Testimony of
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on behalf of the
Wholesale Markets Brokers' Association, Americas

Before the
House Committee on Agriculture
Subcommittee on Commodity Exchanges, Energy, and Credit
The Impact of G-20 Clearing and Trade Execution Requirements

June 14, 2016

Introduction

Chairman Scott, Ranking Member Scott and members of the Subcommittee, thank you for providing this opportunity to participate in today's hearing.

My name is Stephen Merkel. I am the Executive Vice President, General Counsel and Secretary of BGC Partners, Inc. ("BGC Partners"), a leading global intermediary to the wholesale financial markets, specializing in the brokering of a broad range of financial products, including fixed income, interest rate derivative, foreign exchange, equity, equity derivative, credit derivative, listed futures, commodity, and structured product markets. BGC Partners was created in August 2004, when Cantor Fitzgerald separated its voice and electronic interdealer brokerage business from its dealer activities.

I am testifying today in my capacity as a Director and former Chairman of the Wholesale Markets Brokers' Association, Americas (the "WMBAA"), which represents BGC Partners, GFI Group, Tradition, and Tullett Prebon.[1] Each of the WMBAA member firms has registered a swap execution facility ("SEF") with the Commodity Futures Trading Commission ("CFTC"). For each of the last seven years, we have collectively hosted a one-day conference in Washington or New York appropriately entitled "SEFCON" that explores the top issues facing our industry and over-the-counter ("OTC") markets from both a domestic and global perspective. The WMBAA extends thanks to the Chairman and other Members of the Agriculture Committee who have attended and shared their thoughts at this marquee event.

Thank you for inviting me to speak with you about the ongoing implementation of the September 2009 Pittsburgh G-20 commitments to improve OTC derivatives markets.[2] The WMBAA remains supportive of coordinated global efforts to promote trading on regulated venues, central counterparty clearing, and public reporting of standardized OTC derivative contracts in order to "improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse."[3]

I welcome the chance to update you from the WMBAA's perspective as it relates to implementation of trade execution regulations and the impact on global market conditions.

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[1] The WMBAA is an independent industry body representing the largest inter-dealer brokers. The founding members of the group—BGC Partners, GFI Group, Tradition, and Tullett Prebon—operate globally, including in the North American wholesale markets, in a broad range of financial products, and have received permanent registration as swap execution facilities. The WMBAA membership collectively employs approximately 4,000 people in the United States; not only in New York City, but in Stamford and Norwalk, Connecticut; Chicago, Illinois; Jersey City and Piscataway, New Jersey; Raleigh, North Carolina; Juno Beach, Florida; Burlington, Massachusetts; and Dallas, Houston, and Sugar Land, Texas. For more information, please see www.wmbaa.com.

[2] *See* Leaders' Statement, the Pittsburgh Summit, September 24-25, 2009, *available at* https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf.

[3] *Id.*

In my written testimony, I will focus on the following points:

- First, the primary driver of the G-20 commitments was to address systemic risk to our financial system. Trade execution in and of itself was not and has never been singled out as contributing to the financial crisis.
- Second, while not without challenges or material shifts in pre-existing market structure, markets are gradually adjusting to the new regulatory landscape and the new SEF trading environment. There remain significant efforts to ensure a globally coordinated approach is ultimately put in place. The CFTC should continue to review its rules, analyze their impact on market conditions, with quantifiable metrics, and adjust the regulations as appropriate.
- Third, important lessons should be learned from the prolonged clearinghouse mutual recognition negotiations so that trade execution venues do not have to endure the same experience. With liquidity provision services offered by SEFs in the United States ("US"), multilateral trading facilities ("MTFs"), soon to be recognized organized trading facilities ("OTFs") in Europe, introducing brokers, traditional broker-dealers, and others, global regulators should more carefully coordinate regulatory efforts so as to not fragment markets, reduce liquidity, and increase costs to users by rupturing the existing methods by which US and non-US swap dealers, international banks, global asset managers, and end-users access competitive, transparent OTC markets in the US or in other jurisdictions. We have already witnessed liquidity move across borders. Global regulatory gaps have not only promoted bifurcation of trading patterns but can be exploited to the detriment of investors.
- Finally, while some key implementation issues remain with the CFTC's SEF rules, and I will highlight several today, the WMBAA remains hopeful that many of these outstanding issues can be resolved by the regulatory agencies. I will explain how the CFTC interpreted clear Congressional intent to fashion a flexible swap trading regime into a prescriptive, artificially restrictive rule set and, to date, has not fully evaluated the impact of its rules on market quality. Although continued oversight and vigilance, such as this hearing, remain needed on an ongoing basis, it is also our hope that that Congress will not have to be called upon to reiterate through new legislation its previously stated desire for a flexible, technology-neutral trade execution framework that encourages innovation and fosters liquidity formation.

I. The transition to OTC trading on regulated platforms is proceeding, but not without challenges.

While the CFTC's SEF rules were implemented in 2013, the first "made available to trade" or "MAT" determination did not become effective until February 2014. That determination, which can only be initiated by a SEF petition, is the first step towards requiring that a certain swap be traded on a SEF. Currently, the mandatory trade execution requirement only applies to certain interest rate and credit default swaps. Accordingly, in those markets, we have seen increased market reliance on SEFs to facilitate trading in these products.

Indeed, a recent International Swaps and Derivatives Association ("ISDA") study found that more than half of average daily interest rate derivatives trading activity was executed on a SEF

during the first quarter.[4] For the credit default swap index market, SEF trading accounted for 78.8% of average daily trade counts and 78.1% of average daily notional volume.[5]

These statistics, coupled with statements of support for regulated, transparent intermediation of OTC derivatives by the buy-side institutions such as mutual funds, pension funds, insurance firms,[6] and other market participants suggest a broad adjustment to rules implemented in support of the G-20 mandate to promote regulated swap trade execution as a replacement for purely bilateral trade activity.

However, while the ISDA research indicates that market participants have migrated towards regulated intermediation in selected marketplaces, there are serious global market structure issues across the derivative markets generally that remain unresolved.

In the US, for example, there are now 21-fully registered SEFs, one temporarily-registered SEF, and two SEFs with applications still pending. This means, just in the US alone, domestic market participants must choose among 24 different venues to access liquidity. For each SEF, market participants have to review and compare individual rule books, analyze different cost structures, and complete the legal and technical components of onboarding before executing the first trade.

While the ISDA statistics and large number of recently-registered SEFs may suggest a smooth transition to the SEF regime, I will share with the Subcommittee some of the troublesome compliance and interpretative issues related to swap trading that still remain. Some of these issues will likely be dealt with through CFTC staff interpretation of existing regulations and others will require changes to the rules. Regardless, the complexities of connecting market participants –with varying technological sophistication and available resources – with SEFs, clearinghouses, credit hubs, swap data repositories, and other critical market infrastructure, require agreement among these entities about how to best comply with the ruleset adopted by the CFTC, as well as those forthcoming rules from the Securities and Exchange Commission ("SEC") for security-based swaps and corresponding regulation in Europe and Asia. With more clarity from regulators and consensus among market participants, the smoother the ongoing transition to the new rules will be.

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[4] *See* ISDA SwapsInfo First Quarter 2016 Review, June 2016 (stating "[m]ore than half of average daily IRD trading activity was executed on a [SEF] during the first quarter: 52.6% by trade count and 56.0% by notional volume"), *available at* http://www2.isda.org/attachment/ODQxNg==/SwapsInfo%20First%20Quarter%202016%20Review%20.pdf.

[5] *See id.*

[6] *See* Letter from Timothy W. Cameron and Lindsey Weber Keljo, Asset Management Group, Securities Industry and Financial Markets Association to the CFTC, May 11, 2015, *available at* http://www.sifma.org/comment-letters/2015/sifma-amg-submits-comments-to-the-cftc-in-response-to-commissioner-giancarlo-s-white-paper-and-in-regards-to-the-sef-regulatory-framework/.

II. The global swap trading landscape requires global coordination; any other approach will harm financial markets.

A. SEF Rules have Fragmented Global Market Liquidity

As intermediaries of financial products and operators of regulated exchange venues around the world, WMBAA members have observed firsthand the pronounced fragmentation caused by the CFTC's SEF rules. Anecdotally, we have seen market participants refrain from transacting with counterparties in certain jurisdictions to avoid the CFTC's regulatory burdens.

For example, rather than submit to US regulation, a wide spectrum of non-US entities either withdrew from US trading venues or refused to trade with US person counterparties to reduce activity that would be attributed towards the "swap dealer" or "major swap participant" thresholds which carry significant and costly obligations. As a result, liquidity has been formed by jurisdiction. Trading has become more regionalized with, for example, Euro and British Pound interest rate swaps traded almost exclusively among non-US counterparties and away from SEFs, while US Dollar interest rate swaps are now almost exclusively traded in the US.[7]

Last month, ISDA also published its "Second Half 2015 Update" analyzing the cross-border fragmentation of global interest rate derivatives. ISDA concludes that "[t]he fracturing of the global interest rate swaps market that emerged in the aftermath of US [SEF] rules coming into force in October 2013 shows no signs of reversing" and that "some liquidity pools continue to be split on US and non-US lines."[8] Specifically, ISDA found that "91.2% of cleared euro interest rate swap ("IRS") activity in the European interdealer market was transacted between European counterparties in December 2015," compared with 70.7% just before the CFTC's SEF rules went into effect in September 2013.[9]

Other analysis of market data reaches the same conclusion. For instance, a recent Bank of England staff working paper found that:

> the introduction of the SEF trading mandate reduced the proportion of trading taking place between US and non-US persons, particularly for EUR denominated swaps. This suggests that some non-US persons became less willing to trade with US persons as this would require them to trade on a SEF. Thus, an effect of the new regulation was increased geographical fragmentation of the global swap market.[10]

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[7] *See* ISDA Research Note: Cross-Border Fragmentation of Global Interest Rate Derivatives: Second Half 2015 Update, May 2016, *available at* http://www2.isda.org/attachment/ODM4NQ==/Fragmentation%20FINAL1.pdf.

[8] *Id*.

[9] *Id*.

[10] Benos, Evangelos, Richard Payne and Michalis Vasios, Bank of England Staff Working Paper No. 580, *Centralized trading, transparency and interest rate swap market liquidity: evidence from the implementation of the Dodd-Frank Act, available at* http://www.bankofengland.co.uk/research/Documents/workingpapers/2016/swp580.pdf, page 2.

The Bank of England staff did not just identify fragmented markets. The paper also concludes that SEF trading brings benefits to investors. Namely, "as a result of SEF trading, activity increases and liquidity improves across the swap market, with the improvement being largest for [US Dollar] mandated contracts which are most affected by the mandate. The associated reduction in execution costs is economically significant."[11]

B. Policymakers Must Improve the Mutual Recognition Process

While the CFTC SEF registration process may be complete (with the SEC's corresponding security-based SEF regime still outstanding), the impeding MiFID II January 2018 target compliance date makes it vital that any trade execution regulatory gaps among the principal jurisdictions be resolved in the coming months.

This Subcommittee and my fellow witnesses are all familiar with the issue of clearinghouse equivalence, having explored the topic in many prior hearings.[12] We were pleased to see the announcement of a common approach for central clearing counterparties in February 2016.[13] However, as CFTC Commissioner J. Christopher Giancarlo has noted, the equivalence debate for US-registered SEFs/security-based SEFs versus MTFs, OTFs, and other versions of registered trading venues outside the US could lead to another "equivalency standoff."[14]

Furthermore, the CFTC's past efforts to provide a "qualified" MTF regime for execution platforms operating within the EU where US person entities would be allowed to execute off-SEF[15] failed because, among other reasons, the proposed terms allowed the CFTC to unilaterally remove the relief at any time. The proposal also did not attract participants because, under the terms of the relief, an MTF would be required to comply with the CFTC's SEF regime not just for trades involving US counterparties or US-regulated products, but even for trades executed between European counterparties on a European-regulated product through a European trading venue. That expansive overreach went too far for already-regulated market participants to agree to a second layer of regulatory burdens.

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[11] *Id.*

[12] *See* Testimony of Terrance A. Duffy before the House Committee on Agriculture Subcommittee on Commodity Exchanges, Energy, and Credit, *Hearing on CFTC Reauthorization*, March 25, 2015, *available at* http://agriculture.house.gov/uploadedfiles/duffy_testimony.pdf; *see also* Testimony of Chairman Timothy G. Massad before the U.S. House Committee on Agriculture, February 10, 2016, *available at* http://agriculture.house.gov/uploadedfiles/massad_testimony.pdf.

[13] The United States Commodity Futures Trading Commission and the European Commission: Common approach for transatlantic CCPs, February 10, 2016, *available at* http://www.cftc.gov/idc/groups/public/@newsroom/documents/speechandtestimony/eu_cftcstatement.pdf.

[14] *See* Six Month Progress Report on CFTC Swaps Trading Rules: Incomplete Action and Fragmented Markets, August 4, 2015, *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement080415.

[15] CFTC No-Action Letter No. 14-46, April 9, 2014, *available at* http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-46.pdf.

Therefore, while multiple EU-based execution venues, including all WMBAA member firms, were prepared to meet the necessary qualifications for both the CFTC and the UK's Financial Conduct Authority, this proposal did not result in any European intermediaries agreeing to submit it and its participants to comprehensive CFTC oversight. The global derivative markets can ill afford a repeat of this scenario in the equivalence negotiations leading up to MiFID II implementation, especially because the European regulatory regime does not offer the flexibility of no-action relief and, therefore, an avoidable polarization of liquidity pools may become permanent if an agreement is not reached prior to January 2018. We urge the Subcommittee to prioritize execution equivalence as the primary tool to counter the increasingly well-entrenched trend for liquidity to be split along regional lines.

As we have seen, the paralyzing impact this delay in coordination and overall uncertainty can bring to clearinghouses with the accompanying segregation of trading, the same (if not worse) could happen if the current opportunity to shape execution equivalence between the US and the EU is squandered. Of course, the costs will be borne by liquidity providers, asset managers, and end-users who rely on intermediaries to provide this vital function, as they will receive fragmented, less competitive bids and offers due to barriers erected by uncoordinated cross-border rules. All of these artificial blockages to natural liquidity formation result in higher costs to investors who are meant to be the ultimate beneficiary of the reforms instituted by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[16]

Subsequent to the G-20 summit in Pittsburgh and well before the adoption of the Dodd-Frank Act, WMBAA members and other trading firms were preparing for what would ultimately result in the current SEF regime. There has been nearly a decade of time, energy, and resources devoted to post-financial crisis regulatory reform that has been replicated in other G-20 jurisdictions. These parallel work streams should have resulted in a comprehensive, consistent, and coordinated global oversight framework that promotes market liquidity and function while meeting public policy objectives.

Yet, to date, that has not occurred. Some global financial services companies have created and registered separate entities in various jurisdictions purely to avoid being subject to SEF terms and conditions. Some intermediaries have submitted their European platforms for US oversight in a splintered fashion. And, most recently, the CFTC received an application for a jointly-registered SEF and MTF. While market participants remain tentative and unsure as to how the G-20 global trade execution implementation permutations will play out, this also suggests uncertainty among the trading venues themselves.

III. Examples of Necessary Regulatory Improvements to the CFTC SEF Regime

The WMBAA has long publicly supported a flexible, principles-based approach to the implementation of the Dodd-Frank Act trade execution framework. In that light, we continue to harbor reservations about some of the technical points related to the CFTC's interpretation of certain provisions of the Dodd-Frank Act and the staff's reading of the implementing regulations in terms of satisfactory policies and procedures. Furthermore, while other global regulatory

[16] Public Law 111–203, 124 Stat. 1376 (2010).

bodies and industry associations, like the Bank of England and ISDA, have engaged in an empirically-based evaluation of the swap trading rules on market conditions, the CFTC has not yet published any data-driven analysis of their own rules. We strongly believe that should be completed, published for market feedback, and result in appropriate changes to the rules.

As I said at the outset, we remain hopeful that many of these can be resolved at the agency level. But we very much appreciate this Subcommittee's interest in these very important issues and its continued oversight of the CFTC's work.

The current mix of statute, rules, no-action letters, staff guidance, and interpretive statements does not provide sufficiently predictable regulatory certainty for SEFs to plan, invest, and grow domestically or to be able to incorporate SEF activity within global operations. As longstanding businesses placed under a novel regulatory scheme, it is vital to know objectively not just the practical implications of rules but how they may be interpreted on a permanent basis similar to rules adopted under the Administrative Procedure Act. Staff or Division letters and guidance are informative, but can be revoked or amended at any time without any due process protections. The Subcommittee should remain aware of the Commission's reliance on these measures and protect against their overuse.

Chairman Massad has said, even recently, that the CFTC has "fine-tuned" some of its rules through no-action letter relief and will "consider a codification of those adjustments, and potentially other changes to enhance SEF trading and participation."[17] The WMBAA welcomes this approach as an initial step as the formalization in rule text provides additional reliability. However, the WMBAA also believes that more substantive, comprehensive changes are likely necessary on a wider range of issues than simply codifying a few existing no-action letters. We agree with Chairman Massad that the CFTC should work to create "the foundation for the market to thrive" and "permit innovation, freedom and competition."[18]

To assist the Commission in its review of changes to enhance SEF trading and participation, in March of this year, the WMBAA submitted a comprehensive list of issues to Chairman Massad. That letter is attached to my testimony today. We look forward to participating in a productive dialogue with Chairman Massad, his fellow Commissioners, and the hard-working CFTC staff.

Briefly, I would like to highlight a few issues set forth in the WMBAA's March 2016 letter.

[17] Statement of Chairman Timothy Massad before the CFTC's Market Risk Advisory Committee, April 26, 2016, *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/massadstatement042616

[18] Remarks of Chairman Timothy Massad before the ISDA 30th Annual General Meeting, April 23, 2015, *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-17.

Explicit regulatory certainty with respect to flexible modes of execution. The SEF definition, as set forth in the Dodd-Frank Act,[19] is intentionally broad, flexible, and contemplates a wide array of execution methods. The implementing CFTC regulation artificially restricts permitted methods of liquidity formation and execution to an order book or request for quote ("RFQ").[20] First, this is problematic because it is inconsistent with the clear language of the statute. Second, this approach may prevent or discourage certain technologies from facilitating trading through a registered SEF. Finally, and importantly given the ongoing work to achieve global harmonization, the restriction on execution methods is narrower than those clearly permitted under MiFID II, which may ultimately drive derivatives trading away from the US.

The WMBAA urges the CFTC to make clear that SEFs may operate other protocols besides order books or RFQs, including Trading Facilities, under the Commodity Exchange Act ("CEA"). For example, auction-type systems such as BGC Partners' VolumeMatch meet the CEA definition of trading facility and, therefore, should be explicitly permitted as an acceptable execution method for Required Transactions. It has been our experience that these new trading protocols continue to gain favor in the marketplace as an alternative to order book and RFQ trading and more effectively promote competitive price discovery for interested parties.

Made Available to Trade. The WMBAA believes the MAT process should be amended. While SEFs should commence the review through the filing of the petition, the petition's approval should not be a "negative consent" process. The CFTC's Part 40 rules' 10-day negative consent process starts with a presumption of approval and removes any real discretion or judgment from the CFTC's hands. The MAT determinations are important and should benefit from more careful analysis of a wider set of information rather than being subject to the single submission of an individual SEF.

Rather, the CFTC should have the responsibility of making the determination based on objective criteria and subject to public notice and comment on the petition. The factors that the CFTC considers in deciding whether to impose a SEF trading mandate should be consistent with the process and analysis followed by other global financial market regulators in order to prevent any bifurcation of the swap markets and regulatory arbitrage.

SEF Position Limit or Position Accountability Regimes. The Dodd-Frank Act requires SEFs to "adopt for each of the contracts of the facility, as is necessary and appropriate, position limitations or position accountability for speculators" and then to "[m]onitor positions established on or through the [SEF] for compliance with the limit set by the Commission and the limit, if any, set by the [SEF]."[21] The WMBAA and the broader SEF community, including a SEF chief compliance officer working group, have engaged with the CFTC on this issue. Both the National Futures Association and the WMBAA have authored white papers on the topic.

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[19] *See* CEA §1a(50) ("a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that—(A) facilitates the execution of swaps between persons; and (B) is not a designated contract market.").

[20] The traditional RFQ trading protocol, where a single market participant solicits a bid or offer from at least three other market participants, seems to fall short of the "multiple to multiple" component of the SEF definition.

[21] CEA § 5h(f)(6).

Simply put, SEFs, as competitive trading platforms, do not possess information about a trader's overall position in any given swap or its underlying instrument or commodity because of the inherently competitive nature of swap trading. A SEF is not a centralized exchange; each SEF is one of multiple competitive platforms facilitating trading activity in fungible financial products that can and does move easily from one venue to another. Unlike listed futures and options where trading and clearing is vertically integrated and each centralized exchange has information about positions in the marketplace for any specific contract, each SEF only has information about swap transactions that take place on its individual facility and has no access to information as to whether a particular trade on the facility adds to an existing market-wide position or whether it offsets all or part of an existing position in that swap.

The CFTC should specify that SEFs are not obligated to impose position limits or accountability until such time as the CFTC determines that such measures are "necessary and appropriate," especially because unified position information is available at the swap data repository level where all SEF trade data is maintained. Further, implementing position limitations or position accountability is not necessary and appropriate at this time because, it has not been proven that such limits are an effective tool for detecting and preventing manipulation and other abuses for swaps.

SEFs accept and take seriously their obligation as market operators to ensure they provide reliable, resilient venues to access competitive pricing. This includes monitoring for manipulation and other abusive trading activity that takes place on each individual facility which will continue in earnest as part of our responsibility to meet existing SEF core principles.

SEF Financial Resource Requirements. The CEA requires all SEFs to have "adequate financial, operational, and managerial resources." During the SEF registration review process, we learned that CFTC staff believe that all SEF employees are considered part of the SEF's financial obligation, regardless of the employment arrangement (*e.g.*, at-will, contractual, or guaranteed salary). As a result, SEFs with voice-based systems face significantly higher financial resources commitments than those facilities that only provide electronic trading access. The Dodd-Frank Act does not dictate this outcome. From a public policy standpoint, it prevents investment and growth if a SEF must freeze capital to help pay at-will or contracted staff for a full year when, in reality, the SEF does not have that liability to simply "discharge each responsibility of the [SEF]."

We continue to discuss with the CFTC and staff a more realistic, flexible interpretation that promotes all types of swap trading and only attributes the financial resource requirement to cover the fixed costs associated with compliant SEF operation and solely those required to ensure compliant operations. We think that is a more appropriate approach than factoring in variable costs and costs related to staff that are not core to a compliant operating structure and who would not be associated with the SEF for the currently-required 12-month timeframe in the event of a change to the business. One possible solution involves relying on a rule provision that delegates the CFTC's authority on this issue to the Director of the Division of Market Oversight. We look forward to continued engagement with the CFTC on this issue.

IV. Conclusion

Mr. Chairman, the WMBAA appreciates the opportunity to appear today and discuss the ongoing work to implement the G-20 mandates. We look forward to continued work on these developments with Congress, the CFTC, the SEC, and regulatory bodies around the world.

I would be pleased to answer any questions you may have.

APPENDIX

WMBAA Letter to CFTC
March 11, 2016

Swap Execution Facility Regulations, Made Available to Trade Determinations, and Swap Trading Requirements

WMBA
AMERICAS
WHOLESALE MARKETS BROKERS' ASSOCIATION

March 11, 2016

The Honorable Timothy Massad, Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Swap Execution Facility Regulations, Made Available to Trade Determinations, and Swap Trading Requirements

Dear Chairman Massad:

Since the promulgation of the regulations governing swap execution facilities ("SEFs") pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), Commissioners of the Commodity Futures Trading Commission ("CFTC" or "Commission") have discussed the Commission's consideration of potential revisions to various aspects of its swap regulations, including those reforms related to SEFs and trade execution. For example, you have stated that the Commission is "focused on issues concerning trading on [SEFs]," and that you "will ask the Commission to consider a number of rule changes to enhance SEF trading and participation."[1] Calls for the Commission to consider potential revisions to its Dodd-Frank Act regulations have also been raised by Commissioner Bowen[2] and Commissioner Giancarlo.[3] In addition, Commission staff has indicated that they are considering potential no-action relief or guidance with respect to issues that market participants have identified as problematic.

The Wholesale Markets Brokers' Association, Americas ("WMBAA")[4] appreciates the Commission's careful and deliberative approach to the regulation of SEFs and extends its appreciation to the

[1] *See* Keynote Remarks before the Institute of International Bankers Annual Washington Conference (Mar. 7, 2016).

[2] *See* Statement of Commissioner Bowen, Dec. 1, 2014 (stating that "the best way of viewing changes to [the CFTC's Dodd-Frank Act rulemakings] is not that [the CFTC is] tweaking them, but rather that [the CFTC is] enhancing them. Sometimes that may mean making the rules more cost-effective and leaner, but at other times that will mean making them stronger than before. Enhancing a rule can mean reducing burdens to business while strengthening protections for the public"), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/bowenstatement120114.

[3] *See* Commissioner Giancarlo White Paper, "Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank" (Jan. 29, 2015), *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf; *see also* Statement of Commissioner Giancarlo, Six Month Progress Report on CFTC Swaps Trading Rules: Incomplete Action and Fragmented Markets (Aug. 4, 2015), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement080415.

[4] The WMBAA is an independent industry body representing the largest inter-dealer brokers. The founding members of the group—BGC Partners, GFI Group, Tradition, and Tullett Prebon—operate globally, including in the North American wholesale markets, in a broad range of financial products, and have received temporary registration as swap execution facilities. The WMBAA membership collectively employs approximately 4,000 people in the United States; not only in New York City, but in Stamford and Norwalk, Connecticut; Chicago, Illinois; Jersey City and Piscataway, New Jersey; Raleigh, North Carolina; Juno Beach, Florida; Burlington, Massachusetts; and Dallas, Houston, and Sugar Land, Texas. For more information, please see www.wmbaa.com.

Commission for granting permanent registration to each of the member firms' SEFs earlier this year. This milestone represents a significant step toward firmly establishing the regulatory regime for mandatory trade execution as envisioned by the Dodd-Frank Act and providing market participants with further much-needed regulatory certainty. Against the backdrop of permanent SEF registration, the WMBAA looks forward to continuing to work with the Commission and its staff on all matters pertaining to SEFs, including on any future CFTC rulemakings, amendments, guidance, or interpretations related to trade execution and SEFs, to ensure that the regulations are implemented in accordance with the underlying statutory intent and accomplish the Dodd-Frank Act's goal of "promot[ing] the trading of swaps on swap execution facilities."

The WMBAA supports the Commissioners' recognition that the regulations should be assessed and reconsidered on an ongoing basis. In particular, the WMBAA supports Commission efforts to "formalize through notice-and-comment rulemaking a number of the 'no-action' positions the staff has taken, such as simplifying the confirmation process, streamlining the process for correcting error trades, and others."[5] We support the regulatory certainty that formal rule changes would provide to issues related to SEF confirmation and reporting, trades deemed void *ab initio*,[6] and trading of block trades "on facility." The WMBAA also recognizes that certain reporting requirements may merit reconsideration, including the "embargo rule," and would welcome the opportunity to discuss such issues further with the Commission.

Further, to assist the Commission and its staff in its assessment of the SEF regulations, the WMBAA respectfully offers the attached matrix in Appendix A, which we have prepared based on our expertise as over-the-counter market operators for over 25 years and a combined tenure in the industry of over 100 years, and our experience to date with the implementation of the SEF related rules. For each of the following topics, the matrix notes the relevant statutory provision, describes the implementation issue experienced by market participants, references the relevant CFTC rule or staff advisory, and suggests a potential recommendation to address the issue. The topics are not presented in order of importance, but rather represent the regulatory implementation issues that the WMBAA members are addressing:

- Methods of execution;
- Made available to trade process;
- Audit trail requirements for voice-based executions;
- Position limits;[7]
- Financial resource requirements;

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[5] *See* Keynote Remarks of Chairman Massad before the Institute of International Bankers Annual Washington Conference (Mar. 7, 2016).

[6] Revised regulations should permit SEFs to correct clerical or operational errors on swaps rejected for clearing. In addition, if a swap has been accepted by a DCO for clearing, and a clerical or operational error is subsequently identified, the regulations should permit a SEF to correct the error in the trade without initiating a "new trades, old terms" offset and resubmission, provided that the DCO has the operational capability to permit such a correction.

[7] A WMBAA white paper on position limits, which was submitted to the Division of Market Oversight staff, is attached hereto as Appendix B.

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- Cross-border issues;
- Margin requirements;
- Embargo rule; and
- SEF recordkeeping requirement.

In addition to the specific issues addressed in the matrix, the WMBAA recommends that the Commission examine the commercial impact of its SEF regulations and other rules on the swap market. Specifically, wherever possible, the Commission should seek to ensure a level playing field between the futures and swap markets for commercially-equivalent risk management contracts by not permitting any unfair regulatory advantage to either market. The WMBAA believes that such regulatory instances, in which a swap market requirement that results in additional costs or creates disincentives for trading swaps relative to the futures market equivalent, should be reconsidered by the Commission.

Lastly, to the extent that Commission action to modify certain swap-related regulations are constrained by statutory language under the Dodd-Frank Act, the WMBAA would welcome the opportunity to work with the Commission to advocate for appropriate legislative changes before Congress. However, the attached list includes solely those issues which the WMBAA believes can be addressed through regulatory action.

* * * * *

We welcome the opportunity to discuss these comments with you at your convenience. Please feel free to contact the undersigned with any questions you may have on our comments.

Sincerely,

William Shields
Chairman, WMBAA

Enclosure

cc: The Honorable Sharon Bowen, Commissioner
Mr. Vince McGonagle, Director, Division of Market Oversight

WMBA AMERICAS
WHOLESALE MARKETS BROKERS' ASSOCIATION

APPENDIX A: CFTC PART 37 SEF REGULATIONS: RECOMMENDED REVISIONS

Relevant Statutory Provision	Issue	CFTC Regulation	Proposed Solution/Revision
CEA § 1(a)(50) "The term 'swap execution facility' means a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that— "(A) facilitates the execution of swaps between persons; and "(B) is not a designated contract market."	**Methods of Execution** The SEF definition is broad, flexible, and contemplates execution methods beyond an order book or RFQ system. The CFTC regulation artificially restricts the permitted methods of liquidity formation and execution, which may prevent certain technologies from qualifying as a registered SEF, in contravention to Dodd-Frank's goal of promoting the execution of swaps on SEF. It also does not contain an all-to-all requirement.	Rule 37.9(a)(2) "Execution methods. (i) Each Required Transaction that is not a block trade . . . shall be executed on a [SEF] in accordance with one of the following methods of execution: (A) An Order Book . . . ; or (B) A Request for Quote System . . . that operates in conjunction with an Order Book . . . ."	Add a new clause "(C)" to the execution methods in rule 37.9(a)(2) that expands the permissible methods of execution for Required Transactions to include "or any such other system for trading as may be permitted by the Commission." Codify existing policy that certain systems, including Trading Facilities, fall within the SEF definition and qualify as a permissible method of execution for Required Transactions. Additional methods of execution for Required Transactions should include risk-mitigation. The WMBAA notes that auction-type systems meet the CEA definition of trading facility and, therefore, should be permitted as an acceptable execution method for Required Transactions in their own right and not be subject to the definitions of Order Book or RFQ.
CEA § 2(h)(8) "(A) IN GENERAL.—With respect to transactions involving swaps subject to the clearing requirement of paragraph (1), counterparties shall— (i) execute the transaction on a board of trade designated as a contract	**Made Available to Trade Process** The CEA does not detail a required analysis, enumerate criteria in performing a "made available to trade" analysis, or establish that SEFs or DCMs have the burden of persuading the Commission that a swap should be traded on a	Rule 37.10(a)(1): "Required submission. A [SEF] that makes a swap available to trade in accordance with paragraph (b) of this section, shall submit to the Commission its determination with respect to such swap as a rule . . . ."	Amend the made available to trade (MAT) process so that going forward, SEFs commence the MAT determination process by filing a petition, but the CFTC has the responsibility of making the determination based on objective criteria and subject to public notice and comment on the petition.

Relevant Statutory Provision	Issue	CFTC Regulation	Proposed Solution/Revision
market . . .; or (ii) execute the transaction on a [registered SEF] or a swap execution facility that is exempt from registration . . . (B) EXCEPTION.—The requirements [above] shall not apply if no board of trade or [SEF] makes the swap available to trade or for swap transactions subject to the clearing exception . . . ."	registered marketplace.	Rule 37.10(c): "Applicability. Upon a determination that a swap is available to trade on any [SEF] or designated contract market . . . all other [SEFs] and designated contract markets shall comply with the requirements of section 2(h)(8)(A) of the Act in listing or offering such swap for trading."	In addition, as the WMBAA discussed at the recent DMO roundtable, the Commission should harmonize its MAT decisions with those of foreign regulators, including ESMA, in order to prevent any bifurcation of the swap markets and regulatory arbitrage.
CEA § 5h(f)(2)(B)(ii) (Core Principle 2) "A [SEF] shall . . . establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means . . . to capture information that may be used in establishing whether rule violations have occurred."	**Voice Audit Trail** CFTC staff has expressed a desire that SEFs must be able to store recordings of oral communications in a digital database and convert such recordings into searchable text. In addition, CFTC staff has explored the concept of requiring SEFs to record or access not only the communications between the SEF's employees and their customers, and any communications between employees, but also the communications of Introducing Brokers. Introducing Brokers already have the obligation under NFA rules to record communications and SEFs have access to such information pursuant to their rulebooks.	Rule 37.205 Commission rule 37.205 sets forth the audit trail requirement for SEFs to "capture and retain all audit trail data necessary to detect, investigate, and prevent customer and market abuses." The Commission requires that such data is "sufficient to reconstruct all indications of interest, requests for quotes, orders, and trades within a reasonable period of time and to provide evidence of any violations of the rules of the [SEF]." Further, an audit trail must also permit a SEF to "track a customer order from the time of receipt through fill, allocation, or other disposition, and shall include both order and trade data."	Revise the rules or provide guidance related to audit trail requirements for voice-based executions on SEFs to account for the unique characteristics of voice execution and to recognize the currently available technologies. Any such new rules or guidance would supplement the existing audit trail requirements that are tailored to electronic execution and should more accurately reflect a "technology-neutral" approach to SEF execution. In accordance with the preamble discussion to the final rule, the WMBAA believes that "the intent of the final rules is to require that a SEF establish and maintain an effective audit trail program, not to dictate the method or form for maintaining such information. *Importantly, the rule, by not being prescriptive, provides SEFs with flexibility to determine the manner and the technology necessary and appropriate to meet the*

Relevant Statutory Provision	Issue	CFTC Regulation	Proposed Solution/Revision
		The elements of an acceptable audit trail program involve (1) original source documents, (2) electronic transaction history database, (3) electronic analysis capability, and (4) safe storage capability.	*requirements*" (emphasis added). 78 Fed. Reg. 33,476, 33,518 (June 4, 2013). The WMBAA further recommends that the CFTC consider whether the audit trail requirements may be satisfied based on exception or risk-based SEF reviews.
CEA § 5h(f)(6) (Core Principle 6) "(a) . . . a [SEF] that is a trading facility shall adopt for each of the contracts of the facility, as is necessary and appropriate, position limitations or position accountability for speculators. (b) Position limits. For any contract that is subject to a position limitation established by the Commission . . . the [SEF] shall: (1) Set its position limitation at a level no higher than the Commission limitation; and (2) Monitor positions established on or through the [SEF] for compliance with the limit set by the Commission and the limit, if any, set by the [SEF]."	**Position Limits** SEFs do not possess information about a trader's position in any given swap or its underlying instrument or commodity. Rather, SEFs only have information about swap transactions that take place on their individual facilities and have no way of knowing whether a particular trade on the facility adds to an existing market-wide position or whether it offsets all or part of an existing position in that swap. In addition, if SEFs were required to adopt position limits, market participants might abuse such limits. For example, if five SEFs that offer a particular product set their respective limits at a level established by the CFTC, the overall aggregate position available to market participants via trading on such SEFs would be five times greater than the level set by the CFTC. As such, market participants could take advantage of this structure by spreading their transactions across multiple SEFs and DCOs when	Rule 37.600 *Same as statutory provision*	Specify that SEFs are not obligated to impose position limits or accountability until such time as the **Commission** determines that such measures are "necessary and appropriate." Implementing position limitations or position accountability is not necessary and appropriate at this time because, for example: (1) unlike futures and options where trading and clearing is vertically integrated and each DCM has information about positions in the marketplace for any specific contract, they are not an effective tool for detecting and preventing manipulation and other abuses for swaps; and (2) individual SEFs do not possess information about a trader's position in any given swap and, therefore, have no basis of reference as to how and when a position limit should be set. In addition to these comments, the WMBAA has submitted to the Division of Market Oversight ("DMO") staff a white paper explaining why a SEF position limits and position accountability regime is

Relevant Statutory Provision	Issue	CFTC Regulation	Proposed Solution/Revision
	reaching the limit set by each. While staff has acknowledged that, in lieu of position limits, SEFs may establish accountability provisions related to trades rather than positions, the details of such accountability mechanisms and how accountability levels would be set are yet unclear.		neither necessary nor appropriate.[8] Rather than imposing a position limits regime, the WMBAA respectfully reminds the Commission that a SEF is subject to regulatory requirements to provide data to the Commission, including data related to the trading activity on the SEF, to assist the Commission with monitoring compliance with federal speculative position limits.[9] A SEF CCO working group, consisting of CCOs of 18 then-provisionally registered SEFs, commissioned the National Futures Association ("NFA") to conduct a study regarding swap position limits and position accountability. The NFA study suggested that the swap market might not lend itself to notional transaction size position or accountability levels at the SEF level. While this study did not offer an official disposition as to the necessity or appropriateness of position accountability levels at the SEF level, it presented data suggesting that such position limits or accountability levels will do little to "reduce the potential threat of market manipulation or congestion," the stated goal of the Core Principle. The SEF CCO working group provided DMO staff with a synopsis of this study in the form of a discussion

[8] The WMBAA white paper is attached as Appendix B.

[9] This approach was endorsed by a group of SEFs. *See* SEF CCO Group Discussion Document Regarding SEF Core Principle 6 – Position Limits and Position Accountability (May 21, 2015).

Relevant Statutory Provision	Issue	CFTC Regulation	Proposed Solution/Revision
			document. As an alternative to the above proposed solution, the WMBAA would welcome specific guidance on how SEFs can practically comply with an accountability provision, reflecting that: (1) SEFs do not possess position information; and (2) swaps are fungible in terms of being traded on multiple venues and cleared by multiple DCOs. Any accountability level(s) should be established by the CFTC, taking into account the entirety of market activity in a product (both on and off SEFs), and such established level(s) should be applied uniformly to all SEFs.
CEA § 5h(f)(13) (Core Principle 13) "(A) IN GENERAL.—The [SEF] shall have adequate financial, operational, and managerial resources to discharge each responsibility of the [SEF]. (B) DETERMINATION OF RESOURCE ADEQUACY.—The financial resources of a [SEF] shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the [SEF] to cover the operating costs of the [SEF] for a 1-year period, as calculated on a rolling basis."	**SEF Financial Resources** CFTC staff has indicated its preliminary belief that all SEF employees are considered part of the financial obligation, regardless of the employment arrangement, *e.g.* at-will, contractual, and guaranteed salary. As a result, SEFs with voice-based systems face significantly higher financial resources commitments than those facilities that only provide electronic trading access. The Commission's rules do not recognize that: (1) SEFs do not possess or maintain client funds or open interest; (2) there is no practical need for any individual SEF to maintain sufficient	Rule 37.1300 *Same as statutory provision*	Flexibly interpret the SEF financial resources requirements to reflect that SEFs are execution venues only and do not ensure contract performance, making their commercial viability less relevant on a post-transaction basis. As the Commission has delegated authority to the DMO Director on issues pertaining to SEF financial resources, the WMBAA looks forward to working with Commission staff to appropriately account for the following considerations in refining the SEF rules, including with respect to creating an appropriate methodology for computing projected operating costs. *See* Rule 37.1307.

Relevant Statutory Provision	Issue	CFTC Regulation	Proposed Solution/Revision
	resources for a period of one-year after an event that results in the closure of a SEF, as a SEF could wind down its operations in a much shorter time period; and (3) for SEFs with voice brokers, such voice brokers are not necessary to ensure operation of a compliant SEF and could be removed at any point and for any reason without impacting the SEF's ability to satisfy the Core Principles.		The SEF financial resources requirement should focus on the fixed costs associated with compliant SEF operation and solely those required to ensure compliant operations, rather than the variable costs and costs related to staff that are not core to a compliant operating structure. The WMBAA notes that the costs associated with employing SEF brokers constitute variable costs and are not core to the compliance regime and the operations of a SEF, or necessary or required to operate a compliant SEF, as is demonstrated by other registered SEFs that do not employ brokers. Therefore, costs related to employing SEF brokers should be excluded from the financial resources calculation. Contrary to DMO letter 15-26, any salary or compensation for SEF employee-brokers should not be included in the calculation of projected operating expenses. In addition, the WMBAA has submitted information to DMO staff regarding liquid assets and would welcome any further communication as needed for a rule revision to reduce the burden from six months' liquid assets to three months' liquid assets. Any modification of the financial resource rules should take into account the fact that the exit of an individual SEF (or brokers within an operational SEF) would not have broad market-wide or systemic effects on

Relevant Statutory Provision	Issue	CFTC Regulation	Proposed Solution/Revision
			the swap marketplace. This is because the trades previously executed on the SEF would have been fully processed and reported, and the positions resulting from all trades would be unaffected, as they are held either at a DCO for cleared trades or with the counterparties for uncleared trades. Moreover, if a SEF were to experience difficulty or choose to exit the marketplace, the wind-down process would occur quickly. As SEFs do not hold positions, the unwind process would take no longer than a few months.
CEA § 2(i) "The provisions of this Act relating to swaps . . . (including any rule prescribed or regulation promulgated under that Act), shall not apply to activities outside the United States unless those activities— (1) have a direct and significant connection with activities in, or effect on, commerce of the United States; or (2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of this Act . . . ."	**Cross-Border Concerns** The scope of the Commission's cross-border guidance is far reaching such that a permitted transaction involving two non-U.S. counterparties may be subject to SEF execution under footnote 88. This interpretation has had the practical effect of bifurcating markets based on the participants' jurisdictions, impeding liquidity and redirecting activity away from SEFs and, as a result, away from U.S. markets and the oversight of U.S. regulators.	DSIO Advisory No. 13-69 "DSIO is of the view that a non-U.S. SD (whether an affiliate or not of a U.S. person) regularly using personnel or agents located in the U.S. to arrange, negotiate, or execute a swap with a non-U.S. person generally would be required to comply with the Transaction-Level Requirements. For the avoidance of doubt, the Division's view would also apply to a swap between a non-U.S. SD and a non-U.S. person booked in a non-U.S. branch of the non-U.S. SD if the non-U.S. SD is using personnel or agents located in the U.S. to arrange, negotiate, or execute such swap." CFTC staff has issued no-action relief letters pertaining to advisory 13-69, including most recently letter 15-48, which extended relief until September 30, 2016.	Address cross-border issues through a formal rulemaking that invites and addresses public comment. Carefully consider the adoption of equivalency or substituted compliance regimes, such as the establishment of an exempt SEF category, to prevent further fracturing of markets by jurisdiction. Provide guidance regarding who is considered a U.S. person for execution purposes and, consequently, what types of transactions may be conducted off-SEF, such as in the following examples: • A foreign branch of a U.S. person conducting a trade solely in a foreign market with a foreign entity; and • A foreign branch of a U.S. prime broker, acting as a prime broker

Relevant Statutory Provision	Issue	CFTC Regulation	Proposed Solution/Revision
			for a foreign customer. If the Commission engages in a rulemaking pertaining to an exempt SEF category, any exempt SEF should be required to comply with all material, transaction-level requirements applicable to SEFs. In addition, the Commission should work with foreign regulators to ensure they have a reciprocity provision for U.S.-registered SEFs. Any such CFTC rulemaking for exempt SEFs should condition the relief for the foreign MTF on the existence of a reciprocity provision in law or regulation of the applicable foreign jurisdiction. In addition, while non-U.S. swap dealers located in the U.S. have received no-action relief from the execution mandate, no corresponding relief has been issued with respect to platforms operating in an execution capacity for such non-U.S. swap dealers located in the U.S., adding to the uncertainty around the implementation of rules. In the interest of stability, no-action relief should be equally granted to participants and platforms where applicable.

Relevant Statutory Provision	Issue	CFTC Regulation	Proposed Solution/Revision
CEA § 5b(c)(2)(D)(iv) "MARGIN REQUIREMENTS.—The margin required from each member and participant of a derivatives clearing organization shall be sufficient to cover potential exposures in normal market conditions."	**Margin Requirements** CFTC rules related to margin provide a significant commercial advantage to futures over swaps. Specifically, the CFTC's rules provide a five-day margin liquidation period for financial swaps, while all futures have a one-day margin liquidation period.	Rule 39.13(g)(2)(ii): "A derivatives clearing organization shall use models that generate initial margin requirements sufficient to cover the derivatives clearing organization's potential future exposures to clearing members based on price movements in the interval between the last collection of variation margin and the time within which the derivatives clearing organization estimates that it would be able to liquidate a defaulting clearing member's positions (liquidation time); provided, however, that a derivatives clearing organization shall use: (A) A minimum liquidation time that is one day for futures and options; (B) A minimum liquidation time that is one day for swaps on agricultural commodities, energy commodities, and metals; *(C) A minimum liquidation time that is five days for all other swaps . . . .*" (emphasis added).	Re-examine the Part 39 margin requirement for swaps to reflect a realistic liquidation time period for swaps. Margins should be based on the economic characteristics of the products, rather than on whether a product is classified as a future or a swap. Products with similar risk profiles should have the same margin requirements.
CEA § 2(a)(13)(D) "The Commission may require registered entities to publicly disseminate the swap transaction and pricing data required to be reported under this paragraph."	**Embargo Rule** As a result of the embargo rule, SEFs and DCMs that would like to continue to permit work-ups may face workflow issues because they cannot share trade information with their customers until such information is transmitted to an SDR. Such delays can have a material effect on market liquidity.	Rule 43.3(b)(3)(i) "If there is a registered swap data repository for an asset class, a registered [SEF] . . . shall not disclose swap transaction and pricing data relating to publicly reportable swap transactions in such asset class, prior to the public dissemination of such data by a registered swap data repository unless: (A) Such disclosure is made no earlier than the transmittal of such data to a registered swap data repository for public	While the WMBAA appreciates the prior no-action relief provided in letter 13-68, the WMBAA believes that the problematic aspects of the requirement continue to persist and merit removing the requirement from the Part 43 rules. The CFTC should amend its regulations to permit a SEF post-initial trade work stream that promotes liquidity formation, including through SEF workups, while ensuring that the Commission's rules

Relevant Statutory Provision	Issue	CFTC Regulation	Proposed Solution/Revision
	To operate efficiently and competitively, information which reflects current market activity must be available to all market participants without any disruptive pauses for the occurrence of other regulatory activities. Every market participant must have real-time information on executed trades for the entire marketplace to ensure effective price discovery so that they can make informed trading decisions. This allows the market to operate properly as a single liquidity pool. In addition, those SEFs that rely on a third party to transmit information to SDRs are further hindered by the embargo rule in their ability to make available to all market participants current market information.	dissemination; (B) Such disclosure is only made to market participants on such registered [SEF] . . . ; (C) Market participants are provided advance notice of such disclosure; and (D) Any such disclosure by the registered [SEF] . . . is nondiscriminatory.	implementing the post-trade transparency requirement for public dissemination of swap data as soon as technologically practicable do not artificially restrict a SEF's ability to efficiently execute swap transactions. Further, the Commission should consider that, due to SDR "rounding" models and "capping" of large notional transactions, the information publicly disclosed is often not identical to specific trade-level information on the SEF.
CEA § 5h(f)(10) "RECORDKEEPING AND REPORTING.— (A) IN GENERAL.—A swap execution facility shall— (i) maintain records of all activities relating to the business of the facility, including a complete audit trail, in a form and manner acceptable to the Commission for a period of 5 years . . . ."	**SEF Recordkeeping Requirement** CFTC rules requiring SEFs to retain all records through the life of a swap and for at least five years following a swap's termination is an onerous and impracticable requirement for SEFs. Following the execution of a swap, a SEF is not necessarily made aware of a swap's termination. Accordingly, it is often impracticable for a SEF to definitively ascertain the period of time for which it must retain records for a swap and can result in significantly burdensome recordkeeping costs.	Rule 45.2(c): "All records required to be kept pursuant to this section shall be retained with respect to each swap throughout the life of the swap and for a period of at least five years following the final termination of the swap."	Provide guidance to SEFs as to what materials must be retained for five years to satisfy the recordkeeping obligation, which reduces the operational burden of maintaining all possible records, particularly those with minimal value from an audit trail perspective. For both cleared and uncleared swaps, revise the recordkeeping requirement under rule 45.2 to permit SEFs to retain records with respect to each swap for a period of five years after execution.

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APPENDIX B: WMBAA WHITE PAPER REGARDING POSITION LIMITS

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White Paper:
SEF Position Limits and Accountability Regimes are Neither Necessary Nor Appropriate

May 21, 2015

I. Introduction

The Wholesale Markets Brokers Association, Americas,[1] the leading industry organization representing the interdealer broker industry, provides this White Paper to explain why a position limits or position accountability regime for swap execution facilities ("SEFs") is neither necessary nor appropriate.

Section 5h of the Commodity Exchange Act ("CEA"), as added by the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), includes a series of core principles for SEFs. In the five years since Dodd-Frank was adopted, the Commodity Futures Trading Commission ("CFTC" or "Commission") has worked to implement Section 5h of the CEA, adopting final regulations related to the core principles and other requirements for SEFs, including core principle number 6 – position limits or accountability. An applicant SEF must comply with core principles to receive its permanent registration from the CFTC.

In practice, as explained in this White Paper, an overly prescriptive interpretation of this core principle would be unworkable, cost-intensive, and without any readily identifiable public policy benefits. While there have been calls for Congressional review of core principle 6,[2] the WMBAA believes, at this point, the Commission should consider a regulatory solution.

The approach described herein has been recently endorsed by a coalition of SEFs[3] and key industry groups.[4] The WMBAA supports such arguments, particularly that:

> The Commission should exempt SEFs from any requirement to enforce compliance with federal limits or to establish SEF limits for contracts subject to federal limits. As an alternative to setting position limits, SEFs should only be required to provide data to the Commission to assist it in monitoring compliance with federal speculative position limits.[5]

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[1] The WMBAA is an independent industry body representing the largest inter-dealer brokers operating in the North American wholesale markets across a broad range of financial products. The five founding members of the group are: BGC Partners; GFI Group; ICAP; Tradition; and Tullett Prebon. The WMBAA membership collectively employs approximately 4,000 people in the United States; not only in New York City, but in Stamford, Connecticut; Chicago, Illinois; Louisville, Kentucky; Jersey City, New Jersey; Raleigh, North Carolina; and Houston and Sugar Land, Texas. For more information, please see www.wmbaa.org.

[2] *See* Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank, CFTC Commissioner J. Christopher Giancarlo White Paper (Jan. 29, 2015), at 45, *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf.

[3] *See* SEF CCO Group Discussion Document Regarding SEF Core Principle 6 – Position Limits and Position Accountability, May 21, 2015.

[4] *See* Letter from the International Swaps and Derivatives Association and the Securities Industry and Financial Markets Association to Ms. Melissa Jurgens, Secretary, CFTC (Feb. 10, 2014), *available at* http://www.sifma.org/comment-letters/2014/sifma-and-isda-submit-comments-to-the-cftc-on-position-limits-for-derivatives/.

[5] *Id.* at 35.

The SEF marketplace is still in its formative years. The CFTC has not yet adopted a position limits regime for swaps. The Commission should tread carefully to avoid the imposition of a rigid, unworkable requirement that, without adequate cost-benefit analysis, may harm the development of these markets. Rather, as suggested by Chairman Timothy Massad, the CFTC should work to create "the foundation for the market to thrive" and "permit innovation, freedom and competition."[6]

II. Background

A. Position Limits, Position Accountability

The CFTC glossary defines a position limit as "[t]he maximum position, either net long or net short, in one commodity future (or option) or in all futures (or options) of one commodity combined that may be held or controlled by one person (other than a person eligible for a hedge exemption) as prescribed by an exchange and/or by the CFTC." Fundamentally, a position limit caps the size of a position that a trader may hold or control for speculative purposes in a derivatives contract in a particular commodity. There are three elements of the regulatory framework for position limits: the levels of the limits, the exemptions from the limits (such as for hedging), and the policy on aggregating accounts. While the CFTC has set certain commodity position limits, it has not yet established position limits for swaps.

By contrast, the CFTC glossary defines position accountability as "[a] rule adopted by an exchange in lieu of position limits requiring persons holding a certain number of outstanding contracts to report the nature of the position, trading strategy, and hedging information of the position to the exchange, upon request of the exchange." Position accountability does not, by definition, impose a hard limitation on traders' speculative derivatives positions in a commodity. Instead, position accountability provisions grant the exchange additional powers to protect its markets, including the ability to obtain additional information from the trader and to limit the size of a trader's position, when a trader's derivatives position exceeds a specified level.

B. SEFs and Position Limits

Core principle 6 – codified as CEA Section 5h(f)(6) – mandates that a SEF "that is a trading facility" must "adopt for each of the contracts of the facility, as is necessary and appropriate, position limitations or position accountability for speculators."[7] Furthermore, "[f]or any contract that is subject to a position limitation established by the Commission pursuant to section 4a(a) of the [CEA], the [SEF] shall (i) set its position limitation at a level no higher than the Commission limitation; and (ii) monitor positions established on or through the [SEF] for compliance with the limit set by the Commission and the limit, if any, set by the [SEF]."[8]

The CFTC promulgated rule 37.600 by codifying the statutory language.[9] In the preamble to the final SEF rule, the CFTC noted that "[s]everal commenters stated that SEFs will have difficulty enforcing position limitations" because "SEFs will lack knowledge of a market participant's activity on other venues, and that will prevent a SEF from being able to calculate the true position of a market participant."[10] Furthermore,

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[6] Remarks of CFTC Chairman Timothy Massad before the ISDA 30th Annual General Meeting (Apr. 23, 2015), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-17.

[7] Commodity Exchange Act ("CEA") § 5h(f)(6).

[8] *Id.*

[9] 17 C.F.R. § 37.600.

[10] Core Principles and Other Requirements for Swap Execution Facilities, 78 Fed. Reg. 33,476, 33,533 (June 4, 2013).

the CFTC describes the guidance and acceptable practices in appendix B to the part 37 rules as giving "reasonable discretion to comply with § 37.600."[11]

With respect to core principle 6, the guidance in Appendix B states that:

> For Required Transactions, a SEF may demonstrate compliance by setting and enforcing position limitations or position accountability levels only with respect to trading on the SEF's own market. For example, a SEF could satisfy the position accountability requirement by setting up a compliance program that continuously monitors the trading activity of its market participants and has procedures in place for remedying any violations of position levels.
>
> For Permitted Transactions, a SEF may demonstrate compliance by setting and enforcing position accountability levels or sending the Commission a list of Permitted Transactions traded on the SEF. Therefore, a SEF is not required to monitor its market participants' activity on other venues with respect to monitoring position limits.[12]

III. Role of Exchange-set Position Limits and Position Accountability

In contrast to SEFs and position limits, the CFTC has historically adopted position limits for certain agricultural commodities and also has required exchanges, as part of their self-regulatory responsibilities, to adopt position limits or position accountability provisions in their market surveillance programs. Unlike the OTC swap market, futures contracts traded on exchange are owned and exclusively listed by an exchange. They are unique contracts that are unavailable anywhere else.

When the CFTC first promulgated speculative position limits, it noted that "the capacity of any contract to absorb the establishment and liquidation of large speculative positions in an orderly manner is related to the relative size of such positions, i.e., the capacity of the market is not unlimited."[13] In the early 1990s, the CFTC adopted rules allowing exchanges to establish position accountability provisions, in lieu of position limits, for contracts that had been subject to exchange-set speculative position limits.

Exchange-based position limits have been adopted by designated contract markets ("DCMs"), or futures exchanges, and the position limits (or position accountability) provisions have been enforced through exchange rulebooks and their role as a self-regulatory organization conducting market surveillance programs. These protections serve as a prophylactic tool to reduce the threats of market power and to ensure the integrity of and orderly trading in the derivatives market. Exchange-set position limit and position accountability rules help prevent traders from accumulating concentrated positions that could disrupt a market and cause artificial prices and disorderly trading, such as purposefully through the exercise of market power by the position holder (e.g., actual or attempted manipulation) or to prevent one trader from negatively impacting market stability by liquidating too large of a position.

These rules obligate an exchange, as part of its market surveillance effort, to take account of large positions in their market either by imposing hard limits on traders' speculative positions or, in the case of position accountability, by providing exchanges with ways to address the market impact of large positions.

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[11] *Id.*

[12] *Id.* at 33,601.

[13] Establishment of Speculative Position Limits, 46 Fed Reg. 50,938 (Oct. 16, 1981).

IV. SEFs Cannot Adopt an Exchange-centric Position Limits or Accountability Regime

Exchange-based surveillance and position limit and position accountability regimes focus on market participants' concentrated speculative positions. CFTC staff has stated that "an acceptable market surveillance program should regularly collect and evaluate market data to determine whether markets are responding to the forces of supply and demand. An exchange also should have routine access to the positions and trading of its market participants."[14]

Exchanges can readily adopt and enforce position limits or position accountability provisions for futures and futures options because they have the means to carry out this oversight function. As mentioned before, exchanges own their contracts, the trading of which is only allowed on its respective exchange, and exchanges also own and operate the derivatives clearing organizations ("DCOs"), or direct trades to specified DCOs, that process and become the counterparty to each transaction executed on the exchange. Further, unlike futures on physical commodities for which the underlying products are in limited supply, the financial instruments underlying swaps subject to the trade execution mandate (interest rate and credit default swap indices) generally have very large or nearly inexhaustible deliverable supplies and a cash market sufficiently liquid to render swaps traded on those instruments highly unlikely to be susceptible to the threat of manipulation.

Exchanges also have "large trader reporting systems"[15] designed to obtain current information about traders' positions in their derivatives markets. Futures exchanges possess data showing the positions held by all reportable traders for each trading day based on reports from clearing members, futures commission merchants, and foreign brokers detailing close-of-business position data. Each futures exchange's "large trader reporting system" also provides information on the account's ownership and control and identifies futures and options traders who trade for the account. By assigning unique identification numbers to each trader, futures exchanges can aggregate traders' positions across different accounts at multiple clearing members to include the positions of all related affiliates.

By contrast, SEFs are trading platforms that merely foster liquidity for swap execution. They do not have any ownership or proprietary control over the products bought and sold on their platforms. SEFs do not hold customer funds. They do not guarantee performance by counterparties. And, most importantly as discussed below, SEFs do not possess information about a trader's position in any given swap.

A. Position Limits

Under Section 4a of the CEA, the Commission is required to establish position limits only after it determines that such position limits are necessary and appropriate. To date, the CFTC has not made that determination for financial swaps and, as a result, has not established position limits for these products. However, even if such limits were put in place, SEFs are limited in their ability to monitor for position limits violations. SEFs can only monitor market activity for those transactions that take place on its trading system or facility. A SEF only has information about trading activity on its facility and does not possess, and has limited means to obtain, information about its participants' positions in swaps from activity on other venues. There are currently 24 applicant SEFs, making it impossible for any one SEF to know how its participants may transact on the 23 other platforms.

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[14] *See* CFTC Division of Market Oversight, Rule Enforcement Review of ICE Futures U.S. (July 22, 2014), at 4, *available at* http://www.cftc.gov/ucm/groups/public/@otherif/documents/ifdocs/icemarksurrer072214.pdf.

[15] *See* Large Trader Reporting Program, http://www.cftc.gov/IndustryOversight/MarketSurveillance/LargeTraderReportingProgram/ltrp.

In practice, while a participant may enter into a transaction of size on one SEF, the SEF has no way of knowing if the participant has offset (or increased) its position in the swap through trading on other platforms. A swap that is listed and traded on one SEF may, unbeknownst to that SEF, be traded on other SEFs, DCMs, or bilaterally between counterparties away from any SEF or DCM. As a result, SEFs and DCMs listing swaps do not possess information about a trader's position in any given swap.

Position limit information is more appropriately collected by other segments of the swap market, including market participants, DCOs, and swap data repositories ("SDRs"). However, even a DCO or SDR would only have information about traders' cleared positions or reported positions at its individual organization. Only the participants themselves would have information about their overall cleared and uncleared swaps position in a market.

As a result, it is the WMBAA's view that only the CFTC (or a self-regulatory body possessing position information about swap market participants from SDR and DCO reports) can effectively police the swaps market to detect position limit violations and have the enforcement tools to take meaningful action to deal with violations. Imposing a position-based requirement on SEFs would be ineffective and would incur significant redundancies, potential miscounting or double counting of trades, and significant impediments related to data standards among the 24 applicant SEFs. In addition, if all of the SEFs set their individual position limit thresholds equal to the not-yet adopted CFTC's limits, this regime could encourage "gaming" by market participants who could spread their activity across SEFs to avoid triggering a "limit check" by any one SEF.

B. Position Accountability

As the National Futures Association ("NFA") recently concluded after conducting a data-driven analysis, position accountability levels will do little to "reduce the potential threat of market manipulation or congestion, the stated goal of the [SEF core principles]."[16]

The WMBAA believes the concept of a SEF position accountability regime is flawed. Most importantly, as discussed above, position accountability is meaningful as a market surveillance tool only in the context of centralized marketplaces such as exchanges, which is due to the fact that they own the products traded and possess information about traders' actual positions in the relevant derivatives marketplace. Because SEFs do not own products, and therefore do not possess the same position information, it is not necessary or appropriate for SEFs to adopt position accountability.

Moreover, recognizing the impracticability of SEFs adopting position limits or position accountability regimes, there have been suggestions that SEFs adopt, in effect, "trading accountability" provisions as a means of complying with core principle 6 (*i.e.*, SEFs would institute enhanced oversight of and data gathering from a trader based solely on trading activity or the size of transactions). This suggestion is problematic for two reasons. First, the CEA, as amended by Dodd-Frank, does not contemplate a trading activity-based accountability regime, but rather contemplates a position management-focused component. Furthermore, there is no clear metric available for SEFs to conduct a position accountability framework. As identified by the NFA in its recent report, "[n]otional transaction size alone is a misleading measure of risk."[17] The NFA further concluded that "the swap market might not lend itself to notional transaction size accountability levels at the SEF level."[18]

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[16] NFA Swap Accountability Levels Study (Apr. 2, 2015).

[17] *Id.*

[18] *Id.*

V. Conclusions

The WMBAA has always supported efforts to promote stability, efficiency, transparency, and competition in furtherance of Dodd-Frank's goal to promote the trading of swaps on SEFs. This includes taking steps to minimize threats posed to swap markets, including market manipulation from concentrated positions in a certain swap.

For the reasons previously stated, however, the WMBAA does not believe that a SEF-based position limit or position accountability regime is necessary or appropriate to meet the purposes set forth in Dodd-Frank.

The WMBAA members and other competitor SEFs want to be part of the solution. These venues are bound by a series of core principles to ensure fair, vibrant markets. They provide daily CFTC Part 16 lists of transactions to the CFTC, and they transmit full trade details to SDRs pursuant to their Part 43 and Part 45 confirmation and reporting obligations. These data transmissions provide the CFTC with the ability to combine data across SEFs to monitor large positions and address position limit violations should the CFTC determine to establish position limits or position accountability provisions for swap contracts.

In considering ways to monitor swap markets for excessive positions, only the CFTC, or a CFTC designated neutral third-party self-regulatory organization would be in the position to collect, maintain, and synthesize the data to perform this function in an efficient, cost-sensitive manner. SEFs operating within the unique framework of the execution-only, competitive SEF landscape, in contrast to the vertically-integrated futures market structure, are ill-suited to establish a position limits or accountability regime.