



August 10, 2018

Christopher J. Kirkpatrick  
Secretary  
U.S. Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street NW  
Washington, D.C. 20581

**Re: De Minimis Exception to the Swap Dealer Definition  
Notice of Proposed Rulemaking  
RIN 3038-AE68**

Ladies and Gentlemen:

This letter is in response to the request by the Commodity Futures Trading Commission (the “Commission”) for comment to its Notice of Proposed Rulemaking with respect to the De Minimis Exception to the Swap Dealer Definition (the “*Proposed Rulemaking*”)<sup>1</sup>. While supporting the Commission’s proposal to set the aggregate gross notional amount (“*AGNA*”) threshold for the de minimis exception within the swap dealer definition at \$8 billion in swap dealing activity entered into by a person over the preceding 12 months, this letter seeks to address certain of the Commission’s additional potential changes to the de minimis exception; namely, its proposal to except from consideration when calculating the AGNA for purposes of the de minimis threshold (a) swaps that are exchange-traded and/or cleared, and (b) swaps that are categorized as non-deliverable forward transactions (“*NDFs*”).

Cboe SEF, LLC (“*Cboe SEF*”) is a registered swap execution facility (a “*SEF*”). Cboe SEF launched NDF trading in December 2017, and NDFs remain its sole listed product to date. As Cboe SEF continues to work towards onboarding additional participants, we welcome the opportunity to comment on the Commission’s proposal to consider these additional changes to the swap dealer definition, each of which, if implemented, would have a positive impact on these efforts and on the SEF marketplace as a whole.

Cboe SEF’s functionality supports an order book trading model which allows for bilateral, uncleared swaps trading. Cboe SEF’s membership structure allows a prime broker (a “*Prime Broker*”) to be a member and to allow certain of its clients (each, a “*Trading Firm*”) to enter into transactions on Cboe SEF as such Prime Broker’s agent for such Prime Broker’s account. In addition, a firm (a “*Principal Trading Firm*”) may enter into transactions on Cboe SEF for its own account on a proprietary basis.

While a Prime Broker on Cboe SEF will necessarily be a swap dealer, as such term is defined in Section 1a(49) of the Commodity Exchange Act (the “*CEA*”), as amended by the Dodd-Frank Wall

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<sup>1</sup> 83 FR at 27444

Street Reform and Consumer Protection Act of 2010, neither Principal Trading Firms nor Trading Firms are required to be swap dealers under the rules of Cboe SEF. While Cboe SEF is confident that its rules effectively solve certain historical confusion among Prime Brokers with respect to trading on a SEF, thus encouraging additional liquidity and impartial access to on-SEF trading activity, it understands from its prospective members that joining Cboe SEF as a Principal Trading Firm or as a Trading Firm may result in their surpassing the de minimis AGNA of swap transactions through its NDF dealing activity, resulting in a requirement to register with the Commission as swap dealers notwithstanding the availability of the Floor Trader Swaps Exclusion, as defined below. We believe that the Commission's implementation of the proposals to amend the current swap dealer definition so as to except exchange-traded and/or cleared swaps from the AGNA determination, as well as all NDFs, will result in several Principal Trading Firms and Trading Firms joining Cboe SEF, as well as other SEFs, as members, becoming active liquidity providers on SEFs and thus furthering the Commission's goal of encouraging standardized trading on such registered trading platforms.

I. Exception of Exchange-traded and/or Cleared Swaps

A. Floor Trader Swaps Exclusion

As noted in the Proposed Rulemaking<sup>2</sup>, the Floor Trader Swaps Exclusion<sup>3</sup> provides that certain swaps are not to be considered in determining whether a person is a swap dealer. However, notwithstanding the Commission's having addressed certain concerns of prospective floor traders through no-action relief<sup>4</sup>, very few market participants have availed themselves of the Floor Trader Swaps Exclusion by registering as floor traders. Specifically, certain market participants have remained concerned that the Floor Trader Swaps Exclusion could be read to mean that a registered floor trader would be required to comply with the transaction-specific requirements of the exclusion<sup>5</sup> in respect of all of its swaps activity, not only its dealing activity. As noted in the Proposed Rulemaking<sup>6</sup>, we believe that the Floor Trader Swaps Exclusion was included within the swap dealer definition in order to allow registered floor traders to provide liquidity to contract markets in non-dealing capacities, such as proprietary trading, without triggering swap dealer regulation. However, ambiguity in the Floor Trader Swaps Exclusion itself has resulted in very few market participants availing themselves of this avenue, thus depriving the market of additional liquidity and minimizing the Commission's efforts to support its policy goal of encouraging swaps trading on SEFs.

The current proposal of the Commission to except all swaps that are exchange-traded and/or centrally cleared from the AGNA calculation would, we believe, remove any ambiguity from the Floor Trader Swaps Exclusion, and make very clear that, to the extent a market participant were registered as a floor trader, all of its on-exchange activity would be excepted from its AGNA calculation. In fact, the proposal might obviate the need for a market participant to register as a floor trader at all, given that such swaps would be excluded regardless. Either way, the proposal, if implemented, would

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<sup>2</sup> 83 FR at 27469

<sup>3</sup> 17 CFR 1.3(ggg)(6)(iv)

<sup>4</sup> CFTC Staff Letter No. 13-80, No-Action Relief from Certain Conditions of the Swap Dealer Exclusion for Registered Floor Traders (Dec. 23, 2013)

<sup>5</sup> 17 CFR 1.3(ggg)(6)(iv)(B) and (D)

<sup>6</sup> 83 FR at 27469

encourage proprietary trading firms to provide liquidity to SEFs, a constituency of market participants that has not turned to on-exchange swaps trading to the extent that may have been expected or desired upon the introduction of the SEF regime.

B. Prime Brokerage Trading Model

As noted above, Cboe SEF's membership structure allows for a traditional prime brokerage model, whereby a Prime Broker may authorize certain of its clients, Trading Firms, to enter into transactions on Cboe SEF in the name of and for the account of such Prime Broker. Each of the Prime Broker and the Trading Firm is a member of Cboe SEF, subject to the oversight of Cboe SEF and of the Commission. This prime brokerage trading model has been the subject of certain challenges dating from the introduction of the SEF regime, and Cboe SEF has successfully navigated these challenges through thoughtful interpretation of the SEF rules and outreach to its members and prospective members.

In Cboe SEF's model, the vast majority of transactions executed on the SEF will have at least one counterparty that is a Prime Broker, and therefore a swap dealer. This supports the Commission's data as set forth in the Proposed Rulemaking<sup>7</sup> and, further, supports the notion that excepting exchange-traded swaps from AGNA determinations would not result in a meaningful increase in the execution of swaps where neither counterparty is a swap dealer. Therefore, we believe that the implementation of the Commission's proposal in this regard would not reduce the number of swaps that are benefitting from the policy considerations of swap dealer regulation, including reducing systemic risk, increasing counterparty protections, and increasing market efficiency, orderliness, and transparency.

One aspect of the prime brokerage model should be highlighted in the context of the Commission's proposal to except exchange-traded swaps from the AGNA calculation. In this arrangement, a Trading Firm will enter into a transaction on Cboe SEF in the name and for the account of its Prime Broker (where the counterparty to such transaction will either be a Prime Broker, where such transaction is initiated by such Prime Broker's Trading Firm, or a Principal Trading Firm). Once that initial transaction is executed on Cboe SEF (the "*On-SEF Transaction*"), the Prime Broker will enter into a mirror transaction with its Trading Firm (an "*Off-SEF Transaction*") having identical material economic terms as the On-SEF Transaction, thus fulfilling an intermediation role on behalf of its Trading Firm. The Off-SEF Transaction is not executed on Cboe SEF, but is, rather, executed bilaterally between the Prime Broker and its Trading Firm.

Assuming the Commission determines it appropriate to implement its proposal to except all exchange-traded swaps from AGNA determinations, as we certainly encourage it to do, we believe it essential also to clarify that the Off-SEF Transactions described above be similarly excepted. To neglect those transactions would have the unintended effect, we believe, of not recognizing the traditional prime brokerage trading model, which is used regularly in the foreign exchange markets, and of perpetuating some of the challenges that the current SEF rules have introduced to the detriment of the policy goal of encouraging exchange-traded swaps activity in order to increase market

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<sup>7</sup> 83 FR at 27451

efficiency, orderliness and transparency. The benefits of the prime brokerage model include increasing market liquidity and allowing market participants (in our case, Trading Firms) to obtain more favorable pricing from liquidity providers with which the market participant may not have a credit relationship, permitting such market participants to simplify management of counterparty risk by minimizing the number of firms they face, lowering costs for market participants by eliminating the need to enter into trading documentation with each counterparty with which they want to trade, increasing collateral efficiencies by permitting prime brokers to net collateral obligations across all trades for a market participant handled by a prime broker, and reducing operational risk. All of these benefits of the prime brokerage model could be further encouraged by excepting exchange-traded swaps from AGNA calculations while making clear that Off-SEF Transactions would be part of such equation. To neglect Off-SEF Transactions in this context could result in a failure to give full effect to the intended benefits of the proposed exception.

## II. Exception of NDFs

As noted in the Proposed Rulemaking<sup>8</sup>, pursuant to Section 1a(47)(E) of the CEA, the Secretary of the Treasury (the “*Secretary*”) is vested with the authority to determine whether foreign exchange swaps and forwards (“*Exempt FX Transactions*”) should be regulated as swaps under the CEA, provided that the Secretary makes a written determination satisfying certain criteria specified in CEA Section 1b. On November 16, 2012, the Secretary issued a written determination (the “*Treasury Determination*”) that Exempt FX Transactions should not be regulated as swaps under the CEA. The Treasury Determination did make clear that the authority conferred on the Secretary by the CEA did not extend to any other foreign exchange derivative, including NDFs, as a statutory matter. Notwithstanding that limitation, market participants have long sought the inclusion of NDFs within the scope of the Treasury Determination or otherwise requested no-action relief covering several topics with respect to NDFs<sup>9</sup>. Despite those efforts spanning several years, NDFs have consistently been treated as distinct from Exempt FX Transactions as a regulatory matter.

As has been noted in several efforts of market participants to argue that NDFs and Exempt FX Transactions are functionally identical and should, therefore, merit similar regulatory treatment, the policy consideration that resulted in the CEA’s different treatment of NDFs and Exempt FX Transactions is difficult to discern. As a functional matter, NDFs address the same goals as Exempt FX Transactions, with the sole differentiating feature being that Exempt FX Transactions are settled through a physical exchange of currency. As a matter of systemic risk, it is difficult to point to a difference between Exempt FX Transactions and NDFs. If anything, it can be argued that NDFs actually represent a lower amount of counterparty and settlement risk given that they are settled on a net basis.

The different regulatory treatment of these products is therefore curious, and has had many practical effects which we believe have undermined the Commission’s policy goals in introducing the SEF regime. As one example, there has been a steady increase in the electronic trading of NDFs over the

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<sup>8</sup> 83 FR at 27470

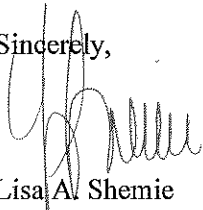
<sup>9</sup> See, for example, CFTC Letter No. 13-12, Relief for Swap Dealers and Major Swap Participants Regarding the Obligation to Provide Certain Disclosures for Certain Transactions Under Regulation 23.431 (May 1, 2013)

past few years. However, given that NDFs are not the subject of a trade execution or clearing mandate, US Persons are free to trade NDFs on electronic platforms that are not registered SEFs, such as single-dealer platforms that are not required to register as SEFs. Therefore, SEFs are competing with trading venues that are not subject to the same regulatory and registration requirements, in particular with regard to “permitted swaps” such as NDFs. In order for the Commission to further its goal of promoting swap trading on SEFs while preserving fair competition among markets, we believe that excepting NDFs from the AGNA calculation can be viewed as one avenue towards furtherance of this objective, by encouraging firms that are not prepared to incur the cost and regulatory burdens of swap dealer registration to join SEFs without the concern of breaching the swap dealer registration threshold.

### III. Conclusion

For the reasons set forth above, Cboe SEF believes it is appropriate and beneficial for the Commission to except exchange-traded and centrally-cleared swaps from AGNA calculations for purposes of the de minimis threshold in the swap dealer definition, and to except all NDFs as well, while taking into account the factors set forth above with respect to the prime brokerage trading model. Cboe SEF appreciates the opportunity to offer comments on these important proposals. Please contact the undersigned at 646-856-8814 should there be any questions.

Sincerely,



Lisa A. Shemie  
Chief Legal Officer  
Cboe SEF, LLC