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

Submitted online: https://comments.cftc.gov

February 25, 2019

Dear Secretary Kirkpatrick

Swap Execution Facilities and Trade Execution Requirement

The Alternative Investment Management Association[1] ("AIMA"; we) welcomes the opportunity to provide comments to the Commodity Futures Trading Commission ("CFTC") in respect of its Proposed Rules on Swap Execution Facilities and Trade Execution Requirement (the "proposed rule").[2]

AIMA has been a consistent supporter of reforms to strengthen oversight of swaps trading, as well as reforms intended to foster the move towards greater multilateral and transparent trading in these markets. We believe that the existing framework has enhanced competition and improved pre-trade transparency, leading to greater liquidity and lower costs for the investors whose money our members manage.

While we believe that it is appropriate that regulators continue to refine rules to ensure that they reflect the characteristics of the market in question and best deliver on policy objectives, we would urge the CFTC to approach any change to swap execution facilities and trade execution in a phased and targeted manner, rather than adopt a wholesale package of changes in a single rulemaking. We believe that a more targeted approach than that in the proposed rule would better allow market participants to feed into the rulemaking process and would give the CFTC greater opportunity to assess the impact of individual changes, addressing their impact on competition,

[1] The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry.
[2] 83 FR 61946. Online at: https://www.cftc.gov/sites/default/files/2018-11/2018-24642a.pdf.

pre-trade transparency and liquidity. Adopting multiple significant changes at the same time greatly increases the risk of unintended consequences.

We have also in the past stressed the importance of recognising the global character of swaps markets; this calls for an approach to regulation that does not lead to duplication of regulatory requirements or create artificial restrictions in terms of who market participants are able to transact with. In this regard, we have been encouraged by the progress in the context of discussions between the CFTC and European Commission, culminating in the welcome Common Approach on Trading Venues.[3]

Accordingly, in this submission we focus on the aspects of the proposed rule that we believe are most relevant from the point of view of maintaining global alignment of requirements applicable to swaps markets, addressing: the scope of the execution requirements; impartial access; and straight-through processing ("STP"). In particular, we highlight areas where we see the greatest risk of divergence between CFTC and European requirements associated with EMIR[4] and MiFIR[5].

In the Annex to this letter, we make the following points:

- We believe that the Made Available to Trade ("MAT") process should be revised in order to ensure that market participants and the CFTC have a stronger voice in determining the scope of products that are sufficiently liquid to be subject to the trade execution requirement and to provide the CFTC, rather than the SEF, with decision-making power. While we welcome revisions to the MAT process, we do not support its elimination.

- We urge the CFTC to maintain a minimum level of pre-trade transparency on SEFs, noting that the RFQ-3 requirement is associated with significant savings in execution costs for end users of mandated swaps.

- We are not convinced by the assertions made by the CFTC that the existing impartial access requirements run counter to the logic of swaps trading and fear that the CFTC risks imposing regulation that unnecessarily perpetuates the existing market structure and entrenches the commercial advantage of the dealer community without a clear policy justification.

- We do not believe that replacing the currently quantitative approach with a qualitative "prompt, efficient, and accurate" standard in the context of straight-through processing would be helpful and encourage the CFTC not to proceed with this change.

[3] See https://www.cftc.gov/PressRoom/PressReleases/pr7629-17.
[4] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories. Online at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0648&from=EN.
[5] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012. Online at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0600&from=EN.

- The proposed “market participant” definition should exclude any client that merely consents to individual transactions made on its behalf by an asset manager, rather than initiate them.

We would be happy to discuss any aspect of this submission with you in further detail. Please contact Adam Jacobs-Dean (ajacobs-dean@aima.org) should you have any questions.

Yours sincerely,

[signed]

Jiří Król
Deputy CEO, Global Head of Government Affairs
AIMA

Annex 1

The trade execution requirement

In the proposed rule, the CFTC highlights the fact that the current "Made Available to Trade ("MAT") process has resulted in a limited number of products that are required to be executed on Swap Execution Facilities ("SEFs").[6] The CFTC suggests that this has "limited the amount of trading and liquidity formation occurring on SEFs"[7] and proposes a revised interpretation of the trade execution requirement to cover all swaps that are both subject to the clearing requirement under section 2(h)(1) of the Commodity Exchange Act ("CEA") and listed for trading on a SEF or Designated Contract Market ("DCM"). As a result of this approach, the CFTC would also withdraw the existing MAT process.

AIMA has in the past expressed our reservations about the structure of the MAT process and specifically about the challenges associated with a regime that effectively gives decision-making powers to SEFs to determine which contracts are subject to a MAT determination, and thus required to trade exclusively on SEFs. However, while we welcome revisions to the MAT process, we do not support its elimination. Instead, we believe that the MAT process should be revised in order to ensure that market participants and the CFTC have a stronger voice in determining the scope of products that are sufficiently liquid to be subject to the trade execution requirement and to provide the CFTC, rather than the SEF, with decision-making power. We further believe that it remains sensible to distinguish between the universe of contracts that is subject to the clearing mandate and those that are subject to the execution requirement.

This elimination of the MAT process – and the resulting extension of the execution requirement to all swaps subject to the clearing requirement – would also stand in contrast to the approach adopted in Europe under Article 32 of MiFIR, which empowers the European Securities and Markets Authority ("ESMA") to determine which derivatives products should be subject to the "trading obligation" of Article 28 of MiFIR. In making this determination, ESMA must consider whether the contract in question meets the tests of: (1) being admitted to trading on at least one trading venue; and (2) being "sufficiently liquid" that it can trade exclusively on a venue.

Despite the differences between the existing MAT process and the ESMA trading obligation determination process, in practice the US and EU regimes today subject a substantially similar set of products to the execution requirement. This is very welcome from the point of view of ensuring that the liquidity pools for these instruments are not fragmented along jurisdictional lines.

The CFTC's proposed expansion of the trade execution requirement would inevitably lead to such fragmentation by creating a significant misalignment between the scope of coverage of the US and EU rules. This would lessen the comparability of the US and EU regimes, and would be contrary to the CFTC's goal of "more efficient, transparent, and cost-effective means of trading".[8]

[6] 83 FR 61950.
[7] 83 FR 61951.
[8] 83 FR 61952.

We encourage the CFTC to reconsider this aspect of the proposals and ensure that any changes in respect of the MAT process factor in the approach adopted in other jurisdictions. We note that the proposed rule would defer for two years the effective date of any new regulations for swaps broking entities, including interdealer brokers that are non-U.S. persons in order to allow the CFTC to further develop its cross-border regulatory regime.[9] Given the fact that these markets are global and that any changes in the U.S. regulatory framework will affect trading worldwide, we suggest that it may be preferable to postpone making any structural changes to that regulatory framework until the CFTC has adopted changes to its cross-border regulatory regime for swaps.

We also note that, for instruments subject to the trade execution requirement, the CFTC proposes to allow a SEF to offer any method of execution, rather than only an Order Book or Request-for-Quote ("RFQ") System. While we support additional flexibility for market participants, we note that the current methods of execution were selected based on pre-trade transparency considerations. Therefore, we urge the CFTC to maintain a minimum level of pre-trade transparency on SEFs, noting that the Bank of England Staff Working Group Paper quantifies the benefits associated with the RFQ-3 requirements for U.S. IRS market as "daily savings in execution costs of as much as $3-$6 million for end-users of [mandated] USD swaps."[10] Allowing any method of execution without a minimum standard would also cause additional misalignment between the US and EU, given that MiFIR contains specific pre-trade transparency requirements.

The proposed rule would also add a new Part 36 to the CFTC's regulations regarding the trade execution requirement. For purposes of determining compliance with that requirement, the CFTC would divide market participants into three categories. The first category would consist essentially of swap dealers. The second category would include many AIMA members and clients thereof, including commodity pools, private funds and persons predominantly engaged in activities that are in the business of banking or are financial in nature. All other counterparties would be in the third category, which would include other institutional investors that are clients of AIMA members. Although the CFTC indicated that it referred to the clearing requirement implementation compliance schedule when drafting the compliance schedule for the trade execution requirement, the CFTC has not included in Category 2 for the trade execution requirement a carve-out for third-party subaccounts similar to that in the original clearing implementation schedule.[11] AIMA requests that the CFTC make this conforming change.

Finally, we note the CFTC's proposals to require a SEF to prohibit its participants from engaging in pre-execution communications away from its facility, including negotiating or arranging the terms and conditions of a swap prior to its execution on the SEF.[12] We would like to echo the views of the Managed Funds Association that this would represent a significant impediment to firms seeking to obtain market colour and to trade and execute block trades on SEFs. We request that the

[9] 83 FR 61957, 61961-63.
[10] 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), p.31. Available online at: https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2018/centralized-trading-transparency-and-interest-rate-swap-market-liquidity-update.
[11] 83 FR 62041, 62087; Regulation 50.25(a).
[12] 83 FR 61986.

Commission retain the current block trade exception to the pre-arranged trading prohibition under section 37.203(a) and allow a corresponding block trade exception to the proposed prohibition on pre-execution communications in section 37.201(b), irrespective of whether the swap is or is not subject to the TER.

Impartial access

We note that the CFTC proposes to modify existing impartial requirements under § 37.202 to provide a SEF with the ability to limit participation as it sees fit based on its own trading operations and market focus. The CFTC justifies the proposed change by stating that an all-to-all trading environment is not necessarily compatible with the structure of the swaps market, which it suggests has structured itself into dealer-to-dealer and dealer-to-client liquidity pools as a result of the episodic nature of trading in the swaps market:

> "[…] imposing all-to-all, market-derived requirements on swaps markets ultimately detracts from achieving the statutory SEF goals of promoting swaps trading on SEFs and pre-trade price transparency in the swaps market. Accordingly, the Commission believes that each SEF should be able to use access criteria to develop its business in a manner that is both consistent with the characteristics of swaps markets and accommodating of the types of participants that comprise the SEF's intended market."[13]

We have consistently expressed our support for a market structure that allows participants to interact with the broadest range of counterparties and which enables investment managers to transact directly with other investment managers where that offers the most cost-effective way of transacting. Fostering the move towards greater all-to-all trading can help deepen liquidity and improve transparency in swaps markets.

We are not convinced by the assertions made by the CFTC that the existing impartial access requirements run counter to the logic of swaps trading and fear that the CFTC risks imposing regulation that unnecessarily perpetuates the existing market structure and entrenches the commercial advantage of the dealer community without a clear policy justification.

This also represents another area of divergence between the US and EU. We note that ESMA's position[14] on the application of Article 18(3) of MiFID II, which covers non-discriminatory access rules, at present aligns closely with the CFTC's existing approach. It would be unwelcome from our perspective if the US were to weaken its provisions on impartial access.

Accordingly, we respectfully urge the CFTC not to depart from its existing approach in respect of impartial access.

---

[13] 83 FR 61994.

[14] ESMA Questions & Answers on MiFID II and MIFIR market structure topics, p.31. Online at: https://www.esma.europa.eu/sites/default/files/library/esma70-872942901-38_qas_markets_structures_issues.pdf.

Straight-through processing (STP)

We note the CFTC's assertion that a qualitative interpretation of "prompt, efficient, and accurate" within the context of § 37.702(b)(2) is more appropriate than imposing a specific time standard upon SEFs for processing and routing transactions to a Derivatives Clearing Organisation ("DCO").[15]

The CFTC justifies this on the basis that many SEFs, particularly those that offer voice-based or voice-assisted trading systems or platforms, have not been able to meet the current 10 minute timeframe for submitting executed trades to CCPs when using manual affirmation hubs. The CFTC also suggests that more accommodative timeframes for trade submission would support the move to a more flexible SEF architecture.

As noted above, we do not believe that the proposed changes to the execution requirement or overall market structure would be in our members' interest and therefore do not believe that STP provisions should be modified in order to facilitate those changes.

We also challenge the idea that the inability of certain SEFs to meet the current 10-minute timeframe provides a justification for removing the timeframe. Ensuring that swaps are submitted to clearing as soon as possible post-execution is critical to promoting market efficiency and reducing systemic, credit, and operational risk. Further, we note that the 10-minute timeframe is also used in the context of EU requirements for trades that are concluded non-electronically, and that an even stricter 10 second standard is provided for trades that are concluded electronically.[16] We are concerned by any move by the CFTC that would imply a weaker level of protection for our members, which would be the case if intended-to-be-cleared trades remain uncleared for extended periods of time. Among others, this is likely to undermine confidence in the US as a place to trade swaps and could lead of a migration of liquidity to other jurisdictions.

As such, we do not believe that replacing the currently quantitative approach with a qualitative "prompt, efficient, and accurate" standard would be helpful and encourage the CFTC not to proceed with this change.

Market participant

The proposed rule would now specifically define the term "market participant" to mean any person who accesses a SEF through directing an intermediary that accesses a SEF on behalf of such person to trade on its behalf. The preamble states that "The proposed "market participant" definition would not capture clients of asset managers who, as market participants of a SEF, trade on a SEF on their clients' behalf." The preamble goes on to discuss that these asset managers have been

[15] 83 FR 62022.

[16] Commission Delegated Regulation (EU) 2017/582 of 29 June 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards specifying the obligation to clear derivatives traded on regulated markets and timing of acceptance for clearing, Article 3. Online at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0582&from=EN.

given broad discretion by their clients and that the clients will generally not know about specific transactions. [17]

We urge the CFTC to extend similar treatment if the client is being "guided" by the asset manager. For example, where an asset manager has a systematic program that recommends specific transactions, but the client has to give consent for each transaction (which happens every time, or almost every time), the client should not be considered a market participant. We note that, in the CFTC's general regulations governing commodity trading advisors ("CTAs"), either having broad discretion over a client's account *or* guiding an account generally requires CTA registration and the requirement to provide a Disclosure Document pursuant to CFTC Regulations 4.31 and 4.10(f) and (g).

These classifications as to who is deemed to be a market participant may also affect recordkeeping requirements. If the latter group of clients, those being guided by the asset manager, is not excluded from the "market participant" category, then it appears that these clients would be subject to CFTC Regulation 37.404, which is included in the proposed rule. This regulation provides that SEFs must have rules requiring market participants to keep records of their trading, including records of their activity in the index or instrument used as a reference price, the underlying commodity, and related derivatives markets, and make such records available, upon request, to the SEF or, if applicable, to its regulatory service provider, and the CFTC.

With respect to the asset manager, the proposed rule states that the proposed "market participant" definition and the preamble discussion does not alter any person's obligations under CFTC Regulation 1.35.[18] The CFTC amended that regulation to provide that registered CPOs/CTAs that are SEF members need not maintain records of oral pre-trade communications, whilst still requiring that records of written pre-trade communications be maintained. If the "market participant" definition does not exclude clients that guide an asset manager, this provision is likely to become more onerous in practice.

The proposed rule would also amend the guidance associated with Regulation 37.404 that is set forth in Appendix B to Part 37, relating to Core Principle 4, paragraph (4). The proposed rule would eliminate a SEF's ability to limit the application of Regulation 37.404 only to those market participants who engage in "substantial trading" on the SEF. Irrespective of how the CFTC ultimately defines the term "market participant," AIMA requests that the CFTC retain a SEF's ability to limit the application of Regulation 37.404 only to those market participants who engage in "substantial trading" on the SEF. Otherwise, even entering into a single swap could trigger the application of the regulation. Although the CFTC notes one reason for this proposal is that the CFTC has not provided further guidance in this area, we believe that SEFs and the CFTC should be able to develop appropriate standards through the SEF rule submission process and otherwise.[19]

Finally, with respect to recordkeeping, the general swap recordkeeping requirement, Regulation 45.2, requires all counterparties to a swap to keep transaction records, even if they are not swap

[17] 83 FR 61955.
[18] 83 FR 61955-61956.
[19] 83 FR 62016.

dealers. To the extent that an asset manager would be required to keep records under CFTC Regulation 37.404, there should be no requirement for the client to maintain records for that swap in accordance with Regulation 45.2.

As a final technical matter, the provision of the "market participant" definition referred to above includes any person who accesses a SEF through directing an intermediary that accesses a SEF on behalf of such person to trade on its behalf. In Part 4 of the CFTC's regulations, "directing" trading refers to the CTA having discretion to make trades without the client's specific authorization. In Part 37, it appears that the word "directing" is used to mean the client is directing the intermediary to act on the client's behalf, *i.e.*, there is no discretion granted to the intermediary. This could create some confusion, and we would suggest that a different word be used in Part 37, perhaps "authorizing" or "instructing."