

March 15, 2019

VIA ELECTRONIC SUBMISSION

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Response to Request for Comments Proposed Rule – Swap Execution Facilities and Trade Execution Requirement (RIN 3038-AE25)

Secretary Kirkpatrick:

On behalf of the eleven Federal Home Loan Banks (the “**FHLBanks**”), we appreciate the opportunity to respond to the Commodity Futures Trading Commission’s (the “**Commission**” or “**CFTC**”) request for comments in respect of its proposed amendments to Commission regulations relating to: (i) the trade execution requirement under the Commodity Exchange Act (“**CEA**”); and (ii) swap execution facilities (“**SEFs**”) and designated contract markets (“**DCMs**”) (such proposed amendments, the “**Proposed Rule**”).¹ The FHLBanks are sophisticated market participants and support a balanced approach to derivatives regulation that provides the requisite amount of protection to the market (and participants therein) while at the same time affording sufficient flexibility for market participants to conduct their business. Accordingly, the FHLBanks commend the Commission’s review of the existing regulatory regime for SEFs and the trade execution requirement with the goal of reducing unnecessary complexity, costs and other burdens that impede SEF development, innovation, and growth. With that said, the FHLBanks are concerned that the Proposed Rule is an unnecessary replacement of the existing regulatory regime which market participants have adapted to and which appears to be meeting the policy goals behind the Dodd-Frank Wall Street Reform and Consumer Protection Act’s (the “**Dodd-Frank Act**”) call for the creation of SEFs and imposition of the trade execution requirement.

A. The FHLBanks

The FHLBanks are government-sponsored enterprises (“**GSEs**”) of the United States, organized under the authority of the Federal Home Loan Bank Act of 1932, as amended, and structured as cooperatives. Each FHLBank is independently chartered and managed, but the FHLBanks issue consolidated debt for which each FHLBank is jointly and severally liable. The FHLBanks serve the general public interest by providing liquidity to approximately 7,000 member financial institutions, including banks, thrifts, credit unions, insurance companies, and community development financial institutions. In doing so, the FHLBanks help increase the availability of credit for residential mortgages, community investments, and other services for housing and community development. Specifically, all of the FHLBanks provide readily available, low-cost sources of funds to their member financial institutions through loans referred to as “advances.”

¹ Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946 (Nov. 30, 2018) (the “**Proposed Rule Release**”). Terms not defined in this letter have the meanings afforded to them in the Proposed Rule Release.

The FHLBanks, as end-users, enter into swap transactions with swap dealers to facilitate their business objective of safely and soundly providing liquidity to their member financial institutions and to manage and mitigate financial risk, primarily interest rate risk. As of September 30, 2018, the aggregate notional amount of interest rate swaps held by the FHLBanks collectively was over \$516 billion. At present, the FHLBanks are clearing a significant and growing percentage of their interest rate swap transactions, certain of which are executed on SEFs.

B. FHLBank Comments

As indicated above, the FHLBanks do not believe that the existing SEF regulatory regime should be completely replaced. The FHLBanks are particularly focused on the following seven aspects of the Proposed Rule, each of which is addressed below: (i) SEF minimum functionality; (ii) implementation of the trade execution requirement; (iii) the revised interpretation of “impartial access”; (iv) the permissibility of pre-execution communications; (v) revisions to existing straight-through processing guidance; (vi) SEF error trade policies; and (v) package transactions relief.

i. SEF Minimum Functionality

The FHLBanks do not oppose affording SEFs the ability to develop and offer alternative methods of execution. However, the FHLBanks do not believe that the CFTC should withdraw the minimum functionality requirements for SEFs that are currently in place under existing CFTC rule 37.9 because such withdrawal could result in SEFs withdrawing or revising existing functionalities.² Following the implementation of the SEF regulatory regime in 2013, market participants like the FHLBanks became members of, and on-boarded with, various SEFs. This process was time consuming and costly, because it entailed legal review of applicable regulations and SEF rulebooks and establishment of systems, processes, and controls to facilitate trading on, and communications with, SEFs. In the FHLBanks’ view, the potential benefits of affording SEFs increased flexibility to develop and offer execution methods that are designed to address market and participant needs does not justify the cost of potentially having to dismantle the systems, processes, and controls that are currently in place pursuant to the regulatory SEF minimum functionality requirements. The Commission could achieve its stated goal by retaining the existing minimum functionality requirements of CFTC rule 37.9 and clarifying that SEFs have the ability to develop additional execution methods which may be available for Permitted Transactions and Required Transactions subject to review by the CFTC via the SEF rule review process. This would avoid the potential for the dismantling of existing systems, processes, and controls and ensure consistency across all SEFs, which is important for end-users like the FHLBanks for which managing multiple SEF platforms can be cumbersome and costly. The FHLBanks would generally support the enhanced disclosure requirements that the Proposed Rule would impose with respect to all execution methods offered by SEFs.³

ii. Implementation of the Trade Execution Requirement

The FHLBanks are strongly opposed to the Proposed Rule’s removal of the made available to trade process for triggering the trade execution requirement without the adoption of an alternative process that provides for regulatory oversight and industry feedback. The FHLBanks recognize that, in the Commission’s view, the existing made available to trade process may have resulted in an insufficient volume of swaps being subject to the trade execution requirement. However, the FHLBanks do not believe that the trade execution requirement should be triggered by the listing of a swap (that is subject to mandatory clearing) by a single SEF or DCM, which would be the case under the Proposed Rule.⁴ As indicated above, the trade execution requirement (i.e., trading on a SEF) carries with it legal and operational costs. The imposition of such a requirement should therefore necessitate some regulatory oversight (in addition to that involved with the process of a swap being listed on a SEF) and industry input. In addition, permitting a

² 17 C.F.R. § 37.9.

³ Proposed 37.201(a).

⁴ Proposed 36.1(a).

single SEF or DCM to trigger a regulatory requirement that could affect a wide segment of the derivatives market inappropriately incentivizes SEFs to list products for which there may not be sufficient standardization or liquidity to justify imposition of the trade execution requirement. For these reasons, the FHLBanks respectfully request that the existing made available to trade process not be removed without the adoption of an alternative process that provides for: (i) regulatory oversight; and (ii) industry feedback to be solicited and considered. If the Commission does not replace the made available to trade process with such an alternative, then the existing made available to trade process should be retained. As the Proposed Rule Release indicates, the current set of swaps that are subject to the trade execution requirement, by virtue of the made available to trade process, represents the most standardized and liquid swaps contracts.⁵ In the FHLBanks' view, this is an appropriate result and evidences that the made available to trade process is functioning properly. This view is supported by the legislative history of the Dodd-Frank Act, which provides that liquidity should be a key consideration for imposition of the trade execution requirement;⁶ such history also supports the view that the mere listing of a swap by a SEF should not trigger the trade execution requirement but that the CFTC should play a role in determining which swaps should be subject the requirement.⁷

iii. Revised Interpretation of "Impartial Access"

The Proposed Rule provides that the CFTC would revise its interpretation of the Dodd-Frank Act's Core Principle 2 for SEFs.⁸ Core Principle 2 provides, among other things, that SEFs must "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 provide market participants with impartial access to the market."⁹

When the current SEF regulatory regime was adopted, the CFTC took the view that Core Principle 2 requires SEFs to provide any eligible contract participant with impartial access to its markets and market services.¹⁰ The CFTC now intends to take the position that impartial access does not preclude a SEF from limiting the scope of persons to which it will offer services via the adoption of rules that specify access criteria so long as such criteria are transparent, fair, and non-discriminatory and applied to all or similarly situated market participants.¹¹ The FHLBanks do not support the revised interpretation of Core Principle 2 pertaining to impartial access. The practical effect of this change is that the current two-tier (interdealer and dealer to customer) SEF market would be perpetuated and could become a multi-tiered market. As discussed in the FHLBanks' comments submitted in response to the Commission's request for comments on post-trade name give-up on SEFs,¹² it is the FHLBanks' view that the Dodd-Frank Act contemplated all-to-all SEFs rather than a two-tier or multi-tier SEF market structure. This is supported by the express purpose of the SEF construct articulated in the Dodd-Frank Act, which is to promote the trading of swaps

⁵ See Proposed Rule Release at 61950, quoting a Bloomberg SEF LLC made available to trade submission dated December 5, 2013.

⁶ See statement of Senator Blanche Lincoln during the Senate's consideration of the trade execution requirement of the Dodd-Frank Act: "[i]n determining whether a swap execution facility 'makes the swap available to trade,' the CFTC should evaluate not just whether the swap execution facility permits the swap to be traded on the facility, or identifies the swap as a candidate for trading on the facility, but also whether, as a practical matter, it is in fact possible to trade the swap on the facility. The CFTC should consider, for example, whether there is a minimum amount of liquidity such that the swap can actually be traded on the facility. The mere 'listing' of the swap by a swap execution facility, in and of itself, without a minimum amount of liquidity to make trading possible, should not be sufficient to trigger the Trade Execution Requirement." See Congressional Record Vol. 156, No. 105 at page S5923, *available at* <https://www.govinfo.gov/content/pkg/CREC-2010-07-15/pdf/CREC-2010-07-15-senate.pdf>.

⁷ *Id.*

⁸ 7 U.S.C. § 5h(f)(2).

⁹ 7 U.S.C. § 5h(f)(2)(B).

¹⁰ 17 C.F.R. § 37.202(a)(1).

¹¹ Proposed Rule Release at 61993.

¹² Submitted on January 29, 2019 and available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61944&SearchText=cain>.

on SEFs and pre-trade transparency.¹³ In addition, a segmented, multi-tiered SEF market would result in decreased liquidity and, therefore, higher costs for many market participants, particularly end-users. This would run counter to the Commission's stated purpose for the Proposed Rule.¹⁴

iv. Pre-Execution Communications

The Proposed Rule would significantly limit the circumstances under which a participant on a SEF may engage in off-SEF, pre-execution communications in respect of Required Transactions. Specifically, such communications would only be permissible for: (i) swaps that are not subject to the trade execution requirement; and (ii) package transactions (discussed below) a component of which must be executed on the SEF.¹⁵ The CFTC's rationale for this narrowing is that, because the Proposed Rule would eliminate prescriptive execution methods and allow for flexible execution of swaps that are subject to the trade execution requirement, pre-execution communications, including the negotiation or arrangement of such swaps, would be able to occur entirely within a SEF's trading system or platform.¹⁶ While the FHLBanks recognize that this may be the case, the FHLBanks are of the view that off-platform communications (irrespective of whether they relate to Required Transactions) should be permissible so long as such communications do not constitute prohibited pre-arranged trading under CFTC rule 37.203(a),¹⁷ particularly since it is not yet clear what additional or alternative trading methods will be offered by SEFs. Currently, SEF platforms do not provide participants sufficient flexibility to address issues related to swaps with bespoke terms or of a large size and, therefore, such issues must be addressed off of the SEF. Retaining the status quo with respect to pre-execution communications would permit market participants to continue addressing such issues and would not prevent SEFs from placing restrictions on pre-execution communications that are tailored to their platforms as such platforms evolve (if and when the Proposed Rule is finalized).

v. Revisions to Existing Straight-Through Processing Guidance

The Proposed Rule purports to streamline existing guidance, issued by Commission staff letters in 2013 and 2015, relating to straight-through processing and affirmation of SEF cleared swaps (the "STP Guidance").¹⁸ Among other things, the Proposed Rule would withdraw a ten minute timeframe imposed by the STP Guidance for a SEF's processing and routing of a swap to a clearing house and instead allow SEFs to adopt rules for the processing and routing of swaps that account for existing market practices and technology, as well as market conditions, at the time of execution, so long as such rules meet a "prompt, efficient, and accurate" standard.¹⁹ The Commission's stated rationale for removal of the ten minute timeframe is that "a rigid time frame for processing and routing trades from a SEF to a DCO is inappropriate under the proposed regulatory framework" in part because "the expansion of the trade execution requirement will lead to the trading of a broader array of swaps on SEFs, many of which are likely more complex in nature and require more time for affirmation to occur."²⁰ The potential result of removing the ten minute timeframe is that SEFs could potentially take longer than ten minutes to process and route a swap to a clearing house.

The existing STP Guidance has resulted in market participants like the FHLBanks enjoying simultaneous execution and clearing of swaps. This is important, because time delays can expose market participants to market, credit and operational risk. Accordingly, the FHLBanks are of the view that it is appropriate for the CFTC to impose a timeframe for SEFs to process and route swaps

¹³ 7 U.S.C. § 7b-2(e)

¹⁴ See Proposed Rule Release at 61952, in which the Commission states its belief that the flexible regulatory approach to be imposed on SEFs by the Proposed Rule will attract greater liquidity formation on SEFs.

¹⁵ Proposed § 37.201(b).

¹⁶ Proposed Rule Release at 61986.

¹⁷ 17 C.F.R. § 37.203(a).

¹⁸ See Staff Guidance on Swaps Straight-Through Processing (Sep. 26, 2013) and CFTC Letter No. 15-67 (Dec. 21, 2015).

¹⁹ Proposed § 37.702(b)(1) and Proposed Rule Release at 62021-62022.

²⁰ Proposed Rule Release at 62022.

to a clearing house and that such timeframe should not be any longer than ten minutes. While the FHLBanks recognize that the Commission seeks to expand the scope of transactions that are executed on SEFs, the Commission should not introduce latency into the execution and clearing process, and risk as a result, for the sake of doing so. SEF trading should be limited to highly liquid and standardized transactions that can be processed expeditiously.

vi. SEF Error Trade Policies

In addition to addressing the timeframe within which a SEF must process and route a swap to a clearing house, the STP Guidance also imposed a requirement on SEFs to deem swaps that are rejected from clearing by a clearing house void *ab initio*. The Proposed Rule would remove this requirement and allow SEFs flexibility to adopt protocols and processes to correct such error trades.²¹ The FHLBanks oppose the removal of the void *ab initio* concept. As discussed above, consistency is important to end-users like the FHLBanks because managing multiple SEF platforms can be cumbersome and costly. Introducing another potential basis for discrepancy between SEFs would increase the cost and operational burdens to which end-users are already subject (e.g., if one SEF retains the void *ab initio* concept and another imposes breakage payments).

vii. Package Transactions Relief

The Proposed Rule would codify existing exemptive relief from the trade execution requirement for, among other things, swaps that are components of a “New Issuance Bond” package transaction.²² For this purpose, a “package transaction” is defined as consisting of two or more component transactions executed between two or more counterparties where execution of each component transaction is contingent upon the execution of all other component transactions and the component transactions are priced or quoted together as one economic transaction with simultaneous or near simultaneous execution of all components.²³ In the context of a New Issuance Bond package transaction, one component is a bond and the other component is at least one swap transaction that is subject to the trade execution requirement.

The FHLBanks support the Commission’s codification of the exemption from the trade execution requirement for New Issuance Bond package transactions as well as the proposed definition of the term “package transactions.” As the Commission correctly notes in the Proposed Rule Release, New Issuance Bond package transactions are not conducive to execution on a SEF trading system or platform because the swap component of such transaction is customized and negotiated in a manner that closely corresponds to the bond issuance process.²⁴ Moreover, the FHLBanks agree that New Issuance Bond package transactions play an important role in helping market participants to raise capital and fund origination loans for businesses.²⁵ In addition, the FHLBanks agree with the proposed definition of “package transaction” because it correctly reflects the nature of such transactions, particularly that the components of such transactions are priced together.²⁶

²¹ Proposed § 37.203(e)

²² Proposed § 36.1(d). See also CFTC Letter No. 16-76 (Nov. 1, 2016), extended by CFTC Letter No. 17-55 (Oct. 31, 2017).

²³ *Id.*

²⁴ Proposed Rule Release at 62039.

²⁵ *Id.*

²⁶ *Id.*


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We appreciate the opportunity to submit comments and your consideration thereof. Please contact Jamie Cain at (202) 383-0133 or james.cain@sutherland.com, or Ray Ramirez at (202) 383-0868 or ray.ramirez@sutherland.com, with any questions you may have.

Respectfully submitted,



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cc: FHLBank Presidents
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