



March 14, 2019

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

**Re: Swap Execution Facilities and Trade Execution Requirements
Notice of Proposed Rulemaking
RIN 3038-AE25**

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 Swap Execution Facilities and Trade Execution Requirements (the “*Proposed Rulemaking*”)¹.

Cboe SEF, LLC (“*Cboe SEF*”) is a registered swap execution facility (a “*SEF*”). Cboe SEF launched trading in non-deliverable forward transactions (“*NDFs*”) 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 make changes to the SEF regime so as to promote more SEF trading and pre-trade price transparency in the swaps market, and to strengthen the existing swaps framework. In that connection we would like to highlight three areas where Cboe SEF has focused its efforts on achieving this same goal with the assistance of the Commission – (a) issues relating to the Floor Trader Swaps Exclusion, (b) the prime brokerage trading model and certain swap dealer external business conduct obligations, and (c) the EU-US equivalence decision for authorized trading venues. We are hopeful that clarification by the Commission on these issues may further encourage on-SEF trading in furtherance of the Commission’s (and Cboe SEF’s) goals.

I. Floor Trader Swaps Exclusion

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 Street Reform and Consumer Protection Act of 2010, neither Principal Trading Firms nor Trading Firms are required to

¹ 83 FR at 61946

be swap dealers under the rules of Cboe SEF. Cboe SEF understands from certain of its prospective members that joining Cboe SEF as a Principal Trading Firm or as a Trading Firm may result in their surpassing the aggregate gross notional amount (“AGNA”) threshold of swap transactions through its NDF dealing activity in respect of the de minimis exception within the swap dealer definition, resulting in a requirement to register with the Commission as swap dealers notwithstanding the availability of the Floor Trader Swaps Exclusion². We believe that clarification by the Commission of certain confusion regarding the Floor Trader Swaps Exclusion 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.

The Floor Trader Swaps Exclusion 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 relief³, 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 require registered floor traders to comply with the transaction-specific requirements of the exclusion⁴ in respect of all of its swaps activity, not only its dealing activity. We understand 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 undermining the Commission’s efforts to support its policy goal of encouraging swaps trading on SEFs. We are encouraged by Commission Chairman Giancarlo’s recent pronouncement on this issue as an acknowledgement that solutions are available and that the Commission is considering them.⁵

The Commission has, in recent proposed rulemaking, considered excepting all swaps that are either exchange-traded or centrally cleared from the AGNA calculation which 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 calculation⁶. In fact, such 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. In the alternative, the Commission could clarify that the Floor Trader Swaps Exclusion should not be read to mean that a registered floor trader would be required to comply with the transaction-specific requirements of the exclusion in respect of its off-exchange, swaps activity. Either way, excepting exchange-traded and centrally cleared swaps from the AGNA determination, or clarifying the Floor Trader Swaps Exclusion so

² 17 CFR 1.3(ggg)(6)(iv)

³ CFTC Staff Letter No. 13–80, No-Action Relief from Certain Conditions of the Swap Dealer Exclusion for Registered Floor Traders (Dec. 23, 2013)

⁴ 17 CFR 1.3(ggg)(6)(iv)(B) and (D)

⁵ <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo65>

⁶ We note that, should the Commission determine it appropriate to move towards excepting all exchange-traded swaps from the AGNA calculation, it should also consider making clear that all Off-SEF Transactions be equally excepted, as such term is discussed more fully in Section II of this letter.

as to confirm when the transaction-specific requirements of the exclusion apply to the swaps activity of registered floor traders, would, we believe, 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.

II. Prime Brokerage Trading Model⁷

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 largely successfully navigated these challenges through thoughtful interpretation of the SEF rules in consultation with Commission staff and outreach to its members and prospective members.

Section 23.431 (a) and (b) of the swap dealer business conduct standards⁸, which standards were introduced to implement Section 4s(h) of the CEA, requires swap dealers, when entering into swaps with certain non-swap dealer counterparties, to provide certain material information (the "**EBC Disclosures**") concerning the swap to the counterparty prior to execution. Such material information includes the material risks of the proposed swap, its material characteristics, and, in the case of swaps that are not made available for trading as provided in Section 2(h)(8) of the Act, certain scenario analysis upon request. However, Section 23.431(c) of the swap dealer business conduct standards (the "**EBC Disclosures Exclusion**") provides that a swap dealer is not required to make the EBC Disclosures to its counterparty if the relevant transaction is:

- “(1) Initiated on a designated contract market or a swap execution facility; and
- (2) One in which the swap dealer or major swap participant does not know the identity of the counterparty to the transaction prior to execution.”

In the trading model of Cboe SEF, a Trading Firm, which is a client of a Prime Broker, enters into transactions on Cboe SEF for the account of its Prime Broker (the "**On-SEF Transaction**") with another participant on Cboe SEF, and the Prime Broker enters into an offsetting transaction with the Trading Firm that is a mirror of the On-SEF Transaction and does not represent a new price forming event, with the execution of that "mirror" transaction occurring off the SEF (the "**Off-SEF Transaction**"). Given that Cboe SEF operates an anonymous electronic trading platform, the exclusion afforded to its Prime Brokers under the EBC Disclosures Exclusion accordingly (and appropriately) applies, relieving the Prime Broker of the obligation to make the EBC Disclosures, as applicable, prior to entering into the On-SEF Transaction. In order for the EBC Disclosures Exclusion to be effective, it is our assumption that it must necessarily apply in respect of the Off-SEF Transaction as well, as it does not represent a new price forming event. Further, but for the execution of the On-SEF Transaction, the Off-SEF Transaction would

⁷ Cboe SEF acknowledges that the arguments contained in this section of our letter have been presented to the Commission in the recent past, and is hopeful that reiterating them in this context is nonetheless helpful.

⁸ 17 CFR 23.431.

not be executed, and is thus said to have been initiated (but not executed) on the SEF. However, a literal construction of Section 23.431(c) leads to some interpretative uncertainty on whether the EBC Disclosures Exclusion is only applicable to the On-SEF Transaction and not to the Off-SEF Transaction. To read the EBC Disclosures Exclusion as applying only to the On-SEF Transaction and not to the Off-SEF Transaction would, we believe, create an impossibility on the part of a swap dealer to comply with the EBC Disclosures in respect of the Off-SEF Transaction in the prime brokerage context, in connection with which its counterparty is still unknown prior to execution.

Cboe SEF encourages the Commission to consider providing interpretive guidance or no-action relief confirming that the Commission will not take action against a swap dealer for failing to make the pre-trade EBC Disclosures in respect of Off-SEF Transactions, as described above, which we believe would encourage more market participants to utilize SEFs in connection with prime brokerage transactions.

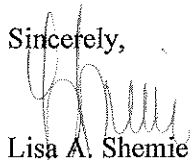
III. Cross-Border Considerations

In December 2017, the Commission, together with the European Commission, issued a joint statement announcing an equivalence decision (the “*Equivalence Determination*”) in respect of certain Commission-authorized contract markets⁹, which venues included Cboe SEF. Following initial enthusiasm, it became clear that the effect of the Equivalence Determination was not as broad as we had hoped, in that it only allowed counterparties in countries within the European Union (EU) to fulfil their trading mandate by trading on such SEFs. Given that NDFs are not the subject of a trading mandate (either under EU law or under the CEA), the Equivalence Determination has had little effect in encouraging EU members to join Cboe SEF. Furthermore, several regulators in individual EU jurisdictions have taken the position that the Equivalence Determination did not obviate the requirement for US SEFs to fulfil such jurisdictions’ own local registration requirements, meaning that, for example, entities under the oversight of such EU jurisdictions are not able to join Cboe SEF without Cboe SEF first having registered as, or having been recognized as, a foreign trading venue in those jurisdictions or otherwise seeking an exemption from registration. We understand that the Commission has continued this dialogue with its European counterparts to further encourage cross-border cooperation on access to trading venues and we are hopeful that additional clarification in this regard may be forthcoming in order to further the Commission’s goal of reducing global market fragmentation.

IV. Conclusion

Cboe SEF appreciates the opportunity to offer its views on how to further promote and strengthen the SEF regime. Please contact the undersigned at 646-856-8814 should there be any questions.

Sincerely,



Lisa A. Shemie
Chief Legal Officer
Cboe SEF, LLC

⁹ https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/171205-joint-statement-ec-cftc_en.pdf