

**MEMO# 28714**

February 4, 2015

# White Paper on Reconsideration of CFTC's Swaps Trading Rules

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 7-15  
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 4-15 RE: WHITE PAPER ON  
RECONSIDERATION OF CFTC'S SWAPS TRADING RULES

Recently, Commissioner J. Christopher Giancarlo of the Commodity Futures Trading Commission ("CFTC") issued a white paper reviewing the CFTC's swaps trading rules ("White Paper"). [\[1\]](#) The White Paper asserts that there is a fundamental mismatch between the CFTC's swaps trading rules and the distinct liquidity and trading dynamics of the global swaps market. The White Paper states that the CFTC's swaps trading regulatory framework does not "accord with the letter or spirit" of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

The White Paper provides an overview of the structure of the swaps market and the legislative provisions of Title VII of the Dodd-Frank Act and reviews the CFTC's implementation of the Dodd-Frank Act's swap trading provisions. The White Paper then identifies what Commissioner Giancarlo believes are the consequences of the CFTC's swap trading rules and concludes with a proposal for an alternative trading framework.

## CFTC's Implementation of Swaps Trading Framework

In the White Paper, Commissioner Giancarlo raises concerns with various CFTC rules and positions taken by the CFTC with respect to the trading requirement. Specifically, the White Paper takes the view that there is no firm statutory support for segmenting swaps into transactions that are subject to the trade execution requirement and those that are not or for limiting the methods of execution for those that are subject to the trade execution requirement. The White Paper also takes the position that the block trade definition, which is based on the futures model, is not appropriate for the swaps market. The White Paper also states that the CFTC's rules for the "made available to trade" ("MAT") process have proven to be unworkable. The White Paper takes the view that the Dodd-Frank Act does not require swap execution facilities ("SEFs") to serve every type of market participant in an all-to-all market structure. The White Paper also discusses, among other things, the CFTC's approach to SEF confirmations and related agreements for uncleared swaps, the embargo rule [\[2\]](#) and name give-up, [\[3\]](#) the obligations imposed on SEFs (including the

establishment of an audit trail and supervision of regulatory service providers), position limits, and financial resources of SEFs.

## **Adverse Consequences of CFTC's Swaps Trading Regulatory Framework**

The White Paper provides its observations regarding the consequences for US market participants of the CFTC's trading rules. Specifically, the White Paper states that the trading rules are driving global market participants away from transacting with entities subject to CFTC swaps regulation, fragmenting swaps trading into numerous artificial market segments, increasing market liquidity risk, hindering swaps market technological innovation, and opening the US swaps market to algorithmic and high frequency trading. The White Paper also takes the view that the CFTC's swaps trading rules threaten the survival of many SEFs by making operating a SEF an expensive, legally intensive activity. The White Paper also criticizes the CFTC's rules as being expensive and time consuming because of the volume of no-action letters, guidance, staff advisories and other written communications that had to be provided to market participants. Finally, the White Paper states that the CFTC's approach has harmed relations with foreign regulators with its overreach and is increasing market fragility and systemic risk.

## **Alternative Swaps Trading Regulatory Framework**

The White Paper proposes reconsideration of many of the CFTC's swaps trading rules. The White Paper recommends that the proposals be adopted as a package. A few of the key recommendations are discussed below.

### **Method of Execution and Trade Execution Requirement**

The White Paper proposes to permit trade execution through "any means of interstate commerce" and allow SEFs to determine what methods of swaps execution are most suitable for the instruments they seek to execute. Rather than having CFTC rules dictate the type of execution that would be required for those swaps that are subject to the trade execution requirement (i.e., a request for quote system to three market participants or a central order book), the White Paper proposes to allow SEFs to provide participants with a choice of methods of swaps execution. These methods could include electronic central limit order books, simple order books, request for quote systems, electronic Dutch Auctions, [\[4\]](#) hybrid electronic and voice execution methods, full voice-based execution methods, work-up and any other "means of interstate commerce" that may today or in the future satisfy customer swap trading and liquidity requirements.

The White Paper also proposes to eliminate the current MAT process. In lieu of the current MAT process, the White Paper proposes to permit new and novel swaps products to develop commercially to the point where market participants naturally would turn to platforms to offer trading in the product and to require those products to trade on a designated contract market ("DCM") or SEF once a product does trade on a platform.

### **Transparency**

The White Paper takes the view that the CFTC's trading rules have emphasized pre-trade price transparency to the detriment of liquidity. The White Paper proposes to permit participants to choose the execution method that meets their needs based upon a swap's liquidity characteristics, which in turn, would promote trading on SEFs and liquidity. The White Paper is of the view that promoting swaps trading and market liquidity will lead to enhanced price transparency.

## Market Structure

The White Paper does not advocate for a particular market structure – dealer-to-dealer, dealer-to-customer or combined all-to-all markets. The White Paper proposes to permit participants to determine the optimal market structure based on their swaps trading needs and objectives.

## Professional Standards

The White Paper proposes to establish standards of conduct for participants in regulated swaps trading. The proposal would focus on raising the knowledge, skills, professionalism, ethics and conduct of key personnel at interdealer brokers, futures commission merchants, introducing brokers, swap dealers and major swap participants, among other entities acting in the swaps market.

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## endnotes

[1] White Paper, Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd Frank, J. Christopher Giancarlo, Commissioner, CFTC (Jan. 29, 2015), available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf>.

[2] Under the embargo rule, a SEF may not disclose swap transaction and pricing data to its market participants until it transmits such data to a swap data repository for public dissemination.

[3] Name give-up is when the identities of the counterparties are disclosed to each other after they have been anonymously matched by a platform (such as through an anonymous order book).

[4] These systems generally deploy algorithms based on time priority that match participants' order at pre-determined prices while protecting participant trading intentions as to side of market and size.