

March 15, 2019

**VIA ELECTRONIC SUBMISSION**

Mr. Christopher Kirkpatrick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581

**Re: Comments on the Proposed Rule, *Swap Execution Facilities and Trade Execution Requirement* (RIN 3038-AE25)**

Dear Mr. Kirkpatrick:

**I. INTRODUCTION**

On behalf of The Commercial Energy Working Group (the "**Working Group**"), Eversheds Sutherland (US) LLP submits this letter in response to the request for public comment set forth in the Commodity Futures Trading Commission's (the "**CFTC**") Proposed Rule, *Swap Execution Facilities and Trade Execution Requirement* (the "**Proposed Rule**").<sup>1</sup>

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Working Group are producers, processors, merchandisers, and owners of energy commodities. Among the members of the Working Group are some of the largest users of energy derivatives in the United States and globally. The Working Group considers and responds to requests for comment regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

**II. COMMENTS OF THE WORKING GROUP**

The Working Group commends the CFTC's ongoing efforts to strengthen the swaps regulatory framework by reducing unnecessary complexity, costs, and other burdens that impede market development, innovation, and growth. The Working Group also appreciates that the CFTC has continued to reassess laws and policies with a critical eye and has put forth novel proposals for public consideration, including with respect to the swaps regulatory framework. In reassessing laws and policies, the CFTC has appropriately maintained an open

---

<sup>1</sup> Proposed Rule, *Swap Execution Facilities and Trade Execution Requirement*, 83 Fed. Reg. 61,946 (Nov. 30, 2018), <https://www.cftc.gov/sites/default/files/2018-11/2018-24642a.pdf>.

dialogue with market participants and properly endeavored to be transparent about its regulatory agenda. For example, the Working Group appreciates that, in an effort to facilitate dialogue and promote transparency, Chairman Giancarlo issued the SEF White Paper in 2015<sup>2</sup> to introduce the public to concepts that are put forth in the Proposed Rule. The Working Group believes the robust discussion the CFTC has continued to facilitate is important as it will provide the CFTC with a range of input on regulatory approaches under consideration.

While the Working Group appreciates the CFTC's efforts, the Working Group, as discussed further below, has concerns about the Proposed Rule, including that the proposal to apply the swap execution facility ("**SEF**") registration requirement generally to swaps brokering entities is too broad.<sup>3</sup> However, if the CFTC determines to go forward with its proposed application of the SEF registration requirement, the Working Group urges the CFTC to consider modifications to that requirement that would help minimize disruption in less liquid markets that rely on swap brokering entities, such as pockets of the electricity swaps markets and the weather swaps markets.<sup>4</sup>

Separately, the Working Group supports the CFTC's goal of increasing the standards among the professionals in the swaps markets and offers the suggestions discussed herein as an alternative to further that goal.<sup>5</sup>

#### **A. The Proposal to Apply the SEF Registration Requirement to Swaps Brokering Entities Is Too Broad**

For several reasons, the Working Group respectfully disagrees with the CFTC's proposal to generally apply the SEF registration requirement to swaps brokering entities, including interdealer brokers.<sup>6,7</sup> Under the CFTC's broad proposal, the SEF registration requirement would effectively apply to all registered introducing brokers ("**IBs**") that engage in swaps activity ("**Swaps IBs**"), including standalone voice brokers.<sup>8</sup> Not only would such an application of the SEF registration requirement be incongruous with the statutory construct of the Commodity Exchange Act (the "**CEA**") and Congressional intent, it would also negatively impact the orderly operation of the swaps markets (*e.g.*, reduce liquidity and increase costs)

---

<sup>2</sup> J. Christopher Giancarlo, CFTC Commissioner, White Paper, *Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank* (Jan. 29, 2015) (the "**SEF White Paper**"), <https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf>.

<sup>3</sup> See Section II.A. of this comment letter.

<sup>4</sup> See Section II.B. of this comment letter.

<sup>5</sup> See Section II.C. of this comment letter.

<sup>6</sup> In the Proposed Rule, the CFTC uses the term "interdealer broker" to refer "to an interdealer broker entity or operation in the aggregate and not to a particular individual, i.e., an associated person, who works as a broker within the entity or operation." Proposed Rule at 61,957 n.78. The CFTC further noted that it "considers such individuals to constitute part of the interdealer broker's trading system or platform." Proposed Rule at 61,957 n.78.

<sup>7</sup> See Proposed Rule at 61,957.

<sup>8</sup> For example, in assessing the potential impact of the SEF registration requirement under the Proposed Rule, the CFTC bases its estimates on the number of registered IBs that are approved by the NFA to engage in swaps activities. See Proposed Rule at 62,045-46.

where market participants are more reliant on smaller swaps brokering entities (e.g., weather swaps markets),<sup>9</sup> which the CFTC acknowledges in the Proposed Rule.<sup>10</sup>

### 1. **SEF Registration Should Not Apply Categorically to All Swaps IBs**

As noted above, the Proposed Rule would essentially apply the SEF registration requirement to all Swaps IBs.<sup>11</sup> This application of the SEF registration requirement is based on the CFTC's proposed interpretation that the activities of such entities "allow multiple participants to trade swaps with multiple participants.... (emphasis added)."<sup>12</sup> The CFTC further notes that it "believes that it is necessary to apply the SEF registration requirement to ensure that the multiple-to-multiple 'trading' that occurs on such trading systems or platforms is subject to the [CEA] and [CFTC]'s regulations as regulated SEFs," and that "[t]his application is consistent with Congressional intent, as evidenced by the statutory SEF registration requirement and SEF definition, and is further consistent with the statutory SEF goals." The Working Group respectfully disagrees with the CFTC's interpretation and urges the CFTC not to impose a SEF registration requirement categorically to all Swaps IBs.

Applying the SEF registration requirement categorically to Swaps IBs would be incongruous with the CEA's statutory construct and Congressional intent as it would render superfluous or unnecessary the requirement in the CEA for Swaps IBs to register and for associated persons ("**APs**") of Swaps IBs to register. Specifically, by subjecting all Swap IBs to the SEF registration requirement, the CFTC would be rendering the concept of a Swaps IB a null set, reading it out of the CEA. That would run contrary to the Congressional intent underlying the Dodd-Frank Act. By including the term "swap" in the definition of "introducing broker"<sup>13</sup> while also adding the definition of "swap execution facility" to the CEA, Congress clearly intended that a Swaps IB and a SEF were two distinct concepts. Therefore, the Proposed Rule's potential categorical treatment of Swaps IBs as SEFs would run contrary to both Congressional intent and the cardinal rule of statutory construction, which is, succinctly stated, "to save and not to destroy."<sup>14</sup> Said another way, every clause and word of a statute

---

<sup>9</sup> The Working Group notes that energy derivatives markets are not generally structured in a manner conducive for SEFs. Specifically, the vast majority of products liquid enough to be cleared through a derivatives clearing organization ("**DCO**") are executed through the central limit order book of a designated contract market ("**DCM**") or as block futures transactions and are cleared through the respective DCO. In contrast, the swaps transacted in the over-the-counter swap market generally are not liquid enough for execution through a DCM or SEF or clearing through a DCO. Any effort to move more liquid energy derivatives products to a SEF would likely result in the same products being executed as swaps and futures, resulting in two pools of trading that, in practice would only differ in the manner in which they are regulated and both of which would have less liquidity than current futures markets.

<sup>10</sup> See Proposed Rule at 62,054 (discussing the likely impact to smaller swaps brokering entities).

<sup>11</sup> See Proposed Rule at 61,957 (proposing to apply the SEF registration requirement to swaps brokering entities, including interdealer brokers).

<sup>12</sup> Proposed Rule at 61,957.

<sup>13</sup> Under CEA Section 1a(31), the definition of an IB includes any person who:

- "is engaged in soliciting or in accepting orders for— the purchase or sale of any commodity for future delivery, security futures product, or swap...;" and
- "does not accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom."

<sup>14</sup> *United States v. Menasche*, 348 U.S. 528, 538–39 (1955) (citing *N.L.R.B. v. Jones & Laughlin Steel Corp.*, 301 U.S. 1, 30 (1937)).

should be given effect, if possible, and entire sections should not be read out,<sup>15</sup> as the CFTC's proposed interpretation would do to the inclusion of "swap" in the definition of "introducing broker."

Some may argue that the CFTC's interpretation in the Proposed Rule would not make superfluous the Swaps IB construct under the CEA's statutory framework by pointing to its applicability in circumstances where an interdealer broker is only soliciting or accepting individual or single bids or offers and introducing them to a SEF.<sup>16</sup> However, such an argument is flawed because it effectively redefines the Swaps IB regulatory construct by only making it applicable to people who facilitate one-sided introductions to a SEF, which is inconsistent with the manner in which Swaps IBs, especially in the energy markets, function and operate. Considering that not all swaps are required to be executed on a SEF, it is unlikely that Congress envisioned the Swaps IB regulatory framework would only apply in instances where an interdealer broker would be facilitating one-sided introductions to a SEF.

## **2. Voice Brokers Do Not Meet the SEF Definition**

Conducting traditional voice broker activity, including the facilitation of bilateral OTC swaps, should not obligate an entity to register as a SEF. The SEF definition captures "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."<sup>17</sup>

Under the SEF definition, the key question to determining whether a standalone voice broker must register as a SEF is whether the voice broker is a platform through which "multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants." A voice broker typically takes an order from one customer and then finds that customer a counterparty to the requested swap. A voice broker does not facilitate a multiple-to-multiple trading environment. That is, unlike execution facilities where multiple sellers and multiple buyers come together to collectively engage in trading activity, a voice broker handles the individual transaction of single buyer or seller. The fact that a voice broker might call multiple parties is irrelevant. There is no multiple-to-multiple trading occurring.

Notably, the CFTC reached this very conclusion in the preamble to the SEF Final Rule when determining that pure voice brokers could not qualify as SEFs. The CFTC stated "**trading systems or platforms facilitating...execution...via voice exclusively are not multiple participant to multiple participant** and do not provide for pre-trade price transparency."<sup>18</sup> (emphasis added). Based on this conclusion, pure voice brokers do not satisfy the definition of "swap execution facility" and should be permitted to facilitate swaps trading without registering as a SEF.

---

<sup>15</sup> See *United States v. Menasche*, 348 U.S. 528, 538–39 (1955).

<sup>16</sup> See, e.g., Proposed Rule at 61,959 n.94 (providing an example where IB registration would apply).

<sup>17</sup> CEA Section 1a(50).

<sup>18</sup> See Final Rule, *Core Principles and Other Requirements for Swap Execution Facilities*, 78 Fed. Reg. 33,476, 33,500 (June 4, 2013) ("**SEF Final Rule**"), <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-12242a.pdf>.

**B. If the CFTC Determines to Go Forward with Its Proposed Application of the SEF Registration Requirement, the CFTC Should Consider Modifications That Would Help Minimize Disruption in Less Liquid Markets**

If the CFTC determines to go forward with its proposed application of the SEF registration requirement, the Working Group requests that the CFTC consider modifications that would help minimize disruption in less liquid markets that rely upon standalone voice brokers. Specifically, because of the variety of commodities, grades, and delivery locations found underlying commodity derivatives, there are many small, specialized markets for particular commodities (*e.g.*, jet fuel or bunker fuel for delivery in specific locations, electricity for delivery at less liquid nodes, and weather derivatives) that provide vital risk management tools. Because of the small size and specialized nature of these markets, they typically rely upon smaller swaps brokering entities, many of whom are standalone voice brokers, to provide liquidity and expertise. Regulating these standalone voice brokers as SEFs would be detrimental to these markets.

That conclusion is consistent with the CFTC's acknowledgement in the Proposed Rule that the proposed SEF registration requirement would harm smaller swaps brokering entities, including the market participants that rely upon such entities. Specifically, the Proposed Rule notes the following:

Smaller entities or platforms are less likely to have existing technology and procedures or available resources to comply with new SEF requirements; therefore, their initial costs of compliance with those requirements may be larger or have a proportionally greater effect on smaller entities. Market participants may also bear some costs if some entities abstain from SEF activities. For example, market participants who have utilized these entities to trade swaps would no longer be able to do so for swaps that must be traded on a SEF or swaps that they would otherwise want to execute on a SEF. Therefore, these participants would incur costs that could include search and transition costs to identify and onboard to new SEFs. In transitioning to a new platform, those market participants may incur less favorable financial terms or have access to reduced services.<sup>19</sup>

Considering the harmful consequences that will likely impact the swaps markets noted above, the Working Group respectfully urges the CFTC to apply its proposed SEF registration requirement only to swaps brokering entities that offer services with respect to swaps subject to mandatory clearing requirement. In the alternative, the CFTC could provide a *de minimis* exception to the SEF definition for standalone voice brokers. That exception could be limited to certain classes of derivatives, such as commodity derivatives, and could be based on any number of factors, such as transaction count, notional volume, or head count of APs.

Given the multitude of approaches the CFTC could take with a *de minimis* exception, the CFTC might review the market data available to it and propose an exception as part of any additional proposal or final rule issued with respect to the definition of SEF. Providing the market with an opportunity to comment and give feedback on a proposed *de minimis* exception, or a number of potential exceptions, would ensure that any final *de minimis* exception works as intended.

---

<sup>19</sup> Proposed Rule at 62,054.

**C. Swaps Proficiency Examination for Certain Professionals Could Be Used to Advance the Effort to Increase Standards for Professionals in the Swaps Market**

The Working Group supports the CFTC's efforts to increase the standards for professionals in the swaps market. The Working Group understands that, in general, the National Futures Association ("**NFA**") currently requires persons seeking to register with the CFTC as an AP to take and pass the Series 3 Exam (National Commodity Futures Examination); however, the Series 3 Exam does not test for swaps proficiency.<sup>20</sup> As a result, NFA Registration Rule 401(e) currently provides an exception to the NFA's Series 3 Exam requirement for a person applying for registration with the CFTC as an AP, if the applicant's sole activities subject to regulation by the CFTC are swaps-related.<sup>21</sup>

The Working Group appreciates and supports the CFTC's goal of increasing the standards for professionals in the swaps market. However, the Working Group respectfully notes that this goal can be accomplished without the proposed restructuring of the swaps market regulatory framework under the Proposed Rule.

Specifically, the Working Group supports the NFA's efforts, which are currently underway, to develop a swaps proficiency requirements program, which would be applicable to APs engaging in swaps activities.<sup>22</sup> The Working Group believes this approach, which can be implemented under the current regulatory framework, would advance the CFTC's goals of improving professionalism in the swaps market while minimizing market disruption.

**III. CONCLUSION**

The Working Group appreciates this opportunity to provide input on the Proposed Rule and respectfully requests that the comments set forth herein are considered.

If you have any questions, please contact the undersigned.

Respectfully submitted,  
/s/Alexander S. Holtan  
Alexander S. Holtan  
Blair Paige Scott

***Counsel to The Commercial Energy Working Group***

---

<sup>20</sup> See Proposed Rule at 61,990 n.353.

<sup>21</sup> See Proposed Rule at 61,990 n.353 (referencing NFA Registration Rule 401(e)).

<sup>22</sup> See NFA Press Release, NFA to Develop Swaps Proficiency Requirements Program (June 5, 2018), <https://www.nfa.futures.org/news/newsRel.asp?ArticleID=5014>.