

**MEMO# 31498**

November 27, 2018

# CFTC Proposes to Amend SEF Rules and Seeks Comment on SEF Name Give-Up Practices

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November 27, 2018 TO: Derivatives Markets Advisory Committee  
ICI Global Trading & Markets Committee RE: CFTC Proposes to Amend SEF Rules and Seeks Comment on SEF Name Give-Up Practices

The Commodity Futures Trading Commission (CFTC) recently proposed amendments to its rules governing swap execution facilities (SEFs) and the trade execution requirement for swaps (collectively, “SEF Proposed Rules”).<sup>[1]</sup> Comments on the proposal are due 75 days after publication in the Federal Register. During the open meeting where the CFTC approved the proposal, CFTC Chairman Christopher Giancarlo announced his intention to finalize revised SEF rules in 2019.

The CFTC also requested public comment (without proposing a rule or advocating a position) on the practice of post-trade name give-up on SEFs for a swap that is executed anonymously on the SEF and is intended to be cleared.<sup>[2]</sup> Comments on this “Give-Up Release” are due 60 days after publication in the Federal Register.

We will hold a conference call to discuss the SEF Proposed Rules and the Give-Up Release on **December 12 at 11:00 a.m. (ET)**. Please contact Monique Curtis at [monique.curtis@ici.org](mailto:monique.curtis@ici.org) to receive dial-in information for the call.

This memorandum provides an overview of the issues in each release that are the most relevant for regulated funds.

## SEF Proposed Rules

In a hefty release spanning about 700 pages, the CFTC proposed sweeping changes to the SEF rules, including changes that would have a substantial impact on regulated funds that trade swaps.<sup>[3]</sup> Specifically, as discussed below, the CFTC proposes to:

- define the term “market participant” in a manner that does not include clients of an asset manager;
- allow a SEF to exclude certain types of market participants (such as end users) from accessing the SEF's markets and services; and

- require more swaps to be traded on a SEF (or a designated contract market, also known as a “DCM”) by (i) requiring more entities to register as SEFs, (ii) expanding the permissible means of execution for swaps subject to the trade execution mandate, and (iii) changing the process for swaps to become subject to the trade execution mandate (referred to as the “made available to trade” or MAT process).

Each of these proposals is discussed below in turn.

### *I. A Helpful Market Participant Definition.*

The SEF Proposed Rules would codify a definition for the term “market participant.” The current SEF rules reference “market participants” in various provisions, but do not define the term and the preamble in the adopting release of those rules also fails to provide a clear definition.

The proposal would define “market participant”<sup>[4]</sup> as any person who accesses a SEF through (i) direct access provided by a SEF, (ii) access or functionality provided by a third-party, or (iii) directing an intermediary that accesses a SEF on behalf of such person to trade on its behalf.<sup>[5]</sup> The CFTC believes that because all persons satisfying this definition could interact with other market participants on the SEF and could engage in abusive trading practices, all such persons should be subject to the SEF's jurisdiction (including disciplinary procedures and recordkeeping obligations).<sup>[6]</sup>

The CFTC explains that this definition would include an asset manager that trades on a SEF on behalf of its clients, but it would not include the asset manager's clients. The CFTC recognizes that (i) clients generally grant the asset manager broad discretion to execute swaps, and (ii) the manager's trading of swaps occurs typically without specific knowledge by the client as to whether the swap is executed on a SEF or the identity of the SEF involved.<sup>[7]</sup> An asset manager's clients thus would not need to become subject to the jurisdiction of the SEF and the SEF would not need the client's records.<sup>[8]</sup> The CFTC asks a number of questions regarding whether the proposed definition strikes the right balance with respect to the customers of asset managers and intermediaries.<sup>[9]</sup>

### *II. Permitted Exclusion Of End Users In the Name Of Impartial Access.*

The SEF Proposed Rules also would reinterpret the statutory impartial access requirement to give a SEF greater ability to limit participation on its market. It appears this proposal would permit the registration of SEFs that explicitly limit the participation of certain types of market participants.

Currently, the SEF rules do not permit this type of formal discrimination. Each SEF must provide any eligible contract participant and any independent software vendor with impartial access to its markets.<sup>[10]</sup> The CFTC has applied this impartial access requirement to various areas of a SEF's operations, including (i) eligibility or onboarding criteria, (ii) a participant's ability to access the SEF's functionalities, (iii) the manner in which a SEF's execution methods treat market participants' bids and offers, in particular the use of discretion, and (iv) participation fee structures. The CFTC asserts that this existing approach has created uncertainty for SEFs seeking to apply access criteria consistently and that the Commission has implemented the impartial access requirements in a manner that promotes “all-to-all” trading, which has limited the ability of SEFs to “adapt their operations to the characteristics and dynamics of the swaps market.”<sup>[11]</sup>

As proposed, the SEF could exclude entire categories of market participants if, among other things, the SEF's access criteria is "transparent, fair and non-discriminatory and applied to all or similarly situated market participants."[\[12\]](#) For example, under the SEF Proposed Rules, a SEF could permit only dealers to access the SEF's markets and services—thereby excluding all end users (who would not be considered similarly situated to dealers).[\[13\]](#) The proposal also would allow a SEF to deny certain classes of market participants access to one or more execution methods and would give SEFs the ability to establish bespoke fee arrangements "based on legitimate business justifications."[\[14\]](#)

The CFTC states that its proposed approach would "align with swaps market characteristics...that have led to the overall swaps market being made up of both dealer-to-client and dealer-to-dealer markets."[\[15\]](#) In practice, this aspect of the proposal could reduce market fairness and transparency to the detriment of regulated funds and other buy-side market participants.

### *III. A Vast Expansion Of The Trade Execution Mandate.*

To encourage the trading of more swaps on SEFs, the CFTC proposes to expand the SEF registration requirement to include (i) swaps broking entities (such as interdealer brokers) that now facilitate multiple-to-multiple swaps trading that does not occur on SEFs, and (ii) trading systems that aggregate one-to-many systems or platforms typically known as "single dealer platform."[\[16\]](#) The CFTC intends that many more swaps execution venues would have to register as SEFs under the SEF Proposed Rules.

Furthermore, the CFTC proposes to relax the standards regarding the means of permitted execution of swaps subject to the trade execution mandate.[\[17\]](#) Specifically, any swap executed on a SEF could be traded through any means of interstate commerce, including voice brokers. This would replace the current requirement that swaps subject to the trade execution mandate be traded on a SEF through a central limit order book or by sending a request for quote to at least three unaffiliated market participants.

The CFTC proposes to withdraw the current MAT determination[\[18\]](#) for swaps to become subject to the trade execution mandate, a process that requires CFTC review and has rarely been utilized. Instead, any swap that is subject to the clearing mandate would automatically be required to be traded on a SEF or DCM if the swap is listed for trading on at least one CFTC-registered SEF[\[19\]](#) or DCM, except if the swap (i) is exempt from the clearing mandate under section 2(h)(7) of the Commodity Exchange Act or part 50 of the CFTC's regulations (such as certain commercial end user swaps), (ii) is executed as a component of a package transaction that includes a component that is a new issuance bond, or (iii) is entered into between eligible affiliate counterparties.[\[20\]](#)

Also, to facilitate a broader range of swaps trading activity on SEFs and promote pre-trade price transparency, the CFTC proposes to eliminate the following three exceptions to the prohibition on prearranged trading (i) the time delay requirement under CFTC Regulation 37.9(b), (ii) block trades permitted by Part 43, and (iii) "other types of transactions" as certified or approved by the CFTC under Part 40. The SEF Proposed Rules also would prohibit pre-execution communications from occurring away from the SEF for swaps subject to the trade execution mandate (except for swaps that are part of certain package transactions).[\[21\]](#)

To address the broadened scope of swaps that the CFTC expects to become subject to the trade execution requirements based on the proposed changes to the MAT determination

the Commission proposes to require each SEF and DCM to file with the CFTC and post on the SEF's or DCM's website a standardized form that details the swaps that it lists for trading that are subject to the trade execution requirement.<sup>[22]</sup> The CFTC would maintain on its website a list of all the swaps that are subject to the trade execution requirement and the DCMs and SEFs that list such swaps.

The CFTC proposes to phase in compliance with this expanded trade execution requirement. Regulated funds would have 180 days after the effective date of the final SEF rules to comply with this expanded trade execution mandate.<sup>[23]</sup>

## **Give-Up Release**

The CFTC requested comments regarding the use of the “post-trade name give-up” practice on SEFs for swaps that are intended to be cleared.<sup>[24]</sup> Under this practice, the identity of each swap counterparty is disclosed to the other after a trade has been matched anonymously on a SEF.

Advocates of the practice claim that it helps liquidity providers allocate their capital more precisely and mitigates liquidity risk and the risk that traders will game the market.<sup>[25]</sup> Critics view the practice as anti-competitive, hindering liquidity and lacking credible justification; they also believe it can expose a market participant's trading intentions, strategies, positions or other sensitive information to competitors or dealers.<sup>[26]</sup>

The Give-Up Release asks whether—and how—the CFTC should limit the practice of post-trade name give-up and whether it should be subject to the choice of customers or SEFs.

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## **endnotes**

<sup>[1]</sup> Swap Execution Facilities and Trade Execution Requirement (November 6, 2018), available at <https://www.cftc.gov/sites/default/files/2018-11/federalregister110518b.pdf>.

<sup>[2]</sup> Post Trade Name Give-Up on Swap Execution Facilities (November 6, 2018), available at <https://www.cftc.gov/sites/default/files/2018-11/federalregister110615a.pdf>.

<sup>[3]</sup> In addition to the proposed changes highlighted in this memorandum, the SEF Proposed Rules would introduce requirements for SEF trading specialists and amend regulations on straight-through processing requirements, swap documentation, SEF's self-regulatory oversight authority, product guidance, and financial resource and chief compliance officer requirements.

<sup>[4]</sup> See SEF Proposed Rules at 33.

<sup>[5]</sup> CFTC Proposed Regulation 37.2(b).

- [6] See SEF Proposed Rules at 34.
- [7] See SEF Proposed Rules at 35-36.
- [8] See SEF Proposed Rules at 35-36.
- [9] See SEF Proposed Rules at 37-38.
- [10] See CFTC Regulation 37.202(a).
- [11] See SEF Proposed Rules at 175-176.
- [12] See CFTC Proposed Regulation 37.202(a).
- [13] See SEF Proposed Rules at 183.
- [14] See SEF Proposed Rules at 189.
- [15] See SEF Proposed Rules. at 178.
- [16] See CFTC Proposed Regulation 37.3(a) and SEF Proposed Rules at 41-55.
- [17] See proposed withdrawal of CFTC Regulation 37.9.
- [18] See CEA Section 2(h)(8), 7 U.S.C. § 2(h)(8). The trade execution mandate requires counterparties to execute swap transactions subject to the clearing requirement on a DCM or SEF, unless no DCM or SEF “makes the swap available to trade.” See *also* CFTC Regulation 37.10.
- [19] Swaps that are listed for trading only by a SEF that is exempt from registration with the CFTC (and no other SEF or DCM) would not be viewed as subject to the trade execution requirement.
- [20] See Proposed Part 36 of the CFTC’s Regulations. ICI repeatedly has urged the CFTC to preserve a separate MAT process for triggering the trading obligation. See *e.g.*, Letter from David Blass, General Counsel, ICI, to Christopher Kirkpatrick, Secretary, CFTC, dated August 17, 2015, available at <https://www.ici.org/pdf/29262.pdf>.
- [21] The CFTC would consider a transaction to be a package transaction if (i) execution of each component transaction is contingent upon the execution of all other component transactions, and (ii) all component transactions are priced or quoted together as part of one economic transaction with simultaneous or near-simultaneous execution of all components. In order to qualify for an exception from the prohibition on pre-execution communications away from a SEF, a package transaction must include at least one component transaction that is not subject to the trade execution mandate.
- [22] See Proposed CFTC Regulation 36.2.
- [23] See CFTC Proposed Regulation 36.3. Swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants would have 90 days to comply.
- [24] See Give-Up Release at 1-3.

[\[25\]](#) See Give-Up Release at 6-7.

[\[26\]](#) See Give-Up Release at 5-6.

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