believes that it is important for the public to be able to provide comments focused on the facts and circumstances of the proposal at hand. Therefore, comments made on the 2018 SEF Proposal relevant to this rulemaking should be resubmitted as comments to this rule proposal in order to be considered.

- The Commission proposes to amend part 37 to allow the swap components of certain categories of "package transactions"[16] to be executed on-SEF through flexible means of execution pursuant to § 37.9(c)(2), rather than through the required methods of execution under § 37.9 for "Required Transactions." In addition, the Commission is proposing to amend part 36 to include an exemption from the trade execution requirement for swap transactions that are executed as a component of a package transaction that also includes a component that is a new issuance bond ("New Issuance Bond package transactions"). CFTC No-Action Letter No. 17-55 ("NAL No. 17-55")[17]

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[16] As used herein a package transaction consists of two or more component transactions executed between two or more counterparties where: (i) at least one component transaction is a Required Transaction; (ii) execution of each component transaction is contingent upon the execution of all other component transactions; and (iii) the component transactions are priced or quoted together as one economic transaction with simultaneous or near-simultaneous execution of all components.

[17] NAL 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 extended no-action relief and related conditions previously granted by Commission staff. *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, 2015) ("NAL No. 15-55"); and 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"). NAL No. 17-55 also provided relief for package transactions where at least one individual swap component is subject to the trade execution requirement and all other components are futures contracts ("MAT/Futures package transactions"). The Commission continues to evaluate MAT/Futures package transactions and their regulatory treatment. Therefore, this rulemaking does not encompass MAT/Futures package transactions.
Further, NAL No. 17-55 also applies to package transactions occurring on a DCM. *See supra* note 3.

currently provides no-action relief for the swap components of certain categories of

package transactions from the required methods of execution, and in some instances,

from the trade execution requirement.

- The Commission proposes to amend part 37 to establish a principles-based

approach for SEF error trade policies that incorporates relief from the required methods

of execution under § 37.9 for Required Transactions for trades intended to resolve error

trades.[18] The amendment would enable SEFs to permit market participants to execute

swaps transactions to correct operational or clerical errors using execution methods other

than those required under § 37.9 for Required Transactions. This proposal does not seek

to codify the specific conditions contained in CFTC No-Action Letter No. 17-27 ("NAL

No. 17-27").[19] Rather, this proposal is intended to capture the intent of NAL No. 17-27

to permit market participants to correct error trades in Required Transactions through

non-required methods of execution while ensuring flexibility for SEFs to determine the

most suitable error trade rules for their markets and participants.[20]

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[18] The Commission notes that in addition to relief from the required methods of execution, staff has also
provided relief from § 37.203(a) of the Commission's regulations, which prohibits "pre-arranged trading,"
for offsetting trades and correcting trades. *See* NAL 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). As discussed
further below, the Commission does not, however, view a regulatory amendment corresponding to that
relief as necessary. *See infra* note 70.

[19] This proposal also does not codify the supplemental conditions to NAL No. 17-27 contained in CFTC
No-Action Letter No. 20-01, Re: Supplemental 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 (Jan. 8, 2020) ("NAL No. 20-01"), conditions that
allow market participants to correct error trades that have been accepted for clearing with an *ex post facto*
review by the SEF. As discussed below, nothing in this proposal would prohibit SEFs from incorporating
such conditions within their error trade rules. *See infra* note 74.

[20] NAL 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). NAL No. 17-27 extended no-action relief and related
conditions previously granted by Commission staff. *See* CFTC Letter No. 16-58, Re: No-Action Relief for
Swap Execution Facilities and Designated Contract Markets in Connection with Swaps with Operational or

- The Commission proposes to amend the definition of "block trade" in § 43.2, which requires the execution of block trades pursuant to the rules of a SEF to "occur[] away" from the SEF, *i.e.*, to be executed outside of any of the SEF's trading systems or platforms. The amendment would enable SEFs to offer non-Order Book methods of execution for market participants to execute swap block trades on the SEF. The proposal codifies CFTC No-Action Letter No. 17-60 ("NAL No. 17-60") while also allowing block trades for swaps that are not intended to be cleared ("ITBC") to be executed on SEF via non-Order Book methods of execution.[21]

The Commission believes that the above-described amendments would continue to effectuate the statutory SEF provisions and better promote the statutory SEF goals, as discussed below.

Clerical Errors Executed on a Swap Execution Facility or Designated Contract Market (June 10, 2016) ("NAL No. 16-58"); CFTC Letter 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"); and 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) (initial relief provided by Commission staff with respect to error trades that are rejected from clearing)("NAL No. 13-66"). NAL No. 17-27 also applies to swap transactions occurring on a DCM. *See supra* note 3. In addition, DMO recently released NAL No. 20-01, which supplements the conditions in NAL No. 17-27 to allow market participants, *sua sponte*, to correct error trades that have been accepted to clearing with an *ex post facto* review by the SEF.

[21] NAL 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). NAL No. 17-60 extended no-action relief and related conditions previously granted by Commission staff. *See* 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) ("NAL No. 16-74"); 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) ("NAL No. 15-60"); and CFTC Letter No. 14-118, No-Action Relief for Swap Execution Facilities from Certain "Block Trade" Requirements in Commission Regulation 43.2 (Sept. 19, 2015) ("NAL No. 14-118"). NAL No. 17-60 only provides relief for swap block trades that are ITBC.

C. 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.[22]

II.   The Proposed Regulations

A. Execution of Package Transactions

1. Background

Package transactions generally involve the execution of multiple component transactions together that market participants consider to represent one economic transaction.[23] The types of transactions that constitute a package transaction are wide-ranging and diverse. In particular, there are package transactions that consist solely of swaps subject to the trade execution requirement; those that include a mix of swaps subject to the trade execution requirement and swaps that are not; those made up of swaps and non-swaps; and those comprised of both swaps that are and swaps that are not exclusively subject to the Commission's jurisdiction.[24] These components range from being very liquid and standardized to being illiquid and bespoke.[25] The variety of package transactions derives, in part, from the fact that the different types of package

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[22] Dodd-Frank Act, Pub. L. No. 111-203, title VII, sec. 712(a)(1), 124 Stat. 1376 (2010).

[23] *See supra* note 16. The Commission notes that there are transactions that otherwise meet the package transaction definition but do not involve a swap subject to the trade execution requirement. While these transactions may colloquially be referred to as package transactions, the Commission notes that such transactions are not the subject of this proposal.

[24] *See infra* note 36 for a more precise description of various package transactions.
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.

[25] Some non-swap components may be subject to different regulatory requirements than the swap components in the package transactions.

transactions are fit for distinct purposes. The Commission understands that certain

package transactions are utilized as tools within market participants' portfolio

management and hedging programs, while other types of package transactions are used to

allow market participants to express views of the market—for example, by allowing

participants to trade the spread between certain products or different maturities in the

same product.

Given the diverse characteristics of the component transactions that may be

involved, the Commission understands that package transactions often pose unique

pricing and execution characteristics. The Commission understands that 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 based primarily on the components that are not subject to the trade execution

requirement. Further, given the individual liquidity and trading characteristics of each

component, certain package transactions will have to trade through methods of execution

that are suitable for an illiquid and bespoke component, which in many cases are not the

required methods of execution.[26]

Notwithstanding the complexity of their pricing and execution, the Commission is

aware of their benefits of such package transactions. By executing multiple components

together as part of a package transaction, market participants can improve transaction

pricing and cost, increase execution efficiency, and decrease execution risk beyond what

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[26] For example, while a swap that is subject to the trade execution requirement is suitable to be executed
through the required methods of execution as an outright transaction, when that same swap is bundled
together with an illiquid and bespoke component in a package transaction, the package transaction takes on
the liquidity and trading profile of the illiquid and bespoke component.

would have been possible if the market participant had executed each component individually, *i.e.*, "legged" or "legging" into the transaction.[27]

During the implementation of the trade execution requirement for certain interest rate swaps and credit default swaps, SEFs and market participants informed the Commission that requiring swaps that are otherwise Required Transactions—but are components of a package transaction[28]—to be executed through the required methods of execution[29] under § 37.9 was in many cases impracticable and increased execution risks and operational challenges. Market participants and SEFs informed the Commission that these risks and challenges generally reflect (i) an initial lack of market infrastructure available to trade and clear certain package transactions;[30] and (ii) the complex, bespoke, and idiosyncratic nature of several categories of package transactions that precluded them from being suitable for execution through required methods of execution.[31]

In response to concerns from market participants, Commission staff in the Division of Market Oversight ("DMO") provided a series of time-limited no-action relief

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[27] For example, a market participant seeking to execute two component transactions independent of one another, instead of executing the two components together in a package transaction, would be forced to pay the bid/offer spread on each leg, which in many cases is more costly and less efficient than paying the single bid/offer spread for a package transaction composed of the same two components.

[28] *See supra* note 16. Consistent with the proposed definition of package transaction under § 37.9(d) the Commission notes that, unless otherwise stated, the term "swap component(s)" as used herein refers to a swap component that is subject to the trade execution requirement under CEA section 2h(8), and therefore a Required Transaction.

[29] As noted above, pursuant to § 37.9, SEFs must provide as the required methods of execution for Required Transactions either an Order Book or an RFQ System.

[30] *See*, *e.g.*, NAL No. 14-12 at 2-3 n.10 (describing the inability of a DCO to simultaneously screen and accept all components of a package transaction for clearing).

[31] *See*, *e.g.*, CFTC Public Roundtable: Trade Execution Requirements and Package Transactions, 72, 84-85 (Feb. 12, 2014), *available at https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/transcript021214.pdf* (commenting on the challenges of applying required methods of execution to package transactions with complex component swaps).

in order to allow the swap components of certain package transactions to be executed

through flexible methods of execution on a SEF, and in some cases completely away

from a SEF. Over time, the initial dearth of available market infrastructure to trade and

clear certain package transactions has diminished, especially for package transactions

composed of liquid and standardized components. As a result, Commission staff has

allowed the relief for certain package transactions to expire as the capabilities and

functionalities of market participants and SEFs have progressed to the point of permitting

the swap component of various package transactions to be executed through the required

methods of execution.[32] The Commission notes that the expiration of relief has been

successful for many types of package transactions given (i) market participants now

actively trade the swap component of several types of package transactions through the

required methods of execution, and (ii) the trading of such package transactions

constitutes a significant portion of swaps trading.[33]

Despite the progress, however, Commission staff has continued to provide relief

for the swap components of certain package transactions where relief is necessary for

market participants to be able to effectively execute the package transaction due to

specific attributes of such transactions.

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[32] *See infra* note 36 for an overview and description of the evolution of the relief for package transactions.

[33] For example, according to publicly available data from ClarusFT, nearly seventy percent of U.S. Dollar interest rate swaps trading in the inter-dealer swap market were carried out as part of just a single type of package transaction: U.S. Dollar Spreadover package transactions, as defined in note 35. *See* Chris Barnes, *USD Spreadovers and SEF Market Share*, Clarus Financial Technology Blog (August 14, 2018), *available at https://www.clarusft.com/usd-spreadovers-and-sef-market-share/.* Further, package transactions involving spreads and butterflies of interest rate swaps make up a material amount of trading in the swaps markets.

2. Proposed Addition of § 37.9(d) and Amendment of § 37.9(a)(2)

In light of the complex nature of these package transactions, the Commission recognizes that the required methods of execution under § 37.9 may inhibit market participants from tailoring the execution of the swap component of the relevant package transactions. This may force market participants to effect such transactions on a leg-by-leg basis—leading to increased execution and operational risk—or prevent them from engaging in the relevant package transactions altogether, precluding effective hedging strategies and decreasing market liquidity. Since DMO's issuance of this no-action relief, the Commission has gained considerable knowledge and experience with the dynamics of the trading of package transactions, particularly with respect to the existing no-action relief from the required methods of execution. Based on this knowledge and experience, the Commission believes that certain aspects of the current requirements for the required methods of execution under § 37.9 should be enhanced to better account for the complex nature of the relevant package transactions.

Therefore, the Commission proposes to add § 37.9(d) and amend § 37.9(a)(2) to permit the swap components of certain package transactions to be executed via flexible methods of execution pursuant to § 37.9(c)(2). The Commission proposes to define a "package transaction" as a transaction consisting of two or more component transactions executed between two or more counterparties where: (i) at least one component transaction is a Required Transaction; (ii) execution of each component transaction is contingent upon the execution of all other component transactions; and (iii) the component transactions are priced or quoted together as one economic transaction with

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simultaneous or near-simultaneous execution of all components.[34] Based on this

proposed definition and consistent with existing no-action relief, the Commission

proposes to allow the Required Transaction swap component of the following three

categories of package transactions to be executed via flexible means of execution

pursuant to § 37.9(c)(2):

(1) A package transaction where at least one of the components is a swap

exclusively within the Commission's jurisdiction that is not subject to the clearing

requirement ("MAT/Non-MAT Uncleared");

(2) A package transaction where at least one of the components is not a swap

(excluding certain package transaction categories as discussed below) ("MAT/Non-Swap

Instrument");[35] and

(3) A package transaction where at least one of the components is a swap for

which the CFTC does not have exclusive jurisdiction, *e.g.*, a mixed swap ("MAT/Non-

Exclusive CFTC Swap").[36]

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[34] *See* proposed § 37.9(d)(1). The Commission notes that there are transactions which otherwise meet the package transaction definition but do not involve a swap that is subject to the trade execution requirement. While these transactions may colloquially be referred to as package transactions, the Commission notes that such transactions are not the subject of this proposal. *See supra* note 16.

[35] Under proposed §37.9(d)(3), consistent with the no-action relief, this category specifically excludes package transactions in which all non-swap components are U.S. Treasury securities ("U.S. Dollar Spreadover package transactions"); MAT/Futures package transactions; package transactions in which all other non-swap components are agency mortgage-backed securities ("MAT/Agency MBS package transactions"); and New Issuance Bond package transactions. *See also* Section II.A.7 - Exemption of New Issuance Bond Package Transactions from the Trade Execution Requirement.
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.

[36] 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

While, as noted above, the swap components of several types of package transactions have been successfully transitioned to SEF and are executed via the required methods of execution, the Commission believes that the types of package transactions covered by this proposal may not be suitable to be traded through the required methods of execution due to their specific characteristics. In particular, the Commission recognizes that these package transactions contain components that are illiquid and bespoke, such as swaptions, or contain components that are subject to regulatory requirements other than or in addition to the CEA and the Commission's regulations issued thereunder.[37]

package transactions"); (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) U.S. Dollar Spreadover package transactions; (iv) MAT/Agency MBS package transactions; (v) New Issuance Bond package transactions; (vi) MAT/Futures package transactions; (vii) MAT/Non-MAT (Uncleared); (viii) excluding aforementioned categories, MAT/Non-Swap Instruments; and (ix) MAT/Non-Exclusive CFTC Swap. *See* NAL No. 14-12; NAL No. 14-62; NAL No. 14-121; NAL No. 14-137; NAL No. 15-55; NAL No. 16-76; and NAL No. 17-55.

Over time, the swap components of the following categories of package transactions were no longer provided relief: MAT/MAT package transactions, MAT/Non-MAT (Cleared) package transactions, U.S. Dollar Spreadover package transactions, and MAT/Agency MBS package transactions. As a result, the swap components of these package transactions must be executed through the required methods of execution under § 37.9(a).

Currently, the swap components of the following categories of package transactions receive no-action relief from the required methods of execution under § 37.9 under NAL No. 17-55: (i) MAT/Non-MAT (Uncleared) package transactions; (ii) MAT/Non-Swap Instruments package transactions (subject to the exclusions previously discussed); and (iii) MAT/Non-Exclusive CFTC Swap package transactions. The proposed addition of § 37.9(d) is consistent with the relief from the required methods of execution under NAL No. 17-55. Within this section, the term "relevant package transactions," unless context requires otherwise, refers to these three categories of package transactions.

In addition to the relief from the required methods of execution in § 37.9, NAL No. 17-55 also provides relief from the trade execution for the swap components of MAT/Futures package transactions and New Issuance Bond Package transactions. As discussed above, the Commission is still evaluating MAT/Futures package transactions. *See supra* note 17.

Further, as discussed in more detail below, the Commission is proposing to exempt the swap components of New Issuance Bond package transactions from the trade execution requirement. This is consistent with the relief currently provided to New Issuance Bond package transactions under 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.

[37] The Commission will continue to evaluate these categories of package transactions for new developments in execution methods on SEFs and may in the future revise the categories of package transactions in which the swap component is eligible to be executed through flexible means of execution.

The Commission believes that if market participants are unable to utilize flexible methods of execution for the swap components of these package transactions, they would potentially be forced to break the package transaction into its individual components, otherwise known as "legging" into the transaction. The Commission understands from market participants that legging into a package transaction is inefficient and increases transaction costs and execution risks. Given that components of package transactions are each priced or quoted together as part of one economic transaction, the Commission recognizes the impracticality of breaking the package transaction into individual legs or components in order to trade the swap components via the required methods of execution under § 37.9.

Based on its experience with the existing no-action relief, the Commission believes that the proposed addition of § 37.9(d) and amendment of § 37.9(a) will allow market participants to choose the most suitable execution method for their package transactions, which will decrease execution risks, improve efficiency, and decrease transaction costs because market participants will no longer be forced to leg into transactions. Given the inherent complexity of the relevant package transactions, the Commission believes that this proposal ensures that market participants are able to trade these package transactions in the most effective, efficient, transparent, and economical manner. SEFs would be able to offer, and market participants would be able to utilize, methods of execution that best suit the characteristics of the relevant package transaction

For example, the Commission notes that Tradeweb Markets Inc. recently released an electronic trading method for package transactions involving swaps and bonds. Such transactions – provided they are not U.S. Dollar Spreadover package transactions – would fall under the MAT/Non-Swap Instruments category of package transactions. Therefore, the Commission asks in this proposal whether the proposed package transaction categories are appropriate.

being traded. The Commission believes this would preserve the benefits and purpose of executing such package transactions.

In addition to causing inefficient execution and increasing risks and cost, forcing the swap components of the relevant package transactions through required methods of execution may also limit the commercial utility of such transactions or entirely frustrate the purposes of entering in such package transactions in the first place. For example, the Commission understands that in some of the relevant package transactions, (i) the swap component serves as the hedging instrument to other instruments in the package transaction, or (ii) the package transaction as a whole may be utilized as part of a market participant's portfolio management program. If the swap component of such package transactions were impractical or unable to be executed due to the required methods of execution, market participants would be prevented from entering or effectively entering into the package transaction, nullifying the package transaction's purpose and benefits as a hedging and portfolio management tool. Based on its experience with the existing no-action relief, the Commission believes that this proposal would allow market participants to utilize flexible methods of execution for the swap component of the relevant package transaction, thereby ensuring that market participants are able to continue to utilize these effective hedging tools.

Finally, the Commission believes that its proposed approach would advance the SEF statutory goal of promoting trading on SEFs.[38] The proposed rule provides relief from execution method requirements that are generally intended to help promote trading on SEFs. However, the relevant package transactions are not suitable for trading via such

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[38] *See* 7 U.S.C. 7b-3(e).

required methods of execution, as discussed above. Accordingly, the Commission believes that in this case flexibility with respect to execution methods will better promote trading of such component swaps on SEFs, consistent with the statutory SEF goals.

3. Request for Comment

The Commission requests comment on all aspects of proposed § 37.9(d) and the proposed amendment of § 37.9(a)(2). The Commission also invites specific comments on the following:

(1) Is the proposed definition of "package transaction" in proposed § 37.9(d)(1) appropriate? Please explain why or why not.

(2) Is the proposed definition's condition that the "execution of each component transaction is contingent upon the execution of all other component transactions" clear in its meaning? If not, please explain how the Commission should clarify this provision.

(3) Similarly, is the proposed definition's condition that "[t]he component transactions are priced or quoted together as one economic transaction" clear in its meaning? If not, please explain how the Commission should clarify this provision.

(4) Is it clear what is meant within the proposed definition's statement that execution of all component transactions is to be "simultaneous or near-simultaneous"? If not, please explain how the Commission should clarify this provision.

(5) Is the proposed addition of § 37.9(d)(2) for MAT/Non-MAT (Uncleared) package transactions appropriate? Please explain why or why not.

(6) Is the proposed addition of § 37.9(d)(3) for MAT/Non-Swap package transactions appropriate? Please explain why or why not.

(7) Are the categories of package transactions that are excluded from § 37.9(d)(3) appropriate? Please explain why or why not.

(8) Are there additional package transactions that should be excluded from § 37.9(d)(3)?

(9) Is the proposed addition of § 37.9(d)(4) for MAT/Non-Exclusive CFTC Swap package transactions appropriate? Please explain why or why not.

(10)   Are there additional types or categories of package transactions not covered in this proposal for which the Commission should allow the swap component to be executed through the flexible means of execution in § 37.9(c)(2)? Please explain in detail why or why not.

(11)   Should the Commission allow swap components to be executed via flexible methods of execution where a package transaction contains more than four components or legs, regardless of the types of components?

(12)   In addition to U.S. Dollar Spreadover package transactions, are there additional package transactions with sovereign debt components for which the Commission should exclude the swap component from flexible methods of execution? Please explain why or why not.

(13)   Should the Commission allow all swap components of a package transaction to be executed via flexible means of execution where a single swap component subject to the trade execution requirement is above the applicable block size? Please explain why or why not.

(14)   Should the Commission allow a package transaction composed of a Credit Default Swap ("CDS") index swap subject to the trade execution requirement and a CDS

index swap that is several series off-the-run to be executed through flexible means of execution? Please explain why or why not.

4. Existing § 37.3(a)

An Order Book is one of the two required methods of execution under § 37.9(a). The Commission designated an Order Book as the "minimum trading functionality" each SEF must maintain and offer for each swap that it lists for trading. An Order Book is defined under § 37.3(a)(3) as (i) an electronic trading facility;[39] (ii) a trading facility;[40] 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."[41]

Generally speaking, it may be complex to apply the existing Order Book requirement in § 37.3(a)(2) to the swap components of the package transactions covered by this proposed amendment. In some situations, § 37.3(a)(2) may require that a SEF maintain separate Order Books for the same type of swap: one Order Book for when the swap is executed as a single transaction (referred to as an "outright transaction"), and a separate Order Book for when the swap is executed as part of a package transaction. In fact, multiple Order Books could be required for the same type of swap if it were included as part of multiple types of package transactions. The Commission understands

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[39] 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).

[40] 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).

[41] 17 CFR 37.3(a)(3).

that, in part because of the availability of relief under the staff letters described above,

SEFs have put in place relatively few Order Books for swaps to be executed as part of the

package transactions covered by this proposed amendment, and any such Order Books in

place are not actively used.

5. Proposed Addition of § 37.3(a)(4)

The Commission proposes to add § 37.3(a)(4), which would allow SEFs not to

offer an Order Book for the swap components of the package transactions covered by this

proposed amendment: (i) MAT/Non-MAT Uncleared package transactions; (ii)

MAT/Non-Swap Instrument package transactions; and (iii) MAT/Non-Exclusive CFTC

Swap package transactions. However, this proposal would not alter any requirement

applicable to such swap components to the extent they are executed in transactions that

are not package transactions covered by this proposed amendment. The text of proposed

§ 37.3(a)(4) makes clear that § 37.3(a)(2) of the Commission's regulations would

continue to apply to such swap components and SEFs would be required to offer Order

Books for these Required Transactions as outright transactions.

As noted above,[42] executing Required Transaction swap components of certain

package transactions through the required methods of execution is operationally complex,

and in many instances, impracticable. Given that the Commission has preliminarily

determined that it is infeasible or inefficient to facilitate swap components of these

package transactions through the required methods of execution, which includes an Order

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[42] *See* section II.A.1 - Background and section II.A.2 - Proposed Addition of § 37.9(d) and Amendment of § 37.9(a)(2).

Book under § 37.3(a), it logically follows that requiring SEFs to offer an Order Book for

the swap components of package transactions would be superfluous.

Finally, the Commission believes that not requiring SEFs to offer an Order Book

for the swap components of the relevant package transactions would help reduce

operating costs for SEFs, as they would no longer be required to operate and maintain

order book systems that are not suitable for trading the swap components of the relevant

package transactions. Instead of employing resources to build (or attempt to build) and

support an unused or underutilized Order Book for the swap components of certain

package transactions, the proposal would instead provide 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 relevant package transactions.[43]

6. Request for Comment

The Commission requests comment on all aspects of proposed § 37.3(a)(4). The

Commission also invites comments specifically on the following:

(15)   Is the addition of § 37.3(a)(4) appropriate?

(16)   Should the Commission still require SEFs to offer an Order Book for

MAT/Non-MAT (Uncleared) package transactions as defined in § 37.9(d)(2)?

(17)   Should the Commission still require SEFs to offer an Order Book for the

swap components of MAT/Non-Swap package transactions as defined in § 37.9(d)(3)?

(18)   Should the Commission still require SEFs to offer an Order Book for

MAT/Non-Exclusive CFTC Swap package transactions as defined in § 37.9(d)(4)?

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[43] The Commission notes that nothing in this proposal would preclude a SEF from offering an Order Book
if it is able to develop an Order Book solution that is effective in trading the swap component of certain
package transactions.

(19)   Are there additional types of package transactions that the Commission

should consider allowing SEFs to not offer Order Books for?

(20)   Should the Commission allow SEFs not to offer an Order Book for swaps

that are not subject to the trade execution requirement but are components of any package

transaction? Would this lead to additional types of package transactions being listed and

traded on SEFs?

7. Exemption of New Issuance Bond Package Transactions from the Trade

Execution Requirement

The Commission proposes to establish an exemption to the trade execution

requirement for swap transactions that are components of a "New Issuance Bond"

package transaction.[44] The Commission believes that exempting these types of

transactions from the trade execution requirement is authorized by, and would be

consistent with the objectives of, CEA section 4(c).[45] This proposed approach is

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[44] The Commission notes that both this proposal and the 2018 SEF Proposal propose to exempt New Issuance Bond package transactions from the trade execution requirement under section 2(h)(8) of the CEA. *See* 2018 SEF Proposal at 62039. However, while these proposals and the supporting rationales are nearly identical, these two proposals are dissimilar in practical effect and scope. Under the 2018 SEF Proposal, the Commission proposed to apply the trade execution requirement to all swaps that are subject to the clearing requirement in section 2(h)(1) of the CEA and are listed on a SEF or a DCM. The 2018 SEF Proposal thus would have significantly expanded the scope of swaps that are subject to the trade execution requirement, including materially expanding the requirement to numerous forward starting interest rate swaps which are used as the swap components for New Issuance Bond package transactions. Contrastingly, this proposal would not alter the scope of swaps that are currently subject to the trade execution requirement, the majority of which are not swaps that are used as a component in New Issuance Bond package transactions. This means that the proposal to exempt New Issuance Bond package transaction under the 2018 SEF Proposal would have a significantly broader impact on the market than the proposed exemption within this proposal.

[45] 7 U.S.C. 6(c).

consistent with the time-limited no-action relief provided by Commission staff for this category of package transactions.[46]

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[47] issued and sold in the primary market.[48] An underwriter (on behalf of an issuer) arranges the issuance of a bond packaged with a fixed-to-floating interest rate swap ("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.[49] To match 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.

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[46] *See supra* note 36 (describing the no-action relief from the trade execution requirement provided by Commission staff for categories of package transactions).

[47] 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.

[48] 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.

[49] 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.

Given the process under which the swap is negotiated,[50] 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 trading venue.[51] 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 if a SEF were able to offer

flexible means of execution, as the Commission is proposing for swap components of

other package transactions within this proposal.[52]

Therefore, consistent with current no-action relief provided by Commission staff,

the Commission proposes to exempt swap components of a New Issuance Bond 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) at least one component

transaction is subject to the trade execution requirement in section 2(h)(8) of the Act; (ii)

execution of each component transaction is contingent upon the execution of all other

component transactions; and (iii) the component transactions are priced or quoted

together as one economic transaction with simultaneous or near-simultaneous execution

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[50] 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.

[51] *See* NAL No. 17-55 at 2-3.

[52] *See* Section II.A.2.

of all components.[53] 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.

       8. Discussion of CEA Section 4(c) Enumerated Factors

      Section 4(c) of the CEA grants the Commission the authority to exempt any

transaction or class of transactions, including swaps, from certain provisions of the CEA,

including the Commission's clearing requirement, in order to "promote responsible

economic or financial innovation and fair competition."[54] Section 4(c)(2) of the CEA

further provides that the Commission may not grant exemptive relief unless it determines

that: (i) the exemption is appropriate for the transaction and consistent with the public

interest; (ii) the exemption is consistent with the purposes of the CEA; (iii) the

transaction will be entered into solely between "appropriate persons;" and (iv) the

exemption will not have a material adverse effect on the ability of the Commission or any

contract market to discharge its regulatory or self-regulatory responsibilities under the

CEA. In enacting section 4(c), Congress noted that the purpose of the provision is to give

the Commission a means of providing certainty and stability to existing and emerging

markets so that financial innovation and market development can proceed in an effective

and competitive manner.[55]

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[53] The Commission notes that this definition is consistent with the proposed definition for package transaction in § 37.9(d)(1).

[54] 7 U.S.C 6(c).

[55] House Conf. Report No. 102-978, 1992 U.S.C.C.A.N. 3179, 3213.

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. The Commission recognizes that allowing the swap components of New Issuance Bond package transactions 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.

Therefore, the Commission preliminarily believes 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 the exemption is limited in scope and the swap components subject to this exemption are still required to be reported to a swap data repository pursuant to parts 43 and 45 of the Commission's regulations. Further, the Commission retains its special call, anti-fraud, and anti-evasion authorities, which will enable it to adequately discharge its regulatory responsibilities under the CEA.

The Commission notes that under the proposed exemption, swap transactions would still be entered into solely between eligible contract participants ("ECPs"), whom the Commission believes, for purposes of this proposal, to be appropriate persons. Previously, the Commission determined that ECPs are appropriate persons within the scope of section 4(c)(3)(K) of the CEA.[56] The Commission noted that the elements of the ECP definition (as set forth in section 1a(18)(A) of the CEA and Commission regulation 1.3) generally are more restrictive than the comparable elements of the enumerated "appropriate person" definition.[57] Given that only ECPs are permitted to enter into swaps off of a DCM, there is no risk that a non-ECP or a person who does not satisfy the requirements for an "appropriate person" could enter into a New Issuance Bond package transaction using this proposed exemption. Therefore, the Commission believes that the class of persons eligible to rely on the exemption for New Bond Issuance package transactions will be limited to "appropriate persons" within the scope of section 4(c)(3) of the CEA.

9. 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(a), including whether the proposed exemptive relief is consistent with the public interest and the other requirements of CEA section 4(c). As noted above, the 2018 SEF Proposal contained a nearly identical provision. Comments made on the 2018 SEF Proposal that are relevant to this rulemaking must be resubmitted

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[56] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21750, 21754 (Apr. 11, 2013).

[57] *Id.*

to be considered. The Commission specifically requests comment on the following

questions:

(21)   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?

(22)   Is the proposed definition of "package transaction" in proposed §

36.1(a)(1) appropriate?

(23)   Is it clear what is meant within the proposed definition when it states that

the "execution of each component transaction is contingent upon the execution of all

other component transactions"? If not, please explain how the Commission should

clarify this provision.

(24)   Is it clear what is meant within the proposed definition when it states that

"[t]he component transactions are priced or quoted together as one economic

transaction"? If not, please explain how the Commission should clarify this provision.

(25)   Is it clear what is meant within the proposed definition when it states that

all component transactions are to be executed on a "simultaneous or near-simultaneous"

basis? If not, please explain how the Commission should clarify this provision.

(26)   Are there additional swap components of different types or categories of

package transactions that should be exempt from the trade execution requirement? If so,

then please describe in detail why such swap components of these types or categories of

package transactions should be exempt from the trade execution requirement.

B. Error Trades: Execution of Trades to Correct Operational and Clerical Errors on Swap Execution Facilities

1. Background

The Commission notes that SEFs have adopted policies to identify and resolve error trades as part of the rules and procedures that govern their respective trading and trade processing operations. Errors in SEF transactions, as observed by the Commission, may be operational or clerical in nature and attributable to either the SEF, the counterparties to the transaction, the counterparties' intermediaries, or the clearing members involved. Clerical errors, in particular, may occur in the process of entering trade details into a SEF's trading system and may relate to the swap's terms and conditions, such as price, size, or direction, as well as counterparty or clearing member identities. The adoption of error trade policies by SEFs reflects the importance of addressing errors to ensure that counterparties are able to execute swap transactions as intended on a SEF, which promotes a fair and orderly trading market for SEF market participants.[58]

Under the current SEF regulatory framework, however, resolving error trades for swaps subject to the Commission's required methods of execution and straight-through processing requirements has occurred pursuant to no-action relief provided by Commission staff on an ongoing basis. Since 2013, the Division of Clearing and Risk ("DCR") and DMO (together, the "Divisions") have issued time-limited no-action relief to allow counterparties to correct swap "error trades"—transactions containing an

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[58] 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").

"operational or clerical error"[59]—involving swaps designated as Required Transactions, which are subject both to the clearing requirement and the trade execution requirement.[60] This relief, as described further below, has facilitated corrections where the error trade has either been (i) rejected by a DCO from clearing due to the error; or (ii) accepted for clearing, and therefore requires correction through an offsetting trade. Pursuant to the relief, SEFs may provide counterparties with a bilateral, "corrective" execution process for Required Transactions that does not satisfy the required methods of execution under § 37.9(a)(2) for swaps subject to the trade execution requirement.

For error trades rejected from clearing by a DCO, the no-action relief has provided operational flexibility from the required methods of execution that otherwise apply in conjunction with the Commission's "straight-through processing" requirements for swaps submitted to a DCO for clearing.[61] To promote the "near[-]instantaneous

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[59] The Divisions previously defined "operational or clerical error" as any type of error other than a rejection from clearing due to credit reasons. *See* NAL No. 17-27 at 1 n.2.

[60] *See* NAL No. 13-66. In April 2015, staff issued additional no-action relief, which not only reinstated the previous time-limited no-action relief from NAL No. 13-66 for SEFs from the requirements of § 37.9(a)(2) and § 37.203(a) for error trades rejected from clearing, but also provided relief for error trades accepted for clearing in NAL No. 15-24. Commission staff subsequently extended the relief provided in NAL No. 15-24 in June 2016 with NAL No. 16-58. This relief was most recently extended in May 2017 by NAL No. 17-27 and would expire on the effective date of any applicable changes in the Commission's regulations. Commission staff in DMO recently issued NAL No. 20-01, which supplements NAL No. 17-27 to allow market participants, *sua sponte*, to correct error trades that have been accepted for clearing. In instances where market participants correct an error trade *sua sponte*, NAL No. 20-01 requires an *ex post facto* review by the SEF of the error trade, offsetting trade, and correcting trade on a T+1 basis. Such review must consider whether a transaction cancellation or price adjustment will adversely impact market integrity, facilitate market manipulation or other illegitimate activity, or otherwise violate the CEA, Commission regulations, or the SEF's rules.

[61] The Commission's "straight-through processing" requirements address the process of routing transactions from execution through clearing. *See* 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"). 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." *Id*. at 21285.

acceptance or rejection of each trade [for clearing],"[62] the Divisions issued a 2013 staff

guidance expressing the view that SEFs should have rules stating that trades that are

rejected from clearing are "void *ab initio*."[63] Accordingly, executed swaps that a DCO

rejects from clearing would be deemed void, including swaps that are rejected due to an

operational or clerical error by the SEF or the counterparties. Where the counterparties

still seek to execute the transaction as intended, void *ab initio* compels the counterparties

to execute a new transaction between one another with the corrected terms. Where the

counterparties seek to execute a correcting swap that is a Required Transaction, the no-

action relief allows SEFs to accept bilaterally-arranged swaps from the counterparties for

execution and submission for clearing, rather than requiring them to execute the

correcting swap through an Order Book or RFQ System.

For error trades accepted for clearing by a DCO in spite of an operational or

clerical error in the swap, the no-action relief has provided similar operational flexibility

from the prescribed execution methods under § 37.9(a)(2).[64] Accordingly, the relief

allows SEFs to accept a bilaterally arranged swap from the counterparties for execution

and submission for clearing that (i) economically offsets the initial error trade that was

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[62] Staff Guidance on Swaps Straight-Through Processing at 2 (Sept. 26, 2013)("2013 Staff STP Guidance").

[63] 2013 Staff STP Guidance at 5. The 2013 Staff STP Guidance also addresses other elements of "straight-through processing" for swap transactions, including void *ab initio*. *See* 2018 SEF Proposal at 61999 - 62002, 62019 - 62024. The Commission notes that it proposed to address certain provisions from the 2013 Staff STP Guidance in the 2018 SEF Proposal, including a clarification that mandatory application of void *ab initio* would be limited to swap transactions that are rejected from clearing for credit-related reasons; for rejections arising from clerical or operational errors, the proposed clarifications would allow a SEF to adopt other corrective approaches that may not involve execution of a offsetting trade or a correcting trade. *Id.* at 62000 - 62001. As noted above, this proposal is independent of the 2018 SEF Proposal.

[64] *See* NAL No. 17-27 at 5.

accepted from clearing; and (ii) corrects the initial error trade with corrected terms as originally intended by the counterparties.

The Divisions also attached certain conditions to this no-action relief that, among other things, specified timing requirements for submitting these transactions to a SEF for execution and to a DCO for clearing. For transactions correcting error trades that a DCO has rejected from clearing, the Divisions specified that the counterparties must execute the transaction on a SEF, and the SEF must submit the transaction for clearing, as quickly as technologically practicable after receipt of notice of the rejection by the DCO to the clearing members, but no later than one hour from the notice.[65] For offsetting and correcting transactions to error trades that a DCO has accepted for clearing, the Divisions specified that such execution and submission to clearing of those transactions must occur no later than three days after the error trade was executed.[66]

2. Proposed § 37.9(e)

The Commission proposes to amend the SEF regulatory framework by adding subsection (e) to § 37.9 to establish a flexible SEF error trade policy standard that would, among other things, incorporate the intent of the existing no-action relief in NAL No. 17-27 for resolving errors in Required Transactions. Proposed § 37.9(e)(2)(i) would specify that a SEF must maintain rules and procedures that are fair, transparent, consistent, and allow for timely resolution of an "error trade," as defined under proposed

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[65] *Id.* at 6.

[66] *Id.* In addition, for error trades that are accepted for clearing, DMO issued NAL No. 20-01, which supplements NAL No. 17-27 to allow market participants, *sua sponte*, to correct error trades that have been accepted for clearing with an *ex post facto* review by the SEF. For error trades accepted for clearing and corrected under the relief in NAL No. 20-01, DMO specified that such error trades would need to be corrected no later than 24 hours after the error trade was executed. *See* NAL No. 20-01 at 4.

§ 37.9(e)(1)(ii).[67] This proposed standard would apply to any error trade that occurs on a SEF, regardless of whether the swap is submitted for clearing or not. The Commission believes that the proposed standard is a flexible approach that also clarifies the key principles that any SEF's error trade policy should address.

Further, under proposed § 37.9(e)(2)(i) SEFs must have error trade rules and procedures that require market participants to provide prompt notice to the SEF of an error trade and, as applicable, the corresponding correcting trade and offsetting trade.[68] This notice need not be separate from the error trade correction process.

The Commission believes that such a requirement is important to facilitate SEFs' fulfillment of their self-regulatory obligations. In particular, the Commission believes that providing a SEF prompt notice that an error trade has occurred on its trading system(s) or platform(s) will further enable it to facilitate direct supervision of it markets in order to determine whether a rule violation has occurred as required under § 37.203(b) as well as enhance its ability to carry out real-time market monitoring of all trading

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[67] As proposed, an "error trade" would be defined as any trade executed on or subject to the rules of a swap execution facility that contains an operational or clerical error. With respect to "package transactions," as defined under proposed § 37.9(d)(1), the Commission deems the submission of the component transactions in a sequence that causes a rejection from clearing of an individual component to constitute an operational error that could be resolved through a correcting trade under proposed § 37.9(e)(2)(i)(A). Market participants had previously informed the Commission that an individual component transaction may be rejected from clearing if prematurely submitted because the risk of that component, in isolation, could cause a trader to exceed its credit limit. Under a different submission sequence of component transactions to the DCO, however, the net risk of all of those transactions may not have exceeded the credit limit, thereby avoiding the rejection. The Commission emphasizes, however, the use of a corrective trade may only apply to the rejected component and otherwise would not apply to the other legs of the package transaction that have been accepted for clearing.

[68] To the extent a SEF implements error trade rules and procedures that allow market participants to correct error trades *sua sponte* with an *ex post facto* review by the SEF, that the SEF must require that market participants notify it of the subsequent correcting and offsetting trades. Conversely, a SEF that adopts error trades rules and procedures in which the SEF is responsible for correcting the error trade, that SEF would not be required to have market participants notify it of the subsequent correcting and offsetting trades. Regardless of the type of error trade rules and procedures a SEF adopts, it is required to adopt rules and procedures which require its market participants to provide prompt notice to it of an error trade that has occurred on its trading system(s) or platform(s).

activity on its system(s) or platform(s) to identify disorderly trading and any market or system anomalies pursuant to § 37.203(e).[69]

Proposed § 37.9(e) would also require a SEF to adopt rules to resolve error trades that involve swaps submitted for clearing. For an error trade rejected from clearing and therefore deemed void *ab initio*, proposed § 37.9(e)(2)(i)(A) would require a SEF to permit the counterparties to subsequently execute a correcting trade, as defined in proposed § 37.9(e)(1)(i), through any method of execution offered by the SEF. For an error trade that has been accepted for clearing, proposed § 37.9(e)(2)(i)(B) would require a SEF to permit the counterparties to subsequently execute both an offsetting trade, as defined in proposed § 37.9(e)(1)(iii), and a correcting trade through any method of execution offered by the SEF.[70]

Consistent with the existing no-action relief, this approach would continue to provide flexibility in the execution methods that a SEF may offer to counterparties to execute offsetting and correcting trades that involve swaps that are Required Transactions.[71] Based on its experience with the existing no-action relief, the Commission believes that this flexibility would continue to promote SEF operational efficiency by allowing SEFs to offer error trade protocols that are tailored to their

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[69] *See* 17 CFR 37.203(b); 17 CFR 37.203(e).

[70] NAL No. 17-27 also provided relief from § 37.203(a), which prohibits pre-arranged trading, for offsetting trades and correcting trades. The Commission, however, does not view a regulatory amendment corresponding to that relief as necessary. The existing prohibition already provides an exception to that prohibition by allowing a SEF to adopt trading practices that are certified or approved by the Commission pursuant to part 40 of the Commission's regulations. *See* 17 CFR 37.203(a). Accordingly, the Commission anticipates that a SEF would implement proposed § 37.9(e) by self-certifying or adopting rules subject to Commission review under part 40 that specify the manner in which counterparties may execute offsetting and correcting trades.

[71] The Commission notes that swaps that are Permitted Transactions, including those that are submitted to a DCO for clearing, may already be executed through any method of execution offered by a SEF pursuant to § 37.9(c)(2).

markets and to allow identification and resolution of operational and clerical errors in a timely manner. Without such flexibility, market participants with an error in Required Transactions would otherwise be prohibited 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 the execution method requirements under § 37.9(a)(2), which require that all Required Transactions be traded via either an Order Book or RFQ System.

The Commission also believes that the proposed approach would further the SEF statutory goals of promoting trading on SEFs and pre-trade price transparency in the swaps market.[72] The proposed rules provide flexibility to depart from required execution methods that are otherwise intended to advance those statutory goals; allowing counterparties to correctly and efficiently execute swaps with the intended terms and conditions, however, enhances market integrity on SEFs, which promotes SEF participation. Additionally, the proposed rules would also help to 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 notes that the existing no-action relief is currently subject to several conditions applicable to SEFs and counterparties—for example, SEFs must affirmatively determine, or determine after an *ex post facto* review, that an error trade has occurred.[73] Except as incorporated in the proposed rules herein, the Commission intends for the proposed approach to otherwise provide SEFs with the flexibility to address such

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[72] *See* 7 U.S.C. 7b-3(e).

[73] *See* NAL No. 17-27 at 5-7 and NAL No. 20-01 at 4-5.

aspects of its error trade policy in a manner that is best suited to its trading and trade processing operations.[74]

The proposed rules, however, would also adopt some limitations that are similar to the existing no-action relief, including specified timeframes for executing and submitting these trades for clearing. For correcting trades associated with an error trade that has been rejected from clearing, proposed § 37.9(e)(2)(i)(A) would require the SEF to submit the correcting trade for clearing to the registered DCO or exempt DCO as soon as technologically practicable, but no later than one hour after notice of the rejection to the relevant clearing members. For an offsetting trade and a correcting trade associated with an error trade that already has been accepted for clearing, proposed § 37.9(e)(2)(i)(B) would require the SEF to submit both types of trades to the registered DCO or exempt DCO as soon as technologically practicable, but no later than three days after the registered DCO or exempt DCO accepted the error trade for clearing.[75] In

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[74] Under the proposal's principles-based approach, the Commission notes that a SEF would not be prohibited from incorporating the conditions contained within NAL No. 17-27, or implementing rules that allow market participants, *sua sponte*, to correct error trades that have been accepted for clearing with an *ex post facto* review by the SEF of the error trade, offsetting trade, and correcting trade on a T+1 basis as is contemplated by NAL No. 20-01. Further, this proposal would not preclude SEFs from deploying error trade rules and procedures which consider whether a transaction cancellation or price adjustment will adversely impact market integrity, facilitate market manipulation or other illegitimate activity, or otherwise violate the CEA, Commission regulations, or the SEF's rules. However, regardless of the error trade rules and procedures that a SEF may adopt, the Commission notes that pursuant to this proposal such rules must be fair, transparent, and consistent. For example, in a scenario where a SEF is unsure as to how to address an error, the SEF may have rules which make it clear that the SEF will seek guidance and consent from both counterparties to the error trade before correcting the error trade. The Commission believes that such rule would be fair as it considers the positions of both counterparties and is transparent as it makes clear what the SEF will do in a specific scenario.

[75] The Commission notes that the supplemental conditions contained in NAL No. 20-01 require error trades that have been accepted to clearing to be corrected as soon as technologically practicable but no later than 24 hours after the error trade was executed. *See* NAL No. 20-01 at 4. However, as noted above, the Commission intends for this proposal to provide a SEF with the flexibility to address such aspects of its error trade policy in a manner that is best suited to its trading and trade processing operations. As such, SEFs may continue to have error trade rules and procedures that are contemplated in both NAL No. 17-27 and NAL No. 20-01 for error trades that have been accepted for clearing. Therefore, the Commission is proposing that an error trade that has already been accepted for clearing would be required to be corrected

addition to these proposed timeframes, proposed § 37.9(e)(2)(ii) would prohibit

counterparties from executing a second correcting trade to fix an error trade if the initial

correcting trade is rejected from clearing.

The Commission believes that these proposed limitations are consistent with the

goal of promoting straight-through processing. The proposed timing requirements, in

particular, are intended to provide a SEF and the counterparties to an error trade with an

appropriate amount of time to identify and resolve error trades, while also minimizing

delays to achieving prompt and efficient clearing of transactions. Similarly, limiting the

number of instances in which counterparties may attempt to correct an error trade would

also help to facilitate prompt and efficient clearing by incentivizing the counterparties to

accurately execute their correcting trade as quickly as possible. The Commission,

however, seeks additional public comment regarding this proposed limitation, as well as

the appropriateness of the proposed timeframes.

3. Request for Comment

The Commission requests comment on all aspects of proposed § 37.9(e). As

noted above, the 2018 SEF Proposal also discussed this topic. Comments made on the

2018 SEF Proposal that are relevant to this rulemaking must be resubmitted to be

considered. The Commission also invites comments specifically on the following:

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as soon as technologically practicable, but no later than three days after the registered DCO or exempt
DCO accepted the error trade for clearing, as this is the longest timeframe for correcting such error trades
as contemplated in both NAL No. 17-27 and NAL No. 20-01. Nonetheless, the Commission is seeking
comment on whether three days is an appropriate timeframe for error trades that have been accepted for
clearing to be corrected. Further, despite the proposed outer limit of three days for correcting error trades
that have been accepted for clearing, the Commission notes that SEFs and market participants are expected
to correct such error trades as soon as technologically practicable as is proposed under § 37.9(e)(2)(i)(B).

(27) The Commission notes that § 37.203(e) already specifies that a SEF may resolve errors by adjusting trade prices or canceling trades to mitigate "market disrupting events;" such action by a SEF must be "transparent to the market and subject to standards that are clear, fair, and publicly available." Should the Commission adopt a single rule for all error trades under proposed § 37.9(e) that is similar to this standard, or is the proposed standard, *i.e.*, "fair, transparent, consistent, [and] allow for timely resolution" more appropriate? If the Commission should maintain separate standards, please explain why.

(28) Is the proposed timeframe adequate for the submission of a correcting trade to resolve an error trade rejected from clearing for non-credit reasons? If not, please provide an alternative timeframe and explain why such an alternative would be more appropriate.

(29) Is the proposed timeframe adequate for submitting an offsetting trade and correcting trade to resolve an error trade accepted for clearing? If not, please provide an alternative timeframe and explain why such an alternative would be more appropriate.

(30) Under proposed § 37.9(e)(2)(i), SEFs must have rules which require market participants to provide prompt notice to the SEF that an error trade has occurred. Is it clear what is meant by "prompt notice" in § 37.9(e)(2)(i)? If not, please explain how the Commission should clarify this provision.

(31) Should the Commission require that notification to a SEF of an error trade occur within a specified timeframe? If so, what is the appropriate time frame for that notification to occur?

(32)   If a SEF adopts error trade rules and procedures that allow market participants to *sua sponte* correct an error trade with an *ex post facto* review by the SEF, should the Commission allow the SEF to have rules permitting market participants to withhold notice of the error trade until the market participant notifies the SEF of the correcting trade and, as applicable, the offsetting trade?

(33)   Should the Commission require SEFs to affirmatively determine, or determine after an *ex post facto* review, that an error trade has occurred? Why or why not?

(34)   If a SEF should affirmatively determine that an error trade had occurred, what is the appropriate time frame for that declaration to occur?

(35)   If a SEF should determine that an error trade has occurred after an *ex post facto* review, what is the appropriate time frame for that review and determination to occur?

(36)   If a SEF should affirmatively determine that an error trade had occurred, should the SEF's review consider whether a transaction cancellation or price adjustment will adversely impact market integrity, facilitate market manipulation or other illegitimate activity, or otherwise violate the CEA, Commission regulations, or the SEF's rules?

(37)   If a SEF should determine that an error trade has occurred after an *ex post facto* review, should the SEF's review consider whether a transaction cancellation or price adjustment will adversely impact market integrity, facilitate market manipulation or other illegitimate activity, or otherwise violate the CEA, Commission regulations, or the SEF's rules?

(38)   Does § 37.9(e) sufficiently address potential situations in which a component of a package transaction is rejected from clearing by the relevant registered DCO or exempt DCO because of the sequencing of the components of the package transaction submitted for clearing at the registered DCO or exempt DCO? With respect to proposed § 37.9(e), are there any other issues that should be addressed regarding package transactions?

(39)   Should the same error trade policy also be available to correct any errors contained in a correcting trade or an offsetting trade, or should the number of corrections be limited? If an initial correcting trade or offsetting trade that is executed to correct an error trade contains an operational or clerical error, should the counterparties be allowed to submit another correcting trade or offsetting trade?

(40)   Should the Commission require SEFs to notify its market when it receives notice from a market participant that an error trade has occurred?

(41)   Should the Commission prescribe different error trade rules and procedures depending on the status (*i.e.*, Required Transactions or Permitted Transactions) of the original swap transaction? Please explain why or why not.

(42)   Are there any conditions in NAL No. 17-27 or supplemental NAL No. 20-01 not contained within this proposal that the Commission should require SEFs to adopt in their error trade rules and procedures? If so, please explain in detail why such conditions are necessary and appropriate to be required in SEF error trade rules and procedures.

C. Real-Time Public Reporting: Block Trade Definition

1. Existing § 43.2

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.[76] In

specifying these elements, the Commission considered the treatment of block trades in

various swap and non-swap markets.[77] In particular, the Commission looked to the

futures markets, where futures block trades are permissible, privately-negotiated

transactions that equal or exceed a DCM's specified minimum quantity of futures or

options contracts and is executed away from the DCM's centralized market but pursuant

to its rules.[78] 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.[79] The Commission clarified the "block trade"

definition by stating that "[a]ny swap that is executed on a SEF or a DCM's trading

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[76] 17 CFR 43.2.

[77] Real-Time Public Reporting of Swap Transaction Data, 75 FR 76140, 76159 (proposed Dec. 7, 2010) (discussion of block trades with respect to futures).

[78] *Id.*

[79] 17 CFR 43.2.

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…."[80] 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.[81]

    2.   Proposed Amendment to § 43.2

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 "occur away" from a SEF's trading system or platform creates an issue with carrying out pre-execution credit screening.[82] These market participants noted 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.[83] Accordingly, SEFs were unable to facilitate pre-execution credit checks for block trades.

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[80] 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).

[81] 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).

[82] For the avoidance of doubt, the Commission believes that if the parties purport to execute a block trade away from the SEF without first obtaining a credit check, an FCM clearing member that clears such trade and does not have knowledge of such purported execution is not in violation of the pre-execution credit check requirement under Commission regulation 1.73. NAL No. 17-60 n.9. The Commission understands that currently no mechanism exists to enable a pre-execution credit check where blocks are executed away from a SEF; however, this proposal does not preclude participants from developing and using such a mechanism in the future.

[83] NAL No. 17-60 at 2.

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.[84] Based on Commission staff no-action relief provided in NAL No. 17-60, a SEF may allow market participants to execute swap block trades that are ITBC[85] on a SEF's non-Order Book trading system or platform.[86] As a result, FCMs and SEFs have been able to comply with their respective pre-execution credit screening obligations.

The Commission proposes to revise the "block trade" definition under § 43.2 in order to allow market participants to utilize a SEF's non-Order Book trading system or platform while still allowing swap block trades to "occur away" from a SEF.[87] The proposed revision to the "block trade" definition not only allows swap block trades that are ITBC to be executed on a SEF's non-Order Book trading system or platform – as is currently provided for in NAL No. 17-60 – but the proposed definition would also permit swap block trades that are not ITBC to be executed on SEF.[88] The Commission believes that having a single set of block trade rules for both ITBC and non-ITBC swap block trades will help to reduce operational complexity for both SEFs and market participants. Further, the Commission believes that permitting execution of block trades on a SEF's non-Order Book trading systems or platforms furthers the statutory SEF goal of

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[84] NAL No. 17-60; NAL No. 16-74; NAL No. 15-60; NAL No. 14-118.

[85] As used herein, swaps that are ITBC are swaps (i) of a type accepted for clearing by a DCO, and (ii) intended to be submitted for clearing contemporaneously with execution. NAL No. 17-60 n.2.

[86] NAL No. 17-60 at 2-3.

[87] The Commission notes that it has proposed to address the issue of block trades on SEFs in the 2018 SEF Proposal. As noted above, this proposal is independent of the 2018 SEF Proposal.

[88] The Commission notes that in the 2018 SEF Proposal, it proposed for all SEF swap block trades to be executed on the SEF. The Commission continues to evaluate this proposal. *See supra* note 15.

promoting the trading of swaps on SEFs.[89] Moreover, for swap block trades that are

ITBC and executed on a SEF's non-Order Book trading system or platform, 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).[90]

Further, 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 and to establish appropriate post-trade reporting time delays.

The provision, however, does not set forth any pre-trade requirements, such as a

requirement that the transaction be executed away from a SEF. In addition, the

Commission believes that allowing participants to use a SEF's non-Order Book

functionalities to execute swap block trades is consistent with the Commission's

regulatory approach to mitigate risks of information leakage (*i.e.*, a "winner's curse") as

market participants can use the functionality of the SEF to execute a block trade in a

manner that will not disclose the order to the entire market.[91] SEFs currently provide

various modes of execution to enable market participants to execute a block trade on the

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[89] *See* 7 U.S.C. 7b-3(e).

[90] 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.

[91] SEF Core Principles Final Rule, 78 FR 33498, 33562, and 33563.

SEF without providing disclosure of the block trade to the market or to multiple market participants.[92]

Finally, the Commission believes that permitting swap block trades to be executed on a SEF's non-Order Book trading platforms while also allowing them to "occur away" from a SEF provides SEFs increased flexibility. In particular, SEFs will be able to provide execution methods for swap block trades that are most suitable, efficient, and cost-effective for the product being traded, the SEF's market, and its market participants.

3. Request for Comment

The Commission requests comment on all aspects of the proposed revision to the definition of "block trade" in § 43.2. The 2018 SEF Proposal also proposed revisions to this definition. Comments made on the 2018 SEF Proposal that are relevant to this rulemaking must be resubmitted to be considered. The Commission also invites comments specifically on the following:

(43)   Is the Commission's proposed revision to the definition of "block trade" appropriate? If not, how should the Commission amend the proposed definition?

(44)   Should the Commission continue to permit market participants to execute ITBC swap block trades away from but pursuant to the rules of a SEF? Please explain why or why not.

(45)   Should the Commission continue to permit market participants to execute non-ITBC swap block trades away from but pursuant to the rules of a SEF? Please explain why or why not.

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[92] For example, the Commission has observed that some SEFs offer a "RFQ-to-one" functionality that allows counterparties to bilaterally negotiate a block trade between two potential counterparties, without requiring disclosure of the potential trade to other market participants on a pre-trade basis.

(46)   Should the Commission prohibit swap block trades that are subject to the

trade execution requirement from "occurring away" from a SEF but pursuant to its rules?

(47)   Should the Commission further limit or prohibit the execution of swap

block trades through an RFQ system, as defined in § 37.9(a)(3)? For example, should the

Commission limit the number of market participants that may receive a RFQ for a swap

block trade that is intended to be executed on the SEF? Please explain why or why not.

(48)   Should the Commission allow swap block trades to be executed through

an Order Book, as defined in § 37.3(a)(3)? Please explain why or why not.

III.   Effective Date and Transition Period

The Commission proposes that the effective date for the proposed regulations be

60 days after publication of final regulations in the *Federal Register*. The Commission

preliminarily believes that such an effective date would allow SEFs and market

participants sufficient time to adapt to the amended and additional rules in an efficient

and orderly manner.

Request for Comment:

The Commission requests comment on whether the proposed effective date is

appropriate and, if not, the Commission further requests comment on possible alternative

effective dates and the basis for any such alternative dates.

IV.   Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA")[93] requires Federal agencies, in

promulgating regulations, to consider the impact of those regulations on small businesses.

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[93] 5 U.S.C. 601 *et seq.*

The regulations adopted herein will affect SEFs and their market participants. The

Commission has previously established certain definitions of "small entities" to be used

by the Commission in evaluating the impact of its regulations on small entities in

accordance with the RFA.[94] The Commission previously concluded that SEFs are not

small entities for the purpose of the RFA.[95] The Commission has also previously stated

its belief in the context of relevant rulemakings that SEFs' market participants, which are

all required to be eligible contract participants ("ECPs")[96] as defined in section 1a(18) of

the CEA,[97] are not small entities for purposes of the RFA.[98] Therefore, the Chairman, on

behalf of the Commission, hereby preliminarily certifies, pursuant to 5 U.S.C. 605(b),

that the regulations will not have a significant economic impact on a substantial number

of small entities. The Commission invites the public to comment on whether SEFs and

SEF market participants covered by these proposed rules should be considered small

entities for the purpose of the RFA.

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,"[99] as defined by the PRA.

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[94] 47 FR 18618 – 18621 (Apr. 30, 1982).

[95] SEF Core Principles Final Rule, 78 FR 33476, 33548 (June 4, 2013) (citing 47 FR 18618, 18621 (Apr. 30, 1982) (discussing DCMs); 66 FR 42256, 42268 (Aug. 10, 2001) (discussing DTFs, ECMs, and EBOTs); and 66 FR 45604, 45609 (Aug. 29, 2001) (discussing registered DCOs)).

[96] 17 CFR 37.703.

[97] 7 U.S.C. 1(a)(18).

[98] 66 FR 20740, 20743 (Apr. 25, 2001) (stating that ECPs by the nature of their definition in the CEA should not be considered small entities).

[99] *See* 44 U.S.C. 3502(3)(A).

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.[100]

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 information collection calls for answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, ten or more persons.[101] The PRA requirements have been determined to include not only mandatory, but also voluntary information collections, and include both written and oral communications.[102] The Commission may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid Office of Management and Budget ("OMB") control number.

This proposed rulemaking contains collections of information for which the Commission has previously received control numbers from OMB. The titles for these collections of information are "Real-Time Public Reporting and Block Trades, OMB control number 3038-0070" and "Core Principles and Other Requirements for Swap Execution Facilities, OMB control number 3038-0074." This proposed rulemaking would not impose any new information collection requirements from any persons or entities that require approval of OMB under the PRA.

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[100] *See* 44 U.S.C. 3501.

[101] *See* 44 U.S.C. 3502(3).

[102] *See* 5 CFR 1320.3(c)(1).

C. Cost-Benefit Considerations

Section 15(a) of the CEA[103] requires the Commission to consider the costs and

benefits of its actions before promulgating a regulation under the CEA or issuing certain

orders. Section 15(a) further specifies that the costs and benefits shall be evaluated in

light of 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.

1. Background

The Commission is proposing to amend certain rules in parts 36, 37, and 43 of its

regulations relating to the execution of certain package transactions on SEFs; the

resolution of error trades on SEFs; and the execution of block trades on SEFs.

The baseline against which the Commission considers the costs and benefits of

these proposed rules is the statutory and regulatory requirements of the CEA and

Commission regulations now in effect, in particular CEA section 5h and certain rules in

parts 37 and 43 of the Commission's regulations. The Commission, however, notes that

as a practical matter SEFs and market participants have adopted some current practices

based upon no-action relief provided by Commission staff that is time-limited in

nature.[104] As such, to the extent that SEFs and market participants have relied on

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[103] 7 U.S.C. 19(a).

[104] In its discussion of alternatives, the Commission believes it is also relevant to consider the costs and
benefits of the proposed regulations in comparison to circumstances in which such no-action relief has
expired and is no longer available. The Commission further notes that in connection with NAL No. 16-58
and its extension NAL No. 17-27 (relief related to clerical or operational error trade resolution), market

relevant staff no-action letters, the actual costs and benefits of the proposed rules as realized in the market may not be as significant.

In some instances, it is not reasonably feasible to quantify the costs and benefits to SEFs and certain market participants with respect to certain factors, for example, market integrity. Notwithstanding these types of limitations, however, the Commission otherwise identifies and considers the costs and benefits of these rules in qualitative terms.

The following consideration of costs and benefits is organized according to the rules and rule amendments proposed in this release. For each rule, the Commission summarizes the proposed amendments and identifies and discusses the costs and benefits attributable to such rule. The Commission, where applicable, then considers the costs and benefits of the proposed rules in light of the five public interest considerations set out in section 15(a) of the CEA.

The Commission notes that this consideration of costs and benefits is based on the understanding that the swaps market functions internationally, with many transactions involving U.S. firms taking place across international boundaries, with some Commission registrants being organized outside of the United States, with leading industry members typically conducting operations both within and outside the United States, and with industry members commonly following substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the

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participants specifically requested that the Commission undertake rulemakings to establish a permanent solution for addressing these clerical and operational errors, rather than merely extending the previous NAL relief. *See* NAL No. 16-58 and NAL No 17-27. In contrast, previous requests for no-action relief from market participants for the NALs which preceded NAL No.16-58 and NAL No. 17-27 were merely for temporary relief.

discussion of costs and benefits below refers to the effects of the proposed rules on all

swaps activity subject to the proposed and amended regulations, whether by virtue of the

activity's physical location in the United States or by virtue of the activity's connection

with or effect on U.S. commerce under CEA section 2(i).[105]

2. Package Transactions

The Commission proposes to add § 37.9(d) and amend § 37.9(a)(2) to permit the

swap components of certain package transactions to be executed via flexible methods of

execution pursuant to § 37.9(c)(2). The Commission proposes to define a "package

transaction" for the purpose of the proposed rule as a transaction consisting of two or

more component transactions executed between two or more counterparties where (i) at

least one component transaction is subject to the trade execution requirement in section

2(h)(8) of the Act; (ii) execution of each component transaction is contingent upon the

execution of all other component transactions; and (iii) the component transactions are

priced or quoted together as one economic transaction with simultaneous or near-

simultaneous execution of all components. Based on this proposed definition and

consistent with existing no-action relief, the Commission proposes to allow the swap

component of the following three categories of package transactions to be executed via

flexible means of execution pursuant to § 37.9(c)(2): (1) MAT/Non-MAT Uncleared

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[105] Section 2(i)(1) applies the swaps provisions of both the Dodd-Frank Act and Commission regulations promulgated under those provisions to activities outside the United States that "have a direct and significant connection with activities in, or effect on, commerce of the United States[.]" 7 U.S.C. 2(i). Section 2(i)(2) makes them applicable to activities outside the United States that contravene Commission rules promulgated to prevent evasion of Dodd-Frank.

package transactions; (2) MAT/Non-Swap Instrument package transactions;[106] and (3) MAT/Non-Exclusive CFTC Swap package transactions.

In addition, the Commission is proposing to exempt the swap components of these three types of package transactions from the requirement in § 37.3 that the SEF offer an Order Book for every swap listed for trading on the SEF, while continuing to require that SEFs offer an Order Book for outright transactions in every swap listed for trading on the SEF. Finally, the Commission is proposing to use its exemptive authority pursuant to CEA section 4(c) to exempt swap transactions that are executed as a component of a package transaction that includes a component that is a new issuance bond from the trade execution requirement under section 2(h)(8) of the Act.

Benefits: The proposed rule would allow market participants to choose the most suitable execution method for each package transaction and will allow SEFs to continue to offer flexible execution methods for these package transactions rather than only offer the required methods of execution for swaps subject to the trade execution requirement. The Commission expects this would reduce execution risks, improve efficiency, and decrease transaction costs as market participants would be able to avoid legging into transactions, that is, entering into each part of the package separately. The Commission notes that these benefits are currently available to market participants through existing no-action relief. The Commission further believes that the proposed rule would provide the liquidity and transparency benefits of increased trading of component swaps on SEFs,

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[106] Under proposed § 37.9(d)(3), consistent with the no-action relief, this category specifically excludes U.S. Dollar Spreadover package transactions; MAT/Futures package transactions, MAT/Agency MBS package transactions; and New Issuance Bond package transactions.

as without the proposed flexibility market participants would be unable or unwilling to

trade such swap components through SEFs' required methods of execution.[107]

The Commission believes that not requiring SEFs to offer an Order Book for the

swap components of the three types of relevant package transactions would benefit SEFs

by helping them to reduce operating costs, as they would no longer be required to operate

and maintain an Order Book for trading those swaps that are components of those

package transactions. However, SEFs would need to retain the availability of Order

Books for those swaps executed as outright transactions.

Further, as discussed above, given the illiquid and bespoke nature of various

components within the relevant package transactions, the Commission acknowledges that

the Order Book is not the ideal method of execution for many such transactions.

Therefore, the Commission anticipates that if SEFs are not required to provide an Order

Book for relevant package transactions that are not suitable for Order Book trading, SEFs

will be able to more effectively employ their resources, and no longer face the prospect of

being required to provide Order Books that will not be utilized given the complex,

illiquid, and bespoke nature of various components of the relevant package transactions.

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[107] Further, while the proposed rules also provide flexibility from the required methods of execution that are otherwise intended to help promote pre-trade transparency on SEFs, the Commission notes that permitting market participants to use flexible methods of execution is consistent with how package transactions are treated within other jurisdictions. For example, in the European Union ("EU") certain package transactions (including package transactions for which the Commission currently requires the swap component to be executed through the required methods of execution, such as U.S. Dollar Spreadover package transactions) are eligible to be waived from the EU's transparency regime. The Commission believes that this proposal strikes an appropriate balance between promoting pre-trade transparency and ensuring that U.S. markets and their participants are not unnecessarily burdened. *See* Regulation (EU) 2016/1033 of the European Parliament and of the Council of 23 June 2016 amending Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) No 596/2014 on market abuse and Regulation (EU) No 909/2014 on improving securities settlement in the European Union and on central securities depositories.

The Commission believes that the proposal to exempt swap transactions that are executed as a component of a package transaction that includes a component that is a new issuance bond from the trade execution requirement will ensure that market participants such as bond underwriters and issuers can continue to execute these packages (where the new-issuance bond is hedged by an interest rate swap with tenor and payment terms that typically match the terms of the bond issuance) off-SEF. As discussed above, this proposed exemption may facilitate new bond issuances, which may benefit capital formation by helping market participants to raise capital and fund origination loans for businesses and homeowners. Moreover, 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. SEFs have not been able to design an execution method suitable for this particular type of package, rendering it impracticable to execute these packages on-SEF. While the swap components of many swap/new-issuance bond packages executed today are not currently subject to the trade execution requirement,[108] the proposed rule would ensure that those transactions would remain exempt in the event the trade execution requirement is expanded to include more types of swaps.

Costs: The proposed amendments to allow flexible execution methods for certain package transactions and the proposed exemption for package transactions that include a

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[108] For example, the swap component may be a forwarding-starting swap whose start date corresponds to the issuance date of the bond. Forward starting swaps are not currently subject to the trade execution requirement.

new issuance bond should not impose costs on market participants since they only provide flexibility to market participants and do not require them to change their current trade practices. Moreover, to the extent that market participants are relying on existing no-action relief, they could continue to implement existing industry practice. The Commission believes that current SEF rules typically allow participants to utilize flexible execution methods pursuant to the existing no-action relief, but to the extent that SEFs need to modify their rules to incorporate the proposed amendments, they may incur modest costs.

As noted, not requiring SEFs to offer an Order Book for the swap components of the relevant package transactions may enable SEFs to reduce operating costs. Since any existing Order Books for swap components of the relevant package transactions are not actively used and are not practicable for market participants to use, removing these Order Books (and not requiring SEFs to create such Order Books) should not impose significant costs on market participants.

Section 15(a) Factors

      a. Protection of Market Participants and the Public

The Commission believes that the proposed amendments and exemption will protect market participants from the risks associated with legging into the relevant packages by enabling market participants to enter into package transactions using appropriate execution methods. Permitting SEFs to eliminate the Order Book for use when swaps are components of package transactions should not impact protection of market participants. While protecting market participants also benefits the public, the

Commission has not identified any further effect of the proposal on protection of the public.

b. Efficiency, Competitiveness, and Financial Integrity of the Markets

The proposed amendments would enhance efficiency by enabling market participants to continue to execute the relevant packages in a single transaction with an appropriate execution method, rather than via the inefficient process of legging into the package one component at a time. The proposed amendments would also enhance financial integrity by enabling market participants to continue to avoid the execution risk associated with potential adverse price movements while attempting to leg a transaction. The Commission has not identified any likely effects of the proposed amendments on competition in the swap markets. The Commission expects that, since there are few, if any, active Order Books for swaps as components of the relevant package transactions, SEFs will not use proposed § 37.3(a)(4) to remove active Order Books that are providing competitive markets.

c. Price Discovery

Package transactions are typically executed at a single price for the entire package, rather than at the prices of the individual components. The proposed amendments would continue to allow the relevant package transactions to be executed using the execution methods that are designed to facilitate price discovery in these packages. For packages that include new issuance bonds, the proposed exemption will permit price discovery to occur at the appropriate venue. The Commission believes that the proposed § 37.3(a)(4), which would exempt swaps that are part of the relevant package transactions from the Order Book requirement, would not materially inhibit price

discovery since the Commission anticipates that SEFs would retain Order Books where price discovery is occurring and that currently price discovery is not occurring in Order Books for swap components of the package transactions addressed within this proposal.

d. Sound Risk Management Practices

The Commission believes that the proposal will continue to promote sound risk management by facilitating the execution of package transactions as market participants consider package transactions to often be useful and appropriate instruments for management and transfer of risk and to avoid the execution risks associated with legging of transactions.

e. Other Public Interest Considerations

The proposed exemption from the trade execution requirement for the swap components of packages involving new issuance bonds may help promote capital formation by facilitating the issuance of bonds to raise capital. The Commission has not identified any other effect of the proposed rules and proposed exemption regarding package transactions on other public interest considerations.

Request for Comment

The Commission requests comment on the costs and benefits of all aspects of the proposed amendments related to certain package transactions, including the discussion of the section 15(a) factors. Comments made on the 2018 SEF Proposal that are relevant to this rulemaking should be resubmitted to be considered. The Commission requests comment on the alternatives discussed above as well as any other alternatives that commenters believe present a superior cost-benefit profile to the proposed amendments. Commenters are requested to provide data and any other information or statistics to

support their position. In particular, to the extent commenters believe that the costs or benefits of any aspect of the proposed rules are reasonably quantifiable, the Commission requests that they provide data and any other information or statistics to assist the Commission in quantification.

　　　　3. Error Trades

The Commission proposes to add subsection (e) to § 37.9 to establish a flexible SEF error trade policy standard that would, among other things, incorporate the intent of the existing no-action relief in NAL No. 17-27 for resolving errors in Required Transactions. Proposed § 37.9(e)(2)(i) would specify that a SEF must maintain rules and procedures that are "fair, transparent, consistent" and "allow for timely resolution" of an "error trade," as defined under proposed § 37.9(e)(1)(ii). This proposed standard would apply to any error trade that occurs on a SEF, regardless of whether or not the swap is submitted for clearing. Further, under proposed § 37.9(e)(2)(i), SEFs must have error trade rules and procedures that require that market participants provide prompt notice to the SEF of an error trade and, as applicable, correcting and offsetting trades.

Proposed § 37.9(e) would also require a SEF to adopt rules to resolve error trades that involve swaps submitted for clearing. For an error trade rejected from clearing and therefore deemed void *ab initio*, proposed § 37.9(e)(2)(i)(A) would require a SEF to permit the counterparties to subsequently execute a correcting trade, as defined in proposed § 37.9(e)(1)(i), through any method of execution offered by the SEF. For an error trade that has been accepted for clearing, proposed § 37.9(e)(2)(i)(B) would require a SEF to permit the counterparties to subsequently execute both an offsetting trade, as

defined in proposed § 37.9(e)(1)(iii), and a correcting trade through any method of execution offered by the SEF.

The proposed rule includes some limitations that are similar to the existing no-action relief, including specified timeframes for executing and submitting these trades for clearing. For correcting trades associated with an error trade that has been rejected from clearing, proposed § 37.9(e)(2)(i)(A) would require the SEF to submit the correcting trade for clearing to the registered DCO or exempt DCO as soon as technologically practicable, but no later than one hour after notice of the rejection to the relevant clearing members. For an offsetting trade and a correcting trade associated with an error trade that already has been accepted for clearing, proposed § 37.9(e)(2)(i)(B) would require the SEF to submit both types of trades to the registered DCO or exempt DCO as soon as technologically practicable, but no later than three days after the registered DCO or exempt DCO accepted the error trade for clearing. In addition to these proposed timeframes, proposed § 37.9(e)(2)(ii) would prohibit counterparties from executing a second correcting trade to fix an error trade if the initial correcting trade is rejected from clearing.

However, the proposed rule does not include certain additional conditions applicable to SEFs and counterparties that are contained in the no-action relief under NAL No. 17-27 or NAL No. 20-01. For example, the no-action relief in NAL No. 17-27 requires that a SEF must make an affirmative finding that an alleged error trade has occurred and must have rules setting forth the procedures for making such a finding.

Benefits: Absent an adoption of these proposed rules, both SEFs and market participants would need to comply with the existing Commission regulations,

notwithstanding the significant procedural and logistical difficulties of doing so. In particular, market participants would have to resolve error trades in Required Transactions using the Order Book or RFQ System, which would likely make it impossible to recreate the trade as originally intended. These difficulties could dissuade SEFs from being actively involved in the error trade resolution process and market participants from executing swaps on a SEF. The Commission believes that the proposal would avoid these potential difficulties.

The Commission preliminarily believes that, given that the proposed amendments are largely consistent with current industry practice, SEFs and market participants may likely have already realized much of the benefit of proposed § 37.9(e). The Commission preliminarily believes, however, that the proposed rules additionally would provide a tangible benefit to market participants on a longer-term basis by allowing market participants to continue utilizing policies and protocols which the Commission understands most SEFs adopted in reliance upon the relief provided in existing no-action letters to resolve error trades.

The proposed rule does not require that a SEF affirmatively determine that an error trade has occurred, either before resolution or via an *ex post facto* review. The Commission preliminarily believes that such a requirement, which is in the existing no-action relief, would impose unnecessary costs on SEFs and market participants, and potentially impair the efficiency of the error trade resolution process. To the extent that SEFs and market participants are currently availing themselves of current no-action relief, they may realize reduced costs under the proposed rule.

The proposed requirement under § 37.9(e)(2)(i) that market participants provide prompt notice to a SEF of an error trade and, as applicable, the corresponding correcting trade and offsetting trade would benefit SEFs in carrying out their self-regulatory obligations. In particular, the Commission believes that providing SEFs prompt notice that an error trade has occurred on their trading system(s) or platform(s) would enhance their ability to carry real-time market monitoring of all trading activity on their system(s) or platform(s) to identify disorderly trading and any market or system anomalies or violations of SEF rules.

The Commission also believes that the proposed amendments will facilitate the goal of promoting consistency in the swaps market with respect to how errors are evaluated and resolved. First, the proposed amendments would require all SEFs to adopt such policies. To the extent SEFs have not yet implemented such policies, the proposed amendments will benefit market participants who will now be able to correct error trades and avoid related economic losses. Further, market participants can obtain the benefit of executing a swap transaction that corrects an error trade with the terms originally intended.

Finally, some SEFs have already implemented robust error trade resolution policies pursuant to existing no-action relief, while other SEFs have not implemented robust error trade policies. This inconsistency among SEFs otherwise causes a "race to the bottom" for SEFs' compliance and market oversight, as certain market participants may prefer SEFs with less stringent error trade policies. As a result, SEFs that have implemented robust error trade policies—and the swaps market in general—will benefit by eliminating this potential "race to the bottom," and the Commission will underscore

the importance of SEF market oversight by adopting such requirements in Commission regulations.[109]

Costs: Similar to the conditions established by Commission staff in time-limited no-action relief, the proposed amendments would require SEFs to establish rules implementing various policies and procedures for resolving error trades. Under the proposal, SEFs would have to submit new rules to the Commission pursuant to part 40 of the Commission's regulations. However, the Commission understands that pursuant to the existing no-action relief, most SEFs currently have rules that otherwise would comply with the proposed regulations. SEFs may choose to adjust their rules in light of the absence in the proposed rules of the requirement in the no-action relief that SEFs affirmatively determine that an error trade has occurred.[110] To the extent that SEFs must draft and submit new rules to the Commission, the Commission estimates that the costs will be modest.

The Commission preliminarily believes that the proposed amendments would not impose significant additional costs on market participants and intermediaries, because resolving error trades is inherently costly regardless of regulations imposed by the Commission, and market participants and intermediaries are currently subject to SEF policies and procedures. The proposed requirement that market participants provide prompt notice to a SEF of an error trade and, as applicable, the correcting trade and

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[109] The Commission notes that a robust error trade resolution policy is also consistent with an effective compliance and oversight program because the ability to resolve error trades (i) helps protect market integrity by unwinding certain error trades that otherwise would have an adverse effect on the market and (ii) promotes legal certainty by ensuring that market participants obtain the economic position in the transaction that they intended.

[110] In light of the flexibility of the proposed rule, SEFs can continue to require such an affirmative declaration if the determine that such requirement provides benefits to market participants or the SEF.

offsetting trade would impose modest costs on market participants, but, in practice,

market participants have likely needed to report error trades to SEFs in order to facilitate

SEF determinations that an error trade has occurred pursuant to NAL No. 17-27, and

would have had to report the correcting trade and offsetting trade in order to facilitate the

SEF's *ex post facto* review pursuant to NAL No. 20-01. Not requiring that a SEF find

that an error trade has occurred either before it has been resolved or via an *ex post facto*

review should impose only minor costs on market participants associated with changes in

procedures to no longer request that a SEF make such a determination.

The Commission notes that NAL No. 17-27 and NAL No. 20-01 apply to both

SEFs and DCMs, but the proposed rule would apply only to SEFs. Therefore, the

Commission believes that the proposed rule would impose no costs on DCMs, and notes

that no DCM is currently availing itself of the no-action relief.

Section 15(a) Factors

      a.   Protection of Market Participants and the Public

The proposed addition of § 37.9(e) regarding error trades will protect market

participants and the public by providing SEFs with greater authority under Commission

regulations to resolve error trades. Further, by providing SEFs with the authority to

permit counterparties to execute correcting trades and offsetting trades, the proposed

amendments would protect market stability and transparency by preventing potential

losses to market participants in connection with error trades and reducing instances in

which market participants rely on inaccurate pricing information to inform their trading

decisions. The proposed addition of § 37.9(e) would also promote greater transparency

of the error trade resolution process to SEFs' market participants as SEFs would be

required to establish policies and procedures for reviewing and determining how to resolve alleged error trades. The proposed requirement under § 37.9(e)(2)(i) that market participants provide prompt notice to a SEF of an error trade and, as applicable, the correcting trade and offsetting trade would promote protection of market participants and the public by enhancing a SEF's ability to carry out its market oversight and monitoring responsibilities. The Commission believes that the absence of a requirement in the proposed rule that SEFs must affirmatively determine, or determine after an *ex post facto* review, that an error trade has occurred (which are conditions in the existing no-action relief under NAL No. 17-27 and NAL No. 20-01) would not materially impact the protection of market participants and the public.

b.   Efficiency, Competitiveness, and Financial Integrity of the Markets

The proposed addition of § 37.9(e) may improve the efficiency and financial integrity of markets by enabling counterparties to correct operational or clerical errors in a swap transaction. In particular, the proposed rules would help promote greater trading accuracy in the market by allowing counterparties to ultimately carry out transactions as originally intended, and would avoid unexpected trading losses caused by error trades. The proposed requirement under § 37.9(e)(2)(i) that market participants provide prompt notice to a SEF of an error trade and, as applicable, the correcting trade and offsetting trade would enhance a SEF's ability to carry out its market oversight and monitoring responsibilities which helps promote the financial integrity of its markets. The Commission believes that the absence of the no-action provision that SEFs must affirmatively determine that an error trade has occurred could enhance the efficiency of

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the error trade resolution process and would not materially impact the competitiveness or financial integrity of the swap market on SEFs.

Absent these proposed rules, counterparties would be required in certain circumstances to correct or re-execute swap transactions in a less efficient and effective manner on a SEF, such as through the required methods of execution under § 37.9(a). The proposed rules, which also require SEFs to adopt certain policies and procedures for addressing error trades, should further promote efficiency in the resolution process by providing market participants that transact on multiple SEFs with a more consistent approach across different platforms for correcting error trades.

c. Price Discovery

The proposed addition of § 37.9(e) regarding error trades would enable SEFs to correct error trades containing a clerical or operational error while maintaining the price discovery benefits associated with the pre-trade transparency requirements of § 37.9. In particular, the proposed rules would help promote price discovery by allowing counterparties, whose original trade has been cancelled upon rejection from clearing due to a clerical or operational error, to re-execute the trade with the terms as originally intended. For error trades that have been accepted by a registered DCO or exempt DCO for clearing, the proposed rules promote greater accuracy in the price discovery process by allowing the counterparties to correct the error trade by executing an offsetting swap transaction and a subsequent swap transaction with the terms as originally intended.

d. Sound Risk Management Practices

The proposed addition of § 37.9(e) regarding error trades may promote sound risk management practices by providing SEFs with greater authority under Commission

regulations to facilitate error trade resolution. The proposed rules will help to mitigate

potential losses to market participants arising out of trade cancellations, where the error

trade is rejected from clearing, or arising from maintaining the position of an unintended

error trade.

e. Other Public Interest Considerations

The Commission has not identified any effect of proposed § 37.9(e) on other

public interest considerations.

Request for Comment

The Commission invites public comment on all aspects of its cost benefit

considerations related to the proposed amendments regarding SEFs' error trade policies,

including the discussion of the section 15(a) factors. Comments made on the 2018 SEF

Proposal that are relevant to this rulemaking should be resubmitted to be considered.

Commenters are requested to provide data and any other information or statistics to

support their position. In particular, to the extent commenters believe that the costs or

benefits of any aspect of the proposed rules are reasonably quantifiable, the Commission

requests that they provide data and any other information or statistics to assist the

Commission in quantification.

The Commission requests comment on the impact of the proposed rule on market

participants who may need to adjust their error trade rules and policies to comply with

SEFs' error trade rules implemented to comply with proposed § 37.9(e). The

Commission also requests comment on any alternatives that commenters believe present

a superior cost-benefit profile to the proposed amendments.

4. Block Trades

The Commission proposes amendments to the definition of block trade, set forth in § 43.2, to allow SEFs to permit market participants to execute swap block trades using a SEF's trading system or platform, with the exception of the Order Book.[111] Market participants could continue to execute a block trade away from the SEF's trading system or platform, but pursuant to the SEF's rules.[112] This rule is similar to existing relief set out in NAL No. 17-60, but the proposed rule would apply to uncleared swaps as well ITBC swaps, while the existing no-action relief only applies to ITBC swaps.

Benefits: The Commission believes that permitting swap block trades to be executed on SEFs pursuant to Commission regulation would provide tangible benefits to market participants by allowing them to further utilize a SEF's trading systems and platforms with the exception of the Order Book. To the extent that a SEF provides the most operationally- and cost-efficient method of executing swap block trades, the proposed amendment would help market participants to continue realizing such benefits. Additionally, allowing market participants to execute swap block trades on a SEF helps to facilitate the pre-execution screening of transactions against risk-based limits in an efficient manner through SEF-based mechanisms. The Commission also recognizes that

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[111] The Commission notes that a swap transaction with a notional size above the appropriate minimum block trade size could still be executed on an Order Book, but would not qualify as a block trade, and therefore, would not receive a time delay from public dissemination requirements set forth in § 43.5(d).

[112] The Commission notes that § 43.6(g)(1)—required notification of block trade election—would still apply to block trade transactions executed on the SEF via the SEF's non-Order Book trading systems and platforms. For example, pursuant to § 43.6(g)(1)(i), SEFs would need to implement a mechanism by which the counterparties notify the SEF of the counterparties' intention to have an on-SEF executed block trade treated as a block trade for reporting purposes. Additionally, pursuant to § 43.6(i)(2), a person transacting a cleared swap block trade on behalf of a customer would still need to receive prior written instruction or consent from the customer to transact the trade as a cleared swap block trade on the SEF. *See* 17 CFR 43.6(i)(2).

many SEFs and market participants have already expended resources to implement technological and operational changes needed to avail themselves of the no-action relief under NAL No. 17-60. The proposed amendments would preclude the need to expend additional resources to negate those changes. Further, incorporating the current no-action relief in the Commission's regulations would promote the statutory goal in CEA section 5h(e) of promoting swaps trading on SEFs. Finally, the proposed amendment would permit SEFs to extend the benefits of executed swap block trades on-SEF to uncleared swaps as well as ITBC swaps.

Costs: The Commission notes that the majority of SEFs have implemented the existing no-action relief. To the extent that SEFs have implemented such relief, they may incur modest costs in adjusting their rulebooks to, for example, include uncleared swaps in their block trading provisions. Any SEF that has not implemented the existing no-action relief but wishes to implement block trading rules consistent with the proposed amendment will incur somewhat higher, but still modest costs.

Section 15(a) Factors

a. Protection of Market Participants and the Public

The proposed amendment to the definition of a swap block trade in § 43.2, which would allow for both ITBC and non-ITBC swap block trades to be executed on a SEF's non-Order Book trading system or platform will provide more options to market participants for executing swap block trades without impeding the protection of market participants and the public provided under existing Commission regulations.

b. Efficiency, Competitiveness, and Financial Integrity of the Markets

The proposed amendment to the definition of block trade under § 43.2 to allow

cleared and uncleared swap block trades to be executed on a SEF's non-Order Book

trading system or platform may improve the efficiency and financial integrity of the

swaps markets. The proposed amendments would provide market participants with the

ability to execute block trades either on a SEF or away from, but pursuant to the rules of,

a SEF. From an efficiency perspective, such choice should allow participants to choose

the most operationally efficient and cost-efficient method of executing block trades.

With respect to the financial integrity of the swaps market, this proposed amendment

would also facilitate the use of pre-trade credit screening functionalities or protocols

offered by the SEF to fulfill its obligations under SEF Core Principle 7—Financial

Integrity of Transactions.[113]

c. Price Discovery

The Commission is not aware of significant effects on the price discovery process

of the proposed amendment to the definition of block trade under § 43.2 to allow block

trades to be executed on a SEF's non-Order Book trading system or platform. The

Commission notes that block trades are currently not subject to the execution methods for

required transactions under § 37.9, which are intended to promote pre-trade price

transparency pursuant to section 5h of the CEA.[114] Based on the previous recognition

that market participants are likely to execute large-sized trades, *i.e.*, block trades, in a

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[113] 17 CFR 37.700.

[114] The Commission stated its belief in the part 37 final rule release that an order book, as defined in § 37.3(a)(3), and the RFQ System, as defined in § 37.9(a)(3), are intended to promote the goals articulated in section 733 of the Dodd-Frank Act, which include promoting pre-trade price transparency. 78 FR 33484, 33497.

manner that would mitigate pre-trade information leakage concerns, the Commission

does not anticipate that the proposed amendment would diminish the price discovery

process for block trades executed on a SEF.

d. Sound Risk Management Practices

The proposed amendment to allow block trades to occur on the SEF (but not on

the SEF's order book) may promote sound risk management practices by providing more

options for the execution of block trades. In this regard, the Commission notes that block

trading can facilitate risk management by providing a means for commercial firms to

transact large orders without the need for significant price concessions and resulting price

uncertainty for parties to the transaction that would occur if transacted on the centralized

market.

e. Other Public Interest Considerations

The proposed amendments should help promote SEF trading and pre-trade price

transparency, *i.e.*, the statutory goals set forth under section 5h(f)(2) of the CEA with

respect to SEFs.[115]

Request for Comment

The Commission requests comment on the costs and benefits of all aspects of the

proposed amendments to permit block trades to be executed on a SEF, including the

discussion of the section 15(a) factors. Comments made on the 2018 SEF Proposal that

are relevant to this rulemaking should be resubmitted to be considered. The Commission

requests comment on the alternatives discussed above as well as any other alternatives

that commenters believe present a superior cost-benefit profile to the proposed

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[115] 7 U.S.C. 7b-3(e).

amendments. Commenters are requested to provide data and any other information or statistics to support their position. In particular, to the extent commenters believe that the costs or benefits of any aspect of the proposed rules are reasonably quantifiable, the Commission requests that they provide data and any other information or statistics to assist the Commission in quantification.

D. Antitrust Considerations

Section 15(b) of the CEA 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 objectives of the CEA, in issuing any order or adopting any Commission rule or regulation. The Commission does not anticipate that the proposed amendments to parts 36, 37, and 43 would promote or result in anti-competitive consequences or behavior. However, the Commission encourages comments from the public with respect to any aspect of the proposal that maybe perceived as potentially inconsistent with the antitrust laws or anti-competitive in nature.

List of Subjects

17 CFR Part 36

Package transactions, Trade execution requirement.

17 CFR Part 37

Block trades, Error trades, Package transactions, Required methods of execution, Swap execution facilities, Swaps, Trade execution requirement.

17 CFR Part 43

Block trades, Large notional off-facility swaps, Real-time public reporting, Reporting and recordkeeping requirements.

For the reasons stated in the preamble, the Commodity Futures Trading

Commission proposes to amend 17 CFR chapter I as follows:

1. Revise part 36 to read as follows:

PART 36 – TRADE EXECUTION REQUIREMENT

Sec.
36.1 Exemptions to trade execution requirement.

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 Exemptions to trade execution requirement.

(a) A swap transaction that is executed as a component of a package transaction

that also includes a component transaction that is the issuance of a bond in a primary

market is exempt from the trade execution requirement in section 2(h)(8) of the Act.

(1) For purposes of paragraph (a) of this section, a package transaction consists of

two or more component transactions executed between two or more counterparties

where:

(i) At least one component transaction is subject to the trade execution

requirement in section 2(h)(8) of the Act;

(ii) Execution of each component transaction is contingent upon the execution of

all other component transactions; and

(iii) The component transactions are priced or quoted together as one economic

transaction with simultaneous or near-simultaneous execution of all components.

(2) [Reserved]

(b) [Reserved]

PART 37 – SWAP EXECUTION FACILITIES

2. The authority citation for part 37 continues to read as follows:

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.

3. In § 37.3, add paragraph (a)(4) to read as follows:

§ 37.3 Requirements and procedures for registration.

(a) * * *

(4) A swap execution facility is not required to provide an order book under this section for transactions defined in § 37.9(d)(2), (3), and (4), except that a swap execution facility must provide an order book under this section for Required Transactions that are components of transactions defined in § 37.9(d)(2), (3), and (4) when such Required Transactions are not executed as components of transactions defined in § 37.9(d)(2), (3), and (4).

* * * * *

4. In § 37.9, revise paragraph (a)(2)(i) introductory text and add paragraphs (d) and (e) to read as follows:

§ 37.9 Methods of execution for required and permitted transactions.

(a) * * *

(2) * * *

(i) Each Required Transaction that is not a block trade as defined in § 43.2 of this chapter shall be executed on a swap execution facility in accordance with one of the following methods of execution except as provided in paragraph (d) or (e) of this section:

* * * * *

(d) *Exceptions to required methods of execution for package transactions.* (1) For purposes of this paragraph, a package transaction consists of two or more component transactions executed between two or more counterparties where:

(i) At least one component transaction is a Required Transaction;

(ii) Execution of each component transaction is contingent upon the execution of all other component transactions; and

(iii) The component transactions are priced or quoted together as one economic transaction with simultaneous or near-simultaneous execution of all components.

(2) A Required Transaction that is executed as a component of a package transaction that includes a component swap that is subject exclusively to the Commission's jurisdiction, but is not subject to the clearing requirement under section 2(h)(1)(A) of the Act, may be executed on a swap execution facility in accordance with paragraph (c)(2) of this section as if it were a Permitted Transaction;

(3) A Required Transaction that is executed as a component of a package transaction that includes a component that is not a swap, as defined under section 1a(47) of the Act, may be executed on a swap execution facility in accordance with paragraph (c)(2) of this section as if it were a Permitted Transaction. This provision shall not apply to:

(i) A Required Transaction that is executed as a component of a package transaction in which all other non-swap components are U.S. Treasury securities;

(ii) A Required Transaction that is executed as a component of a package transaction in which all other non-swap components are contracts for the purchase or sale of a commodity for future delivery;

(iii) A Required Transaction that is executed as a component of a package transaction in which all other non-swap components are agency mortgage-backed securities; and

(iv) A Required 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.

(4) A Required Transaction that is executed as a component of a package transaction that includes a component swap that is not exclusively subject to the Commission's jurisdiction may be executed on a swap execution facility in accordance with paragraph (c)(2) of this section as if it were a Permitted Transaction.

(e) *Resolution of operational and clerical error trades.* (1) As used in this paragraph:

(i) *Correcting trade* means a trade executed and submitted for clearing to a registered derivatives clearing organization, or a derivatives clearing organization that the Commission has determined is exempt from registration, with the same terms and conditions as an error trade other than any corrections to any operational or clerical error and the time of execution.

(ii) *Error trade* means any trade executed on or subject to the rules of a swap execution facility that contains an operational or clerical error.

(iii) *Offsetting trade* means a trade executed and submitted for clearing to a registered derivatives clearing organization, or a derivatives clearing organization that the Commission has determined is exempt from registration, with terms and conditions that economically reverse an error trade that was accepted for clearing.

(2) *Execution of correcting trades and offsetting trades.* (i) A swap execution facility shall maintain rules and procedures that facilitate the resolution of error trades. Such rules shall be fair, transparent, and consistent; allow for timely resolution; require market participants to provide prompt notice of an error trade—and, as applicable, offsetting and correcting trades—to the swap execution facility; and permit market participants to:

(A) Execute a correcting trade, in accordance with paragraph (c)(2) of this section, regardless of whether it is a Required or Permitted Transaction, for an error trade that has been rejected from clearing as soon as technologically practicable, but no later than one hour after a registered derivatives clearing organization, or a derivatives clearing organization that the Commission has determined is exempt from registration, provides notice of the rejection; or

(B) Execute an offsetting trade and a correcting trade, in accordance with paragraph (c)(2) of this section, regardless of whether it is a Required or Permitted Transaction, for an error trade that was accepted for clearing as soon as technologically practicable, but no later than three days after the error trade was accepted for clearing at a derivatives clearing organization or a derivatives clearing organization that the Commission has determined is exempt from registration.

(ii) If a correcting trade is rejected from clearing, then a swap execution facility shall not allow the counterparties to execute another correcting trade.

PART 43 – REAL-TIME PUBLIC REPORTING

5. 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).

6. 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 trading system or platform of a registered swap execution

facility that is not an order book as defined in § 37.3(a)(3) of this chapter, or occurs away

from a registered swap execution facility's or designated contract market's trading

system or platform and is executed pursuant to the registered swap execution facility's or

designated contract market's rules and procedures;

(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 means 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 this section.

Major currencies means 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 means 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 means the currencies of the European Monetary Union, Japan, the United Kingdom, and United States.

Swaps with composite reference prices means 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.

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 February 6, 2020, 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 Facility Requirements and Real-Time Reporting

Requirements – Commission Voting Summary and Commissioners' Statements

Appendix 1 – Commission Voting Summary

On this matter, Chairman Tarbert and Commissioners Quintenz, Behnam, Stump, and Berkovitz voted in the affirmative. No Commissioner voted in the negative.

Appendix 2 – Statement of Support of Commissioner Brian D. Quintenz

I support today's proposal that seeks to resolve through rulemaking three issues currently addressed in staff no-action letters. I believe this proposal is an important first step to provide market participants with much needed regulatory certainty while also promoting swap execution facility (SEF) participation, though regulatory certainty over additional current market practices is necessary as well.

Staff initially granted these requests for relief in 2013 and 2014, as SEFs were first coming into compliance with the Commission's then-new SEF regulatory framework. With the benefit of six-plus years of implementation experience, and multiple extensions of each of these no-action letters, it is long overdue for the Commission to codify and clarify its policy on each of these important issues.

First, the proposal would amend part 37 regulations to permit the swap components of certain categories of package transactions to be executed on-SEF through

flexible means of execution, rather than via the required methods of execution under Rule 37.9.[1] In addition, the proposal would also include an exemption from the trade execution requirement for swap transactions that are executed as a component of a new issuance bond package transaction. These amendments recognize the need to provide flexible means of execution for swaps that are negotiated and executed concurrently with other components of a larger, integrated transaction.

Second, the proposal adopts a principles-based approach regarding SEF policies to correct operational or clerical errors.[2] The proposal directs SEFs to adopt fair, transparent, and consistent policies and procedures that allow for the timely resolution of error trades. SEFs would be permitted to allow market participants to execute offsetting or correcting trades through any method of execution offered by the SEF. I believe these amendments will facilitate the prompt identification and correction of error trades, thereby minimizing market participants' exposure to market, credit, and operational risks.

Thirdly, the proposal recognizes the difficulties associated with performing a pre-trade execution credit check on block trades occurring away from a SEF's trading system or platforms.[3] Accordingly, it would permit block trades to be executed on a trading system of the SEF that is not an order book, thereby allowing FCMs to conduct pre-execution credit screenings. The proposal also continues to allow block trades to be executed away from the SEF.

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[1] These amendments address the relief currently provided by CFTC No-Action Letter 17-55 (Oct. 31, 2017).

[2] These amendments address the relief currently provided by CFTC No-Action Letters 17-27 (May 30, 2017) and 20-01 (Jan. 8, 2020).

[3] These amendments address the relief currently provided by CFTC No-Action Letter 17-60 (Nov. 14, 2017).

This proposal should in no way preclude the Commission from considering additional SEF no-action letters and policy issues through rulemaking. For example, codifying the current no-action letter providing relief from the trade execution requirement for inter-affiliate swaps, or providing greater clarity about permissible methods of execution and minimum SEF trading functionality are prime examples. In order to truly foster and promote market liquidity, transparency, innovation, and competition in the SEF marketplace, I believe these outstanding issues should be addressed. I will support today's proposal but remain hopeful that these and other important areas can be addressed through rulemaking in the near future.

Appendix 3 – Statement of Concurrence of Commissioner Rostin Behnam

I respectfully concur in the Commission's proposal to amend certain swap execution facility (SEF) requirements and real-time reporting requirements. A little more than a year ago, the Commission issued a proposal that would have constituted a complete overhaul of the existing regulatory framework for SEFs.[1] As I stated in my concurrence to the 2018 SEF proposal, I do not believe that such an overhaul is necessary.[2] However, despite my opposition to the overhaul, I supported issuing the SEF proposal for public comment because it contained several policy changes which separately warranted further consideration. Market participants have spent a great deal of resources to build systems and businesses that comply with our existing SEF rules. Fundamental changes amounting to an overhaul of the entire system should only be done

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[1] Swap Execution Facilities and Trade Execution Requirement, 83 FR 61946 (proposed Nov. 30, 2018).

[2] Rostin Behnam, Statement of Concurrence of Commissioner Rostin Behnam Regarding Swap Execution Facilities and Trade Execution Requirement (Nov. 5, 2018), *https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement110518a*.

in circumstances where there is a regulatory concern that necessitates action.[3]

Accordingly, in the past I have suggested we should focus on targeted reforms, such as codifying existing no-action relief for SEFs.[4] I warned that we should not allow issues with the broader vision of the 2018 SEF proposal to distract us from making targeted changes.[5]

Today, the Commission proposes to limit changes to our existing SEF rules, specifically focusing on the codification of long-standing no-action relief regarding package transactions, error trades, and block trades. While I support today's proposal, I do have some concerns where I think we deviate from the path of targeted codification. The provisions in today's proposal regarding package transactions and block trades basically mirror the existing no-action relief.[6] However, the proposal regarding error trades does not.[7]

DMO currently provides no-action relief from the required methods of execution under § 37.9 for trades intended to resolve error trades.[8] The existing relief provides a

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[3] Rostin Behnam, Sowing the Seeds of Success in 2020, Remarks of CFTC Commissioner Rostin Behnam at the 2019 ISDA Annual General Meeting, Grand Hyatt Hong Kong, Hong Kong (Apr. 9, 2019), *https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam13*.

[4] *Id.*

[5] *Id.*

[6] *See* CFTC No-Action 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); CFTC No-Action 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).

[7] *See* CFTC No-Action 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); CFTC No-Action Letter No. 20-01 ("NAL No. 20-01"), Re: Supplemental 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 (Jan. 8, 2020).

[8] NAL 17-27.

number of conditions, including a requirement that a SEF determine (either prior to execution or within 24 hours after) that an error has occurred. Among other things, the no-action relief requires that a SEF have error trade rules that account for whether a transaction cancellation or price adjustment will adversely impact market integrity or facilitate market manipulation or other illegitimate activity.[9] None of these conditions appear in the error trade rules proposed today, and under the proposal SEFs will no longer have any obligation to determine whether a trade is an error trade – the determination can instead be left entirely to the parties to the trade. I look forward to comments regarding whether this "principles-based" approach goes too far and fails to give market participants sufficient clarity regarding error trades.

I support targeted, thoughtful reform of our SEF regulations, and I particularly applaud staff's efforts to provide market participants with greater legal certainty through the codification of our existing no-action relief. I look forward to the comments.

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[9] *Id.*

Appendix 4 – Statement of Commissioner Dan M. Berkovitz

I am voting in favor of today's proposed rule that would amend certain Commission rules in parts 36, 37, and 43 relating to package transactions, block trades, and error transactions on swap execution facilities ("SEFs") ("Proposal"). Today's amendments largely codify longstanding no-action letters for limited categories of swaps transactions regarding the required methods of execution. Generally, I support the codification of no-action letters where, based on experience, doing so is consistent with our statutory mandate, protects customers, provides market participants with a greater level of certainty, and promotes market integrity.

Package Transactions

This Proposal would amend part 37 to allow the swap components of certain package transactions—including those that are illiquid and bespoke and therefore not suitable for trading on-SEF—to be executed on-SEF but through flexible methods of execution. In addition, the Proposal amends part 36 to exempt from the trade execution requirement a swap in a package transaction involving a bond sold in the primary market ("new issuance bond transaction"), which also is not conducive to trading on-SEF.

Beginning in 2014, the Commission issued a series of no-action letters specifying permissible methods of execution for certain package transactions, which have enabled market participants and the agency to apply the trading mandate to these transactions in a phased manner. As the market infrastructure for the trading and clearing of swaps has improved, the trading mandate has been applied to the packages involving more liquid

and standardized swap components.[1] The remaining package transactions that would be covered by today's Proposal represent a small percentage of swaps trading on the most active SEFs.

I encourage the industry to continue to develop systems that allow for increased execution of package trade swap components on-SEF. I also appreciate the Staff's commitment, if this rule is finalized, to continue to evaluate the categories of package transactions subject to the rule and revise the rule as necessary in the future to reflect developments in trading methodologies.

Error Trades

The Proposal also would amend part 37 to enable SEFs to permit market participants to use flexible methods of execution to correct error trades, and would require a SEF to establish error trade policies that largely track the conditions set forth in prior no-action letters. Notably, the Proposal would require market participants to provide prompt notice of an error trade to the SEF, enabling the SEF to fulfill its self-regulatory obligations. It would not alter the requirement that SEFs must adopt rules declaring that trades rejected from clearing are deemed void *ab initio*. The Proposal also includes the requirement under CFTC No-Action Letter No. 17-27 that after submitting one error trade, market participants will not be able to submit a second new trade with the original terms. These conditions facilitate a SEF's direct supervision of its markets, protect against abuse, and promote fair competition.

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[1] For example, U.S. Dollar Spreadover package transactions account for nearly seventy percent of interest rate swaps trading in the inter-dealer swap market. No-action letters for these package transactions have expired and market participants now actively trade the swap component of these packages through required methods of trading. *See* Proposed Rule, Sect. II.A.1 and n.33.

Block Trades

The Proposal would revise the definition of "block trade" in Commission Regulation 43.2 to permit SEFs to offer non-Order Book methods of execution for market participants to execute swap block trades on-SEF. Like package transactions, block trades encompassed within the Proposal are a small percentage of the number of swaps traded. A significant benefit of this Proposal is that it would facilitate pre-trade credit checks by SEFs for block trades, in accordance with the SEF core principles.

It is my preliminary view that this Proposal would provide certainty to market participants and increase trading efficiencies, while not compromising the Congressional goal of moving standardized OTC derivative contracts to exchanges or electronic trading platforms. I look forward to public comments on the anticipated effects of these amendments, and I thank the staff of the Division of Market Oversight for their work on this Proposal.

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