VIA CFTC COMMENTS PORTAL
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Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st St., N.W.
Washington, D.C. 20581

RIN 3038-AE25—Swap Execution Facilities and Trade Execution Requirements, 83 *Federal Register* 61946 (November 30, 2018).

Dear Mr. Kirkpatrick:

Shorcan Brokers Limited ("Shorcan"), a wholly owned subsidiary of TMX Group Limited ("TMX Group"), writes to comment on the Commodity Futures Trading Commission's ("Commission") notice of proposed rulemaking entitled, "Swap Execution Facilities and Trade Execution Requirements," 83 *Federal Register* 61946 (November 30, 2018) (the "Proposal").

TMX Group's key subsidiaries operate cash and derivative markets and clearinghouses for multiple asset classes, including equities and fixed income. TMX Group's subsidiaries include Toronto Stock Exchange, TSX Venture Exchange, TSX Alpha Exchange, The Canadian Depository for Securities, Montréal Exchange, Canadian Derivatives Clearing Corporation, Trayport, and other TMX Group companies, which provide listing markets, trading markets, clearing facilities, depository services, technology solutions, data products and other services to the global financial community.

I. Introduction

Shorcan appreciates the effort and thought behind the Proposal. Although one aim of the proposed amendments to the SEF rules is to ameliorate fragmentation of liquidity, as a result of its treatment of non-U.S. introducing brokers ("IBs"), the Proposal, if adopted, potentially would have the opposite effect and increase the fragmentation of certain non-U.S. liquidity pools. The preamble recognizes that the proposed amendments would have profound effects when applied to markets outside the U.S.[1] Rather than offering a workable alternative, however, it merely delays the compliance date with the hope that an appropriate framework for foreign IBs can, and will, be constructed during that time. This approach has a number of significant flaws.

A two-year delayed compliance date would create a cloud of uncertainty over markets that currently operate well. Markets operate on certainty and trust, both of which would be impaired were the Commission to leave this shadow hanging over non-U.S. markets, including the market in Canada. This uncertainty exists because the Commission's framework as it applies to non-U.S. jurisdictions is grounded in the questionable assumption that foreign jurisdictions that currently do not have comparable regulatory frameworks in place will be able to develop and implement them during the two-year compliance period.

If a comparable framework is not adopted within the two-year period, there is the potential that some markets, such as in Canada, that currently operate with a single global liquidity pool, will find that the liquidity pool must be bifurcated, perhaps with the result that non-U.S. IBs will simply be forced to abandon serving their U.S. customers. For some less liquid instruments, the withdrawal of liquidity provided by U.S. persons may adversely affect market efficiency for both home country and U.S. participants.

This comment letter offers an alternative that would positively address this issue.

II. Shorcan

A. Business activities

Shorcan is an inter-dealer bond broker, acting as the agent for both buying and selling customers in all trades facilitated using Shorcan's brokerage services. Shorcan does not take a principal position at any time, nor does it offer advice to its customers.

Shorcan offers hybrid voice and electronic brokerage services to customers. It offers its services pursuant to, and operates under, trading protocols and trading policies to which all Shorcan customers must adhere. Products include Canadian, Provincial, Corporate, Strip and CMB bonds along with Repo, and Treasury Bills.

[1] See Proposal at 61957.

Shorcan also uses its voice brokerage services to facilitate the offer and sale of Canadian Dollar swaps, chiefly Canadian Dollar interest rate swaps ("CAD IRS").

B. Regulation

Shorcan is registered under the Canadian Securities Administrators National Instrument 31-103 as an Exempt Market Dealer in the provinces of Ontario, Quebec and Nova Scotia. It is also bound by Investment Industry Regulatory Organization of Canada ("IIROC") Rule 36 and Rule 2100, which establishes the foundation to become and access Inter-Dealer Bond Brokers in Canada.

Shorcan also is registered with the Commission as an IB and is a member of the National Futures Association ("NFA") in connection with its swaps facilitation business and has been continuously registered since November 07, 2013. NFA visited Shorcan at its office in Toronto for a routine onsite compliance review during 2018.

C. The market for CAD IRS

CAD IRS are subject to mandatory clearing in the U.S. and Canada.[2] CAD IRS currently are not subject to mandatory trade execution on a SEF in the U.S. pursuant to a Made Available to Trade (MAT) determination. However, some U.S. SEFs list CAD IRS for multi-lateral trading as Permitted Transactions on their platforms. Canada currently does not have formal centralized markets comparable to SEFs. However, inter-dealer brokers, such as Shorcan, facilitate trading in Canadian swaps. As noted above, Shorcan operates a voice-brokerage platform to facilitate trading in CAD IRS.

The market for CAD IRS in Canada is international in scope, including Canadians and U.S. Persons, participating as part of a single liquidity pool. Shorcan facilitates trading in CAD IRS by such participants, often matching U.S. with non-U.S. counterparties. The value of trade involving Shorcan customers who are U.S. Persons is approximately $34 billion notional, which represents about 15% of the total value of transactions facilitated by Shorcan and 30% of the volume.

Transactions facilitated by Shorcan that involve a U.S. counterparty are forwarded to a U.S.-registered SEF for execution and onward submission to a derivatives clearing organization ("DCO"). The counterparty in such transactions may be another U.S. Person, or more likely, a Canadian participant. Transactions which do not include a U.S. counterparty are routed by Shorcan

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[2] See Commission Rule 50.4 and Canadian Securities Administrators (CSA) Notice of National Instrument 94-101, Mandatory Central Counterparty Clearing of Derivatives and Related Companion Policy (January 19, 2017) available at http://www.osc.gov.on.ca/en/SecuritiesLaw csa 20170119 94-101 derivatives.htm.

directly to clearing through a post-trade affirmation platform. Shorcan is not affiliated with any SEF or swaps clearinghouse; it is independent.

III. The Proposal

One aspect of the Proposal is to restructure the role of IBs and their relationship to SEFs. The effect of the Proposal on global trading generally, and on independent, non-U.S. IBs specifically, would be profound. Currently, an independent non-U.S. IB, like Shorcan, is able to facilitate transactions involving U.S. Person counterparties by routing such matched orders to a Commission-registered SEF. These transactions are matched outside of the U.S., submitted for execution to a U.S. SEF, and often cleared by a non-U.S. DCO. Abrogating the matched order flow between independent non-U.S. IBs and U.S.-registered SEFs would have an overwhelmingly negative effect on the ability of U.S. and non-U.S. counterparties to seamlessly engage in cross-border transactions, resulting in the fragmentation of global markets where currently there is none. This unfortunate and likely unintended consequence of the Proposal is precisely contrary to the Commission's stated goal of reducing market fragmentation.

A. The Proposal impermissibly asserts Commission jurisdiction

Although the Proposal is couched in terms of respect for the limits of U.S. jurisdiction and cross-border deference, it is particularly aggressive in imposing its regulatory mantle over non-U.S. jurisdictions, even though that activity may not have a direct and significant connection to commerce in the U.S. The Proposal would reverse five years of market practice and Commission interpretation by concluding that in order to service U.S. swaps clients, non-U.S. brokering entities must be regulated as a SEF by the CFTC or an equivalent market by the entity's home authority and be exempted by the Commission.[3]

[3] The Commission recognizes that its proposed amendments are intended to force IBs and others who have organized their businesses in accordance with the SEF framework as originally promulgated by the Commission into a new, experimental framework. Thus, the Commission explained that, " Based on its experience and observation of market developments since the adoption of part 37, the Commission has witnessed the various ways in which swaps broking entities, including interdealer brokers, have structured themselves to facilitate swaps trading, and therefore liquidity formation, outside of the existing SEF regulatory framework." Proposal at 61952. However, IBs do not exist outside of the SEF framework, but rather are part of the entire SEF trading ecosystem and should be viewed in that manner rather than as existing outside of the SEF framework. In this regard, IBs are Commission registrants and subject to active oversight by NFA.

Despite the fact that for over five years brokers in many non-U.S. jurisdictions have registered as IBs in order to tie trading in local markets to the U.S. regulatory framework, the Commission would now revise that framework, to require non-U.S. IBs to adhere to the Commission's new framework, noting that:

> [C]ounterparties that are required to comply with the trade execution requirement may only satisfy the requirement by executing a swap on a SEF, a DCM, or an Exempt SEF. Accordingly, any foreign multilateral swaps trading facility that seeks to offer such swaps to such counterparties for trading must be registered as a SEF or DCM or obtain an exemption from SEF registration pursuant to CEA section 5h(g), *regardless of whether that trading system or platform meets the standards (or any future standards the Commission may develop) for CEA section 2(i),* i.e., a ''direct and significant connection,'' to trigger SEF registration.[4]

This provision is a back-door attempt to force compliance by non-U.S. trading venues with the Commission's revised trading requirements without regard to the jurisdictional limitations contained in section 2(i) of the Act. The current guidance, consistent with the provisions of section 2(i) of the Act, is based on determining whether the non-U.S. market has such a direct and significant effect on U.S. commerce. The proposed expansion of the trading mandate coupled with this extra-territorial approach is contrary to previous CFTC staff guidance that the SEF registration requirement would apply to non-U.S. markets based upon whether: (1) the platform directly solicits or markets its services to U.S. persons; or (2) a significant portion of the market participants are U.S. persons or U.S.-located persons.[5]

The expansion of the trading mandate coupled with application of the Proposal's extra-territorial SEF registration framework[6] would have the incongruous result that U.S. customers could not use Shorcan to facilitate their trading of Canadian Dollar-denominated swaps in *Canada* under the current Canadian regulatory framework. More disturbing, under the Proposal to amend the MAT process, this result could be dictated by a U.S. SEF competitor of the home country venue listing such a swap for trading. This would be a very strange, but foreseeable, outcome of the proposed rules.

The result of these interrelated proposed amendments is to aggressively assert U.S. jurisdiction with regard to trade execution far beyond its current bounds, withdrawing a successful method for knitting together global liquidity in a manner compliant with the current U.S. trade execution

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[4] Proposal at 61962 (emphasis added).

[5] Division of Market Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities, note 8 (November 15, 2013) available at https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/dmosefguidance 111513.pdf.

[6] Such U.S. requirements include an exemption requirement under which the Commission determines the applicability of the exemption.

requirements. It is ironic that the Proposal does so while at the same time couching its explanations in concepts of cross-border deference.[7] As discussed in detail below, a foreseeable consequence of the Proposal in many jurisdictions will be to force non-U.S. trade facilitators to either register as a SEF with the Commission, a requirement which may well be impractical, or to stop doing business with U.S. customers, further fragmenting global liquidity pools.

The Proposal would appear to attempt to apply the U.S. framework to all non-U.S. markets without reference to the limitations of section 2(i). The Proposal recognizes that the Commission's extra-territorial jurisdiction is not unlimited, but nevertheless takes the position that Shorcan and other similar non-U.S. brokers, regardless of their compliance with local law and regulation, may not facilitate transactions for their U.S. customers outside of the U.S. in any swap subject to the expanded trade execution mandate, unless the U.S. SEF registration framework, or exemption therefrom under section 2h(g) of the Act is met. Although the Proposal suggests that the Commission might consider this issue in the future through some unspecified type of *de minimis* threshold, the entire approach should be reconsidered.

Current market structure follows the Commission's historic territorial approach to its regulatory jurisdiction with respect to non-U.S. markets. The current relationship between foreign IBs and US registered SEFs follows the same pattern as for futures. In this regard, the Commission does not regulate futures transactions conducted outside of the U.S. on a foreign board of trade[8] but rather regulates the relationship between foreign intermediaries and U.S. customers, requiring that such intermediaries register with the Commission or be exempt from registration.[9] The current framework follows this pattern, appropriately providing that foreign brokers that facilitate off-shore swaps trading by U.S. customers register as IBs. Not only does the Proposal depart from this time-tested and well understood and accepted pattern, but the Proposal seeks to introduce an entirely new paradigm, one which is only partially constructed.[10] Before the Commission attempts to impose a requirement that trading conducted off-shore must be conducted on U.S. registered venues

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[7] Proposal at 61962 (similar to other deference initiatives, [the Proposal] should generally reduce market fragmentation, regulatory arbitrage, and duplicative or conflicting regulatory requirements, while increasing the potential for harmonized regulatory standards on a global level . . . .).

[8] The Commission under Part 48 does register foreign boards of trade, but only when they have activities in the U.S. by permitting U.S. Persons directly to access their markets from the U.S. this is not the case with respect to swaps trading in Canada which is conducted outside the territory of the U.S.

[9] See e.g. Commission rule 30.10 which provides an exemption from FCM registration for intermediaries of U.S. customers who do not have a presence in the U.S. and are subject to comparable regulation in their home jurisdiction.

[10] In this regard, the Commission proposes to delay compliance with its final rule while it sorts out the applicability of section 2(i) to the rule which it adopts, stating, "The proposed delay would also provide the Commission with time to develop any threshold standards for the application of CEA section 2(i) to the SEF registration requirement in CEA section 5h(a)(1). While the Commission has yet to determine standards in this area, the Commission notes that any such standard could include a de minimis component, whereby the activity of U.S. persons below some defined quantitative threshold on a particular foreign multilateral swap trading facility would not trigger a need for SEF registration." Proposal at 61920.

or exempted by the Commission, the Commission should first determine that it is acting within its jurisdiction; it cannot simply take the position that its requirements apply to markets located outside of the U.S. "*regardless* of whether that trading system or platform meets the standards (or any future standards the Commission may develop) for CEA section 2(i)."

B. A De Minimis test will not cure the jurisdictional overreach

The Commission asks about the merits of adopting a de minimis exemption to address the jurisdictional issue under section 2(i) of the Act. Typically, this approach might offer a solution. However, the structure of the Proposal reduces the utility of a de minimis solution. This is because the Proposal attempts to require swaps that are subject to the expanded trade execution mandate be traded only on registered SEFs or facilities exempt under section 5h(g) of the Act "regardless of whether that trading system or platform meets the standards (or any future standards the Commission may develop) for CEA section 2(i)." A de minimis exclusion would be a means or standard for application of section 2(i). Accordingly, the Commission appears to be taking the position that a *de minimis* exclusion from SEF registration will not be operative with respect to swaps that are subject to the trade execution mandate.

Insofar as CAD IRS currently is subject to mandatory clearing and is listed (as Permitted Transactions) on some SEFs, CAD IRS would be subject to the proposed expanded trade execution mandate, and any *de minimis* exclusion therefore would have no utility to Shorcan or other independent Canadian IBs. The only way in which a *de minimis* test would have any utility in the Canadian market would be if the revised trade execution mandate is modified so that it can be fulfilled by trading on a registered SEF, a foreign facility exempt from registration under section 5h(g), *or a facility excluded from regulation under an applicable de minimis test*. Even with this drafting change, to have practical effect and, to offer any meaningful relief to market facilitators like Shorcan, the notional trading volume would have to be far higher than the current de minimis threshold of $8 billion notional value applicable to swap dealers.

C. An extended two-year compliance period is not a cure

Even if it were the case that the new requirement is a better structure for the U.S. market, a two-year compliance deferral is not a solution to address the issue of off-shore or cross-border transactions. Under the Proposal, foreign IBs that currently route matched orders to U.S. registered SEFs for execution would be able to continue to do so for two years following adoption of the rule. The Commission states that it would use that time to determine standards under section 2(i) of the Act when it would require non-U.S. trading facilitators to register as a SEF or to seek exemption from the Commission from SEF registration.[11] The Commission supposes that this two-year period

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[11] Id.

will enable foreign IBs to come into compliance with the new U.S. structure. However, the structure that may eventually apply to such non-U.S. IBs currently is far from complete and is simply an inchoate concept. The Commission explains that:

> [U]pon the expiration of the proposed two-year delay, any Eligible Foreign Swaps Broking Entity that seeks to offer such swaps to such counterparties for trading on its trading system or platform must be registered as a SEF or DCM or obtain an exemption from SEF registration pursuant to CEA section 5h(g).
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> During this time, the Commission could formalize a regulatory framework for providing exemptions from the SEF registration requirement for foreign multilateral swaps trading facilities, including foreign swaps broking entities, that meet that CEA section 2(i) standard. The proposed two-year delay not only could provide the Commission with sufficient time to formalize this framework, which would require standards and processes for evaluating exemption requests, but also give Eligible Foreign Swaps Broking Entities more time to determine their best course of action, i.e., seek SEF registration with the Commission or obtain a CEA section 5h(g) exemption from registration.[12]

Although two years would appear to be generous; it clearly is not sufficient. The Commission in that two-year period would have to complete two rulemakings—one on the 2(i) criteria and one setting forth the procedure for applying for exemption; many foreign jurisdictions would have to complete adoption of a SEF-type market framework and the Commission would have to make comparability determinations and complete consideration of applications for exemption. This is a significant amount of work to be completed within a two-year window. Consider that the Commission required five years between first proposing SEF rules and the issuance of registrations to the initial SEF applicants.[13]

More importantly, two years may very well be insufficient for a jurisdiction to consider and adopt an entirely new market framework if it does not already have one in place. For example, although the EU has adopted a framework governing MTF and OTF trading facilities, which the Commission has recognized as equivalent, other jurisdictions are still considering such frameworks. For example, the Canadian Securities Administrators published a Request for Comment relating to registration of derivatives and related trading platforms in April of 2018.[14] However, the proposal has met with a number of comments that the framework would reduce liquidity in the Canadian market and in cross-border transactions. Moreover, commenters have recommended that Canada delay its rulemaking process until final rules are adopted in the U.S. to enable Canada to more

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[12] Proposal at 61962.
[13] The first registrations were issued on January 22, 2016. The rules were proposed on January 7, 2011 (76 Fed. Reg. 1214).
[14] See Proposed National Instrument 93-102 (April 19, 2018).

closely harmonize its rules with the U.S. framework and thereby reduce potential obstacles to cross-border transactions.[15] In light of these comments, the proposal is likely to require further consideration before a final framework is adopted.

As suggested in the CMIC comment, non-U.S. jurisdictions that currently do not have a framework in place might reasonably choose to wait until final rules are adopted by the Commission before beginning, or relaunching, their own process to adopt a framework harmonized to the new U.S. rules. This very reasonable response by non-U.S. jurisdictions makes the prospect of the Commission completing its equivalency determinations within the two-year compliance window more doubtful, and it follows that the section 5h(g) exemption process would be unavailable during that period in many jurisdictions, including Canada.

Even if as a consequence of the Proposal's threat to divert liquidity in the local market to U.S. SEFs non-U.S. jurisdictions adopt trading frameworks comparable to the new U.S. rules (whatever they may be) within two years, the Commission likely may be unable to complete the exemption process within the time it has allotted. The Commission states that "such exemptions may take some time based upon the large number of jurisdictions in which these operations are currently located."[16]

In light of the many portions of this concept that have yet to be worked out, the Commission, at a minimum, should grandfather indefinitely independent, non-U.S. IBs which are currently submitting matched orders to U.S. SEFs for execution, and the SEFs to which they submit such matched orders (including permission to engage in required pre-execution communications), until such time as the Commission is able to complete a rulemaking relating to foreign IBs that is fully considered. Currently, the public is being asked to comment on a mere concept, devoid of any detail. This is contrary to the provisions of the Administrative Procedures Act.[17]

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[15] See Comment Letter of the Canadian Market Infrastructure Committee ("CMIC") at page 3. The CMIC was formed at the request of Canadian regulators and represents both sell side and buy side market participants. The CMIC commented that the Canadian framework should adhere more closely to the U.S. rules in effect in order to facilitate cross border activity. That letter also supported delaying the framework in Canada pending final rules by the Commission and the Securities and Exchange Commission's ("SEC"), in order to be able to harmonize Canadian rules with those in force in the U.S.

[16] Id.

[17] *Am. Med. Ass'n* v. *Reno*, 57 F.3d 1129, 1132–33 (D.C. Cir. 1995) (Notice of a proposed rule must include sufficient detail on its content and basis in law and evidence to allow for meaningful and informed comment).

A. The Proposal would not increase overall pre-trade transparency of cross-border transactions

The Commission noted that the effect of its interpretation would be to require foreign IBs to either register as a SEF or to seek exemption from that registration.[18] The Commission justifies its imposition of U.S. registration on foreign trade facilitators based not on any empirical evidence, but on its belief that this action will assist pre-trade price transparency, and:

> [H]elp foster vibrant and liquid SEF markets as liquidity formation and price discovery is centralized on these markets. With more swaps trading activity occurring in a concentrated SEF environment, the Commission anticipates that a greater number of observable transactions—for example, IRS of varying tenors along a single price curve—would allow for a richer price curve that provides participants with more accurate pricing for economically similar swaps along other points of the curve.[19]

However, even if the Commission's hypothesis is correct, the effect of its action might very well be to increase liquidity on U.S. SEFs *by draining liquidity from non-U.S. venues*. It is hard to understand how forcing U.S. Participants to purchase or sell CAD IRS on U.S. SEFs at the expense of the local Canadian trading venues is a contemplated goal of the Dodd-Frank Act. In fact, that sort of protectionism is contrary to the spirit of the G-20 swaps proposals on which Dodd-Frank is based.[20] It is difficult to see any justification for this result when currently non-U.S. trade facilitators, like Shorcan, register with the Commission as foreign IBs and are supervised by NFA.

Moreover, the Commission's conclusion that concentration of trading on U.S. registered SEFs will inexorably lead to greater price transparency than is provided by trade facilitation venues provided by Shorcan and other similar non-U.S. IBs is not based on empirical evidence; it is based only on conjecture. First, Shorcan provides a high degree of price transparency through its trading protocols. Trading is episodic, but generally multiple potential counterparties are exposed to a bid or offer by Shorcan's desk brokers going out to the entire market anonymously to locate a contra-party. In contrast, if a registered SEF under the relaxed regulatory standard were to provide a trading protocol of RFQ to 1 with no exposure to multiple counterparties, it is hard to see how the revised SEF platform would be more transparent than broker facilitation. Accordingly, the

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[18] Proposal at 61957 (The Commission understands that the proposed interpretation may require certain non-domestic operations—in particular, foreign swaps broking entities, such as foreign interdealer broker operations—to seek SEF registration or an exemption from SEF registration pursuant to CEA section 5h(g), provided that they fall within the Commission's jurisdiction).

[19] Proposal at 61957.

[20] See Leaders' Statement; The Pittsburgh Summit, available at https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh summit leaders statement 250909.pdf. (We are committed to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage).

Commission's Proposal threatens to drain liquidity from Canadian venues to U.S. registered SEFs when it is not clear that under the Proposal's relaxed trade execution protocols, transparency necessarily will be increased.

B. The Proposal is likely to result in greater concentration and less choice

It should be concerning to the Commission that this Proposal likely will lead to increased concentration in venues for trading Canadian Dollar denominated swaps. Although U.S. Participants constitute a not insignificant portion of the liquidity of swaps trading facilitated by Shorcan, they do not contribute sufficient volume to support the regulatory cost to Shorcan of compliance with U.S. SEF registration requirements. Moreover, the expanded trade execution mandate has the potential to diminish this liquidity further, leaving very little, if any, of the market available to independent IBs unless their ability to report matched, mandated transactions to a SEF is preserved. And, as explained above, the exemptive alternative (absent significant modification) is illusory.

The result is entirely foreseeable that the increased regulatory costs imposed by the Commission will cause those firms offering facilitation services with a smaller base of U.S. participants to exit the market. This may concentrate liquidity on U.S. SEFs, but it will do so by forcing from the market smaller, independent trade facilitators, particularly those outside the U.S. This would continue a familiar pattern occasioned by the implementation of Dodd-Frank leading to greater concentration in the financial sector. And although the Commission has predicted many new potential SEF registrations, many will likely be affiliates of existing SEFs which either can be folded into their affiliate's SEF structure or can share the regulatory and compliance systems and costs. A far smaller number of the new SEFs referred to by the Commission will be from the ranks of independent IBs.

The Commission's analysis is focused on only one model of the relationship between foreign IBs and SEFs. The Commission's analysis is focused on a

> common structure consist[ing] of an entity that serves as a parent to a registered SEF entity and several affiliated broker entities that negotiate or arrange trades and participate exclusively on the affiliated SEF as market participants. While many of those broker entities are domestically domiciled, a significant number of them are also located in numerous foreign jurisdictions. Similar to domestic swaps broking entities, these foreign swaps broking entities are not currently registered as SEFs, but are typically registered with the Commission as IBs (footnotes omitted).[21]

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[21] Proposal at 61961.

The Commission does not analyze the role of independent foreign IBs, the relationship between independent IBs and their home market, or the differential impact of the Commission's rules on independent foreign IBs and foreign IBs that are affiliated with a U.S. SEF. Although some of the impacts may be the same for independent and affiliated foreign IBs, affiliated IBs have many more options to structure their businesses in response to the rules. For example, they may concentrate all U.S. customers on their U.K. affiliated MTFs during non-U.S. trading hours and direct local trades to their MTFs, when necessary. Or, if they choose to comply with U.S. SEF registration in various locations, they could outsource all compliance and back-office operations to their U.S. SEF affiliate.

Independent foreign IBs do not have this flexibility. Their only choices are to bear the regulatory cost of registering as a SEF, hope that their home regulator establishes a comparable framework and that the Commission exempts the foreign IB from the SEF registration requirement within the two-year window that the Commission has proposed, or bar any U.S. participation. For many foreign IBs, barring U.S. Participants is a likely outcome. No doubt this will lead to fewer trading choices for U.S. Participants and in some cases, may lead to a serious contraction in the liquidity in a local market. None of these foreseeable effects of the Proposal is analyzed or discussed in the cost/benefit analysis that the Commission is required to perform under section 15 of the Act. This is a serious shortcoming in the analysis. For example, the Commission has failed to consider that section 2(i) may have different application to independent IBs compared to affiliate IBs. This analysis would be similar to the Commission's consideration of the role of conduit affiliates under its cross-border guidance. Certainly, these distinctions deserve analysis and merit an opportunity for public comment.

As explained above, it is unlikely that many independent non-US IBs readily will be able to bear the cost of becoming a U.S. regulated SEF. The compliance requirements are high, particularly only to address a portion of the business. And, it raises the potential difficulty of answering to two regulators, in the case of Shorcan, the Ontario Securities Commission (and possibly other provincial regulators) and the U.S. CFTC. The Commission is familiar with the potential difficulties that such dual registration across national boundaries may raise.

For independent non-US IBs, the current framework provides a means of complying with US law that successfully balances U.S. regulatory interests in off-shore transactions. In the absence of any evidence of harm to the public or to market participants, the possible harm that the Proposal may have in certain jurisdictions, such as Canada, should be given greater consideration.

The Proposal, by requiring persons subject to an expanded trade execution mandate to execute only on SEF or exempt SEF and without preservation of non-U.S. IB routing, would have the perverse effect of preventing U.S. persons from trading in Canada with Canadian persons on CAD IRS using the services of a Canadian firm that is facilitating trading as permitted under the current Canadian regulatory framework.[22]

IV. Proposed Alternative

For the reasons discussed above, the Proposal has the potential to fragment markets that currently are not fragmented, disadvantage independent IBs in favor of IBs that are affiliated with a U.S. SEF, favor U.S. interests over non-U.S. interests *even where the underlying interest of the swap is an interest rate based on the non-US jurisdiction's economy*, and to impose an aggressive deadline on foreign regulators to avoid these adverse effects.

These adverse effects are not a required outcome of the Act. Rather, they are regulatory choices that the Commission is making within the guiderails of the Act. To be sure, the current regulatory framework does not impose these adverse effects and costs on independent foreign IBs. For this reason, and based on the analysis above, Shorcan respectfully requests that the Commission reconsider the aspects of the Proposal identified by Shorcan in this letter that would adversely affect the Canadian market for CAD IRS generally, and Shorcan, specifically.

An alternative that treats non-U.S. entities more fairly and avoids creating incentives for market fragmentation where currently there are none, would be to recognize that non-US entities that have complied with current rules, are currently registered as IBs, are independent of a U.S. SEF, and that currently route matched orders to CFTC-registered SEFs, may continue to operate in this manner (including necessary pre-execution communication) indefinitely, as long as their home jurisdiction continues to apply its current regulatory framework. In essence, this means extending the two-year compliance deferral into a grandfather provision, which enables such entities to continue to operate in their home jurisdiction as they do under the current U.S. regulatory framework so long as their home regulator continues under its current structure.

When such a jurisdiction adopts rules that would require the entity to register and be regulated as a trading facility, then the facility would continue to have six months to apply to the CFTC for exemption under section 2h(g) under whatever process for exemption the CFTC has adopted. The exemption would be provisionally granted during the period that the review for the exemption is pending with the Commission. If the CFTC denies the application, then the facility would no

[22] The Commission clearly is aware that a likely result of the Proposal is that non-U.S., independent IBs will refuse to do business with U.S. clients. Footnote 80 clearly illustrates this result: "The Commission notes that potential courses of action for such entities may include seeking SEF or DCM registration; reorganizing into an existing affiliated SEF; working with the appropriate regulator within their home country to seek an exemption from registration pursuant to CEA section 5h(g); *or adjusting their activity to avoid the Commission's jurisdiction*." Proposal at 61858. Despite this awareness, the Commission does little analysis on how to lessen the adverse impact the Proposal on non-U.S. markets. Avoiding the Commission's jurisdiction means refusing to take U.S. clients, a step that many foreign SEFs have already taken and one of the primary reasons for the current fragmentation of liquidity.

longer be able to accept U.S. customers except upon a finding that it did not have a direct and significant effect on U.S. economy and U.S. customers could trade only instruments not subject to the expanded trade execution mandate.

Shorcan understands that the nations that have agreed to the Pittsburgh G-20 recommendations are moving toward the same regulatory framework. The timetable under which they do so should be a matter of international agreement among regulators; the Commission should not use its rules to punish non-U.S. market facilitators and the U.S. and non-U.S. participants that they serve, as a means of "incentivizing" non-U.S. jurisdictions.[23] The path to reach such commitments is through government-to-government engagement.

Even if the Commission proceeds with its framework largely as proposed, Shorcan respectfully suggests that a grandfather provision applicable to independent foreign IBs and the SEFs that currently provide them with execution services would be a workable approach, providing for a more orderly transition, hold harmless foreign participants and foreign markets, better achieve a main goal of the proposal—to mitigate against liquidity fragmentation, and is more in line with a cost/benefit analysis under Section 15 of the Act and with the Administrative Procedures Act.

V. Conclusion

The Commission's Proposal has broad adverse implications for global markets, particularly the Canadian market. The Commission recognizes these issues and has proposed a two-year compliance deferral as a consequence. However, a two-year deferral clearly is not a solution in light of the fundamental nature of many of these issues and the obvious lack of proposed solutions at this time on which to comment.

The current foreign IB framework enables independent, non-US IBs to offer unified liquidity on their platforms to both U.S. and non-U.S. clients. The Proposal ignores the very important role that the IB structure plays for such independent, non-U.S. IBs and the likely effect of the Proposal in fragmenting that currently unified liquidity pool. For this segment of the market, routing to a CFTC-registered SEF by an independent non-U.S. IB may be the only practical means of including US Participants.

One alternative that the Commission should consider is to grandfather independent foreign IBs and the current order workflow (including pre-execution communications) for an indefinite period.

[23] The Commission acknowledges that these rules, as they apply to non-U.S. IBs are in part geared toward pressuring other national authorities, stating that the Proposal, "create strong incentives for foreign jurisdictions to establish or bolster their own robust regulatory regimes for swaps trading. Such measures would also be consistent with the commitment made among the G–20 countries in 2009 'to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage.' "Proposal at 61962.

The replacement framework for these independent, non-U.S. IBs should be the subject of a fully articulated framework, developed in consultation with other national authorities, considering the range of timetables for action by various non-U.S. regulators, and subject to a full and considered opportunity for public comment.

If the Commission proceeds with the Proposal in its current form, the likely result will be greater concentration in the swaps trading structure and increased, not decreased, fragmentation of liquidity pools in various markets. For the above reasons, Shorcan respectfully requests that the Commission reconsider its proposal as it applies to independent, non-U.S., IBs.

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Shorcan would be pleased to discuss our comments at greater length with the Commission. Please feel free to contact Heath Thomlinson, CCO/COO at (416) 315 8478 or Paul M. Architzel, of WilmerHale, outside counsel to Shorcan at (202) 663-6240, with any questions about this comment letter.

Respectfully submitted,

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