

September 28, 2023

*Via electronic submission to CFTC comments portal*

Mr. Clark Hutchinson, Director, Division of Clearing and Risk  
Mr. Vincent McGonagle, Director, Division of Market Oversight  
Ms. Amanda Olear, Director, Market Participants Division  
U.S. Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581

Re: Request for Comment on the Impact of Affiliations of Certain CFTC-Regulated Entities

Dear Mr. Hutchinson, Mr. McGonagle, and Ms. Olear:

The Wholesale Markets Brokers' Association, Americas ("WMBAA")<sup>1</sup> appreciates the opportunity to comment on the U.S. Commodity Futures Trading Commission ("CFTC" or the "Commission") staff request for comment on the impact of affiliations on certain CFTC-regulated entities (the "Request for Comment").<sup>2</sup>

As interdealer brokers and operators of global trading venues for financial instruments, including swap execution facilities ("SEFs"), WMBAA members have a significant interest in any possible rulemakings that would govern the operations and activities of SEFs. In addition, WMBAA member firms have affiliated introducing broker ("IB") participants that execute their respective swaps business on their affiliated SEFs.

It is with decades of experience acting in these capacities that we provide these comments.

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<sup>1</sup> The WMBAA is an independent industry body representing the largest inter-dealer brokers. The members of the group – BGC Partners, GFI Group, Tradition, and TP ICAP – operate globally, including in the North American wholesale markets, in a broad range of financial products, and have received registration as swap execution facilities. The WMBAA membership collectively employs approximately 4,000 people in the United States; not only in New York City, but in Stamford and Norwalk, Connecticut; Chicago, Illinois; Jersey City and Piscataway, New Jersey; Raleigh, North Carolina; Miami and Juno Beach, Florida; Burlington, Massachusetts; and Dallas, Houston and Sugar Land, Texas. Our members and their employees arrange trades that enable sophisticated market participants to manage their commercial and market risk.

<sup>2</sup> Request for Comment on the Impact of Affiliations of Certain CFTC-Regulated Entities (June 27, 2023), <https://www.cftc.gov/media/8826/rfcimpactaffiliations062823/download>.



## **Overview**

WMBAA members have long acted as intermediaries in connection with price discovery, liquidity formation, and the execution from the inception of the over-the-counter swaps. We support the CFTC staff's efforts to promote more transparent markets. However, we also believe that the suggestions posed in the Request for Comment are addressed by current CFTC regulations and current market practices. It is important that the CFTC is mindful of not proposing an overly prescriptive implementation of the Core Principles. Such an approach would impede SEFs in their operations and undermine the primary objectives of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

We welcome the opportunity to inform CFTC staff's understanding of potential conflicts of interest concerns, particularly between SEFs and affiliated IBs in the interdealer market. For the reasons discussed below, we believe that adopting additional measures specific to conflicts of interest could be burdensome and unnecessary given the existing CFTC conflicts of interest rules have proven satisfactory. Moreover, the WMBAA is concerned that if CFTC staff is inclined to take a more prescriptive approach, it could dissuade future entrants into the swaps market and reduce competition.

## **SEFs and Affiliated Intermediaries**

Any proposal to address potential conflicts of interests between SEFs and their affiliated intermediaries must consider the evolution of the swaps market structure. Bilaterally negotiated, bilaterally executed, and uncleared over-the-counter ("OTC") derivatives are widely recognized as a contributing factor to the 2008 financial crisis. In an effort to move the execution of OTC derivatives to a regulated market and improve price transparency, the Dodd-Frank Act created a framework and registration requirement for SEFs.<sup>3</sup> SEFs were defined as 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 facilitates the execution of swaps between persons and is not a designated contract market.<sup>4</sup>

Drawing inspiration from the markets that execute futures and securities transactions, the drafters of the Dodd-Frank Act seemed to envision SEFs as trading facilities that would utilize central limit order books to execute swap transactions. As the Commission quickly recognized in implementing the SEF registration requirement, a standalone central limit order book is a limited tool for the variable and episodic liquidity that is present in many swap markets and would fail to account for hybrid execution methods that allow swaps markets to operate efficiently (*e.g.*, broker work-up or auction processes). To address these issues, the Commission worked with the industry to create a regulatory framework that allowed a market structure that permitted voice brokers to continue to perform their vital services by registering as introducing brokers. These introducing

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<sup>3</sup> Commodity Exchange Act ("CEA") §5h(f)(2)(B)(i).

<sup>4</sup> CEA §1a(50).



brokers solicit and accept orders, source liquidity, and arrange swap transactions that are subsequently executed on a SEF, which is frequently affiliated with the IB. This market structure allows SEFs to leverage the expertise, resources and infrastructure of their affiliated intermediaries and has drastically improved price transparency in the swaps markets to the benefit of market participants and end-user customers.

Any attempt to address potential conflicts of interest that could arise between a SEF and an affiliated intermediary must begin by recognizing that the affiliated intermediary is inextricably linked to the effective operation of a SEF in many markets and provides a commercial and public benefit to those commercial entities who rely on swaps to hedge risk on a regular basis.

#### **Question 24. Impartial Access**

The Request for Comment contemplates whether additional measures should be implemented to ensure affiliated and non-affiliated intermediaries, and their respective customers, receive impartial access.<sup>5</sup> The WMBAA notes that its member's SEFs are already required to provide impartial access to market participants pursuant to CEA Section 5h(b)(3) and CFTC Regulation 37.200. This access is provided through multiple trading modalities, including direct electronic and non-electronic (voice) access, intermediated access, sponsored access, access through prime brokers and other means. These access methods are defined and implemented in each of the SEF's rulebooks. We believe that additional measures would be duplicative given that the CEA and existing CFTC rules require SEFs to provide impartial access to its markets and market services, and WMBAA affiliated SEFs demonstratively support impartial access. Each of the SEFs has incorporated this statutory core principle requirement into its rulebooks, as required by the SEF registration process. This provision has been monitored for compliance in a number of ways, including through SEF rule enforcement reviews.

Within the context of impartial access and consistent with the CFTC's historical principles-based regulation, SEFs should have the discretion to establish a set of objectives and criteria for participation, so long as the criteria is applied in a fair and impartial manner. It is important that SEFs continue to be able to use its own commercial judgments for establishing the criteria for each of its markets and standards for the participants that access the platform in different ways, as long as they do not advantage some participants and disadvantage others.

The current SEF Core Principles impose enforcement obligations to promote fair and impartial access. Core Principle 2 requires SEFs "establish and enforce trading, trade processing, and participation rules that will deter abuses and it shall have the capacity to detect, investigate, and enforce those rules including means to provide market participants with impartial access to the market and to capture information that may be used in establishing whether rule violations have occurred."<sup>6</sup> As there are regulations in place to promote impartial access to SEFs, we do not

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<sup>5</sup> Request for Comment at 13.

<sup>6</sup> 17 C.F.R. § 37.200(b).



believe that there should be an expansion of impartial access requirements. Further, WMBAA members fully believe that, in compliance with SEF Core Principles, each of our member's participants will continue to have impartial access to the respective facilities. Any restrictions on access would be counterproductive to not only the benefits of efficient markets, but also the primary objectives of the Dodd-Frank Act.

### **Question 25. Market Integrity**

SEF Core Principles require the monitoring of trading in swaps to prevent manipulation, price distortion and disruptions of the settlement process.<sup>7</sup> We support the CFTC's overarching goals of promoting increased transparency and oversight in the swaps market. However, we also support the ability of SEFs having reasonable discretion and flexibility in order to meet participant needs. WMBAA members have an active role in preventing manipulation and disruptions in their markets. Moreover, SEFs should continue to have reasonable discretion to determine the appropriate risk controls for its own systems. If a SEF were unable to maintain market integrity, given the competitive landscape for swaps market trading, Participants would immediately depart from that venue and conduct its activity elsewhere. In other words, SEFs have commercial incentives to make sure their markets have robust surveillance, market examination, and enforcement authority to prevent bad actors.

### **Question 29. Execution**

The WMBAA believes that the current regulatory framework for SEFs imposes adequate requirements with respect to trade executions. As the Request for Comment acknowledges, Regulations 37.9 and 37.201 provides for the methods of execution and compliance with SEF rules regarding trade execution. The existing requirements effectively address the potential conflicts of interests that could arise between a SEF and an affiliate in trade execution. Imposing or modifying the existing requirements could have negative consequences on the market structure that participants currently enjoy.

From a market efficiency perspective, the current framework allows for multiple modes of execution which, in turn, broadens participation in the markets. The benefits to liquidity and execution of properly segmented shared resources between SEFs and their affiliates are manifold. SEFs can offer state-of-the-art platforms without the prohibitive costs of developing them independently. Shared communications infrastructure ensures seamless coordination, while co-located office spaces lead to operational efficiencies, including global access to SEF markets for US entities operating in non-US locations. In contrast to designated contract markets, which are subject to execution requirements under Core Principle 9, SEF regulations only require that SEFs develop trading rules.<sup>8</sup> As a principles-based regulatory framework, SEFs have been allowed to develop rules that are appropriate for both their platform and consistent with the CEA.

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<sup>7</sup> CEA §5h(f)(4)(B).

<sup>8</sup> 17 C.F.R. § 37.200(c).



From an operational perspective, the benefits of properly segmented shared resources between SEFs and their affiliates are also manifold. Shared IT infrastructure allows scaling and cost benefits towards complying with the CFTC’s system safeguards, third-party vendor management, cyber security, capacity management, business continuity and similar requirements. Shared office space, human resource and accounting resources allows cost and efficiency benefits to SEFs and subsequently Participants. Unlike futures exchanges, which are permitted to generate revenue from real-time data sales, SEFs are primarily limited to generating revenue from transaction fees and access charges. Properly segregated cost and operations sharing between SEFs and their affiliates is a primary means by which SEFs keep transaction fees minimal for their participants.

With respect to conflicts of interest, SEFs have implemented rigorous procedures to manage potential conflicts of interest between themselves and their affiliates. This includes rulebooks, distinct and transparent governance structures and operational policies that ensure fairness, transparency, and compliance with all applicable laws and regulations. SEFs have responsibilities to surveil, investigate, and discipline participants on their markets (see, e.g., §§ 37.203, 37.204, 37.205, and 37.206). SEFs also are subject to SEF Core Principle 12, which requires a SEF to “minimize conflicts of interest in its decision-making process.” WMBAA SEFs have hired a third-party regulatory service provider and built data separation barriers. Implementing these measures ensures that surveillance remains independent even if other resources are shared.

While addressing conflicts of interest in markets is of utmost importance, we encourage CFTC staff to consider the potential impact on the flexibility that the current regulations permit. SEFs are acutely aware of the potential conflicts of interest that can arise between themselves and their affiliates. To manage these conflicts, many SEFs have implemented robust market surveillance, governance structures and policies. These include clear segregation of duties, transparent reporting mechanisms, and regular audits.

Additionally, SEFs have established independent oversight committees to ensure that decisions are made in the best interest of all market participants. This flexibility is what allows U.S. markets to remain competitive while also allowing SEFs to meet the servicing needs of market participants. We believe that that CFTC rules already appropriately account for conflicts of interest with respect to swap execution methods, and that mandating additional protocols for execution is unnecessary.



**Conclusion**

We support the overall goals of CFTC staff and believe that mitigating conflicts of interest is essential to proper regulatory oversight of the derivatives market. As discussed above, WMBAA members want to emphasize the equal importance of flexibility for SEFs to maintain an open, non-discriminatory, liquid and competitive market structure. When contemplating potential rules to address conflicts, we respectfully urge CFTC staff to consider whether additional rules would disturb the trading activities and operations of SEF participants.

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We thank the CFTC staff's willingness to consider our opinions and welcome the opportunity to discuss these issues further.

Sincerely,

A handwritten signature in dark ink, appearing to read "Shawn Bernardo". The signature is fluid and cursive.

Shawn Bernardo

cc: The Honorable Rostin Behnam, Chairman  
The Honorable Kristin N. Johnson, Commissioner  
The Honorable Christy Goldsmith Romero, Commissioner  
The Honorable Summer K. Mersinger, Commissioner  
The Honorable Caroline D. Pham, Commissioner