

# Derivatives Alert

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## CFTC Finalizes Post-Trade Name Give-Up Rule, Introduces New Electronic Trading Proposal

On June 25, 2020, the Commodity Futures Trading Commission (CFTC or Commission) held an open meeting and voted unanimously to approve a final rule prohibiting post-trade name give-up for swaps executed anonymously on a swap execution facility (SEF) and intended to be cleared. The Commission also voted 3-2 to withdraw its prior proposal, called Regulation Automated Trading (Reg AT), and 4-1 to introduce a new proposed rulemaking on electronic trading.<sup>1</sup>

### Post-Trade Name Give-Up Rule

The final rule on post-trade name give-up on SEFs (Final Rule) prohibits the practice of post-trade name give-up for swaps executed, prearranged or prenegotiated anonymously on or pursuant to the rules of a SEF and intended to be cleared.<sup>2</sup> The final rule contains an exception for package transactions that include a component transaction that is not a swap intended to be cleared.<sup>3</sup>

Certain SEFs disclose the identities of each swap counterparty to the other party once a trade has been matched anonymously on the SEF, typically through the SEF's own trading protocols or through a third-party service provider that processes and routes swaps for clearing to a derivatives clearing organization (DCO).<sup>4</sup> Prior to the Dodd-Frank Act, when many swaps were not cleared, post-trade name give-up allowed market participants to determine their counterparty's identity to manage credit risk by performing credit checks and tracking credit exposure and payment obligations.<sup>5</sup> The

<sup>1</sup> See Press Release, "CFTC Approves Two Final Rules and Two Proposed Rules at June 25 Open Meeting," CFTC (June 25, 2020); CFTC, "Post-Trade Name Give-Up on Swap Execution Facilities" (June 25, 2020) [hereinafter "Final Rule"]; CFTC, "Electronic Trading Risk Principles" (June 25, 2020) [hereinafter "Proposal"]; Regulation Automated Trading, 80 Fed. Reg. 78,824 (Dec. 17, 2015). For further information regarding Reg AT, see Skadden's January 20, 2016, client alert, "CFTC Proposes Regulation AT for Automated Trading."

<sup>2</sup> See Final Rule at 50-51 (Proposed CFTC Regulation 37.9(d)).

<sup>3</sup> See Final Rule at 51 (Proposed CFTC Regulation 37.9(d)(4)). "Package transaction" is defined as "two or more component transactions executed between two or more counterparties where: (i) execution of each component transaction is contingent upon the execution of all other component transactions; and (ii) the component transactions are priced or quoted together as one economic transaction with simultaneous or near-simultaneous execution of all components." *Id.*

<sup>4</sup> See Final Rule at 2.

<sup>5</sup> See CFTC, "Joint Statement of Chairman Heath P. Tarbert, Commissioner Rostin Behnam, and Commissioner Dan M. Berkovitz in Support of Final Rule Restricting Post-Trade Name Give-Up" (June 25, 2020); Post-Trade Name Give-Up on Swap Execution Facilities, 83 Fed. Reg. 61,571, 61,571 (Nov. 30, 2018).

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Commission has described the rationale for the practice as “less clear cut” with respect to cleared trades, however, because DCOs enable counterparties to “substitute the credit of the DCO for the credit of the parties,” effectively eliminating individual credit risk and counterparty exposure.<sup>6</sup>

On November 5, 2018, the Commission voted to request public comments regarding post-trade name give-up, asking whether and how the CFTC should restrict the practice,<sup>7</sup> and on December 31, 2019, published a proposal to prohibit it.<sup>8</sup>

Post-trade name give-up has been controversial and subject to varying claims that, on the one hand, it helps liquidity providers allocate capital and reduce liquidity risk, but, on the other hand, it is anti-competitive and can expose market participants’ sensitive information, such as trading strategies and positions.<sup>9</sup> Some responses to the November 2018 request for comment expressed views that prohibiting post-trade name give-up would lead to an increase in the number of participants trading on SEFs, improve price transparency, and increase competition among dealers and liquidity providers; it would also be consistent with CFTC Regulation 49.17(f)(2), which prohibits a swap data repository from providing a swap counterparty with access to the identity of the other counterparty or its clearing member.<sup>10</sup> Other commenters disagreed, opining that prohibiting the practice would cause dealers to reduce trading on SEFs and reduce competition and choice among trading protocols.<sup>11</sup> While the Commission stated that, in its view, there is “not convincing evidence” that prohibiting post-trade name give-up will lead to a decrease in trading on SEFs, going forward, it will “study the state of the swaps market in order to observe any changes to trading on SEFs” after the rule is implemented.<sup>12</sup>

In a joint statement, Chairman Heath P. Tarbert and commissioners Rostin Behnam and Dan M. Berkovitz stated that it is a “fundamental principle of exchange-style trading” that counterparties “have no reason to know” and “do not know” one another’s identity; that principle “levels the playing field” and allows traders to participate in the market “without exposing

their trading positions and strategies.” They expressed their belief that the Final Rule represents a “balanced” and “workable” approach that will “improve overall market vibrancy.”<sup>13</sup>

The Final Rule provides for two compliance deadlines: November 1, 2020, for swaps subject to the trade execution requirement under Commodity Exchange Act (CEA) Section 2(h)(8) and July 5, 2021, for swaps not subject to the trade execution requirement.<sup>14</sup> The Final Rule will become effective 60 days after it is published in the Federal Register.<sup>15</sup>

## Electronic Trading Proposal

The proposed rulemaking on electronic trading, titled “Electronic Trading Risk Principles” (Proposal), would address the risk of a designated contract market’s (DCM) trading platform experiencing a disruption due to electronic trading. In the Proposal, the Commission cited as examples several instances in which exchanges disciplined electronic traders for trading activity and computer malfunctions that caused disruptions, such as sudden price increases, exchange technology failures and latency for other market participants.<sup>16</sup>

The Proposal would require DCMs to adopt rules that implement three overarching principles:

- The implementation of exchange rules applicable to market participants to prevent, detect and mitigate market disruptions and system anomalies associated with electronic trading;
- The implementation of exchange-based pre-trade risk controls for all electronic orders; and
- The prompt notification of the Commission by DCMs of any significant disruptions to their electronic trading platforms.<sup>17</sup>

The Proposal also includes “acceptable practices” that a DCM can use to comply with these principles by implementing rules and controls that are “reasonably designed to prevent, detect, and mitigate market disruptions and system anomalies associated with electronic trading.”<sup>18</sup>

<sup>6</sup> See 83 Fed. Reg. at 61,571.

<sup>7</sup> See 83 Fed. Reg. at 61,571; Post-Trade Name Give-Up on Swap Execution Facilities, 84 Fed. Reg. 3350 (Feb. 12, 2019) (extending the comment period). For further information on the request for comment, see Skadden’s November 20, 2018, client alert, “[CFTC Proposes Swap Execution Facility Rule Amendments and Seeks Comments on Post-Trade Name Give-Up.](#)”

<sup>8</sup> See Post-Trade Name Give-Up on Swap Execution Facilities, 84 Fed. Reg. 72,262 (Dec. 31, 2019).

<sup>9</sup> See 83 Fed. Reg. at 61,572.

<sup>10</sup> See Final Rule at 6-18.

<sup>11</sup> See *id.*

<sup>12</sup> See Final Rule at 9.

<sup>13</sup> See CFTC, “[Joint Statement of Chairman Heath P. Tarbert, Commissioner Rostin Behnam, and Commissioner Dan M. Berkovitz in Support of Final Rule Restricting Post-Trade Name Give-Up](#)” (June 25, 2020).

<sup>14</sup> See Final Rule at 1. CEA Section 2(h)(8) provides that swaps required to be cleared under CEA Section 2(h)(1) must be executed on a board of trade that is a designated contract market, or on a SEF, unless no board of trade or SEF makes the swap available to trade. See 7 U.S.C. § 2(h)(8).

<sup>15</sup> See Final Rule at 1.

<sup>16</sup> See Proposal at 10-12.

<sup>17</sup> See Proposal at 1.

<sup>18</sup> See Proposal at 59-60 (proposing new subparagraph (b)(6) under Appendix B to Part 38, “Core Principle 4 of section 5(d) of the Act: Prevention of Market Disruption”).

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Reg AT, which was proposed in December 2015 but was never finalized, took a more prescriptive, rules-based and less principles-based approach to the regulation of electronic trading by imposing new risk and compliance controls on any person engaged in “algorithmic trading” on any U.S. derivatives exchange that is a DCM.<sup>19</sup> It also proposed additional regulatory reporting requirements for “AT Persons” — defined as any CFTC registrant engaged in algorithmic trading on or subject to the rules of a DCM — and futures commission merchants that clear trades for them.<sup>20</sup> Reg AT proved controversial, particularly because it would have required each AT Person to maintain a repository of its source code as part of its record-keeping obligations and make its source code available for inspection upon the request of the CFTC or Department of Justice (DOJ). It would also have given the CFTC Division of Enforcement staff and DOJ wide access to algorithmic traders’ source code without a subpoena.<sup>21</sup> Those proposed requirements drew questions and criticism, including from then-Commissioner J. Christopher

Giancarlo, regarding the government’s ability to protect sensitive and proprietary information from data breaches.<sup>22</sup>

Chairman Tarbert said that Reg AT “drove a very healthy discussion” about the risks posed by electronic trading, and how best to address them, and that “principles-based regulations can bring simplicity and flexibility while also promoting innovation when applied in the right situations.”<sup>23</sup> He noted that in enforcing the principles in the Proposal, the CFTC would judge exchanges “on a reasonableness standard.”<sup>24</sup> Commissioner Behnam dissented from the withdrawal of Reg AT and the issuance of the Proposal and questioned “what the proposed Risk Principles do differently than the status quo.”<sup>25</sup>

Comments on the Proposal, which is not yet published in the Federal Register, must be received on or before the later of August 24, 2020 (60 days from the date of the Commission vote), or 30 days following publication in the Federal Register.

<sup>19</sup> Reg AT would have defined “algorithmic trading” broadly, including any computer algorithm or system that determines whether to initiate, modify or cancel an order where such order is electronically transmitted to the DCM. See 80 Fed. Reg. at 78,937 (Proposed CFTC Regulation 1.3(zzzz)).

<sup>20</sup> See 80 Fed. Reg. at 78,937 (Proposed CFTC Regulation 1.3(xxxx)); 78,939 (Proposed CFTC Regulation 1.83).

<sup>21</sup> See 80 Fed. Reg. at 78,938 (Proposed CFTC Regulation 1.81(a)(vi)).

<sup>22</sup> See 80 Fed. Reg. at 78,947 (Statement of Commissioner J. Christopher Giancarlo).

<sup>23</sup> CFTC, “[Statement of Chairman Heath P. Tarbert in Support of the Proposed Rule on Electronic Trading Risk Principles](#)” (June 25, 2020).

<sup>24</sup> *Id.*

<sup>25</sup> CFTC, “[Dissenting Statement of Commissioner Rostin Behnam Regarding Electronic Trading Risk Principles](#)” (June 25, 2020). Commissioner Berkovitz, who dissented from the withdrawal of Reg AT but supported the Proposal, said that while “certain elements” of Reg AT “attracted intense opposition” and “may have been a bridge too far,” the Proposal was a “comprehensive approach for addressing automated trading in Commission regulated markets.” CFTC, “[Statement of Commissioner Dan M. Berkovitz on Proposed Rules for Electronic Trading Risk Principles and Withdrawal of Regulation AT](#)” (June 25, 2020).