SEF CCO Working Group Comments Regarding CFTC 2017 KISS Initiative

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Mr. Amir Zaidi
Director
Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

Dear Mr. Zaidi:

Chief Compliance Officers ("CCOs") of Swap Execution Facilities play important and critical roles in fostering integrity and establishing compliance in the swaps markets. We appreciate the imminent changes/revisions being made to Part 37 in association with Commissioner Giancarlo's White Paper, KISS Initiative, and from one-on-one conversations with the SEFs. That said, we are providing some suggestions for consideration by the Commission, below.

Please note that this list in not all-inclusive. Many SEFs have already communicated other suggestions to Commission Staff. The following is intended only to supplement those recommendations.

1. SEF CCO Annual Report Requirements

Pursuant to CFTC Regulation 37.1501, the CCO for each SEF is required to prepare, every year, a lengthy report with detailed information regarding (among other things) the SEF's written policies and procedures and compliance program. These reports are unduly burdensome to prepare in comparison to the regulatory benefit of much of the information required to be provided, and we, therefore, believe the requirements for such reports should be amended.

1.1. Content

Registered swap dealers, major swap participants, and futures commission merchants are subject to a similar requirement to produce an annual CCO report, and the Commission recently proposed to amend those requirements in order to make them less onerous. The Commission noted that CCOs of such entities are currently required to provide a significant amount of information with regard to "each applicable CFTC regulatory requirement to which the Registrant is subject. In other words, for each applicable CFTC requirement, the CCO Annual Report must identify a WPP [i.e., a written policy and procedure], assess the WPP, and discuss related areas of improvement." In response to comments that such requirements are "burdensome when compared to the intrinsic value of this portion of the report, particularly given that many of the WPPs do not change from year to year," and recognizing that the current requirements may not be "promoting an active, on-going self-evaluation," the Commission proposed a number of changes to the CCO report requirements for swap dealers, major swap participants and futures commission merchants.

The comments that led the Commission to propose amendments to the CCO report requirements for swap dealers, major swap participants, and futures commission merchants are equally applicable to the CCO reports required of SEFs. Therefore, the SEFs request that the Commission adjust the requirements for a SEF's CCO report in the same ways. Specifically, the Commission should no longer require that a CCO report analyze its WPPs with regard to each applicable CFTC requirement. Rather,

the CCO report should be required only to describe: (1) the SEF's WPPs (including any material changes thereto), (2) the CCO's assessment of the effectiveness of the SEF's WPPs, (3) recommended areas for improvement in the coming year, (4) the resources set aside for compliance with laws and regulations applicable to its business as a SEF, and (5) any material instances of non-compliance.

1.2. Frequency

The SEFs note that SEF compliance programs are very consistent once established and that material changes are likely to be less frequent. Therefore, the SEFs request that: (1) CCO reports for SEFs be required to contain all of the information listed above every other year, and (2) in each intervening year, SEF CCO reports be required only to describe material changes to the SEF's WPPs and any material issues of non-compliance. The SEFs believe this would properly align the burdens of preparing such reports with the regulatory benefits associated with them.

1.3. Timing

SEF CCOs are currently required to file their Annual Reports to the Commission within 60 days after the SEF's fiscal year-end. The SEFs are requesting that the SEF CCO Annual Reports be extended to 90 days after the SEF's fiscal year-end, which would be consistent with other regulated entities.

2. Compliance Manual Filing Requirement under Part 40

Arguments/reasons for allowing SEFs to place Compliance Manual amendments into effect without certification by the Commission:

2.1. Administrative Burden

A requirement to file all changes to the Compliance Manual and related documents creates a significant administrative burden on the SEFs. In accordance with CFTC Regulation 40.6, each amendment to the Compliance Manual and related documents requires an approval from the Boards of the SEFs. Since final registration, SEFs have had to file amended Compliance Manuals as well as all or certain related documents, each filing potentially containing over 400 pages at times. Without this requirement, the Commission will continue to have oversight over all changes to SEF Rulebooks which will be substantive in nature and will give the Commission a chance to review potential novel or complex issues and ensure consistency with the CEA or Commission's regulations. The Compliance Manual, in contrast, is a document that proceduralizes the same SEF Rulebooks and are unlikely to be substantive in nature or present novel or complex issues that would merit the same level of secondary review by the Commission.

2.2. Compliance Manual Amendments Do Not Rise to the Level of Rule Amendments

The Compliance Manual is an internal document outlining the procedures to ensure compliance with the rules outlined in the SEF Rulebook and applicable CFTC Regulations. Changes to the Compliance Manual or related documents are generally administrative in nature unlikely to contain novel or complex issues that merit Commission review contrary to the stated purpose of the rule certification process. Therefore, amendments to the Compliance Manual and related documents do not rise to the level of a rule or trading protocol change meriting certification by the Commission. Furthermore, CFTC Regulation 15.01(e)(3) requires the Chief Compliance Officer to include in the SEF annual compliance report any material changes to compliance policies and procedures since the last annual compliance report. In doing so, the Commission is aware on an annual basis of any changes and the SEF can provide the Commission further information regarding these changes upon request. SEFs can maintain documentation internally regarding all changes to the Compliance Manual and related documents and can provide the Commission with any individual document(s) upon request.

2.3. Compliance Manuals Are Not Public

Compliance Manuals are proprietary internal documents that the CFTC grants "confidential" treatment when filed and does not make public. As stated above, changes to the Compliance Manual can be quite frequent as they are generally live and ongoing documents reflecting the overall compliance of the SEF. In accordance with the KISS initiative, the SEFs request relief from the filing and or certification requirement to maintain an updated Compliance Manual in accordance with its rules, regulations and policies and procedures.

3. Swap Record Retention Requirement (Life of Swap + 5 years) under Part 45

Arguments/reasons for exempting SEFs and DCMs from record keeping requirement in CFTC Regulation 45.2(c):

3.1. Redundant:

SEFs and DCOs are required to retain records of any swap for the life of the swap + 5 years. This is a departure from the recordkeeping requirement of other derivatives under the CFTC's jurisdiction which is 5 years from the date the record was created. While it is true that the duration of a swap is typically much longer than futures or options, there is an added component for swaps that does not exist for other products in that all swaps are reported to an SDR. Each counterparty to a swap, the DCO (if cleared) and an SDR are also each required to maintain these records for the same period of time. This seems to be unnecessarily redundant as under the current regulation, at least four (4) separate copies of the same records are required to be stored. The recordkeeping requirement for the execution venue should be tied to the date of execution of the swap, not its termination, as its role in the lifecycle of the trade is limited to its execution. It should be noted that:

- Counterparties and SDRs have complete swap records following the execution of the swap prior to its final termination or expiration based on access to all the details of transactions reported to the SDRs by the counterparties, including the date of termination of a swap, and can easily calculate the residual retention period after "termination" message was generated or received, which is not received by a SEF or DCM. The SEF/DCM has no knowledge of an early termination or novation and therefore is forced to maintain the records based on the original termination date of the swap.
- Each SDR registered with the Commission is required to keep full, complete, and systematic records, together with all pertinent data and memoranda, of all activities relating to the business of the swap data repository throughout the existence of the swap and for five years following final termination of the swap. All required creation data and all required swap continuation data for a given swap must be reported to a single swap data repository, which shall be the swap data repository to which the first report of required swap creation data is made, using a single USI that ties all the records together. After execution and the initial reporting of the swap to the SDR, the SEF's/DCM's role in ongoing continuation data ceases. The reporting counterparty or the DCO report all lifecycle events on the swap to the SDR, which bypasses the SEF/DCM. As such, the CFTC will continue to have direct oversight over complete swap records via these other registered entities.
- For cleared swaps, the Commission should recognize that technically a swap that was executed on the SEF or DCM terminates as soon as it is cleared, where the USI of the original swap is replaced by the USIs of the cleared swap. Therefore, maintaining records for 5 years from the date of execution is sufficient for audit trail and other investigative purposes.

3.2. Burdensome

The requirement for SEFs to maintain these records is burdensome, particularly as some records may be required to be kept for a period up to 65 years from execution for uncleared swaps, and up to 55 years from execution for cleared swaps.

4. Audit Trail requirements of CFTC Regulation 37.205

4.1. Allocations

The SEFs request that the Commission codify the No-Action Relief given in CFTC No-Action Letter 15-68, which relieves SEFs of the requirement to capture post-trade allocations in audit trail data or to conduct associated audit trail reviews of post-trade allocations, as required by CFTC Regulations 37.205(a) and (b)(2) respectively, subject to the following conditions:

1. The SEF must have a rule that requires that market participants provide post-trade allocation information to the SEF for particular trades, if the SEF, at the request of the Commission or otherwise, requests such information; and
2. In the course of a trade practice surveillance or market surveillance investigation into any trading activity involving post-trade allocations, upon such request pursuant to condition 1 above, the SEF

must ascertain whether a post-trade allocation was made, and if so, the SEF must request, obtain and review the post-trade allocation information as part of its investigation.

The reasons articulated in the NAL Request from certain SEFs has not changed since the No-Action relief was requested in November 2015.

4.2. Customer Type Indicator ("CTI") Code

CFTC Regulation 37.205(b)(2)(ii) requires Customer Type Indicator ("CTI") code to be included as part of a comprehensive audit trail. The usefulness of CTI codes is outdated, and in fact, CFTC Regulation 1.35(g) which defines the CTI codes has not been updated to reflect changes agreed to in 2004 by exchanges that participate in the Joint Compliance Committee. CTI codes were originally meant for floor trading in order to determine the relationship between the trader and the account for which trades were executed for surveillance purposes. The code(s) have had to be refined over time in order to make them more useful for electronic trading. For swaps specifically, Legal Entity Identifiers ("LEIs") can serve the same purpose and are more accurate and verifiable. The time spent attempting to explain what a CTI code is to a clearing firm or participant, and to obtain accurate CTI codes is not worth the benefit derived from obtaining them. No SEF or regulatory service provider uses CTI codes for trade practice and market surveillance as was originally intended by CTI codes. The Commission should update the regulation to eliminate this requirement.

4.3. Enforcement of Audit Trail Requirements

CFTC Regulation 37.205(c) includes enforcement of audit trail requirements, which requires a SEF to enforce its audit trail and recordkeeping requirements through at least annual reviews of all members and persons and firms subject to the SEF's recordkeeping rules to verify their compliance with the swap execution facility's audit trail and recordkeeping requirements.

In 77 FR 75531, the Division of Swap and Intermediary Oversight ("DSIO") issued guidance on whether a participant can rely on another Commission registrant's records to satisfy its recordkeeping obligations. DSIO stated that while complying with the final rule is the responsibility of the covered participant, and the covered participant will be liable for failure to comply, depending on the type of record and arrangements made for access, covered persons may reasonably rely on a DCM, SEF or other Commission registrant to maintain certain records on their behalf. For example, a member of a DCM or SEF can rely on electronic order routing or order execution systems of FCMs, DCMs, or SEFs to record the audit trail information it enters into the system in accordance with Commission requirements, if the covered person arranges to get access to such records in order to satisfy requirements under the regulation. The Commission should incorporate this guidance into CFTC Regulation 37.205(c) to narrow the scope of audit trail reviews that a SEF must conduct for participants who meet the criteria of this guidance.

5. Master Agreements for Uncleared Swaps (Part 37 Footnote 195)

As discussed in Commissioner Giancarlo's white paper, footnote 195 to the preamble of the final SEF rules states, in part, that "[t]here is no reason why a SEF's written confirmation terms cannot incorporate by reference the privately negotiated terms of a freestanding master agreement... provided that the master agreement is submitted to the SEF ahead of execution." Commissioner Giancarlo states, "These master agreements set out the non-transaction specific credit and operational terms that apply to all transactions entered into under them. As a result, SEFs do not know or have access to all of these terms and corresponding documentation."

The CFTC has extended No-Action Relief to this obligation four times (CFTC Letters No. 14-108, 15-25, 16-25 and 17-17), with the last letter granting relief until the effective date of any changes in the regulation. The SEFs request that the CFTC codify the No-Action Relief subject to the conditions last stated in CFTC Letter 17-17.

6. Embargo Rule

The SEFs request that the Commission repeal the CFTC Regulation 43.3 (also known as "the Embargo Rule") and not include it within Project KISS. Under the Embargo Rule, a SEF may not disclose swap transaction and pricing data to its market participants until it transmits such data to a swap data repository

(SDR) for public dissemination. In order to do so, a SEF must first enrich and convert such transaction data as required by the SDR. Moreover, SEFs that use a third-party to route data to an SDR interpret the rule to mean that they need to delay flashing execution data until the third-party has notified the SEF that the data has been sent to the SDR. In both scenarios, the delays in transaction and pricing data disclosure caused by the Embargo Rule inhibit the "work-up" process and stunt liquidity. As stated by Commissioner Giancarlo, "It is believed that the work-up process increases wholesale trading liquidity in certain OTC swaps by as much as 50 percent."

Thus, the Embargo Rule impedes this liquidity generation.

The purpose of the Embargo Rule is to increase public transparency of the swap market (in a market that is closed to the general public) at the expense of transparency for actual participants that trade on-SEF. This prioritization of the general public price transparency over the market participants further impedes liquidity as the market participants who may transact on this information, via a work-up transaction, are hindered by the rule.

7. Additional Considerations

Due to the limited time, we decided to provide bullet points to other items we believe merit attention. At some point, in the near future, the Sef's will provide additional color, perspective, and recommendations to the following:

- Reducing the time period of the projected operating costs to determine the financial resource requirement and liquid of financial resources required by CFTC Regulation 37.1303 and 37.1305 respectively.
- Establishing uniform quarterly financial filing requirements to the Commission as required by CFTC Regulation 37.1306 for all SEFs
- Monitoring of reference indices (Appendix B to Part 37, Core Principle 4 (B)(a)(4))
- Changes to SEF transactions in emergency circumstances (Appendix B to Part 37, Core Principle 8 (a)(1))

On behalf of all the participating SEF's, we appreciate your time and consideration.If you have any questions, please contact Saundra Armstrong at (646) 344-3267.

Cordially,

Saundra Armstrong
LatAm SEF, LLC
with
Other Participating SEFs