MANAGED FUNDS ASSOCIATION

WRITTEN STATEMENT

OF

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DIRECTOR, GOVERNMENT & REGULATORY POLICY,
CITADEL LLC

ON BEHALF OF
MANAGED FUNDS ASSOCIATION

For the Hearing
To Review the Impact of G-20 Clearing
and Trade Execution Requirements

BEFORE THE

U.S. HOUSE COMMITTEE ON AGRICULTURE
SUBCOMMITTEE ON COMMODITY EXCHANGES, ENERGY & CREDIT

JUNE 14, 2016

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WRITTEN STATEMENT OF MANAGED FUNDS ASSOCIATION

To Review the Impact of G-20 Clearing and Trade Execution Requirements

June 14, 2016

Chairman Scott, Ranking Member Scott, my name is Stephen Berger and I am the Director, Government & Regulatory Policy, of Citadel LLC. Citadel is a global financial firm built around world-class talent, sound risk management, and innovative market-leading technology. For more than a quarter of a century, Citadel's hedge funds and capital markets platforms have delivered meaningful and measurable results to top-tier investors and clients around the world. Citadel operates in all major asset classes and financial markets, with offices in the world's leading financial centers, including Chicago, New York, San Francisco, Boston, London, Hong Kong, and Shanghai.

I am here today to speak on behalf of Managed Funds Association ("**MFA**") and its members regarding the impact of the G-20 clearing and trade execution requirements for OTC derivatives. MFA represents the majority of the world's largest hedge funds and is the primary advocate for sound business practices for hedge funds, funds of funds, managed futures funds, and service providers. MFA's members manage a substantial portion of the approximately $3 trillion invested in hedge funds around the world. Our members serve pensions, university endowments, and other institutions.

MFA's members are among the most sophisticated investors and play an important role in our financial system. They are active participants in the commodity and securities markets, including over-the-counter ("**OTC**") derivatives markets. They provide liquidity and price discovery to capital markets, capital to companies seeking to grow or improve their businesses, and important investment options to investors seeking to increase portfolio returns with less risk, such as pension funds trying to meet their future obligations to plan beneficiaries. MFA members engage in a variety of investment strategies across many different asset classes. As investors, MFA members help dampen market volatility by providing liquidity and pricing efficiency across many markets. Hedge fund managers are fiduciaries that invest funds on behalf of institutional and high-net worth investors. Our members' skills help their customers plan for retirement, honor pension obligations, and fund scholarships, among other important goals.

As part of their asset management strategies, MFA members are active participants in the derivatives markets, and have consistently supported reforms to the OTC derivatives markets in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**") that mitigate systemic risk, increase transparency, and promote an open, competitive, and level playing field. We welcomed the market's transition to central clearing for liquid, standardized swaps that occurred over the course of 2013, and actively engaged in the market's evolution of trading liquid, standardized, cleared swaps on registered swap execution facilities ("**SEFs**") that commenced in 2014.

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As a result, MFA has a strong interest in the successful implementation of central clearing and organized trade execution in the OTC derivatives markets, which further the goals of the G-20 and the Dodd-Frank Act to mitigate systemic risk and provide open and accessible markets for investors. In this respect, we believe there are several additional steps that the Commodity Futures Trading Commission ("**CFTC**") should take to promote further central clearing and the market's transition to trading on SEFs. These steps include: (1) expanding mandatory central clearing of interest rate swaps ("**IRS**") to include swaps denominated in all the G-10 currencies; (2) further working with the Securities and Exchange Commission ("**SEC**") to develop a viable portfolio margining regime for cleared credit default swaps ("**CDS**") as mandated by Congress in the Dodd-Frank Act, (3) codifying existing CFTC staff guidance addressing impartial access to SEFs; (4) clearly prohibiting post-trade name disclosure by SEFs that offer anonymous execution of cleared swaps; and (5) making certain other targeted amendments to its final SEF rules to improve the overall trading regime. In addition, we believe the Basel Committee on Banking Supervision ("**Basel Committee**") should modify its treatment of segregated initial margin for centrally cleared derivatives for purposes of the Basel III leverage ratio to ensure that central clearing remains affordable for customers.

On behalf of MFA, I appreciate the Committee's review and oversight of the impact of the G-20 clearing and trade execution requirements. MFA has consistently provided constructive comments and suggestions to regulators to help implement these mandates. We believe our comments are consistent with the Committee's public policy goals and will further enhance the benefits of OTC derivatives markets. As active participants in the U.S. markets for OTC derivatives, we would like to work with the G-20 countries, Congress, the Committee, the CFTC, and all other interested parties to further the optimal implementation of the clearing and trade execution rules, which will reduce systemic risk, ensure affordable and impartial access to our financial markets, and strengthen our Nation's economy.

CENTRAL CLEARING AND ITS U.S. IMPLEMENTATION

MFA has consistently supported policymakers' efforts to reduce systemic risk in the derivatives markets by transitioning standardized and liquid OTC derivative contracts into central clearing. The implementation of central clearing was a central goal of the 2009 G-20 commitments and the U.S. has been at the forefront of the move to central clearing.

MFA believes that central clearing has reduced systemic risk by eliminating the complex, interconnected web of counterparty exposures and replacing it with a safer system where all counterparties face a single well-regulated central counterparty ("**CCP**"). Today, the prominent CCPs serving the U.S. market are operated by CME Group ("**CME**"), the Intercontinental Exchange, Inc. ("**ICE**"), and LCH.Clearnet ("**LCH**"). While not all derivatives products have sufficient liquidity to merit being made subject to the mandatory clearing requirement, in the U.S., we have seen the

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successful implementation of central clearing for a significant portion of the IRS and index CDS markets.

The progress in implementing central clearing in the U.S. has been impressive. According to CFTC Chairman Timothy Massad, approximately 75% of outstanding U.S. swap transactions (measured by notional value) are being cleared, as compared to only 16% in 2007.[1] In particular, the progress in implementing central clearing for end-users and other customers of OTC derivatives has been notable. LCH has approximately $21.3 trillion notional of customer IRS transactions outstanding.[2] At CME, open interest in IRS is approximately $17.7[3] trillion notional, and predominantly driven by customers. Finally, ICE has cleared approximately $20.8 trillion notional of index CDS for customers.[4]

As a result, in MFA's view, the implementation of central clearing in the U.S., thus far, has been successful and made our financial system much safer. In particular, we believe that central clearing has greatly benefitted the market by:

- Mitigating systemic risk and reducing the risk of contagion;
- Providing a mechanism for the orderly unwind of the portfolio of a defaulting market participant that is also designed to protect non-defaulting customers from losses;
- Promoting discipline with respect to margin and collateral practices;
- Improving market transparency;
- Increasing competition among potential trading counterparties and liquidity providers; and
- Supporting the migration of trading onto more open, transparent, trading venues.

In addition, the CFTC has enhanced the integrity of the execution-to-clearing workflow by implementing straight-through processing ("**STP**") requirements. The CFTC's STP rules require clearing members to conduct pre-execution credit checks in order to pre-empt post-execution rejections of trades submitted for clearing, and to establish strict timeframes around how quickly an executed trade must be submitted to, and accepted or rejected by, a CCP. As a result, these STP requirements strengthen

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[1] Remarks of Timothy G. Massad before the Swaps Execution Facilities Conference (SEFCON V), November 12, 2014, available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-4.

[2] *See* LCH Daily Volumes – SwapClear Global, available at: http://www.lch.com/en/asset-classes/otc-interest-rate-derivatives/volumes/daily-volumes-swapclear-global.

[3] *See* CME Open Volume Tracker, available at: http://www.cmegroup.com/education/cme-volume-oi-records.html.

[4] *See* https://www.theice.com/clear-credit.

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market resilience, enhance risk management, protect investors by reducing counterparty risk, and promote overall market transparency and efficiency. Importantly, the CFTC's STP rules established a standard that has now been adopted by the European Union ("**EU**") in the context of implementing the Markets in Financial Instruments Directive ("**MiFID II**").

While not all of the G-20 countries have implemented mandatory clearing requirements, we appreciate the positive steps taken by many countries to achieve harmonization and implementation of central clearing on a global basis. For example, mandatory central clearing of certain OTC derivatives will begin in the EU later this month. In addition, central clearing has already begun in Australia and Mexico, and is expected to begin soon in other countries, including Canada, Hong Kong, Singapore, and Switzerland. Notably, in light of these global developments, the CFTC has recently proposed to expand the central clearing requirement in the U.S. to harmonize with these foreign jurisdictions.[5] Lastly, we applaud the CFTC and the European Commission for reaching an agreement on a common approach to the regulation of CCPs earlier this year.[6] This agreement will help to ensure that the G-20 goal of global, harmonized OTC derivatives regulation is fully achieved.

EXPANDING CENTRAL CLEARING OF IRS TO OTHER CURRENCIES

Consistent with the CFTC Additional IRS Proposal, MFA supports the expansion of central clearing to IRS denominated in additional currencies.

Under current CFTC rules, the clearing requirement applies only to IRS denominated in the G4 currencies, which include U.S. Dollars, Euros, Japanese Yen, and British Pound Sterling. MFA believes that the clearing mandate should be expanded to include IRS denominated in all of the G-10 currencies[7] because those additional IRS classes are traded in significant volumes globally.

The CFTC Additional IRS Proposal to expand the clearing mandate would apply to IRS denominated in Australian dollars, Swiss francs, Canadian dollars, Mexican pesos, Polish zloty, Swedish Krona, Norwegian Krone, Hong Kong dollars, and Singapore dollars. The European Commission has also recently adopted final regulatory technical

[5] *See* CFTC notice of proposed rulemaking on "Clearing Requirement Determination under Section 2(h) of the CEA for Interest Rate Swaps" ("**CFTC Additional IRS Proposal**"), available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/federalregister060916.pdf.

[6] *See* The United States Commodity Futures Trading Commission and the European Commission: Common approach for transatlantic CCPs, 10 February 2016, available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/speechandtestimony/eu_cftcstatement.pdf.

[7] The G-10 currencies are the U.S. Dollar (USD), Euro (EUR), Japanese Yen (JPY), British Pound (GBP), Swiss Franc (CHF), Australian Dollar (AUD), New Zealand Dollar (NZD), Canadian Dollar (CAD), Swedish Krona (SEK), and Norwegian Krone (NOK).

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standards that expand the EU clearing mandate to IRS denominated in Polish zloty, Swedish Krona, and Norwegian Krone.[8] The CME and LCH already clear IRS denominated in these currencies and market participants already voluntarily clear a significant amount of these instruments.

Consistent with the goal of reducing systemic risk through the international convergence of central clearing, MFA believes that transitioning IRS denominated in the G-10 currencies to the clearing requirement is appropriate and timely.

ENSURING THE AFFORDABILITY OF CUSTOMER CLEARING

Customers are a vital part of the derivatives markets and have been critical to the success of central clearing in the U.S. While some clearing of swaps between dealers existed prior to enactment of the Dodd-Frank Act, artificial barriers to entry prevented customers from similarly participating in the cleared swaps market. Implementation of the central clearing requirement eliminated many of those artificial barriers and resulted in substantial customer clearing.

However, at present, swaps customers exclusively access CCPs indirectly through clearing members, rather than becoming direct members of CCPs, for a variety of reasons, both financial and operational. MFA expects the demand for clearing services to increase as regulators in different jurisdictions fully implement their respective mandatory clearing initiatives. As a result, it is critical that customer clearing services remain available at an affordable price to ensure that customers have fair and equal access to CCPs.

MFA has strong concerns about the Basel Committee's treatment of segregated initial margin for centrally cleared derivatives exposure under the Basel III leverage ratio ("**Leverage Ratio**") because it threatens the ability of customers to use centrally cleared derivatives and could limit the ability of end-users to hedge their risks.

CCPs' risk management methodologies are predicated on the collection of initial margin and variation margin from clearing members and customers in order to collateralize potential exposure. In addition, direct clearing members guarantee payment of their customers' obligations to the CCP. Because the initial margin is the customer's money,[9] CFTC rules require clearing members to segregate customer funds from the clearing member's own assets.

[8] *See* European Commission Delegated Regulation (EU) .../... of 10.6.2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation, 10 June 2016, available at: http://ec.europa.eu/finance/financial-markets/docs/derivatives/160610-delegated-regulation_en.pdf.

[9] Under CFTC rules, a clearing member must separately account for, and segregate as belonging to the customer, all money, securities and property it receives from a customer as margin. *See* 17 C.F.R. §§ 1.20-

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While the Basel Committee's framework captures a clearing member's guarantee to the CCP as an off-balance sheet exposure, the Leverage Ratio fails to provide an offset that recognizes the exposure-reducing effect of customers' segregated initial margin. According to the Basel Committee, the reason for the lack of an offset for customer initial margin is that segregated customer initial margin not only offsets exposures, but also can be used by the clearing member for further leverage. In the U.S., segregation rules severely restrict the ability of initial margin to be held in anything other than extremely low-risk and extremely liquid assets, assuring that it is always available to absorb losses ahead of the bank.[10] Moreover, the substantial majority of segregated initial margin is posted to the CCP, and therefore, is entirely outside the control of the clearing member.[11]

The Leverage Ratio's failure to recognize the purpose of segregated initial margin is a threat to the use of cleared derivatives by customers. Because of the lack of offset, clearing members will incur large Leverage Ratio exposures, which will likely raise prices for customer clearing significantly. The Leverage Ratio, as currently structured, is estimated to increase significantly the cost of using cleared derivatives.[12] This substantial cost increase may cause customers to reduce their hedging activities to levels that are inadequate to manage their risk, which could result in price increases and volatility for food, gasoline, and other consumer goods.

Therefore, to ensure the continued affordability and robustness of customer clearing in the U.S., we respectfully request that the Committee encourage the Basel Committee to modify the Leverage Ratio by providing an offset for clearing members to the extent that customer initial margin is posted to the CCP, or is segregated under the U.S. regulatory regime.

1.30; 17 C.F.R. §§ 22.2-22.7; *see also* CFTC Chairman Timothy Massad, Testimony before the U.S. House Committee on Agriculture (Feb. 12, 2015).

[10] In the United States, segregated margin cannot be reinvested except for investments in low-risk and highly liquid assets, such as U.S. government securities, managed "with the objectives of preserving principal and maintaining liquidity". *See* 17 C.F.R. § 1.25(b).

[11] Applicable U.S. margin and CCP regulations result in a significant majority of margin being passed onto the CCP. Although margin rules vary across jurisdictions outside of the U.S., non-U.S. margin frameworks for centrally cleared derivatives generally result in a substantial portion of margin held at the CCP rather than the clearing member.

[12] The Commodity Markets Council ("**CMC**") estimates that the Leverage Ratio, as currently structured, would increase the cost of using cleared derivatives by more than five times current levels. This estimate is based on conversations by CMC members with clearing members. The increase in costs would be due to increased fees for cleared derivatives. CMC and MFA members also anticipate incurring business costs due to their diminished ability to hedge commercial and financial risks. *See also*, Fiona Maxwell, *Non-bank FCMs unlikely to fill OTC gap*, Risk, Oct. 7, 2015, available at: http://www.risk.net/risk-magazine/news/2429225/non-bank-fcms-unlikely-to-fill-otc-gap#.

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ENSURING A VIABLE PORTFOLIO MARGINING REGIME

The Dodd-Frank Act divided jurisdiction over OTC derivatives between the CFTC and the SEC. For CDS, the CFTC has jurisdiction over most CDS indices, while the SEC has jurisdiction over single-name CDS. The CFTC has mandated clearing of certain CDS indices, but the SEC has not yet issued a clearing mandate for single-name CDS. However, a number of MFA members would like to voluntarily clear single-name CDS in order to take advantage of the portfolio margining benefits arising from offsetting positions in cleared index CDS and single-name CDS.

Portfolio margining simply means recognizing the offsetting positions within a cleared OTC derivatives portfolio, resulting in margin efficiencies. Section 713 of the Dodd-Frank Act specifically encouraged the SEC and the CFTC to work together to implement a regulatory framework that facilitates portfolio margining.

ICE has an offering that enables market participants to clear both index CDS and single-name CDS in a CFTC-regulated account under the Commodity Exchange Act, as amended ("**CEA**"). In 2011, both agencies issued orders approving ICE's portfolio margining regime for dealers' proprietary CDS positions. Over a year later, both agencies approved ICE's portfolio margining regime for customers. However, the SEC's approval order imposed a number of conditions on ICE and clearing member firms seeking to offer a CDS customer portfolio margining program.

Notably, each clearing member firm is required to establish its own margin methodology that is different from the margin methodology of the CCP and must submit its margin methodology to the SEC for review and approval. The requirement for each clearing member to have its own margin methodology undermines one of the fundamental benefits of central clearing, which is the ability for all market participants to rely on the same, fully vetted and approved margin methodology maintained by the CCP. In addition, it reduces transparency for clearing customers, as it is difficult to evaluate and compare the different margin methodologies separately established by each clearing member.

In our view, the requirements imposed by the SEC have delayed voluntary buy-side clearing of single-name CDS, with resulting adverse effects on trading volume and liquidity. We urge the SEC to use the CCP's vetted and approved margin methodology as the baseline, with clearing members able to collect additional margin as they deem appropriate according to their assessment of a clearing customer's credit risk. This approach will enable a viable portfolio margining regime for cleared CDS as mandated by Congress in the Dodd-Frank Act.

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SWAP EXECUTION FACILITIES AND THE TRADE EXECUTION REQUIREMENT

MFA continues to support the Dodd-Frank Act's goal of transitioning the trading of standardized, liquid, cleared swaps onto SEFs that provide open and impartial access and enable the emergence of an "all-to-all" market (where multiple market participants are able to meet and transact). MFA believes the CFTC SEF framework benefits the swaps market and its participants by increasing market efficiency, competition, transparency and liquidity. In fact, according to recent Bank of England research, the implementation of the clearing and trading reforms in the U.S. interest rate swaps market has already yielded significant improvements in pricing and liquidity, with market participants saving as much as $20 million - $40 million per day, of which $7 million - $13 million is being saved by market end-users alone per day.[13]

While the SEF market continues to evolve, MFA believes the current SEF regime can be enhanced by the CFTC taking certain additional steps to address the current two-tier market structure and the legacy practice of post-trade name disclosure on SEFs that offer anonymous execution of cleared swaps.

TWO-TIER MARKET

Nearly three years after the launch of the SEF marketplace, MFA is concerned that the swaps market remains bifurcated between "dealer-to-dealer" or inter-dealer broker ("**IDB**") SEFs that exclude most buy-side firms and "dealer-to-customer" (or "**D2C**") SEFs.

- IDB SEFs: In one tier, the IDB SEFs offer central limit order books ("**CLOBs**") and voice-brokered request-for-quote ("**RFQ**") models, among others, with trading on an anonymous basis but the identities of counterparties revealed post-trade. While IDB SEFs may have onboarded a number of buy-side firms, there is no meaningful buy-side trade execution and participation on IDB SEFs.

- D2C SEFs: In the second tier, D2C SEFs offer electronic RFQ systems, which effectively require the buy-side to trade with dealers by requesting quotes on a name-disclosed basis. Although D2C SEFs provide order books, there is

[13] *See* Staff Working Paper No. 580 "Centralized trading, transparency and interest rate swap market liquidity: evidence from the implementation of the Dodd-Frank Act", Bank of England (January 2016), available at: http://www.bankofengland.co.uk/research/Documents/workingpapers/2016/swp580.pdf.

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more limited liquidity available. Nearly all SEF trading volume by the buy-side occurs on two dominant D2C SEFs via name-disclosed RFQ.

This two-tier market structure prevents the buy-side from accessing important pools of liquidity for cleared swaps, including the liquid order books. This market structure also confines the buy-side to a "price-taker" role, rather than providing the opportunity to become a "price-maker" as well.

MFA believes that the persistence of the two-tier swaps trading market structure "*status quo*" is contrary to Congress's reform goals. It is inconsistent with the Dodd-Frank Act's express impartial access requirement for SEFs.[14] In our view, the *status quo* needs to change to improve competition and market liquidity.

Impartial access has contributed to the health and vitality of several other significant markets (such as equities and futures markets, where any participant can "make" or "take" prices). By contrast, the two-tier swaps market structure perpetuates traditional dealers' control of liquidity and protects their role as exclusive "price makers". It also limits the manner and extent to which buy-side participants may interact in the swaps market. Such structural limitations on liquidity provision and risk transfer may increase the likelihood of market volatility and instability over the long term. The willingness and capacity of traditional dealers to allocate balance sheet (*i.e.*, for dealers to use their own funds) to swaps market-making activities appears to be diminishing in certain respects. This trend will likely continue over time as traditional dealers continue to restructure their businesses post-financial crisis and adapt to new capital, leverage, and liquidity requirements under Basel III and similar rules. Without swaps market reforms that facilitate impartial access to all SEFs and encourage alternative forms of price formation and liquidity provision and greater diversity of participation (among participants and modes of interaction), MFA fears that the U.S. swaps market could risk greater volatility and dislocation in times of market stress.

Congress designed the swaps market reforms under Title VII of the Dodd-Frank Act to produce a more competitive and transparent swaps market structure. Based on the examples set by other significant trading markets noted above, MFA believes that true impartial access, once implemented and enforced, will provide a stronger foundation for U.S. swaps market liquidity and enhance price transparency in the U.S. swaps market. This outcome will contribute beneficial effects to the Nation's economy.

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[14] Pub. L. 111-203, 124 Stat. 1376 (2010). Section 733 of the Dodd-Frank Act amends the CEA to require, in pertinent part, that SEFs both establish and enforce participation rules and have the capacity to enforce those rules, including the means to provide market participants with impartial access to the market. *See also* CFTC rule 37.202 in the CFTC final rule on "Core Principles and Other Requirements for Swap Execution Facilities", 78 Fed. Reg. 33476, 33587 (June 4, 2013), available at: https://www.gpo.gov/fdsys/pkg/FR-2013-06-04/pdf/2013-12242.pdf.

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POST-TRADE NAME GIVE-UP

A key mechanism suppressing buy-side trading on IDB SEFs and directly contributing to the current two-tier market structure in the U.S. is the legacy practice of post-trade name disclosure (or "give up"). We believe that a SEF that imposes access limitations that deter buy-side participation in its market contravenes the impartial access requirement. Even though otherwise eligible buy-side participants have access to all SEFs in theory, the loss of anonymity caused by the continuation of post-trade name disclosure is a strong disincentive to buy-side participation in IDB SEFs in practice.

The practice of post-trade name give-up originates in anonymous markets for *uncleared* swaps. Participants in the uncleared swaps market reasonably need to limit the firms with which they may trade in order to manage counterparty credit risk. Further, to record each new bilateral swap with a given counterparty on their books, participants need to learn the identity of the counterparty with whom they were matched. Thus, post-trade name disclosure and the attendant limitations on interactions among market participants are justified in the uncleared swaps markets where counterparties have credit exposure to each other.

While the practice may have served a purpose prior to the implementation of the current swaps trading and clearing regime, today it needlessly reveals the identities of counterparties to otherwise anonymous cleared trades. In the early days of the cleared swaps market, counterparties used post-trade name disclosure to coordinate submission of trades to clearing after trade execution. However, the successful implementation of STP for SEF-executed trades, including the pre-trade credit check process, has eliminated any need to use post-trade name disclosure to either manage counterparty credit risk or facilitate clearing submission. Post-trade name disclosure nevertheless continues to occur as a routine practice on IDB SEFs.

MFA strongly believes that for swaps that are anonymously executed and then immediately cleared, there is no legitimate reason for a party to the cleared swap to know the identity of its original executing counterparty. Once the CCP accepts the trade for clearing, the trade exists only as a cleared trade. The obligations to perform on a cleared trade run only between the CCP and the party to the trade (and, where applicable, its agent clearing member). In a cleared trade, the CCP is the sole counterparty to each of the original transacting parties, and, again, the original transacting parties have no rights or responsibilities with respect to each other.

As a result, we firmly believe that the legacy practice of post-trade name disclosure no longer has a legitimate commercial, operational, credit or legal justification in cleared swap markets where transacting parties face the clearinghouse and are not exposed to each other's credit risk following trade execution.

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Adverse Effects of Post-Trade Name Disclosure in the Current Swaps Trading and Clearing Regime

Among its other adverse effects, post-trade name disclosure is a source of random and uncontrolled "information leakage" of private information on SEFs that offer anonymous execution of cleared swaps. It deters buy-side firms from trading on IDB SEFs because it reveals a firm's private trading positions and trading strategies to competitors or dealers. By doing so, post-trade name disclosure appears inconsistent with CFTC rules prohibiting access to private trading information. In contrast, when a buy-side firm discloses its identity and trading interests in the RFQ market, a buy-side firm has control of the associated "information leakage" because it can choose to whom it sends an RFQ.

Prohibiting post-trade name disclosure on SEFs would protect the privacy of an original counterparty's identifying information as required by CFTC rule 49.17(f)(2), as amended. In response to concerns that MFA and other market participants raised that the identity of counterparties to anonymously executed swap trades could be inadvertently revealed post-trade by a swap data repository ("**SDR**"), the CFTC voted unanimously to adopt an interim final rule that amended the scope of CFTC rule 49.17(f)(2) by making explicit the limitation on counterparty access to data and information related to an anonymously executed, cleared swap that applies to SDRs by virtue of the privacy requirements of CEA section 21(c)(6). Without further regulatory action to prohibit the practice of post-trade name disclosure, a counterparty can continue to obtain the identities of its original transacting parties from the SEF or from the affirmation hub that processes the SEF's trades, even though the SDR is required to protect the privacy of such information. Because section 21(c)(6) of the CEA mandates the privacy requirement imposed under CFTC rule 49.17(f)(2), MFA believes that allowing a SEF to facilitate or permit post-trade name disclosure frustrates clear Congressional intent.

Post-trade name disclosure also perpetuates informational and trading advantages for traditional dealers that benefit from their ability to access and achieve full visibility into both the inter-dealer and dealer-to-customer markets. Buy-side firms do not have true impartial access to the IDB SEFs that offer anonymous execution through CLOBs and other execution models due to the continued practice of post-trade name disclosure. MFA believes that the continuation of this practice creates an uneven playing field and impairs competition, as it reduces pre-trade price transparency for otherwise qualified buy-side market participants and restricts their ability to trade certain swap products anonymously.

Due to the nature of liquidity in swap markets, it is unlikely that the market will resolve this artificial barrier to buy-side participation on IDB SEFs on its own. Post-trade name disclosure appears inconsistent with the letter and intent of the Dodd-Frank Act's swaps market reforms and CFTC rules, and in our view the CFTC has ample authority to prohibit this practice. MFA believes that regulatory action to prohibit post-trade name disclosure would increase the volume of buy-side trading on SEFs as it would attract more users and thus more trading volume to these platforms, and allow more flexible and efficient execution of both outright swaps and package transactions.

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While some argue that market dynamics will address post-trade name disclosure and its adverse effects, we respectfully disagree. Commercial and competitive dynamics make it difficult for any one IDB SEF to disable post-trade name disclosure unilaterally, as traditional dealers that opposed such a change might easily shift their trading to other IDB SEFs. This is a classic case where only the regulator can readily bring competition and fairness to the market by eliminating post-trade name disclosure on any SEF that offers anonymous execution of cleared swaps. Doing so will increase the diversity, breadth, and depth of liquidity on SEFs and thereby reduce the potential for market volatility and disruptions.

MFA is aware of several arguments to preserve the practice of post-trade name disclosure on IDB SEFs. We summarize below our counter-arguments based on the extensive swaps trading experience of many MFA members.

- *Post-Trade Name Disclosure is Not Necessary to Deter "Gaming".* Some have argued that the practice of post-trade name disclosure should be preserved to prevent buy-side firms from "gaming" the market. Proponents of this view claim that buy-side firms could post a low resting bid (or high resting offer) in an anonymous CLOB, and then solicit a dealer through an RFQ to motivate the dealer to lower its price in reliance upon the price level posted in the CLOB. This theoretical risk exists in any market that employs both anonymous and disclosed trading protocols and historically, has not risen to a level of serious concern. The Treasury securities and foreign exchange markets, for example, have operated for years with both anonymous and disclosed execution channels, and participants have been able to trade across both without concerns of gaming. Nothing about the swaps market necessitates a different policing paradigm from other markets. Further, SEF CLOBs require market participants to post *firm* resting bids/offers. SEF participants that attempt to "game" dealers on pricing would be at risk of their firm offers being matched, resulting in potentially unfavorable positions. The likelihood of detection for engaging in any gaming behavior, regardless of whether or not a SEF uses post-trade name disclosure in its market, also serves as a strong deterrent. Such actions carry serious reputational and enforcement risks that buy-side market participants naturally avoid.

- *Post-Trade Name Disclosure Does Not Facilitate Dealer Capital Allocation.* Contrary to some claims, MFA believes that post-trade name disclosure does not help dealers in allocating their capital among their customer base. In an anonymously executed market, there is no affirmative decision by a dealer to direct business to a particular counterparty based on a pre-existing relationship, or to reward loyal customers with better prices — the parties are transacting only on the basis of *anonymously* posted bids and offers. The pricing for a particular swap does not change when the parties' identities are disclosed to each other *post*-execution. MFA does not expect that the elimination of post-trade name disclosure will have any impact on future pricing of such swap trades, because trading decisions are not based on the identity of the counterparty to begin with.

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- *Concerns that Dealers Will Provide Less Liquidity to Markets Without Post-Trade Name Disclosure Lack Precedent in Similar Markets*. In electronic order-driven trading markets, it should not matter whether a dealer's counterparty is another dealer or a buy-side firm. Thus, these markets should remain anonymous to create a level playing field for all participants. Further, as the willingness and capacity of traditional dealers to allocate balance sheet to swaps market-making activities appears to be diminishing in certain respects due to Basel III's higher capital requirements, regulatory steps that promote impartial access to all SEFs encourage alternative forms of price formation and liquidity provision and greater diversity of participation (among participants and modes of interaction). These steps are essential investments for building a more robust and competitive swaps market in our country.

In MFA's view, the unintended consequence of regulatory inaction may be increased volatility in the U.S. swaps market. It is time for the CFTC to exercise its regulatory authority to prohibit post-trade name disclosure for anonymously executed, cleared swaps. By doing so, the CFTC will promote the transition to SEFs that operate in accordance with Dodd-Frank's contemplated reforms for the U.S. swaps market. We anticipate that regulatory prohibition of this practice will encourage greater voluntary trading by buy-side firms on IDB SEFs and make the SEF regime more attractive internationally, as a result of the true impartial access to these markets.

MFA petitioned the CFTC for this rule change as well as other rule changes to improve the SEF regime, as discussed below. We respectfully urge the Committee to support such changes at the CFTC.

PROPOSED SEF-RELATED RULE AMENDMENTS

MFA urges the CFTC to modify and update its SEF-related rules in light of experience with SEF trading. In October 2015, MFA submitted a petition to the CFTC to amend certain provisions of its regulations related to OTC derivatives trading on SEFs, based on MFA members' experiences to date and the "lessons learned" through the implementation process.[15] MFA's proposed amendments would: (1) codify existing CFTC staff guidance around the implementation of the CFTC's impartial access requirements; (2) codify existing CFTC staff guidance around the implementation of the CFTC's STP requirements; (3) clearly prohibit post-trade name disclosure by SEFs for swaps that are executed anonymously; (4) facilitate SEF execution of package

[15] *See* MFA Petition for Rulemaking to Amend Certain CFTC Regulations in Parts 1 (General Regulations under the Commodity Exchange Act), 39 (Derivatives Clearing Organizations, Subpart B – Compliance with Core Principles) and 43 (Real-Time Public Reporting), submitted to Mr. Christopher Kirkpatrick, Secretary of the Commission, on October 22, 2105, available at: https://www.managedfunds.org/wp-content/uploads/2015/10/CFTC-Petition-for-SEF-Rules-Amendments-MFA-Final-Letter-with-Appendix-A-Oct-22-2015.pdf.

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transactions by requiring the package transaction as a whole to become "made available to trade" in order to be subject to the CFTC's trade execution requirement; (5) provide a mandatory public comment period for every "made available to trade" ("**MAT**") determination submission by a SEF under Part 40 of the CFTC's regulations; (6) establish a clear process for determining when a swap product should no longer be considered available to trade on a SEF; (7) codify existing CFTC staff guidance and no-action relief around rejection of swaps from clearing and resubmission for operational and clerical errors; (8) clarify the order interaction requirements between different SEF trading protocols; and (9) modify the definition of "block trade" in Part 43 of the CFTC's regulations to authorize on-SEF execution of a block trade as a "permitted transaction" as defined in section 37.9(c) in order to facilitate pre-execution credit checks of block trades that are intended to be cleared.

In addition, in subsequent discussions with the CFTC, the MFA also advocated for increased mandatory disclosure from SEFs regarding trading protocols, fees, and governance.

I will review MFA's supporting arguments for each of MFA's proposed amendments, other than our rationales for the requested rule to prohibit post-trade name give-up discussed above.

Codify Existing CFTC Staff Guidance: Impartial Access

MFA's proposed amendments to section 37.202(c) would codify existing staff guidance to prohibit the use of enablement mechanisms and breakage agreements for swaps that are intended to be cleared on SEFs. A SEF that requires or permits such arrangements imposes barriers to the buy-side's access to that SEF and contravenes the CFTC's impartial access requirements. In addition, our proposed amendments prohibit a SEF from limiting access to certain types of eligible contract participants in a discriminatory manner. Such access limitations could be based on the manner in which certain types of eligible contract participants typically interact in the market, anticipated levels of trading activity, or entity registration status. These and other status-based access criteria also act as artificial barriers to the buy-side's access to SEFs.

Codify Existing CFTC Staff Guidance: STP

MFA's proposed amendments to section 1.73 would codify existing CFTC staff guidance clarifying the pre-execution risk management requirements for clearing futures commission merchants ("**FCM**") and the obligation for SEFs to facilitate compliance with these requirements.

Consistent with current CFTC staff guidance, MFA's proposed amendments to section 1.74 would establish an outer boundary of 60 seconds after submission of a trade to the clearing FCM for acceptance for clearing. Our proposed amendments would retain the current timing standard of "as quickly as technologically practicable if fully automated systems were used" ("**ASATP**") to require timing reductions for clearing

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acceptance from the 60-second outer boundary that continuing improvements in technology will enable.

Finally, consistent with current CFTC staff guidance, MFA's proposed amendments to section 39.12(b)(7) would establish an outer boundary of 10 seconds after submission of any trade for clearing to a CCP for the CCP to accept or reject a trade for clearing. Our proposed amendments would retain the ASATP standard to require timing reductions for clearing acceptance from the 10-second outer boundary that continuing technology improvements will enable.

More Clearly Address Package Transactions in MAT Determination Process

MFA's proposed amendments to section 37.9 would revise the definition of a "required transaction" to include "any transaction involving a stand-alone swap or any package transaction that is subject to the trade execution requirement in section 2(h)(8) of the [CEA]". We would also define a "package transaction" as follows:

> Package transaction means a transaction involving two or more instruments: (1) that is executed between two or more counterparties; (2) that is priced or quoted as one economic transaction with simultaneous or near simultaneous execution of all components; (3) where the execution of each component is contingent upon the execution of all other components; and (4) where the risk of the offsetting components is reasonably equivalent.

A transaction meeting this definition would not be deemed a required transaction, unless the package transaction as a whole has become subject to the CFTC's trade execution requirement in section 2(h)(8) of the CEA.

Based on the implementation experiences of MFA members, we believe a determination should be made regarding the liquidity characteristics of the package transaction as a whole. This approach would avoid the need for CFTC staff to resort to issuing serial no-action relief as the industry continues to work on the remaining execution challenges and infrastructure solutions for certain types of package transactions.

This approach differs from the current process, where a MAT determination has implications not only for the execution of a given swap on a stand-alone basis, but also for all package transactions that include such a swap. Both the liquidity profile and the ability of market infrastructure to facilitate trading of swaps executed on a stand-alone basis versus as part of a package transaction can vary widely. Therefore, our changes to section 37.10 would require SEFs to apply the CFTC's MAT criteria separately at the package level to avoid execution challenges and the need for extended or permanent staff no-action relief from the trade execution requirement for certain types of package transactions.

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Provide Public Comment Period for MAT Determinations

MFA's proposed amendments would require a public comment period with respect to each MAT determination submission by a SEF. We believe a mandatory public comment period would provide market participants with a critical opportunity to inform the CFTC as to a swap product's suitability and the industry's technological and operational readiness to move the product from the OTC market to SEF trading. We also believe that our proposed amendments would enable the CFTC to perform a more meaningful oversight role, furthering international harmonization.

Establish a Process for de-MAT Determinations

MFA's proposed amendments would establish a clear process for determining when a stand-alone swap or package transaction is no longer available to trade on a SEF (a "**de-MAT determination**"), based on the CFTC's current six MAT factors. We believe the CFTC should administer this process by retaining its authority to make such a determination on an annual basis or if the CFTC receives notice of de-listing submissions from at least two SEFs for a particular swap. Consistent with our request for MAT determinations, our proposed amendments would also require a public comment period to further inform the CFTC's consideration of any de-MAT determination.

We believe that a separate de-MAT determination process would serve as an important check-and-balance mechanism, rather than a process that relies exclusively on determinations of SEFs. If none of the six MAT factors support a determination that a stand-alone swap or a package transaction is made available to trade, as confirmed objectively by the CFTC's broader view of market trading data for the product in question, the CFTC should issue a public de-MAT determination order that will suspend the trade execution requirement for that product. That suspension would apply universally to all SEFs.

Codify Existing CFTC Staff Guidance and No-Action Relief: Rejection from Clearing and Resubmission

MFA's proposed amendments would codify, with clarifying modifications, existing CFTC staff no-action letter 15-24 that facilitates the correction of operational or clerical errors made in the submission of a swap to clearing. Specifically, the current no-action letter authorizes the resubmission of a corrected trade that matches the terms and conditions of the erroneous trade, other than the relevant operational or clerical error and the time of execution. MFA's proposed amendments would also further codify the treatment of an intended-to-be-cleared swap that is rejected from clearing (*i.e.*, void *ab initio*), which MFA strongly supports.

We note that ESMA included both void *ab initio* and a resubmission procedure in its published regulatory technical standards under MiFID II. As a result, codifying these points would further harmonization between SEFs and MiFID II trading venues.

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Clarify RFQ and Order Interaction

MFA's proposed amendments to section 37.9(a)(3)(i) involve the CFTC's requirement that firm bids and offers must be taken into account and communicated to an RFQ requester along with the RFQ responses. These amendments would further clarify that any firm bid or offer that is communicated to an RFQ requester in this situation must be provided in an executable form so that the RFQ requester can easily access such price if so desired. In addition, as SEFs continue to make innovations in trading protocols, it is important that the order interaction requirement not be construed so narrowly as to render it inapplicable for these new trading protocols. As a result, these amendments would clarify that a SEF must communicate to an RFQ requester any firm bid or offer pertaining to the same instrument resting on any of the SEF's markets, trading systems or platforms. We believe these amendments promote pre-trade price transparency by ensuring the RFQ requester has the ability to view and access competitive firm quotes anywhere on the SEF.

Codify Existing CFTC Staff No-Action Relief: Eliminate "Occurs Away" Requirement for Authorized On-SEF Execution of Block Trades

MFA's proposed amendments would codify, with modification, existing CFTC staff no-action letter 14-118 by eliminating the "occurs away" requirement for block trades. More specifically, our proposed amendments would expressly authorize on-SEF execution of any block trade as a permitted transaction. By doing so, a block trade can be executed by RFQ to 1 or by voice to facilitate the requisite pre-execution credit checks of block trades that are intended to be cleared.

Increased Mandatory Disclosure from SEFs regarding Trading Protocols, Fees, and Governance

In November 2015, the CFTC issued a notice of proposed rulemaking regarding "Regulation Automated Trading", which included a provision requiring a designated contract market ("**DCM**") to provide additional public information regarding its market maker and trading incentive programs. MFA supported such requirement and, in addition, recommended that the CFTC require SEFs to make similar types of market maker and trading incentive program disclosures. Applying these transparency requirements to SEFs would level the playing field with DCMs, as DCMs may directly compete with SEFs by listing swaps or economically similar contracts. MFA believes that such disclosure requirements will provide investors and the broader public with more information and transparency into DCM and SEF market maker and trading incentive programs, and we agree with the CFTC that such disclosure will enhance market integrity.

Further, it is our view that market participants can benefit from greater transparency from SEFs regarding other important aspects of their offering, including trading protocols, fees, and governance. Ensuring that this type of information is consistently provided to market participants, will level the playing field and ensure that all investors can make informed decisions regarding whether to join a particular platform.

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CONCLUSION

On behalf of MFA, I appreciate the Committee's review of the impact of the G-20 clearing and trade execution requirements. As discussed, we believe that the CFTC should expand mandatory central clearing to IRS denominated in all G-10 currencies. We also believe that the CFTC should engage in further rulemaking to ensure anonymous and impartial access to SEFs so as to promote an open, competitive, and level playing field. In addition, we respectfully ask Congress to encourage the Basel Committee to modify the Basel III leverage ratio to ensure that central clearing remains affordable for customers. We believe that, by promoting central clearing and organized trade execution in the OTC derivatives markets, these measures will advance the G-20's and Congress's goal of reducing systemic risk.

MFA is committed to working with Members and staff of Congress, the Committee, and regulators to reduce systemic risk, ensure affordable and impartial access to our financial markets, and strengthen our Nation's economy. Thank you for the opportunity to appear before you today. I would be happy to answer any questions that you may have.

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