**FINAL**

May 22, 2020

**Filed Electronically at www.cftc.gov**

Christopher Kirkpatrick, Secretary

Commodity Futures Trading Commission

Three Lafayette Centre

1155 21st Street, NW

Washington, DC 20581

**Re: Commodity Futures Trading Commission’s Notice of Proposed Rulemaking: *Swap Execution Facility Requirements and Real-Time Reporting Requirements*, 85 Fed. Reg. 9407 (published February 19, 2020) in RIN 3038-AE94**

Dear Mr. Kirkpatrick:

The International Energy Credit Association (“IECA”) appreciates the efforts of the Commodity Futures Trading Commission (“CFTC” or “Commission”) and its Staff as set forth in the Commission’s proposed revisions to the existing regulations relating to the execution of package transactions on swap execution facilities (“SEFs”); the execution of block trades on SEFs; and the resolution of error trades on SEFs, as set forth in the above-captioned notice of proposed rulemaking (“2020 SEF NOPR”).[[1]](#footnote-1)

In addition to the IECA’s support of the above-mentioned proposals, the IECA respectfully requests that the Commission clarify that (i) “package transactions,” (ii) “error trades,” and (iii) uncleared bilateral swaps in which at least one party has elected the End-User Exception or the Hedging-Affiliate Exception, which are executed on a SEF as Permitted Transactions under Section 37.9(c)(2), are all exempt from the Commission’s prohibition against “pre-arranged trading” under Section 37.203(a) of the Commission’s Regulations, just as “block trades” are explicitly exempt from such prohibition.

**I. General Support of Increased Trade Execution Flexibility for Package Transactions and Error Trades**

The IECA is generally supportive of the Commission’s proposed action which would, among other things, codify increased trade execution flexibility for the execution of package transactions, block trades, and error trades on SEFs pursuant to long-standing no-action letter determinations. Particularly, the Commission’s stated benefits flowing from such codification are of importance to the IECA and its members. Benefits mentioned by the Commission include allowing market participants to choose the most suitable execution methods for the transactions; reducing execution risks; improving negotiation and trade execution efficiency, decreasing transaction costs or other harmful effects to the commodity swaps markets; increasing market liquidity; promoting sound risk management; and capturing the benefits for portfolio management and hedging programs.[[2]](#footnote-2)

Many of the IECA members represent commercial end-users (“CEUs”), which are eligible for, and which elect, the end-user exception to clearing under CEA Section 2(h)(7)(A) (“End-User Exception”) and the hedging-affiliate exception to clearing under CEA Section 2(h)(7)(D) (“Hedging-Affiliate Exception”). As such, their swaps are referred to by the Commission as “Permitted Transactions,” which are exempt from both the clearing requirements of CEA Section 2(h)(1) and the trade execution requirements of CEA Section 2(h)(8).

As the Commission has made clear in Section 37.9(a) of its Regulations, Required Transactions, which are subject to the trade execution requirements of CEA Section 2(h)(8), are currently subject to certain “required” methods of execution, namely an Order Book and a Request for Quote System.

Permitted Transactions, such as uncleared bilateral swap transactions in which at least one counterparty is eligible for and has elected the End-User Exception or the Hedging-Affiliate Exception, are statutorily exempt from the trade execution requirements of CEA Section 2(h)(8) and, as explained in Section 37.9(c)(2) of the CFTC’s Regulations:

(2) Execution methods. A swap execution facility may offer any method of execution for each Permitted Transaction.

As the Commission explained in the 2020 SEF NOPR:[[3]](#footnote-3)

The Commission proposes to amend part 37 to allow the swap components of certain categories of “package transactions” to be executed on-SEF through flexible means of execution pursuant to § 37.9(c)(2), rather than through the required methods of execution under § 37.9 for “Required Transactions.” In addition, the Commission is proposing to amend part 36 to include an exemption from the trade execution requirement for swap transactions that are executed as a component of a package transaction that also includes a component that is a new issuance bond (“New Issuance Bond package transactions”). … The Commission proposes to amend part 37 to establish a principles-based approach for SEF error trade policies that incorporates relief from the required methods of execution under § 37.9 for Required Transactions for trades intended to resolve error trades.”

The IECA supports the Commission’s efforts to allow SEFs to develop innovative new execution methods under Section 37.9(c), as alternatives to the “required execution” methods under Section 37.9, for “package transactions” and “error trades,” as well as “block trades,” which are already allowed by the Commission’s regulations to be negotiated “off SEF” and then introduced onto a SEF for execution.

As the IECA explained in its comments, previously submitted to the Commission on March 15, 2019, in response to the CFTC’s Notice of Proposed Rulemaking: *Swap Execution Facilities and Trade Execution Requirement*, 83 Fed. Reg. 61946, published November 30, 2018, in RIN 3038-AE25 (the “2018 SEF NOPR”):

The IECA supports the proposal in the SEF NOPR to eliminate the current restriction that prohibits SEFs from executing Required Transactions using “any means of interstate commerce” other than an Order Book or a RFQ System. We support allowing SEFs to use any method of execution for Required Transactions, because allowing SEFs this flexibility will encourage SEFs to develop new and innovative trade execution methods for Required Transactions in order for SEFs to compete for a company’s swap business.

While commercial end-users and their hedging affiliates are exempt from clearing and SEF trade execution requirements, if SEFs are able to develop innovative trade execution methods for Required Transactions that will allow SEF-traded swaps to (i) be customized to address the various unique commercial risks being hedged by commercial end-users and (ii) achieve efficiencies and cost-savings that may not be available using uncleared OTC swaps, then commercial end-users and their hedging affiliates will be more likely to take advantage of such efficiencies by choosing to execute more of their swaps on SEFs as Permitted Transactions.

Accordingly, we believe that the development by SEFs of innovative and efficient alternative methods of executing swaps that are Required Transactions, which could be commercially beneficial to market participants that are otherwise exempt from mandatory clearing and trade execution, could present an attractive alternative thereby increasing the use of SEF-traded swaps by commercial end-users and hedging affiliates as Permitted Transactions. To the extent that the number of otherwise exempt swaps are executed on SEFs as Permitted Transactions, we submit that the CFTC would be advancing one of the CFTC’s goals under the Dodd-Frank Act of promoting SEF trading and expanding pre-trade price transparency in the swaps market.

As the Commission explained the relationship between the 2018 SEF NOPR and the 2020 SEF NOPR in footnote 15 of the 2020 SEF NOPR:

“Further, while the proposals and rationales contained herein are, in some cases, identical or similar to the proposals and rationales used in the 2018 SEF Proposal, the Commission believes the context surrounding these two proposals distinguishes them in application and scope. While the Commission received comments on the 2018 SEF Proposal, the Commission believes that it is important for the public to be able to provide comments focused on the facts and circumstances of the proposal at hand. Therefore, comments made on the 2018 SEF Proposal relevant to this rulemaking should be resubmitted as comments to this rule proposal in order to be considered.” [[4]](#footnote-4)

Accordingly, the IECA is restating the above comments, which the IECA filed in support of the CFTC’s proposed relaxing of the “required execution” methods available for SEF’s to apply to Required Transactions under 2020 SEF NOPR, which are copied directly from the IECA’s comments on the CFTC’s 2018 SEF NOPR.

The IECA continues to believe that if SEFs are encouraged to develop innovative execution methods, in lieu of the “required” methods of execution set forth in Section 37.9(a) of the Commission’s Regulations, for “package transactions” and “error trades,” or, as we stated in our comments on the 2018 SEF NOPR, for Required Transactions too, then:

the development by SEFs of innovative and efficient alternative methods of executing swaps that are [package transactions and error trades], which could be commercially beneficial to market participants that are otherwise exempt from mandatory clearing and trade execution, could present an attractive alternative thereby increasing the use of SEF-traded swaps by commercial end-users and hedging affiliates as Permitted Transactions.

The IECA believes that such a policy can further the Commission’s statutory goal in CEA Section 5h(e), which says: “The goal of this section is to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market.”

Generally speaking, we support allowing SEFs to use any method of execution under Section 37.9(c)(2) for “package transactions,” “error trades,” and Permitted Transactions, because allowing SEFs this flexibility will encourage SEFs to develop new and innovative trade execution methods for Permitted Transactions in order for SEFs to compete for a CEU’s and its hedging-affiliate’s swap business.

While CEUs and their hedging-affiliates are exempt from clearing and SEF trade execution requirements, if SEFs are able to develop innovative trade execution methods for Permitted Transactions that will allow SEF-traded Permitted Transactions to (i) be customized to address the various unique commercial risks being hedged by CEUs and (ii) achieve efficiencies and cost-savings that may not be available using OTC uncleared bilateral swaps, then CEUs and their hedging affiliates will be more likely to take advantage of such efficiencies by choosing to execute more of their swaps on SEFs as Permitted Transactions.

**II. Clarifying that the Exception to the Prohibition Against “Pre-Arranged Trading” in Section 37.203(a) Applies to (i) Package Transactions, (ii) Error Trades, (iii) Block Trades, and (iv) Uncleared Bilateral Swaps that are Traded on SEFs as Permitted Transactions**

In addition to the IECA’s support of the above-mentioned proposals, the IECA is concerned with the impacts of the prohibition against “pre-arranged trading” as set forth in Section 37.203(a) of the Commission’s Regulations. That prohibition is explicitly not applicable to “block trades,” but the IECA respectfully requests that the Commission clarify that the prohibition against “pre-arranged trading” also does not apply to “package transactions,” “error trades,” and uncleared bilateral swaps that are traded on a SEF as Permitted Transactions.

As the Commission explained in footnote 70 of its 2020 SEF NOPR:

NAL No. 17–27 also provided relief from § 37.203(a), which prohibits pre-arranged trading, for offsetting trades and correcting trades. The Commission, however, does not view a regulatory amendment corresponding to that relief as necessary. The existing prohibition already provides an exception to that prohibition by allowing a SEF to adopt trading practices that are certified or approved by the Commission pursuant to part 40 of the Commission’s regulations. *See* 17 CFR 37.203(a). Accordingly, the Commission anticipates that a SEF would implement proposed § 37.9(e) by self-certifying or adopting rules subject to Commission review under part 40 that specify the manner in which counterparties may execute offsetting and correcting trades.

We note that the language in Section 37.203(a) of the CFTC’s Regulations recognizes as “Abusive trading practices prohibited” the following:

pre-arranged trading (except for block trades permitted by part 43 of this chapter or other types of transactions certified to or approved by the Commission pursuant to the procedures under part 40 of this chapter)…”

The Commission’s prohibition against pre-execution communications[[5]](#footnote-5) flows from the Commission’s SEF core principles regulations, which prohibit abusive trading practices. As discussed in the Commission’s Notice of Proposed Rulemaking for *Swap Execution Facilities and Trade Execution Requirement*, 83 Fed. Reg. 61,946 (Nov. 30, 2018) (hereinafter, “2018 SEF NOPR”): “The Commission notes that ‘pre-arranged trading’ is prohibited as an abusive trading practice under § 37.203(a)” of its regulations.[[6]](#footnote-6)

The Commission explained that “[t]his prohibition generally applies to market participants who communicate with one another to pre-negotiate the terms of a trade away from a SEF’s trading system or platform, but then execute the trade on such system or platform in a manner that appears competitive and subject to market risk.” [[7]](#footnote-7) The prohibition covers, among other things, “actual negotiation or arrangement of a swap transaction’s terms and conditions prior to execution on a SEF.”[[8]](#footnote-8)

However, notwithstanding the prohibition, SEFs may permit pre-execution communications on their facilities pursuant to the Commission’s regulations in Part 37.[[9]](#footnote-9) Relevantly, the Commission explained that Section 37.203(a) of its regulations (i) states that a SEF may permit pre-execution communications for swaps that it lists to be executed as a “block trade” away from a SEF, and (ii) allows a SEF to permit pre-arranged trading for other types of transactions through rules that are filed with the Commission pursuant to part 40 of its regulations.

Currently, these rules permit pre-execution communications with respect to Required Transactions that are executed as a component of certain categories of package transactions or are intended to resolve error trades; however, such relief is available based on time-limited no-action determinations issued by DMO pursuant to CFTC No-Action Letter No. 14-12,[[10]](#footnote-10) as amended and extended[[11]](#footnote-11) (for package transactions), and CFTC No-Action Letter No. 13-66,[[12]](#footnote-12) as amended and extended[[13]](#footnote-13) (for error trades).

The IECA respectfully requests that the Commission clarify that “package transactions” and “error trades” (as defined within the 2020 SEF NOPR) will be treated similarly to “block trades” with respect to the exception to the prohibition against pre-arranged trading.

**More importantly, the IECA also respectfully requests that the Commission further clarify, in any final rule issued with respect to the 2020 SEF NOPR, that uncleared bilateral swaps that are Permitted Transactions — specifically those uncleared bilateral swaps in which at least one party thereto is eligible for, and has elected, the End-User Exception or the Hedging-Affiliate Exception — will be treated similarly to “block trades,” “package transactions,” and “error trades” and will be exempt from the prohibition against pre-arranged trading, to make it clear that an alternative method of execution proposed by a SEF for Permitted Transactions, that recognizes and allows parties to negotiate an uncleared bilateral swap transaction, where at least one party thereto elects the End-User Exception or the Hedging Affiliate Exception, will not violate the prohibition against pre-arranged trading as an “abusive trading practice” in Section 37.203(a) of the Commission’s Regulations.**

As acknowledged by the Commission in the 2018 SEF NOPR, under current practices:

For swaps that are not subject to the trade execution requirement, i.e., Permitted Transactions, SEFs have allowed their market participants to conduct trading via-pre-execution communications away from their respective facilities and then submit the resulting transaction, with the price terms, and conditions already agreed upon between the participants, to the SEF’s trade capture functionality for execution.[[14]](#footnote-14)

Such current practices appear to be exercised pursuant to Section 37.9(c)(1) and (c)(2), which allows a SEF to offer any method of execution for Permitted Transactions. However, it is currently unclear whether such methods of execution may include prohibited pre-execution communications pursuant to Section 37.203(a), which specifically exempts “block trades,” and by extension in the proposed 2020 SEF NOPR, also exempts “package transactions” and “error trades.”

Because uncleared bilateral swaps that are Permitted Transactions are oftentimes customized in efforts to hedge or mitigate unique risks with respect to a CEU’s commercial business, prohibiting pre-execution communication would not promote the Commission’s objective of maximizing the number of swap transactions traded on SEFs, at least not with respect to Permitted Transactions.

The IECA believes that clarifying that uncleared bilateral swaps that are Permitted Transactions, in which at least one party thereto is eligible for and has elected the End-User Exception or the Hedging-Affiliate Exception, are similarly exempted from the prohibition against pre-execution communications in Section 37.203(a) will add consistency and clarity to SEF markets and may encourage more CEUs to execute such uncleared bilateral swaps as Permitted Transactions on a SEF.

**III. Correspondence Regarding These Comments**

Please direct correspondence concerning this Request to:

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**CONCLUSION**

The IECA appreciates the opportunity to submit these Comments in response to the Commission’s SEF NOPR proposing revisions to the existing regulations relating to the execution of “package transactions” on SEFs; the execution of “block trades” on SEFs; and the resolution of “error trades” on SEFs.

The IECA respectfully requests that the Commission consider these Comments and clarify that (i) “package transactions,” (ii) “error trades,” and (iii) uncleared bilateral swaps in which at least one party thereto is eligible for and has elected the End-User Exception or the Hedging-Affiliate Exception, that are executed on SEFs as Permitted Transactions under Section 37.9(c)(2) of the CFTC’s Regulations, are exempt from the prohibition against “pre-arranged trading” in Section 37.203(a), just as “block trades” are exempt from such prohibition.

We believe such clarification will facilitate the Commission’s goal of increasing the number of Permitted Transactions traded on SEFs, as the Commission moves forward to improve its regulations affecting the commodity markets, market participants, and the fundamental benefits to our economy provided by well-functioning commodity markets. We would welcome the opportunity to discuss these Comments further should you require any additional information on any of the topics discussed herein in.

Yours truly,

INTERNATIONAL ENERGY CREDIT ASSOCIATION

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| */s/ Phillip G. Lookadoo*  Phillip G. Lookadoo, Esq.  Serge B. Agbre, Esq.  Haynes and Boone, LLP | */s/ Jeremy D. Weinstein*  Jeremy D. Weinstein, Esq.  Law Offices of Jeremy Weinstein |

1. The 2020 SEF NOPR’s comment due date of April 20, 2020, was extended to May 22, 2020 pursuant to the Commission’s *Extension of Currently Open Comment Periods for Rulemakings in Response to the COVID-19 Pandemic*, 85 Fed. Reg. 22690 (April 23, 2020). [↑](#footnote-ref-1)
2. *See, e.g.,* 2020 SEF NOPR at 9421. [↑](#footnote-ref-2)
3. *See* 2020 SEF NOPR at 9409 (emphasis added). [↑](#footnote-ref-3)
4. *See* 2020 SEF NOPR at 9409 (emphasis added). [↑](#footnote-ref-4)
5. The Commission defines “pre-execution communications” as communications between market participants to discern interest in the execution of a transaction prior to the exposure of the market participants’ orders (e.g., price, size, and other terms) to the market; such communications include discussion of the size, side of market, or price of an order, or a potentially forthcoming order. To the extent that SEFs would allow their market participants to engage in such pre-execution communications, the Commission required SEFs to adopt associated rules. *Swap Execution Facilities and Trade Execution Requirement*, Proposed Rule, 83 Fed. Reg. 61,946, 61,985 (Nov. 30, 2018) (citing *Core Principles and Other Requirements for Swap Execution Facilities,* 78 Fed. Reg. 33,476, 33,509 (June 4, 2013)). [↑](#footnote-ref-5)
6. *See* 2018 SEF NOPR at 61,985. Section 37.203(a) of the Commission’s regulations states:

   A swap execution facility shall prohibit abusive trading practices on its markets by members and market participants. Swap execution facilities that permit intermediation shall prohibit customer-related abuses including, but not limited to, trading ahead of customer orders, trading against customer orders, accommodation trading, and improper cross trading. Specific trading practices that shall be prohibited include … **pre-arranged trading** (except for block trades permitted by part 43 of this chapter or other types of transactions certified to or approved by the Commission pursuant to the procedures under part 40 of this chapter) … and any other trading practices that a swap execution facility deems to be abusive. 17 C.F.R. 37.203(a) (2019) (emphasis added). [↑](#footnote-ref-6)
7. 2018 SEF NOPR at 61,985. [↑](#footnote-ref-7)
8. *Id*. [↑](#footnote-ref-8)
9. For example, “Section 37.9(b)(1) currently permits a broker or dealer to engage in pre-execution communications to prearrange or pre-negotiate a swap, as long as one side of the resulting transaction is entered into the Order Book for a 15- second delay before the second side is entered for execution against the first side (the “time delay requirement”).” *Id.* [↑](#footnote-ref-9)
10. CFTC Letter No. 14–12, No-Action Relief from the Commodity Exchange Act Sections 2(h)(8) and 5(d)(9) and from Commission Regulation § 37.9 for Swaps Executed as Part of a Package Transaction (Feb. 10, 2014) [↑](#footnote-ref-10)
11. *See, e.g.,* CFTC Letter No. 17–55, Re: Extension of No-Action Relief from Sections 2(h)(8) and 5(d)(9) of the Commodity Exchange Act and from Commission Regulations 37.3(a)(2) and 37.9 for Swaps Executed as Part of Certain Package Transactions (Oct. 31, 2017). [↑](#footnote-ref-11)
12. CFTC Letter No. 13–66, Time-Limited No-Action Relief for Swap Execution Facilities from

    Compliance With Certain Requirements of Commission Regulation 37.9(a)(2) and 37.203(a)

    (Oct. 25, 2013). [↑](#footnote-ref-12)
13. *See, e.g.,* CFTC Letter No. 17–27, Re: No-Action Relief for Swap Execution Facilities and Designated

    Contract Markets in Connection with Swaps with Operational or Clerical Errors Executed on a Swap Execution Facility or Designated Contract Market (May 30, 2017). [↑](#footnote-ref-13)
14. 2018 SEF NOPR at 61,958. [↑](#footnote-ref-14)