



March 15, 2019

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

**Re: Swap Execution Facilities and the Trade Execution Requirement
(RIN Number 3038-AE25)**

Dear Mr. Kirkpatrick:

Managed Funds Association¹ (“**MFA**”) welcomes the opportunity to provide comments to the Commodity Futures Trading Commission (the “**Commission**”) on its proposed rule on “Swap Execution Facilities and Trade Execution Requirement” (“**SEF Proposed Rule**”).² In our view, the Commission’s proposed approach undermines the statutory goal of promoting pre-trade price transparency in the U.S. swaps market, and risks sacrificing the documented benefits of price competition, lower transaction costs, and better liquidity on registered swap execution facilities (“**SEFs**”). As we explain below, this approach would reduce existing benefits for investors, and impose significant costs that outweigh any potential benefits of the Commission’s proposed changes.

MFA members are active participants as investors in the U.S. swaps market and support regulatory efforts to decrease systemic risk, increase transparency, and promote an open, competitive, and level playing field. Based on over five years of trading experience under the Commission’s swaps trading regime, MFA members agree that targeted improvements can be made to the regulatory framework and MFA has previously submitted recommended rule changes

¹ MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

² 83 Fed. Reg. 61946 (Nov. 30, 2018) (“**SEF Proposing Release**”), available at: <https://www.cftc.gov/sites/default/files/2018-11/2018-24642a.pdf>.

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to the Commission.³ However, MFA is concerned that the breadth of the current SEF Proposed Rule would dramatically alter the price discovery and competitive execution process on SEFs, imposing significant costs on market participants. In this letter, we detail these concerns and update our recommendations to offer constructive alternatives to the Commission on the following topics:

- **Trade Execution Requirement.** We do not believe that all swaps currently subject to the Commission's clearing requirement are suitable for mandatory execution on SEFs and instead recommend changes to the current MAT process, including (i) eliminating the self-certification process and providing the Commission with a more defined role, and (ii) providing more opportunity for market participants to participate in the process, such as through industry advisory committees and public comment.
- **Methods of Execution.** While we support providing SEFs with greater flexibility, we believe the Commission should ensure a baseline level of pre-trade transparency and multiple-to-multiple execution on SEFs by retaining RFQ-to-3 to preserve the documented benefits of greater transparency, liquidity, and competition.
- **Impartial Access Requirements.** The proposed approach would allow SEFs to establish artificial barriers designed to limit investor access and choice and undermine free market competition. We instead recommend that the Commission codify the existing impartial access guidance.
- **Pre-Execution Communications and Block Trades.** We do not believe the SEF Proposed Rule fully considers the costs to clients of prohibiting pre-execution communications and removing block trade exemptions. We recommend that the Commission retain block trade exemptions to allow for an appropriate degree of execution flexibility and permit clients to continue to engage in bilateral conversations to obtain market color, particularly if the trade execution requirement is expanded in scope.
- **STP Requirements.** The Commission's proposed changes would introduce unnecessary market, operational, and credit risks for clients, disrupting current trading practices on

³ 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, 2015, 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>. See also letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to Christopher Kirkpatrick, Secretary of the Commission, CFTC, on September 29, 2017, regarding Project KISS recommendations, at pp. 14-21, available at: https://www.managedfunds.org/wp-content/uploads/2017/09/MFA-Proj.KISS_.final_.appendix.9.29.17.pdf.

SEFs. We instead recommend that the Commission codify existing guidance and no-action relief setting forth the current straight-through-processing (“**STP**”) standards.

MFA agrees with the Commission that there is a need to reassess and improve certain aspects of the *status quo* swaps trading framework. Rather than proceeding with a broad and comprehensive overhaul of the current framework that would reduce existing benefits and impose significant costs, we suggest that the Commission consider industry comments and focus on more targeted reforms in 2019. Accordingly, MFA recommends that the Commission proceed with an alternative package of reforms that would include the following three components: 1) an improved process for the trade execution requirement based on MFA’s alternative recommendation below; 2) codification of the existing impartial access guidance; and 3) codification of the existing STP guidance and no-action relief. By focusing on these three components, the Commission would address critical process flaws and enhance and preserve key aspects of the current framework that are working well for investors.

1. Trade Execution Requirement

The SEF Proposed Rule would eliminate the existing “made available to trade” (“**MAT**”) process and expand the scope of the trade execution requirement (“**TER**”) to cover any swap that is subject to the Commission’s clearing requirement and listed for trading on a SEF. This would include all package transactions that contain at least one swap that is subject to the expanded TER, with the exception of packages that include a bond issued in the primary market.⁴

Based on our members’ collective trading experience, we do not believe that all swaps subject to the Commission’s clearing requirement are suitable for mandatory execution on SEFs. We note that the clearing requirement includes swaps with varying liquidity characteristics, ranging from very liquid fixed-to-floating interest rate swaps to less liquid custom and bespoke swaps, such as broken-dated interest rate swaps. In our view, the scope of the TER should be tailored to reflect these varying liquidity characteristics.

Similarly, we believe the proposed exception for packages that include a bond issued in the primary market is too limited in practice. No-action relief currently exists for a broader range of package transactions, and the scope of the TER should take into account the liquidity characteristics of, and the ability of SEFs to support trading in, particular types of package transactions.

Linking the TER and the clearing requirement results in an overly expansive TER that does not adequately take into account the considerations set forth above. In addition, the proposal could have the negative effect of discouraging market participants from bringing more products into

⁴ SEF Proposing Release, sec 36.1 at 62088.

central clearing if such products are automatically made subject to the TER. Discouraging central clearing can undermine efforts to mitigate systemic risk and improve transparency in the U.S. swaps market and reduce the benefits from central clearing that have made our financial system safer.

Finally, we note that eliminating the MAT process would also create divergence with the EU derivatives trading obligation under MiFID II, where the European Securities and Markets Authority (“ESMA”) conducts a separate liquidity assessment to determine which products subject to the clearing requirement are suitable for mandatory execution on a trading venue. This liquidity assessment has resulted in a derivatives trading obligation that is nearly identical in scope to the Commission’s current TER. To ensure sufficient comparability with the EU’s derivatives trading obligation, we believe the Commission should assume a more defined role in determining which subset of swap products subject to the clearing requirement meet the Commission’s separate liquidity-related criteria.

Cost-Benefit Considerations. In the SEF Proposing Release, the Commission states that the expanded scope of the TER would significantly increase the amount of swaps trading that occurs on SEFs and in turn, “centralize liquidity, foster additional competition among a more concentrated number of market participants, and reduce information asymmetries that would increase market efficiency and decrease transaction costs”.⁵

However, MFA members are not convinced that they will realize such benefits from expanding the TER. The practical impact of expanding the TER must be assessed in connection with other aspects of the proposal. In particular, even though the proposal contemplates SEFs being able to offer more flexible methods of execution to accommodate the expanded TER, the revised interpretation of impartial access means that investors may not be able to use many of these trading protocols, such as voice-based execution methods, auction platforms and workup sessions, if such protocols are only offered or supported by “dealer-to-dealer” SEFs. Similarly, certain swap products may only be available for trading on SEFs that investors and other buy-side firms are unable to access. As a result, such firms may experience significant difficulties in complying with the proposed expansion of the TER.

Even if the Commission were to reconsider its proposal on impartial access, permitting more flexible methods of execution does not change a swap’s underlying liquidity characteristics and automatically make it suitable for the TER. By attempting to cater for these less liquid and more bespoke swaps, the Commission risks undermining benefits achieved for swaps that are required to be executed on SEFs today. The current scope of the TER promotes competitive and transparent execution on SEFs, resulting in better liquidity and lower transaction costs for

⁵ *Id.* at 61979, fn. 280.

investors. Weakening current requirements to facilitate less liquid swaps becoming subject to the TER creates significant costs and few benefits for investors.

Alternative Recommendation. In our view, the Commission would avoid such adverse consequences and costs by maintaining the MAT process independent from the clearing determination and considering revisions to improve the current framework. Such revisions should address the following weaknesses of the current SEF self-certification process: (i) the Commission has no meaningful ability to disapprove SEF MAT determinations, and (ii) market participants have no meaningful opportunity to participate in the process, such as through industry advisory committees and mandatory public comment periods.

MFA suggests that the Commission address such weaknesses by assessing whether a swap product meets objective liquidity-related criteria for the TER, which criteria could be based on the Commission's consideration of all the existing MAT factors⁶ and available trading data across SEFs, rather than relying on individual SEFs to initiate the potential application of the TER. To ensure that the Commission provides sufficient industry participation by non-SEFs in determining whether swap products meet such criteria, we recommend that all prospective MAT swap products be subject to mandatory public comment periods. As a complementary means to ensure meaningful industry input, the Commission could form an industry advisory committee with adequate buy-side participation to achieve consensus across the industry on whether certain swap products meet the Commission's separate liquidity-related criteria as a condition for subjecting such products to the TER. In addition, MFA believes that a revised MAT process should include separate determinations for package transactions to ensure that sufficient liquidity and trading functionality are available.

2. Methods of Execution

Under the SEF Proposed Rule, the Commission would remove both the RFQ-to-3 and Order Book requirements for Required Transactions and permit a SEF to offer any execution method, as long as it meets the SEF definition (*i.e.*, multiple participants have the ability to accept bids and offers from multiple participants in the facility or system).

MFA supports an innovative SEF marketplace that offers a broad variety of trading protocols, provided that (i) all market participants have true impartial access to the available trading protocols, and (ii) requirements for pre-trade price transparency, price competition, and multiple-to-multiple execution are preserved. However, MFA is concerned that the current proposal does not achieve either of these outcomes.

⁶ The CFTC's six MAT factors are: (1) Whether there are ready and willing buyers and sellers; (2) The frequency or size of transactions; (3) The trading volume; (4) The number and types of market participants; (5) The bid/ask spread; or (6) The usual number of resting firm or indicative bids and offers. *See* 17 CFR sec. 37.10(b).

We detail our concerns with the Commission’s proposed interpretation of impartial access in Section 3 below. With respect to pre-trade transparency and multiple-to-multiple competitive execution, the SEF Proposed Rule would appear to permit trading protocols that are inconsistent with these objectives. For example, the Commission re-defines a SEF to include a platform that solely aggregates single-dealer pages. Single-dealer pages only provide the ability to view and meaningfully engage with the prices of one dealer at a time, contrary to the multilateral and pre-trade transparent execution process that is statutorily required to take place on SEFs.

In addition, the Commission acknowledges that removing the RFQ-to-3 requirement may result in less pre-trade price transparency.⁷ This is consistent with the experience of MFA members, who have observed that the RFQ-to-3 requirement has resulted in greater price competition among liquidity providers, motivating them to differentiate their offerings by streaming firm and competitive prices, which increases pre-trade price transparency for investors. This increased price competition and pre-trade transparency have led to meaningful benefits for investors and other buy-side firms in terms of lower transaction costs and better liquidity. In our view, the Commission’s proposal should seek to preserve the current benefits by ensuring multiple-to-multiple execution and a minimum level of pre-trade price transparency. Therefore, MFA requests that the Commission retain the RFQ-to-3 requirement for swaps that are subject to the TER to ensure a baseline level of pre-trade price transparency on SEFs. By doing so, the Commission would preserve the current benefits of RFQ-to-3 for trading liquid and standardized swap products on SEFs, while enabling customer choice to use other execution methods that satisfy the minimum criteria detailed above (*i.e.*, impartial access, pre-trade transparency, multiple-to-multiple execution, and price competition).

MFA notes that the reduced pre-trade transparency resulting from the Commission’s current proposal may also create divergence with the EU’s MiFID II requirements, which establish pre-trade transparency obligations for OTC derivatives traded on Multilateral Trading Facilities (“**MTFs**”) and Organized Trading Facilities (“**OTFs**”). MFA strongly believes the Commission should minimize regulatory divergence to avoid disrupting the mutual recognition agreement on derivatives trading venues.

With respect to the proposed elimination of the order book requirement, MFA supports the ability of eligible market participants to have true impartial access to all SEF order books. However, we acknowledge that requiring all SEFs to invest in the technology to operate an order book may create a barrier to entry for new SEFs that may list swap products that may not be suitable for order book trading. In such cases, the order book functionality would remain dormant, resulting in opportunity costs for SEFs that prefer to invest in developing new and innovative

⁷ SEF Proposing Release at 62060.

execution methods for less liquid and standardized swap products. MFA is therefore receptive to the Commission's proposal that not all SEFs need to have an order book.

Concerning the proposed disclosures of SEF rules that govern the operation of the SEF, MFA requests that the Commission require greater transparency from SEFs regarding other important aspects of their offerings. In addition to the proposed disclosures, SEFs should be required to disclose their fees and governance to ensure a complete baseline level of transparency. This additional information would level the SEF playing field and ensure that all market participants can make informed decisions regarding whether to onboard to a SEF. MFA believes the need for such disclosures is heightened by the Commission's proposed expansion of the SEF definition and registration requirement that would substantially increase the number of registered SEFs with potentially diverse offerings.

Cost-Benefit Considerations. The SEF Proposed Rule fails to consider the available market research that documents the benefits realized by investors and other buy-side firms as a result of the multiple-to-multiple and pre-trade transparent execution process on SEFs today.⁸ For example, an updated Bank of England Staff Working Group Paper quantified these benefits in the U.S. interest rate swaps market as "daily savings in execution costs of as much as \$3-\$6 million for end-users".⁹

Eliminating the RFQ-to-3 requirement and permitting trading protocols that do not provide for multiple-to-multiple and pre-trade transparent execution risks would erode documented, material benefits. Providing SEFs with complete discretion regarding whether the execution process will be competitive and transparent ignores the governing statutory requirements and risks leading to a more opaque and fragmented U.S. swaps market for investors. MFA's concerns are not addressed by the Commission's assertion that "this cost may be mitigated because every SEF still has the option of offering an Order Book and continuing to offer market participants the ability to submit RFQs to multiple liquidity providers on the SEF."¹⁰ MFA's concerns with the proposed elimination of RFQ-to-3 are heightened by the fact that SEFs are not prohibited from disclosing to liquidity providers the number of RFQ recipients on a given RFQ sent by a client; today, the two dominant "dealer-to-customer" SEFs give such information to liquidity providers.

Alternative Recommendation. MFA recommends that the Commission inform its cost-benefit analysis by undertaking its own study before eliminating RFQ-to-3 as a required execution

⁸ *Id.* at 62144 (citing studies at fns. 4, 7 and 10 and their conclusions in related text).

⁹ Evangelos Benos, Richard Payne & Michalis Vasios, Centralized trading, transparency and interest rate swap market liquidity: evidence from the implementation of the Dodd-Frank Act, Bank of England Staff Working Group Paper No. 580 (May 2018) at 31, available at: <https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2018/centralized-trading-transparency-and-interest-rate-swap-market-liquidity-update>.

¹⁰ SEF Proposing Release at 62060.

method in a final rule. In our view, the Commission should retain the RFQ-to-3 requirement to ensure a baseline amount of pre-trade price transparency and multiple-to-multiple execution on SEFs.

With respect to the proposed elimination of the requirement that SEFs offer an Order Book, MFA supports market participants having true impartial access to all SEF Order Books. However, we acknowledge that requiring all SEFs to invest in the technology to operate an Order Book may create a barrier to entry for new SEFs and, therefore, MFA agrees that this requirement could be removed.

3. Impartial Access Requirements

The revised impartial access requirements in the SEF Proposed Rule represent a significant step backwards in terms of ensuring an open, competitive, and level playing field for market participants transacting on SEFs. The SEF Proposed Rule would permit a SEF to establish rules or access criteria that discriminate against specific types of market participants, as long as the rules or access criteria are applied equally to “similarly situated market participants”.¹¹

Since each SEF is permitted to define which market participants are to be considered “similarly situated,” the proposed interpretation will allow SEFs to impose access limitations on buy-side firms either (i) directly by prohibiting buy-side firms from joining the venue or (ii) indirectly through activities-based criteria, such as by establishing minimum volume thresholds that buy-side firms are unable to meet in practice. These concerns are magnified given the Commission’s explicit endorsement of dealer-only SEFs and a two-tier market structure in the SEF Proposed Rule.¹²

These concerns highlight the importance of assessing the practical effect of access limitations. MFA is concerned that a SEF could impose access limitations based on quantitative or qualitative activities-based criteria that, in practice, are a proxy for entity-based discrimination. In our view, access criteria based on the manner in which certain types of eligible contract participants typically interact in the market, anticipated levels of trading activity or volume, or entity registration status, act as artificial barriers to the buy-side’s access to SEFs and disable the emergence of market-led competition and customer choice in the SEF marketplace. In our view, the Commission should not permit SEFs to establish artificial barriers designed to limit buy-side access and to suppress natural market evolution. Such artificial barriers limit market competition and innovation and restrict the ability of buy-side firms to access specific liquidity pools and trading protocols. For example, if buy-side firms are only permitted to access the current “dealer-to-customer” SEFs, they would have no ability to utilize the voice-based execution protocols that

¹¹ SEF Proposing Release, sec. 37.202(a) at 62098.

¹² *Id.* at 62060.

are intended to be facilitated by the SEF Proposed Rule. All market participants should be able to select the liquidity pools and trading protocols that are best suited for their specific trading activity, without being subject to discriminatory treatment sanctioned by the Commission.

Artificial barriers also will entrench the two-tier *status quo* swaps market structure, and prevent the natural development of a more “all-to-all” market.¹³ In our view, this *status quo* market structure favors the commercial interests of dealers at the expense of a large and diverse group of non-dealers, and may increase the likelihood of market volatility over the longer term given the resulting concentration of liquidity providers. However, regardless of whether the Commission agrees with this view, it should not be dictating market structure by allowing SEFs to discriminate against specific types of market participants. Instead, the Commission should ensure there is an open, competitive, and level playing field and allow the market to determine the optimal structure.

Congress sought to facilitate market competition and innovation by requiring SEFs to provide market participants with impartial access.¹⁴ In our view, permitting discrimination against buy-side firms is contrary to this statutory intent. In addition, we note that this proposal would diverge with MiFID II requirements, including guidance issued by ESMA that prohibits discriminatory practices on MTFs and OTFs.¹⁵

Cost-Benefit Considerations. The Commission acknowledges that its proposed interpretation of impartial access may impose costs on certain market participants, such as by:

- inhibiting the ability of certain market participants to access trading protocols and liquidity pools;¹⁶

¹³ The legacy practice of post-trade name give-up is a continuing artificial barrier to the buy-side’s access and participation in D2D SEF markets. MFA encourages the Commission to review this letter in conjunction with MFA’s separate and related comment letter on “Post-Trade Name Give-Up on Swap Execution Facilities”.

¹⁴ CEA Section 5h(f)(2)(B).

¹⁵ On July 7, 2017, ESMA issued Q&A to clarify that the following types of discriminatory criteria are prohibited:

Any requirement for members or participants to be direct clearing members of a CCP

Any requirement for members or participants to become enabled to trade centrally cleared financial instruments with other members or participants

Any requirement for minimum trading activity to become a member or participant of a trading venue

Any imposition of restrictions on the number of participants with whom a participant can interact on the trading venue.

See https://www.esma.europa.eu/sites/default/files/library/esma70-872942901-8_qas_markets_structures_issues.pdf.

¹⁶ SEF Proposing Release at 62061.

- preventing certain market participants from accessing competitive prices;¹⁷ and
- creating information asymmetries between market participants in the “dealer-to-dealer” and the “dealer-to-client” segments of the market that may increase costs for buy-side firms.¹⁸

The Commission minimizes these costs by suggesting that the current two-tier swaps market structure is beneficial for all market participants, including participants in the “dealer-to-client” market. The Commission reasons that since the current market structure is divided into “dealer-to-dealer” and “dealer-to-client” segments, even in the absence of its proposed interpretation of impartial access, the “costs to market participants may not change much from the current situation.”¹⁹

On the contrary, MFA believes there are significant costs associated with affirmatively permitting SEFs to discriminate against specific types of market participants. Although an “all-to-all” market structure has not yet developed, buy-side firms are currently permitted to selectively access “dealer-to-dealer” liquidity pools and trading protocols. The SEF Proposed Rule may prevent such selective access by buy-side firms; at the same time, the SEF Proposed Rule would permit “dealer-to-dealer” SEFs to offer a wider range of execution protocols that may also be inaccessible to buy-side firms. In addition, the SEF Proposed Rule would result in new SEFs that, again, buy-side firms may not be able to access. Furthermore, the Commission’s newly permitted discrimination may prevent new liquidity providers from entering the market, which reduces overall price competition. In our view, the Commission has failed to consider the impact of this approach on overall market liquidity, price discovery, and transparency from the perspective of a buy-side market participant.

Finally, as discussed above, the fact that that an “all-to-all” market structure has not yet developed is not sufficient to justify the Commission affirmatively mandating that it never will develop. Instead, the Commission should allow the market to naturally develop by continuing to prohibit anticompetitive practices and discrimination against specific types of market participants.

The practical impact of the Commission’s proposed interpretation of impartial access for SEFs is to cement the existing artificial barriers to access important liquidity pools and execution methods on “dealer-to-dealer” SEFs that many MFA members and other buy-side market participants have experienced since the launch of the SEF regime over five years ago.

¹⁷ *Id.*

¹⁸ *Id.* at 62061-62.

¹⁹ *Id.* at 62062.

Alternative Recommendation. Based on the foregoing, MFA recommends that the Commission codify existing Commission staff guidance detailing the current interpretation of impartial access, including prohibitions on enablement mechanisms and breakage agreements for cleared swaps executed on SEFs.²⁰ Separately, the Commission should continue to dismantle artificial barriers that are preventing natural market evolution, such as the practice of post-trade name give-up.

4. Pre-Execution Communications and Block Trades

The SEF Proposed Rule requires a SEF to prohibit its participants from engaging in pre-execution communications away from its facility for instruments that are subject to the trade execution requirement, except for certain package transactions.²¹ This prohibition would also apply to block trades. This proposal means that all “pre-execution communications between dealers and their customers could not occur through non-SEF telephones, email systems, instant messaging systems, or other means of communication outside of the SEF”.²²

This aspect of the proposal would have a significant impact on the current trading practices of MFA members, impeding the ability to obtain market color and execute block trades. While the Commission explains the rationale for this change involves a concern that SEFs have allowed too much trading activity and liquidity formation to occur away from the trading venue,²³ it appears much of the analysis involves practices in the “dealer-to-dealer” segment of the market. We recommend that the Commission consider the practical impact on the “dealer-to-client” segment of the market, particularly given available SEF functionality. In particular, the Commission should ensure clients are able to execute block transactions in a sufficiently flexible manner that prevents information leakage. At the moment, many discussions regarding block transactions occur bilaterally over the phone between clients and dealers.

Cost-Benefit Considerations. As detailed above, MFA believes that the proposed prohibition on pre-execution communications will create significant costs for clients. We do not believe that it is practical for dealer-to-client SEFs to adequately mitigate these costs, such as by

²⁰ See “Division of Clearing and Risk, Division of Market Oversight and Division of Swap Dealer and Intermediary Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities”, issued Nov.14, 2013 (“**Impartial Access Guidance**”), available at: <https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/dmostaffguidance111413.pdf>

As defined in the Impartial Access Guidance, the term “enablement mechanism” refers to any mechanism, scheme, functionality, counterparty filter, or other arrangement that prevents a participant in a SEF from interacting or trading with, or viewing the bids and offers (firm or indicative) displayed by, any other participant in such SEF.

²¹ SEF Proposing Release at 61986-87.

²² *Id.* at 62061.

²³ *Id.* at 61986.

providing telephones to market participants as suggested by the Commission in the SEF Proposed Rule.²⁴ We urge the Commission to more fully consider the impact on trading practices in the “dealer-to-client” segment of the market.

Alternative Recommendation. To mitigate the magnitude of the costs imposed on clients, MFA requests that the Commission retain the current block trade exceptions, which allow block trades to be negotiated away from a SEF. Retaining exceptions for block trades would also be consistent with the EU MiFID II regime.²⁵ Block trades in instruments subject to the trade execution requirement should still be required to be finalized on a SEF, and subject to STP requirements, such as pre-trade credit checks.

In addition, to the extent the trade execution requirement is expanded to include less liquid and more bespoke swaps, clients should be allowed to obtain market color through bilateral conversations. In response to the related question in the SEF Proposed Rule, MFA believes that it would be too prescriptive for the Commission to define “market color” for purposes of this exception.²⁶

5. STP Requirements

The Commission’s proposed amendments to the STP requirements for SEF-executed cleared trades would: (i) eliminate the requirement that SEF-executed cleared trades be submitted to the DCO within ten minutes; (ii) eliminate the current prohibition on breakage agreements; and (iii) eliminate void *ab initio* for trades that are rejected from clearing for non-credit reasons (*i.e.*, operational or clerical errors).

The Commission’s current STP requirements have been successfully implemented for over five years and benefit all market participants by providing clearing certainty immediately following execution. This certainty facilitates risk management and expands access to trading counterparties by eliminating the need to negotiate individual credit arrangements in order to trade. In addition, the associated reduction in operational risk promotes SEF trading and central clearing, consistent with statutory objectives. Finally, clearing certainty is essential for certain SEF trading protocols, such as anonymous order book trading.

The proposed changes undermine clearing certainty. SEFs would be permitted to delay submission to the DCO following execution, increasing market risk and operational risk during

²⁴ *Id.* at 62061.

²⁵ See ESMA Q&A 11 under MiFID II issued on February 7, 2018 (“Concerning derivatives subject to the trading obligation, pre-arranged transactions are only possible under the [Large in Scale]-waiver (Article 9(1)(a) of MiFIR) and the package order waiver (Article 9(1)(e) of MiFIR).”

²⁶ SEF Proposing Release at 61988 (comment question 33).

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the interim period. Submission delays would also introduce the potential for bilateral counterparty risk to be re-introduced if the trade is ultimately rejected from clearing. Permitting breakage agreements and no longer declaring all rejected trades to be void *ab initio* would re-introduce bilateral documentation to address the newly created counterparty credit risk, creating significant costs and disruption for investors transacting on SEFs.

We also note that MiFID II contains STP requirements that are nearly identical to the Commission's current standards, including with respect to submission timeframes and clearing certainty. MFA strongly believes the Commission should minimize regulatory divergence to avoid disrupting the mutual recognition agreement on derivatives trading venues.

Cost-Benefit Considerations. The Commission has failed to set forth the benefits of changing key standards that have been successfully implemented by market participants. In contrast, MFA has identified significant costs associated with the proposed changes.

Delaying clearing submissions for SEF-executed trades will introduce new market, operational, and credit risks for market participants. While the Commission asserts SEFs require more time to submit trades to clearing, this has not been the experience of MFA members when trading on SEF. In our experience, the vast majority of SEF-executed trades are successfully cleared within seconds and, therefore, there is no reason to change the current standard.

Permitting the re-introduction of bilateral breakage agreements will disrupt access to current liquidity providers, as buy-side firms may be required to put in place new documentation in order to transact on SEFs. This will also reduce access to new trading counterparties, undermining a key benefit associated with trading cleared swaps on-SEF today.

Alternative Recommendation. In light of the benefits of the current STP requirements, MFA requests that the Commission codify existing staff guidance and letters that set forth these standards.²⁷ The clear ten-minute submission deadline should continue to apply to SEFs and breakage agreements should continue to be prohibited for SEF-executed cleared trades. While a SEF should have the flexibility to develop error trade policies addressing the correction of operational or clerical errors, a trade that is unable to be successfully cleared should be deemed void *ab initio* in order to provide certainty and market-wide consistency. Accordingly, we request that the Commission codify this requirement under proposed section 37.203(e) for SEF error trade policies, which we discuss further in Section 6 below.

²⁷ Commission Staff Guidance on Swaps Straight-Through Processing (Sept. 26, 2013), available at: <http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/stpguidance.pdf>. See also CFTC Staff Advisory Letter 15-67 and CFTC Staff No-Action Letter ("NAL") 17-27.

6. Error Trade Policies

The SEF Proposed Rule would permit a SEF to establish its own rules and procedures to help resolve error trades rejected from clearing for non-credit reasons in a “fair, transparent, consistent, and timely manner”.²⁸ As noted above, we support SEFs having the flexibility to develop error trade policies to address the correction of operational or clerical errors. Certain of the conditions that are currently imposed by the Commission relating to the correction of error trades, including requiring a SEF to make an affirmative finding that the trade resulted from an error,²⁹ have proven to be extremely burdensome, particularly for “dealer-to-client” SEFs. Given the absence of voice brokers to assist in the error correction process, these electronic SEFs should be permitted to allow the trading counterparties to quickly remediate error trades. In all circumstances, SEFs should be required to consult with, and obtain the consent of, the parties involved before taking unilateral action.³⁰ Given that resolving a potential error trade requires a clear understanding of the intended commercial terms, the trading counterparties should be involved in the resolution process.

In connection with providing SEFs with greater flexibility around error trade policies, MFA requests that the Commission consider requiring SEFs to provide automated functionality to correct error trades.³¹ MFA believes that, with years of experience in handling error trades, SEFs should be required to make modest technological improvements in order to reduce operational risk, consistent with their obligations as self-regulatory organizations. MFA members have observed SEF error correction processes that are largely manual, resulting in significant delays and market risk (*e.g.*, a delay until T+1 is not uncommon), and that lack sufficient safeguards to ensure approvals provided by the SEF are appropriately documented.

7. Uncleared Swap Confirmation Requirements

The SEF Proposed Rule would require a SEF to provide the counterparties to an uncleared swap with a “trade evidence record” that memorializes the agreed terms of the swap, but not all terms.³² Under the proposal, the SEF would be required to deliver the trade evidence record to the counterparties or to the intermediary trading on behalf of a counterparty “as soon as technologically practicable after the execution of the swap transaction on the [SEF]”.³³ The Commission states that the trade evidence record would include, at a minimum, the agreed

²⁸ SEF Proposing Release, sec. 37.203(e)(2) at 62098.

²⁹ See CFTC Staff NAL 17-27.

³⁰ SEF Proposing Release at 62002 (comment question 52).

³¹ SEF Proposing Release at 62002 (comment question 56).

³² *Id.*, sec. 37.6(b)(1)(ii) at 62096.

³³ *Id.*, sec. 37.6(b)(2)(i) and (iii) at 62096.

“economic terms” of the uncleared swap, such as the trade date, notional amount, settlement date, and price.³⁴ In practice, this proposal means that counterparties would not need to submit all of their relevant underlying ISDA Master Agreements to SEFs in order to trade uncleared swaps.

MFA appreciates and supports this proposal, because it responds to MFA’s previous request that the Commission adopt a modified confirmation delivery requirement for uncleared swaps that is more workable and respects the confidentiality concerns of the counterparties.

8. Definition of SEF Market Participant

Proposed section 37.2(b) would codify the definition of “market participant” to mean “any person who accesses a [SEF] in the following manner: (1) Through direct access provided by a [SEF]; (2) Through access or functionality provided by a third-party; or (3) Through directing an intermediary that accesses a [SEF] on behalf of such person to trade on its behalf.”³⁵ MFA appreciates and supports this proposed definition in order to provide greater clarity to market participants.

9. SEF Disclosures

Regarding the Commission’s proposed Form SEF amendments relating to the SEF registration process, we support the proposed disclosure in Exhibit K of a SEF applicant’s market maker programs, incentive programs, or other discounts on dues, fees, or charges.³⁶ MFA requests that such disclosures should be made publicly available to inform the business decisions of all market participants regarding whether to join a particular SEF. MFA believes the need for such disclosures is heightened by the Commission’s proposed expansion of the SEF registration requirement that is expected to substantially increase the number of registered SEFs.

10. Conclusion

MFA believes that the collective effect of many of the proposed reforms will be to create significant disruption and costs for investors, while undermining the observed benefits associated with the current baseline regulatory framework,³⁷ including increased pre-trade price transparency, price competition, and liquidity.

³⁴ *Id.* at 61973.

³⁵ *Id.*, sec. 37.2(b) at 62094.

³⁶ *Id.* at 61966.

³⁷ *See id.* at 62052 (explaining that the baseline for the consideration of costs and benefits is the existing regulations in part 37; sec. 37.10 and sec. 38.12; sec. 39.12(b)(7); and sec. 43.2).

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In the SEF Proposing Release, the Commission states that it “recognizes that the proposed rules may impose costs, but currently lacks the requisite data and information to reasonably estimate them.”³⁸ We urge the Commission to examine the available data collected by SEFs, swap data repositories, and the Commission over the last five years, as well as numerous academic studies that document the benefits of the current swaps trading regime.³⁹ Based on the empirical evidence from these studies and the collective trading experience of MFA members, MFA asks the Commission to reconsider the massive scale of its proposals and adopt more targeted reforms to enhance the benefits of the current swaps trading regime. In addition, to the extent the Commission proceeds to finalize certain of the proposed amendments to the regulatory framework for SEFs, MFA requests that the Commission perform a retrospective market study to assess the combined impact of such changes.

MFA thanks the Commission for considering our views on the SEF Proposed Rule. We welcome the opportunity to discuss our views with you in greater detail. Please do not hesitate to contact the undersigned at (202) 730-2600 with any questions the Commission or its staff might have regarding this letter.

Respectfully submitted,

/s/ Laura Harper Powell

Laura Harper Powell
Associate General Counsel
Managed Funds Association

cc: The Hon. J. Christopher Giancarlo, Chairman
The Hon. Brian D. Quintenz, Commissioner
The Hon. Rostin Behnam, Commissioner
The Hon. Dawn DeBerry Stump, Commissioner
The Hon. Dan M. Berkovitz, Commissioner

Amir Zaidi, Director, Division of Market Oversight

³⁸ *Id.* at 62051.

³⁹ *Id.* at 62144.