

Derivatives Alert

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CFTC Proposes To Ease Certain Swap Execution Facility Rules

On January 30, 2020, the Commodity Futures Trading Commission (CFTC) unanimously approved proposed amendments (SEF Proposed Rules) to CFTC regulations related to the execution of package transactions, the correction of error trades and the execution of block trades on swap execution facilities (SEFs).¹ The proposal addresses certain issues identified in letters granting no-action relief related to the CFTC's SEF rules and, in many cases, codifies the relief. It represents a considerably scaled-back version of a November 2018 CFTC proposal to revamp SEF trading under then-Chairman J. Christopher Giancarlo that received substantial industry opposition.²

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 amended the Commodity Exchange Act (CEA) to create registration requirements and core principles for SEFs, reflecting Congress's goals to promote swap trading on regulated platforms and pretrade price transparency in the swaps market.³ The CFTC implemented those amendments by adopting regulations regarding, among other things, swap trading requirements and practices as well as criteria for executing and reporting block trades.⁴ In the wake of those regulations, SEFs and market participants identified significant operational and compliance burdens related to the new rules, and in response, the CFTC granted time-limited no-action relief from certain requirements.⁵ The new proposal, which largely codifies that relief, covers several subjects:

¹ See press release, "[CFTC Approves Two Proposed Rules at January 30 Open Meeting](#)," CFTC (Jan. 30, 2020). A SEF is a trading system or platform on which counterparties can trade swaps, similar though not identical to an exchange. See 7 U.S.C. § 1a(50) (defining "swap execution facility"); 17 C.F.R. § 1.3 (same).

² See, generally, Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61,946 (Nov. 30, 2018). In the new proposal, the CFTC noted that the broader reforms proposed in 2018 are still under consideration and that the proposal should not be viewed as "superseding" them. See [Amendments to Certain Swap Execution Facility Requirements and Real-Time Reporting Requirements](#), RIN No. 3038-0074, at 6 n.15 (proposed Jan. 30, 2020). For additional information regarding the November 2018 proposal, see Skadden's [November 20, 2018 client alert](#).

³ See 7 U.S.C. § 7b-3(e).

⁴ See SEF Proposed Rules at 4, 6.

⁵ See, e.g., CFTC Letter No. 17-55 (Oct. 31, 2017) (extending no-action relief for swaps executed as part of certain package transactions); CFTC Letter No. 17-27 (May 30, 2017) (providing no-action relief for SEFs and designated contract markets (DCMs) in connection with swaps with operational or clerical errors executed on a SEF or DCM); CFTC Letter No. 17-60 (Nov. 14, 2017) (extending no-action relief for SEFs from certain block trade requirements).

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Execution of Package Transactions: The CFTC proposes to amend Part 37 of its rules to allow the swap components of several types of “package transactions”⁶ to be executed on a SEF through flexible means of execution under Rule 37.9(c)(2) rather than through restricted methods of execution for “required transactions” under Rule 37.9(a)(2).⁷ Rule 37.9(a)(2) prescribes specific methods of execution for required transactions that are not block trades.⁸ Required transactions are transactions involving a swap that is subject to the CEA’s requirement under Section 2(h)(8) that all swaps subject to mandatory clearing be executed on DCMs or SEFs, unless no DCM or SEF makes the swap available to trade.⁹ However, Rule 37.9(c)(2) permits a SEF to offer “any method” of execution for a “permitted transaction,” which is any transaction not involving a swap that is subject to the CEA Section 2(h)(8) trade execution requirement.¹⁰ Based on feedback from SEFs and market participants that in some cases executing component transactions of package trades as required transactions posed practical and operational challenges, often due to lack of market infrastructure and the bespoke nature of certain package transactions, CFTC staff granted no-action relief to allow other methods of execution.¹¹ The CFTC explained that while it has allowed certain relief to expire as SEFs and market participants’ swap execution capabilities have improved, it has not done so in all cases and suggested that continued flexibility

is needed for certain types of package trades.¹² As part of the package trade proposal, the CFTC would allow SEFs *not to* offer an order book (a method of execution for required transactions) for the swap components of the package transactions covered by the new proposal, noting that such a requirement would result in SEFs incurring unnecessary costs.¹³

The CFTC also proposes to amend Part 36 of its rules to exempt entirely from the trade execution requirement swaps that are (a) executed as part of a package transaction and (b) include a component that is a new bond issuance.¹⁴

Error Trades: The proposal would amend Part 37 of the CFTC’s rules to establish a “principles-based” approach for SEF error trade policies.¹⁵ Consistent with existing no-action relief, market participants could execute swaps to correct operational or clerical errors¹⁶ in required transactions using flexible execution methods under Section 37.9(c)(2) rather than those mandated for required transactions under Rule 37.9(a)(2).¹⁷ However, the proposal would require SEFs to maintain rules calling for market participants to promptly notify the SEF when an error trade occurs,¹⁸ impose requirements related to the time in which a SEF must submit a correcting trade for clearing¹⁹ and prohibit counterparties from executing a second correcting trade to fix an error trade if the initial correcting trade is rejected from clearing.²⁰

⁶ A “package transaction” is a transaction that “consists of two or more component transactions executed between two or more counterparties where: (i) At least one component transaction is subject to the trade execution requirement in section 2(h)(8) of the Act; (ii) Execution of each component transaction is contingent upon the execution of all other component transactions; and (iii) The component transactions are priced or quoted together as one economic transaction with simultaneous or near-simultaneous execution of all components.” See SEF Proposed Rules at 70 (CFTC Proposed Regulation 36.1(a)(1)). The CFTC is soliciting public comment on specific questions related to the proposed rules, including whether the amendments should cover additional types of package transactions. See *id.* at 24.

⁷ See SEF Proposed Rules at 70-72 (CFTC Proposed Regulations 37.3(a)(4) & 37.9(a)(2), (d)).

⁸ See 17 C.F.R. § 37.9(a)(2).

⁹ See 17 C.F.R. § 37.9(a)(1) (defining “required transaction”); 7 U.S.C. § 2(h)(8) (trade execution requirement).

¹⁰ See 17 C.F.R. § 37.9(c)(1) (defining “permitted transaction”) & (2) (setting forth execution methods for permitted transactions).

¹¹ See SEF Proposed Rules at 12.

¹² See *id.* at 13. Specifically, the proposal covers the following types of package trades: “(1) A package transaction where at least one of the components is a swap exclusively within the Commission’s jurisdiction that is not subject to the clearing requirement (‘MAT/Non-MAT Uncleared’); (2) A package transaction where at least one of the components is not a swap (excluding certain package transaction categories as discussed below) (‘MAT/Non-Swap Instrument’); and (3) A package transaction where at least one of the components is a swap for which the CFTC does not have exclusive jurisdiction, *e.g.*, a mixed swap (‘MAT/Non-Exclusive CFTC Swap’).” See *id.* at 15, 76-77 (CFTC Proposed Regulation 37.9(d)(1)-(4)).

¹³ See *id.* at 23, 70 (CFTC Proposed Regulation 37.3(a)(4)).

¹⁴ See *id.* at 24-27, 69 (CFTC Proposed Regulation 36.1).

¹⁵ Error trade policies are policies adopted by SEFs to identify and correct error trades, which the proposal defines as “any trade executed on or subject to the rules of a [SEF] that contains an operational or clerical error.” See *id.* at 31 and 77 (CFTC Proposed Regulation 37.9(e)(iii)).

¹⁶ The CFTC defines “operational or clerical error” as “any type of error other than a rejection from clearing due to credit reasons.” See *id.* at 32 n.59 (citing CFTC Letter No. 17-27 at 1 n.2).

¹⁷ See *id.* at 72-74 (CFTC Proposed Regulation 37.9(e)).

¹⁸ See *id.* at 73 (CFTC Proposed Regulation 37.9(e)(2)(i)).

¹⁹ See *id.* at 73 (CFTC Proposed Regulation 37.9(e)(2)(i)(A)).

²⁰ See *id.* at 74 (CFTC Proposed Regulation 37.9(e)(2)(ii)).

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Block Trades: The CFTC proposes to amend Rule 43.2, which requires block trades executed under the rules of a SEF to “occur[] away” from the SEF — in other words, “to be executed outside the SEF’s trading systems or platforms.”²¹ The amendment would allow SEFs to offer non-order book methods of execution for market participants to execute block trades *on* SEFs.²² The CFTC cited feedback from market participants that requiring such swaps to occur away from a SEF can cause problems for pre-execution credit screening, because clearing futures commission merchants are unaware of and therefore unable to conduct pre-execution credit screening for block trades that occur away from a SEF.²³ To address this problem, CFTC staff issued no-action relief under which swap block trades that are accepted for clearing by a derivatives clearing organization and submitted for clearing contemporaneously with execution

²¹ See *id.* at 9, 74-79 (CFTC Proposed Regulation 43.2).

²² Proposed Rule 43.2 would define a “block trade” as a “publicly reportable swap transaction” that “(1) Involves a swap that is listed on a registered swap execution facility or designated contract market; (2) Is executed on a trading system or platform of a registered swap execution facility that is not an order book as defined in § 37.3(a)(3), or occurs away from a registered swap execution facility’s or designated contract market’s trading system or platform and is executed pursuant to the registered swap execution facility’s or designated contract market’s rules and procedures; (3) Has a notional or principal amount at or above the appropriate minimum block size applicable to such swap; and (4) Is reported subject to the rules and procedures of the registered swap execution facility or designated contract market and the rules described in this part, including the appropriate time delay requirements set forth in § 43.5.” See *id.* at 75 (CFTC Proposed Regulation 43.2).

²³ See *id.* at 44.

may be traded on-SEF (called “Intended-To-Be-Cleared” or “ITBC” swap block trades). Under the proposal, both ITBC and non-ITBC swap block trades could be executed on a SEF’s non-order book trading platform, a change which the CFTC says would reduce operational complexity and serve Congress’s goal to promote trading on SEFs and help ensure that block trades can be executed in a manner that minimizes the risk that the trade will be disclosed to the market.²⁴

In approving the proposal, CFTC Chairman Heath Tarbert observed that “[s]ome requirements are suitable for the swaps market as a whole but do not work well for particular types of transactions.” While the no-action relief had addressed difficulties encountered by SEFs and market participants, the chairman communicated that further action was timely and appropriate given that the staff relief had been in place for six years.²⁵ He stated that if finalized, the proposal “will provide certainty and clarity to SEFs and their participants.”²⁶

The proposal will be open for public comment for 60 days following publication in the Federal Register.

²⁴ See *id.* at 45-47.

²⁵ See [Statement of Chairman Heath P. Tarbert in Support of Proposed Rule on Swap Execution Facilities](#), CFTC (Jan. 30, 2020).

²⁶ *Id.*