

MEMO# 34126

April 28, 2022

SEC Proposes Rules for Registration and Regulation of SBSEFs

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TO: Derivatives Markets Advisory Committee
Equity Markets Advisory Committee RE: SEC Proposes Rules for Registration and Regulation of SBSEFs

The SEC recently re-proposed rules that would create a regime for the registration and regulation of security-based swap execution facilities (SBSEFs).^[1] The Proposal would also: (i) implement the "trade execution requirement" for security-based (SB) swaps and address related cross-border issues; (iii) address conflicts of interest at SBSEFs and national securities exchanges that trade SB swaps ("SBS exchanges"); and (iv) promote consistency between the proposed rules for SBSEFs and existing rules under the Exchange Act. The Proposal seeks to closely harmonize with analogous CFTC rules for SEFs, except in certain instances.^[2] This approach reflects the Commission's belief that the entities most likely to register as SBSEFs are those already registered with the CFTC as SEFs.

This memorandum focuses on the proposed procedures to implement the trade execution requirement for SB swaps, including the process for determining which SB swaps would be subject to mandatory clearing; and the proposed mandatory trade execution methods that a SBSEF must offer, including the exceptions to those methods for block trades and other types of transactions.

Comments on the Proposal are due the later of: (i) June 6, 2022, or (ii) 30 days following the Proposal's publication in the Federal Register.

Methods of Execution for Required and Permitted Transactions

Under the proposed rules, a SBSEF must, at a minimum, offer an "order book,"^[3] and each "required transaction" (i.e., transactions that are subject to the trade execution requirement) that is not a block trade must be executed on a SBSEF through an order book or through a request-for-quote (RFQ) system that operates in conjunction with an order book.^[4] The Proposal suggests that these requirements, among others, would increase pre-trade transparency in the SB swap market.^[5]

The Proposal would prohibit "pre-arranged trading" as an abusive trading practice,^[6] but provide that SBSEFs may permit pre-arranged trading on their facilities in certain instances.

For example, for "required transactions" executed via an order book, a SBSEF may permit market participants to pre-arrange or pre-negotiate a SB swap away from the SBSEF's trading system or platform, subject to a time delay requirement.^[7] SBSEFs may also permit pre-arranged trading for block trades, as discussed below, as well as for other types of transactions approved by or certified to the Commission under the proposed filing procedures.^[8]

A SBSEF may offer any execution method for a "permitted transaction," which would be a transaction not involving a SB swap that is subject to the trade execution requirement. In addition to permitted transactions, the Proposal also includes certain exceptions from the required methods of execution for package transactions that meet certain enumerated criteria, as well as for "block trades."^[9] The Proposal defines a "block trade" as a SB swap transaction (not including any equity SB swap) that is subject to public dissemination and:

- involves a SB swap that is listed on a SBSEF or SBS exchange;
- is a SB swap based on a single credit instrument (or issuer of credit instruments) or a narrow-based index of credit instruments (or issuers of credit instruments) having a notional size of \$5 million or greater; and
- is reported subject to the rules and procedures of the SBSEF or SBS exchange.^[10]

Notably, in proposing a notional size of \$5 million or greater for the definition of a block trade, the Commission pointed out that it previously employed a \$5 million block threshold for credit SB swaps as a condition to one prong of its no-action statement regarding Regulation SBSR.^[11] The Proposal also noted that "[i]n proposing the definition of a block trade, the Commission considered the distribution of transaction size in the single-name CDS market, which the Commission believes is representative of the market for [SB swap] based on a single credit instrument (or issuer of credit instruments) or a narrow-based index of credit instruments (or issuers of credit instruments)."^[12]

Trade Execution Requirement and Exemptions

Proposed Rule 816 would establish procedures for a SBSEF to make a SB swap "available to trade," thereby activating the "trade execution requirement" for that SB swap.^[13] Under this proposed rule, a SBSEF must submit "make available to trade" (MAT) determinations for SB swaps to the Commission, either for approval or self-certification.^[14] The SBSEF's filing would be required to include, among other things, an explanation and analysis of its consideration, as appropriate, of the factors set out in proposed Rule 816.^[15] A SBSEF that makes a SB swap available to trade must demonstrate that it lists or offers that SB swap for trading on its trading system or platform.^[16]

If the MAT determination is submitted for the proposed approval procedure,^[17] the Commission would have a 45-day period to review the determination, any time during which it could notify the SBSEF that the determination would not be approved because it is inconsistent with the Exchange Act or the Commission's rules thereunder.^[18] Market participants would be able to comment on MAT filings.^[19]

Under the proposed self-certification procedure,^[20] the Commission would have 10 business days to review a MAT determination before it would be deemed certified and could be made effective, unless the Commission notifies the SBSEF during the review period that it intends to issue a stay of the certification for an additional 90 days.^[21] The self-certification process would include a 30-day mandatory public comment period, which would only occur during the 90-day period in which a stay is in effect.

If the Commission either approves the SBSEF's MAT determination, or permits a certified MAT filing to become effective, then the SB swap would be deemed available to trade. From there on, the SB swap can only be traded on a SBSEF or a SBS exchange pursuant to Section 3C(h), and all bilateral trading in that SB swap must cease.[\[22\]](#) The Proposal, however, also provides that the Commission may issue a determination that a SB swap should no longer be available to trade upon determining that no SBSEF or SBS exchange lists such SB swap for trading.

The Proposal would also provide certain exemptions from the trade execution requirement, specifically for: (i) a SB 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;[\[23\]](#) (ii) a SB swap transaction that qualifies for an exception under Section 3C(g) of the Exchange Act, or any exemption from the clearing requirement that is granted by the Commission; and (iii) a SB swap transaction that is executed between counterparties that qualify as "eligible affiliate counterparties."[\[24\]](#)

Lastly, for purposes of notifying the public that a SBSEF has made a swap available to trade, under the proposed approval or self-certification procedures, SBSEFs would be required to post a notice and copy of their MAT submissions on their website at the same time they file the submission with the SEC. The Commission would also post the SBSEF MAT filings on its website.[\[25\]](#)

Trade Execution Compliance Schedule

The Proposal provides that a SB swap transaction shall be required to be executed on a SBSEF or SBS exchange upon the later of:

- a determination by the Commission that the SB swap is required to be cleared under Section 3C(a) of the Exchange Act, or any later compliance date that the Commission establishes as a term or condition of such determination, or following a stay and review of such determination; and
- 30 days after a MAT determination submission or certification for that SB swap is approved or certified, respectively.

Post-Trade Name Give-Up Prohibition

The Proposal would also prohibit any person, directly or indirectly, from disclosing the identity of a counterparty to a SB swap that is executed anonymously on a SBSEF and intended to be cleared, and would require the SBSEF to establish and maintain rules to that effect.[\[26\]](#) The Commission explains believing that prohibiting post-trade name give-up will promote pre-trade price transparency by encouraging a greater number, and a more diverse set, of market participants to anonymously post bids and offers.

Impartial Access

The Proposal would require a SBSEF to "provide any eligible contract participant[\[27\]](#) and any independent software vendor with impartial access to its market(s) and market services, including any indicative quote screens or any similar pricing data displays, provided that the facility has, [among other things], [c]riteria governing such access that are impartial, transparent, and applied in a fair and non-discriminatory manner." A SBSEF would also be required to have comparable fee structures for market participants that receive comparable access to, or services from, the SBSEF.

Nicolas Valderrama
Counsel

endnotes

[1] Rules Relating to Security-Based Swap Execution and Registration and Regulation of Security-Based Swap Execution Facilities, Release No. 34-94615 (Apr. 6, 2022) ("Proposing Release" or "Proposal"), available at <https://www.sec.gov/rules/proposed/2022/34-94615.pdf>. The Commission's Fact Sheet is available at <https://www.sec.gov/files/34-94615-fact-sheet.pdf>. The Proposal would require "any person operating a facility that offers a trading system or platform in which more than one market participant has the ability to execute or trade SB swaps with more than one other market participant on the system or platform, to register the facility as a SBSEF under this section or as a national securities exchange." Proposed Rule 803(a)(1) (emphasis added).

[2] Particularly when differences in the Commission's and the CFTC's statutory authority, or in the SB swap and the swap markets, necessitate the Commission's and the CFTC's rules to differ, or where the Commission believes that the benefits of deviating from the CFTC's rules would justify the burdens and costs associated with imposing different or additional requirements than the corresponding CFTC rule. Proposing Release at 14-15.

[3] Proposed Rule 802(r) would define "order book" as an electronic trading facility, a trading facility, or 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.

[4] See Proposed Rule 815(a)(1). An RFQ system would be defined as "a trading system or platform in which a market participant transmits a request for a quote to buy or sell a specific instrument to no less than three market participants in the trading system or platform, to which all such market participants may respond" and specify other requirements for an RFQ system to be recognized as such under the rule. The three market participants could not be affiliates of or controlled by the requester and shall not be affiliates of or controlled by each other. Proposed Rule 815(a)(3).

[5] Proposing Release at 294.

[6] Proposed Rule 819(d)(1).

[7] Under proposed Rule 815(b), for a required transaction executed on an order book, when a broker or dealer seeks to trade against a customer order or cross two customer orders, following some form of pre-arrangement or pre-negotiation of such orders, the broker or dealer must expose the customer orders on the SBSEF's order book for a required minimum period so that other market participants have the opportunity to offer a better price than the broker or dealer had intended for the cross.

[8] Proposed Rule 819(d)(1). The proposed filing procedures refer to those under proposed Rules 806 and 807.

[9] Block trades may be executed on the SBSEF's or SBS exchange's non-order book trading system, or away from the SBSEF's or SBS exchange's trading system, provided that it is executed pursuant to the SBSEF's or SBS exchange's rules and procedures.

[10] Proposed Rule 802(a).

[11] The Proposal states that in imposing such condition, the Commission then noted that FINRA applies a \$5 million cap when disseminating transaction reports of economically similar cash debt securities. Proposing Release at 97. In adopting Regulation SBSR in 2015, the Commission did not finalize rules relating to block trades, in particular a reporting delay. Under the current reporting rules, counterparties have up to 24 hours after the time of execution to report most SB swap transactions, which would then be publicly disseminated immediately thereafter. During this "interim phase," the SEC stated that it will collect and analyze data to inform a future rulemaking related to block trades and non-block trades. While it did not finalize rules for block trades, the SEC had previously specified general criteria that it said that it would consider in determining a block threshold. Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 34-74244 (Feb. 11, 2015), 80 Fed. Reg. 14564, 14617 (Mar. 19, 2015), available at <https://www.govinfo.gov/content/pkg/FR-2015-03-19/pdf/2015-03124.pdf>.

[12] Proposing Release at 279.

[13] Proposed Rule 816 is modelled on § 37.10 of the CFTC's rules. The Commission notes that an SBSEF may list an SB swap that is subject to mandatory clearing but listing the product does not by itself subject the SB swap to the trade execution requirement. Only if a product that is subject to mandatory clearing is listed and MAT would the SB swap then become subject to the trade execution requirement. Proposing Release at 104. The Proposal notes that Section 3C of the Exchange Act sets out the procedure whereby a SB swap becomes subject to mandatory clearing.

[14] The Proposal points out that an SBS exchange, like any other registered exchange, must submit any rule change (including one to list a new SB swap and/or MAT an SB swap product) pursuant to Exchange Act Rule 19b-4. The Commission is not proposing new procedures for SBS exchanges to list or MAT SB swap products. Proposing Release at n.107.

[15] Under Proposed Rule 816(b), a SBSEF "shall consider, as appropriate, the following factors: (1) whether there are ready and willing buyers and sellers; (2) the frequency or size of transactions; (3) the trading volume; (4) the number and types of market participants; (5) the bid/ask spread; or (6) the usual number of resting firm or indicative bids and offers. These are the same six factors enumerated in § 37.10(b) of the CFTC's rules.

[16] The Proposal would allow a SBSEF to list a new SB swap product for trading (i.e., without triggering the trade execution requirement) through a self-certification procedure or by voluntarily submitting the product to the Commission for approval. See Proposed Rules 804 and 805.

[17] See Proposed Rule 806 ("Voluntary submission of rules for Commission review and approval").

[18] The Commission may extend the review period for an additional 45 days under certain circumstances.

[19] See Proposed Rule 806(a)(8) (requiring that, among other things, the SBSEF's request for approval provide a brief explanation of any substantive opposing views expressed to the SBSEF by governing board or committee members, the SBSEF's members, or market participants that were not incorporated into the rule, or a statement that no such opposing views were expressed).

[20] See Proposed Rule 807. The self-certification procedure would require a SBSEF to, among other things, submit a certification to the Commission that the SB swap product meets applicable standards under the Exchange Act and the Commission's rules thereunder.

[21] The Commission may stay the certification on the grounds that the new rule or rule amendment presents novel or complex issues that require additional time to analyze, is accompanied by an inadequate explanation, or is potentially inconsistent with the Exchange Act or the Commission's rules thereunder.

[22] With regards to cross-border transactions, proposed Rule 832 provides that the trade execution requirement under the Exchange Act would not apply to a SB swap transaction unless at least one counterparty to the SB swap is a "covered person," as defined in the proposed rule (e.g., it would not apply if neither side had a connection to the US). The Commission explains that this proposed rule is consistent with the Commission's territorial approach to applying Title VII of Dodd Frank in other contexts, such as when a SB swap transaction exists in whole or in part within the US. Proposing Release at 201. The Proposal also sets out conditions for allowing a SB swap to trade on foreign venues not registered with the Commission, notwithstanding the SB swap being subject to the Exchange Act's trade execution requirement. Proposing Release at 204-205 (Proposed Rule 833).

[23] Proposed Rule 815(d) would define "package transactions" as two or more component transactions executed between two or more counterparties where at least one component is a required transaction, execution of each component is contingent upon the execution of all other components, and the component transactions are priced or quoted together as one economic transaction with simultaneous (or near-simultaneous) execution of all components. Proposing Release at 107.

[24] Proposed Rule 816(e)(3) sets out the requirements to qualify as "eligible affiliate counterparties."

[25] See Proposed Rule 808(b).

[26] Proposed Rule 815(f).

[27] Exchange Act Section 3(a)(65) defines "eligible contract participant" by reference to Commodities Exchange Act Section 1(a)(18). Such definition includes an investment company regulated under the Investment Company Act of 1940 acting for its own account.