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June 10, 2022

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549–1090

Re: Rules Relating to Security-Based Swap Execution and Registration and Regulation of Security-Based Swap Execution Facilities (File No. S7-14-22)

Dear Ms. Countryman:

We appreciate the opportunity to provide comments to the Securities and Exchange Commission (the "Commission") on the proposal to create a regime for the registration and regulation of security-based swap execution facilities ("SBSEFs").[1]

Transitioning OTC derivatives onto open, competitive, and transparent trading venues is a key objective of the G20 post-crisis reforms. Ensuring that OTC derivatives are traded on well-regulated venues enhances market stability and integrity, and delivers material benefits to investors through increased market competition, improved liquidity conditions, lower transaction costs, and better execution quality analysis.

We have witnessed these benefits accrue to investors transacting on swap execution facilities ("SEFs") regulated by the Commodity Futures Trading Commission ("CFTC").[2] Therefore, we strongly endorse the Commission's general approach of harmonizing closely with existing CFTC rules. In Section I below, we detail particular issues where harmonization is critical in order to deliver the desired benefits to investors in security-based swaps, including several areas where the Proposal should be revised to more fully align with CFTC rules.

That said, the existing CFTC rules continue to be further refined through no-action letters, guidance, and rule amendments. As a result, we encourage the Commission to take into account market participant experience with the current CFTC regime to identify targeted refinements that

[1] 87 Fed. Reg. 28872 (May 11, 2022), available at: https://www.govinfo.gov/content/pkg/FR-2022-05-11/pdf/2022-07850.pdf (the "Proposal").

[2] *See, e.g.,* Benos, E., Payne, R., and Vasios, M., Centralized trading, transparency and interest rate swap market liquidity: evidence from the implementation of the Dodd-Frank Act, Bank of England Staff Working Paper, May 2018, available at: https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2018/centralized-trading-transparency-and-interest-rate-swap-market-liquidity-update; Junge, J., Essays on the Market Structure and Pricing of Credit Derivatives, November 2016, available at: https://infoscience.epfl.ch/record/222511/files/EPFL_TH7322.pdf; and "What Traded On-SEF in 2018?" Clarus Financial Technology (Feb. 12, 2019), available at: https://www.clarusft.com/what-traded-on-sef-in-2018/ (price dispersion observed for on-venue transactions is "two orders of magnitude" lower than the price dispersion observed for off-venue trading activity).

can be made in order to further optimize the regulatory framework. In Section II below, we detail several such targeted refinements that warrant the Commission's consideration.

Our response to the Proposal is informed by the market experience of two separate and distinct businesses – Citadel Securities, a leading global market maker, and Citadel, a global alternative investment firm.

Citadel Securities is a leading global market maker across equities and fixed income asset classes, and entered the U.S. interest rate swaps market as a new liquidity provider following the implementation of the CFTC's SEF rules, demonstrating the potential of these rules to unlock new sources of liquidity and competition. Citadel Securities has become one of the top liquidity providers in this market, improving conditions for end investors by introducing innovations such as firm on-screen pricing. Citadel Securities is a CFTC-registered swap dealer and a self-clearing member.

Citadel is a leading investor in the world's financial markets, including in OTC derivatives markets regulated by the Commission, managing in excess of $50 billion in investment capital on behalf of a diverse array of investors, including pensions (local, corporate, and union), endowments, healthcare providers, foundations, and insurance companies. Founded in 1990, our flagship fund has delivered a 19.3% annualized return since inception, returns that help our investors fund innovative research, support leading academic institutions, and secure the retirement futures of their beneficiaries. Citadel participates in OTC derivatives markets both on-SEF and off-SEF, and has directly witnessed the material benefits for end investors that have resulted from the implementation of the CFTC's SEF rules.

Table of Contents

I. Issues Where Harmonization With The Existing CFTC Regime Is Critical

1. Ensuring a Robust Execution-to-Clearing Operational Workflow

Core Principle 6 in the Securities Exchange Act of 1934 (the "Exchange Act") requires SBSEFs to "establish and enforce rules and procedures for ensuring the financial integrity of security-based swaps entered on or through the facilities of the SBSEF, including the clearance and settlement of security-based swaps."[3] Pursuant to a corresponding statutory provision, the CFTC has implemented detailed straight-through-processing standards for swaps executed on SEFs that are intended to be cleared. Unfortunately, the Commission's Proposal fails to include these important requirements.

Currently, there is a lack of market consistency regarding the execution-to-clearing workflow for security-based swaps that are intended to be cleared. This lack of consistency unnecessarily complicates the trading of cleared security-based swaps, which should be more accessible to market participants since central clearing eliminates bilateral counterparty credit risk and the need for complex bilateral trading and credit support documentation between each and every pair of potential trading counterparties.

Key issues (and the manner in which they were addressed by the CFTC) include:

- **Clearing submission timeframes**. It often takes hours, if not days, following execution for a transaction to be submitted to, and accepted for clearing by, a clearing agency ("CCP"). This extended length of time between execution and clearing acceptance introduces risks for both market participants and CCPs. In particular, these delays increase market, credit, and operational risks for market participants, as a transaction may not be considered successfully executed until it is accepted for clearing. In addition, these delays impair the ability of CCPs to monitor current market trading activity and the number of transactions pending submission to clearing, information that is important for a CCP's risk management framework, particularly during volatile market conditions.

  In order to minimize delays between execution and clearing acceptance, the CFTC's straight-through-processing standards require (i) SEFs to submit all cleared swaps to a CCP no later than 10 minutes after execution,[4] and (ii) CCPs to accept or reject transactions within 10 seconds of receipt.[5]

- **Clearing certainty**. There is little pre-trade visibility regarding whether a potential security-based swap transaction will successfully clear and a lack of consistency regarding what happens if the transaction is subsequently rejected from clearing. When

[3] *See* Exchange Act Section 3D, Core Principle 6.

[4] CFTC Letter No. 15-67 (Dec. 21, 2015), available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/15-67.pdf.

[5] "Staff Guidance on Swaps Straight-Through Processing" (Sept. 26, 2013), available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/stpguidance.pdf.

combined with the submission delays described above, market participants may introduce bilateral breakage agreements to manage, and allocate responsibility for, potential risks arising during the period between execution and clearing acceptance. Requiring bilateral trading documentation undermines one of the main benefits of central clearing and limits client access to a broader range of trading counterparties.

In order to provide greater certainty to market participants that a transaction will successfully clear, the CFTC's straight-through-processing standards require pre-execution credit checks by a client's clearing member to ensure available clearing capacity.[6] In the rare circumstance that a transaction passes the pre-execution credit check but nonetheless is rejected by the CCP, the straight-through-processing standards permit the transaction to be resubmitted for clearing in order to address operational or clerical errors within one hour of the CCP's rejection.[7] In the event a transaction cannot be successfully cleared, it is considered to be void *ab initio*.[8] This approach provides a consistent standard for all SEF transactions that are intended to be cleared, and obviates the need for bilateral breakage agreements, which were subsequently prohibited by the CFTC for SEF transactions.[9]

The CFTC's straight-through-processing standards have been successfully implemented by the industry since 2013 and have significantly enhanced the SEF trading environment. The combination of pre-execution credit checks and well-defined submission timeframes has reduced market, credit, and operational risks for SEF trading, and has focused market participants on streamlining the execution-to-clearing workflow. As a result, the void *ab initio* backstop has rarely been used, but has promoted SEF trading by enabling clients to seamlessly trade cleared swaps without complex bilateral documentation and with a wider range of trading counterparties. This ease of trading cleared swaps on SEFs has also facilitated the entry of new liquidity providers that do not have legacy bilateral trading documentation in place with clients.

We note that UK and EU rules contain nearly identical straight-through-processing requirements for cleared OTC derivatives under MiFID II. [10]

Unfortunately, these existing global standards for other cleared products are not being applied when market participants voluntarily clear security-based swaps, despite the availability of the necessary market infrastructure and the fact that security-based swaps and CFTC-regulated swaps are often transacted together as part of a single investment strategy.

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[6] *Id.*

[7] CFTC Letter No. 17-27 (May 30, 2017), available at: https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/17-27.pdf.

[8] *Supra* note 104.

[9] Staff Guidance on Swap Execution Facilities Impartial Access (November 14, 2013) at FN 3, available at http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/dmostaffguidance111413.pdf.

[10] Commission Delegated Regulation (EU) 2017/582, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0582&from=EN

It is therefore incumbent that the Proposal harmonize with existing CFTC straight-through-processing standards. Otherwise, the prospect of material delays between execution and clearing submission increases market, credit and operational risks for trading counterparties, and makes it more likely that bilateral breakage agreements would be introduced for cleared security-based swaps. As detailed above, bilateral breakage agreements undermine key benefits of trading cleared swaps on SBSEFs, including ease of trading and access to a wider range of trading counterparties, and impede market evolution, as certain trading protocols (e.g. anonymous trading) are based on the assumption that bilateral trading documentation is not required for cleared security-based swaps.

Recommendation: Achieve harmonization with the CFTC regime by establishing straight-through-processing standards, incorporating relevant CFTC guidance, and prohibiting breakage agreements for intended to be cleared security-based swaps.

2. Effectively Implementing Impartial Access Requirements

The statutory requirement for SBSEFs to provide impartial access to all market participants[11] is fundamental to achieving the desired policy objectives. As such, we strongly support Proposed Rule 819(c), which is closely modeled on CFTC Rule §37.202. However, the Proposal does not provide market participants with sufficient clarity regarding how Proposed Rule 819(c) will be interpreted and applied in practice, in sharp contrast to the CFTC SEF regime.

The CFTC has provided market participants with extensive guidance regarding impartial access, including in the preamble to the SEF rules[12] and in subsequent staff guidance.[13] We urge the Commission to provide similar clarity when finalizing the SBSEF rules. This includes the following:

Membership Criteria. In order to provide market participants with impartial access, a SBSEF may not limit membership to:

- Self-clearing members;
- Registered security-based swap dealers;
- Banks or liquidity providers with a minimum amount of Tier 1 capital;
- Liquidity providers that have been "enabled" by, or have bilateral documentation with, a minimum number of other liquidity providers; or
- Liquidity providers with a minimum amount of transaction volume.

[11] *See* Exchange Act Section 3D, Core Principle 2.

[12] *See* 78 FR 33476 (June 4, 2013) at 33508, available at: https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2013-12242a.pdf.

[13] Staff Guidance on Swap Execution Facilities Impartial Access (November 14, 2013), available at http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/dmostaffguidance111413.pdf.

Instead, access to SBSEFs should be based on "objective, pre-established criteria," and any ECP should be able to demonstrate financial soundness by showing that it is a clearing member or that it has clearing arrangements in place with a clearing member.[14]

Trading Protocols and Functionality. Similarly, trading protocols may not be applied in a manner that results in impermissible discrimination among market participants. For example:[15]

- A SBSEF may not support functionality that allows participants to engage in impermissible discrimination against other venue participants, including by selectively "turning-off", or otherwise restricting trading with, certain venue participants through "enablement mechanisms";
- Market participants should be permitted to act as both liquidity providers or liquidity takers on a SBSEF (instead of being compelled to operate in only one capacity);
- All SBSEF participants should have the opportunity to both send and receive an RFQ, if selected by the RFQ requester (instead of only designated liquidity providers being eligible to receive RFQs); and
- SBSEFs may not require participants to have bilateral documentation, such as "breakage agreements", in place in order to trade cleared security-based swaps, given that this could provide a pretext for participants to "turn-off", or otherwise restrict trading with, certain other participants.

Fee Arrangements. SBSEFs may not use fee arrangements to effect otherwise impermissible discrimination.

It is critical to remove these types of discriminatory practices in order to increase competition, transparency, and liquidity in security-based swap markets. Access limitations allow incumbent liquidity providers to be insulated from competition, as potential new liquidity providers are blocked from accessing necessary pools of liquidity for pricing and hedging purposes and clients are unable to access the full breadth of venues and trading protocols. The removal of these discriminatory access barriers, as required by the Exchange Act, will result in greater competition and market-led innovation.

Recommendation: Achieve greater harmonization with the CFTC regime by clearly setting forth how Proposed Rule 819(c) will be applied, incorporating relevant CFTC guidance.

3. Ensuring Multilateral and Transparent Execution on SBSEFs

The Proposal should further clarify that it is harmonizing with CFTC rules to ensure that (i) SBSEFs are required to offer multilateral trading protocols, instead of only single-dealer pages or one-to-one negotiations, and (ii) all types of multilateral trading venues listing security-based

[14] *See* 78 FR 33476 (June 4, 2013) at 33508.

[15] *See* Staff Guidance on Swap Execution Facilities Impartial Access (November 14, 2013).

swaps are required to register as a SBSEF, regardless of the specific trading protocol used (e.g. electronic, voice, order book, RFQ, auction).

First, requiring SBSEFs to offer multilateral trading protocols facilitates a market transition away from bilateral negotiations and single-dealer pages to platforms where quotes from multiple liquidity providers can be more easily consolidated and compared. At the moment, dealer-to-client trading in security-based swaps is largely opaque and fragmented, with most executions arising out of one-to-one private negotiations. When engaging with clients, liquidity providers typically provide "indicative" quotes (as opposed to firm binding quotes), inviting interested clients to follow-up bilaterally in order to obtain an executable price for a specific instrument.

From a client's perspective, this market structure is disadvantageous for several reasons. The lack of published firm quotes and the unavailability of multilateral trading protocols compels clients to rely on one-to-one private negotiations in order to obtain an executable price. Given that these executable prices are often only then honored at that exact moment in time, clients are unable to effectively put liquidity providers in competition and have little to no pre-trade transparency regarding other available prices in the market. Instead, clients face the choice of either accepting the first executable price received or starting over with a new one-to-one negotiation, where pricing could move against the client as its trading interest is sequentially disclosed to additional market participants. As a result, this opaque and fragmented execution process impairs client access to best execution by denying clients the ability to effectively compare and evaluate the quality of prices.

The emphasis on multilateral and transparent execution is further achieved by requiring the most liquid security-based swaps (i.e. those required to trade on a SBSEF) to be transacted via multilateral and pre-trade transparent trading protocols, such as multilateral RFQs (i.e. RFQ-to-3). For transactions in these instruments, liquidity providers will have no choice but to compete with each other to win client transactions.

The resulting competition and pre-trade transparency from the introduction of multilateral trading protocols should be expected to improve liquidity conditions, reduce transaction costs, and facilitate execution quality analysis, as clients will be able to put liquidity providers in direction competition. On-screen pricing should materially improve, becoming more competitive and dependable, as liquidity providers seek to differentiate their offerings in light of the increased competition. This trend will particularly benefit smaller market participants, as widely available on-screen pricing makes it more difficult for liquidity providers to discriminate against certain "tiers" of clients.

The introduction of pre-trade transparency and competitive execution under the SBSEF regime also provides new liquidity providers with an opportunity to compete for client business on a more level playing field. The entry of new liquidity providers will further improve conditions for clients, as new liquidity providers introduce additional innovation to attract client business. For example, Citadel Securities became one of the top liquidity providers in CFTC-regulated interest rate swaps by introducing firm on-screen pricing (as opposed to indicative quotes), responding immediately to client RFQs, increasing quoted sizes, and demonstrating dependable liquidity provision during all types of market conditions. In response to this market competition, other liquidity providers

have improved their offerings as well, further benefiting clients through better pricing and liquidity.

Second, ensuring all types of multilateral trading venues listing security-based swaps are required to register as a SBSEF, regardless of the specific trading protocol used, establishes a level playing field across trading venues. A security-based swap transaction executed via a fully electronic multilateral RFQ protocol should be subject to the same regulations as one executed by voice with the assistance of a voice broker (who may or may not be employed by the SBSEF).

Both of these aspects are consistent with existing CFTC rules and the relevant statutory provisions in the Exchange Act, including the definition of a security-based swap execution facility (which includes a multiple-to-multiple prong).

Recommendation: Further clarify that the Proposal is harmonizing with CFTC rules to ensure that:

- SBSEFs are required to offer multilateral trading protocols, instead of only single-dealer pages or one-to-one negotiations; and
- All types of multilateral trading venues listing security-based swaps are required to register as a SBSEF, regardless of the specific trading protocol used (e.g. electronic, voice, order book, RFQ, auction).

4. Appropriately Calibrating Block Thresholds

We agree with harmonizing with CFTC rules to provide an exemption from the required methods of execution for block trades. However, it is critical for the Commission to also harmonize with the CFTC's methodology for determining block trade thresholds in order to avoid providing an overly expansive exemption that undermines the trade execution requirement.

The Proposal defines a block trade as any security-based swap based on a single credit instrument (or narrow-based index of credit instruments) with a notional size of $5 million or greater. A cursory review of publicly available data from security-based swap data repositories shows that single-name CDS transactions larger than $5 million in notional account for *far more than 50% of total notional transacted* and *more than 25% of total transactions (by trade count)*. Both of these figures are far larger than corresponding CFTC block trade thresholds.

Under CFTC rules, block trades are determined based on a "67 percent notional amount calculation" that is intended to ensure that *no more than 33% of total notional transacted* in a particular category of instruments is eligible for an exemption from the required methods of execution.[16] This threshold results in *fewer than 10% of total transactions (by trade count)* qualifying for block trade treatment.[17] Importantly, the CFTC only recently reviewed its approach

[16] 85 Fed. Reg. 75422 (Nov. 25, 2020) at 75453, available at: https://www.cftc.gov/sites/default/files/2020/11/2020-21568a.pdf.

[17] *Id.*

for determining block trade thresholds, and following extensive public comment, concluded that the 67% notional calculation appropriately balanced relevant considerations. We strongly recommend the Commission to harmonize with this approach and apply the same to its public reporting regime.

In addition, the Commission should also harmonize with the CFTC approach for package transactions, and clarify that block treatment will only be granted when all of the security-based swap components of a package are above the applicable block size.[18] The average notional value of a security-based swap leg of a package is often larger than the average notional value of a standalone transaction, and therefore it is not appropriate to grant an exemption to packages where only one leg is above the applicable block size.

Finally, we recommend the Commission reserve the ability to update block thresholds on a regular basis to ensure they remain representative of current market conditions.

Recommendation: Harmonize with the CFTC approach for calculating block trade thresholds and for applying these thresholds to package transactions.

5. Prohibiting the Practice of Post-Trade Name Give-up on SBSEFs

We strongly support the Proposal harmonizing with CFTC rules to prohibit post-trade name give-up ("PTNGU") for security-based swaps executed anonymously on SBSEFs and intended to be cleared.

As detailed at length in feedback submitted to the CFTC,[19] PTNGU has no legitimate purpose for centrally cleared financial instruments, since trading counterparties face the central clearinghouse and do not have any credit, operational, or legal exposure to each other post-trade. Instead, it is a discriminatory practice that impedes market participant access to trading venues.

First, it functions as a source of uncontrolled information leakage since a market participant has no control over who it will be matched with when executing through a pre-trade anonymous trading protocol, such as an order book (in contrast to a disclosed RFQ, where a market participant will carefully choose which firms to disclose trading information to). Therefore, before using an anonymous order book with PTNGU, a buy-side firm must be comfortable potentially sharing its trading activity with every other participant on the trading venue, including other buy-side firms. This is an unattractive proposition for buy-side firms that completely undermines the anonymous nature of the trading protocol and deters access and participation.

[18] *See, e.g.,* https://data.bloomberglp.com/professional/sites/4/BSEF-2014-R-7-Self-Certification-2014-10-291.pdf.

[19] *See* https://comments.cftc.gov/PublicComments/CommentList.aspx?id=3066, including the Citadel Letter at https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=62420&SearchText=.

Second, PTNGU allows dealers to monitor whether buy-side firms have started to transact in anonymous order books. This information can be used as a policing mechanism by dealers to deter buy-side access and participation. This is unfortunately not a theoretical concern.[20]

Due to the discriminatory nature of the practice, it is inconsistent with the impartial access requirements applicable to SBSEFs in the Exchange Act. It is notable that, prior to prohibiting the practice, the CFTC engaged in extensive market outreach, and the feedback was overwhelmingly in favor of prohibiting the practice.

With respect to the proposed drafting of the prohibition, we note Proposed Rule 815(f)(3) is important to prevent evasion by voice brokers. Without clarifying that ''executed anonymously'' includes a security-based swap that is pre-arranged or pre-negotiated anonymously, voice brokers, operating either within a SBSEF or through an affiliated broker, may seek to evade any prohibition on name give-up by pre-negotiating or pre-arranging trades anonymously and then disclosing counterparty identities prior to formally executing the transaction on the SBSEF.

However, Proposed Rule 815(f)(4) is overbroad and may significantly limit the scope of the prohibition. Many security-based swaps are transacted as part of a package transaction with other instruments (e.g. single-name CDS and index CDS). At a minimum, any exemption for package transactions should only apply to packages that include a component that is not a security-based swap intended to be cleared *or a swap that is intended to be cleared*. The current language would appear to exempt packages containing CFTC-regulated swaps, even if those instruments should be subject to an equivalent prohibition (notwithstanding the wording of the corresponding CFTC exemption for packages). The Commission should work with the CFTC to avoid creating a loophole for common packages containing swaps and security-based swaps that are all intended to be cleared.

More generally, we question the need for Proposed Rule 815(f)(4) at all. As proposed, the prohibition on PTNGU only applies to security-based swaps that are executed anonymously and intended to be cleared. Therefore, for a package transaction containing both a cleared security-based swap and an uncleared security-based swap, PTNGU could still be used for the uncleared security-based swap leg even without Proposed Rule 815(f)(4). Current market practice already applies different post-trade operational workflows to the various legs of a package depending on the instrument and its clearing status, and therefore it should not be difficult to apply the prohibition on PTNGU to one leg of a package and not another. This obviates the need for the Commission to provide any type of special exception for package transactions that could be result in significantly limiting the scope of the prohibition.

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[20] *See, e.g.,* Karen Brettell, "Banks' pressure stalls opening of US derivatives trading platform," Reuters (Aug. 27, 2014) ("Several hedge fund managers that had planned to join GFI's credit platform received phone calls from multiple banks that indicated that they would stop trading with them or send them unfavorable pricing if they joined an interdealer venue, people familiar with GFI plans said"), available at: https://www.reuters.com/article/usa-derivatives-banks-idUSL1N0QW1T220140827; and "Meet the new OTC market-makers," Risk (Feb. 27, 2014) ("'In interest rate swaps, we have been given strong signals by our dealers that they would be annoyed if we, as a buy-side firm, showed up in the interdealer platforms,' says one US-based hedge fund manager"), available at: https://www.risk.net/derivatives/2331122/meet-new-otc-market-makers.

Recommendation: Maintain the proposed approach, but delete Proposed Rule 815(f)(4) or, at a minimum, remove the exemption for packages containing CFTC-regulated swaps that are intended to be cleared.

6. Appropriately Applying the SBSEF Regime to Package Transactions

Under CFTC rules, the vast majority of package transactions are subject to the SEF execution requirement and the required methods of execution. Transitioning package transactions onto SEFs was important, as in certain asset classes, a significant percentage of overall trading activity is transacted as part of a package. For example, data has shown that over 50% of all USD interest rate swaps are entered into as a package.[21]

Security-based swaps are also frequently transacted as part of a package and therefore we support the Proposal harmonizing with CFTC rules in order to transition package transactions onto SBSEFs. However, we recommend the following modifications:

- Proposed Rule 815(d)(2) reflects how the CFTC drafted an exemption to capture packages containing both cleared and uncleared swaps.[22] However, given the breadth of the CFTC's clearing mandate, there is less voluntary clearing of swaps not subject to a clearing requirement (particularly by customers) and therefore the CFTC did not consider in detail the treatment of packages containing an instrument that is intended to be cleared but not subject to the clearing requirement (along with a swap subject to the trade execution requirement).

  The situation is much different for security-based swaps. Given the scope of any future clearing requirement remains unclear, they may be significant trading activity in packages containing a security-based swap that is intended to be cleared but not subject to the clearing requirement (along with a security-based swap subject to the trade execution requirement). As a result, we recommend Proposed Rule 815(d)(2) be modified to grant an exemption to packages that include a *security-based swap that is not intended to be cleared*. This is consistent with the intent of the corresponding CFTC provision.

- Proposed Rule 815(d)(3) appears to grant an exemption to a package containing (i) a security-based swap subject to the Commission's trade execution requirement and (ii) a swap subject to the CFTC's trade execution requirement, even though both instruments are independently subject to trade execution requirements. This is an outcome that would be contrary to the policy objectives of the Proposal and would risk creating mechanisms for evasion. We recommend revising Proposed Rule 815(d)(3) so it does not apply to packages where all of the other components are swaps subject

[21] *See* "Spreadovers: US Treasury Spreads in the Swaps Data," Clarus Financial Technology (March 23, 2105), available at: https://www.clarusft.com/spreadovers-us-treasury-spreads-in-the-swaps-data/.

[22] *See* 85 Fed. Reg. 82313 (Dec. 18, 2020), available at: https://www.cftc.gov/sites/default/files/2020/12/2020-26555a.pdf (referring to "MAT/Non-MAT Uncleared" throughout).

to the CFTC's trade execution requirement. The Commission should work with the CFTC to avoid creating a loophole for common packages containing swaps and security-based swaps.

Recommendation: Maintain the proposed approach, but with the following refinements:

- Amend Proposed Rule 815(d)(2) to remove the exemption for a package containing a security-based swap that is intended to be cleared but not subject to the clearing requirement (along with a security-based swap subject to the trade execution requirement); and
- Amend Proposed Rule 815(d)(3) to remove the exemption for a package containing a swap subject to the CFTC's trade execution requirement (along with a security-based swap subject to the trade execution requirement).

II. Targeted Refinements To The Existing CFTC Regime

1. Ensuring SBSEF Participants Are Aware of Competitive Firm Prices

Proposed Rule 815(a)(3)(i) requires RFQ systems to communicate to an RFQ requester any firm bid or offer pertaining to the same instrument resting on any of the SBSEF's order books. This follows a CFTC requirement that was designed to ensure that a client sending an RFQ was always made aware of more competitive firm liquidity that might be available elsewhere on the SBSEF. In addition, the requirement was designed to incentivize liquidity providers to post firm prices (rather than indicative prices), as this would allow them to participate in more client negotiations.

However, in practice, order books continue to be infrequently used on SEFs that offer RFQ systems and, therefore, the interaction requirement has had little impact. Trading protocols other than order books that nonetheless allow liquidity providers to post firm prices have developed on these platforms though (and have been deemed by the CFTC to constitute a permissible method of execution for transactions subject to the trade execution requirement). A prime example is the "request-for-stream" trading protocol, which allows liquidity providers to stream firm prices. These firm prices are not required to be communicated to clients sending an RFQ, however, as the interaction requirement only technically applies to firm prices displayed in an order book.

In light of this market experience, we recommend that Proposed Rule 815(a)(3)(i) be amended to require a SBSEF to communicate any firm bid or offer pertaining to the same instrument resting on *any of the SBSEF's trading systems or protocols*. This will achieve the objective of ensuring clients are made aware of more competitive firm liquidity available elsewhere on the SEF that will allow them to reduce transaction costs and achieve best execution, while recognizing that order books are not commonly used on RFQ platforms that are expected to register as a SBSEF.

In addition, Proposed Rule 815(a)(3)(ii) should be modified to ensure that the RFQ requester has the ability to execute against all of the prices provided in connection with an RFQ *on the same screen*. This will prevent a SBSEF from requiring the RFQ requester to click-through multiple

screens in order to execute against firm prices, which serves to disadvantage those prices versus other prices provided in response to an RFQ.

Finally, given the scope of any future clearing and trade execution requirement remains unclear for security-based swaps, there may be significant trading activity on SBSEFs in security-based swaps that are not subject to these requirements. As a result, we recommend Proposed Rule 815(a)(3) be modified to apply to all security-based swaps transacted on SBSEFs, and not solely Required Transactions. This will help to ensure that market participants transacting on SBSEFs are always provided with the necessary transparency to achieve the most favorable execution possible.

Recommendation: Make the following refinements:

- Amend Proposed Rule 815(a)(3)(i) to require a SBSEF to communicate any firm bid or offer pertaining to the same instrument resting on *any of the SBSEF's trading systems or protocols*;
- Amend Proposed Rule 815(a)(3)(ii) to ensure that the RFQ requester has the ability to execute against all of the prices provided in connection with an RFQ *on the same screen*; and
- Amend Proposed Rule 815(a)(3) to apply to all security-based swaps transacted on SBSEFs, and not solely Required Transactions.

2. Further Safeguarding the Transparent and Competitive Execution Process By Restricting Pre-Arrangement

In order to protect the price discovery process on SBSEFs and to ensure pre-trade price transparency and competition among liquidity providers, the pre-arrangement of Required Transactions should be subject to additional limitations to prevent abuse.

First, Proposed Rule 815(b)(1) requires a broker or dealer to be subject to at least a 15-second time delay before crossing two orders that have been pre-arranged. This follows a CFTC requirement that was designed to ensure that transactions executed through an order book are always subject to a minimum level of pre-trade price transparency and competition, instead of being bilaterally arranged away from the venue.

However, in practice, this 15-second requirement has been applied by certain SEFs in a manner that makes it very difficult for other market participants to step-in and provide a better price for a pre-arranged trade before it is formalized on the venue (for example, these trades may be published on a screen that few, if any, market participants have access to). As a result, we recommend Proposed Rule 815(b)(1) be supplemented by the Commission requiring the SBSEF to (i) provide periodic regulatory reporting around pre-arranged trading on its platform, including the percentage of pre-arranged orders for which other SBSEF participants step-in to join the trade and (ii) demonstrate that it offers a bona fide order book in order to permit the execution of pre-arranged orders (such as a minimum level of trading activity on the order book or a minimum percentage of

pre-arranged orders where pricing is improved as a result of other SBSEF participants stepping-in). This will deter abuses observed in connection with the existing CFTC requirement.

Second, the Proposal and CFTC rules are silent with respect to the permissibility of pre-arrangement on RFQ systems. It is important that pre-trade price transparency and the RFQ-to-3 requirement not be undermined through bilateral pre-arrangement of a Required Transaction followed by a directed RFQ that merely formalizes that transaction. For Required Transactions, we recommend that the Commission require SBSEF rulebooks to prohibit the pre-arrangement of Required Transactions.

Recommendation: Make the following refinements:

- For Required Transactions on an order book, supplement Proposed Rule 815(b)(1) by requiring the SBSEF to (i) provide periodic regulatory reporting around cross-trading on its platform, and (ii) demonstrate that it offers a bona fide order book in order to permit the execution of crossed orders; and
- For Required Transactions on an RFQ system, the Commission should require SBSEF rulebooks to prohibit pre-arrangement.

3. Requiring SBSEFs to Offer an Anonymous Order Book

Proposed Rule 803(a)(2) requires a SBSEF to offer an order book. This follows a CFTC requirement that was designed to promote all-to-all order book trading.

However, experience with the CFTC requirement has demonstrated that certain SEFs have implemented a fully disclosed order book (or bulletin board) instead. This is an intentionally unattractive trading protocol that undermines the spirit of the regulatory requirement. For example, to use a fully disclosed order book, a buy-side firm must be comfortable displaying its orders on a publicly attributed basis to every other participant on the trading venue, including other buy-side firms.

To address the above, we recommend the Commission modify Proposed Rule 803(a)(2) to require a SBSEF to offer *a pre-trade anonymous* order book.

Recommendation: Modify Proposed Rule 803(a)(2) to require a SBSEF to offer *a pre-trade anonymous* order book

4. Providing the Commission a Role in the MAT Process

Proposed Rule 816 enables a SBSEF to submit to the Commission a determination that a security-based swap has been "made available to trade" ("MAT") and therefore should be subject to the trade execution requirement. This follows the current CFTC MAT process.

However, experience with the existing CFTC regime suggests that the scope of the trade execution requirement should not be determined solely by the SBSEFs. The trade execution

requirement is a key pillar of the G20 post-crisis reforms, as ensuring that standardized and liquid derivatives are traded on well-regulated venues enhances market stability and integrity, and delivers material benefits to investors through better liquidity and lower transaction costs. Therefore, we recommend that the Commission also be able to propose MAT determinations for public comment, based on its independent assessment of the criteria set forth Proposed Rule 816(b).

Recommendation: Modify Proposed Rule 816 to provide the Commission with the ability to make MAT determinations as well.

5. Preventing Cross-Border Evasion

We support Proposed Rule 832(b)(3), which applies the trade execution requirement to security-based swap transactions arranged, negotiated or executed using personnel located in the United States ("ANE Transactions").

The Commission has correctly concluded that security-based swap transactions arranged, negotiated or executed using personnel located in the United States ("ANE Transactions") fall within the Commission's jurisdiction, even if the transactions are booked to non-U.S. entities.[23] The Commission has estimated that ANE Transactions account for a significant portion of total security-based swap dealing activity in the U.S.[24] Given the Commission's supervisory interests and policy objectives, it is warranted for the Commission to exercise its jurisdiction over ANE Transactions with respect to the trade execution requirement.

It is interesting to note that, following the CFTC granting no-action relief from the trade execution requirement for ANE Transactions, interdealer trading activity in EUR interest rate swaps began to be booked almost exclusively to non-U.S. entities, a fact pattern that academic research found was "consistent with (although not direct proof of) swap dealers strategically choosing the location of the desk executing a particular trade in order to avoid trading in a more transparent and competitive setting."[25] It is important to avoid this outcome in the security-based swap market.

Recommendation: Maintain the current approach in Proposed Rule 832(b)(3) to apply the trade execution requirement to ANE Transactions.

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[23] *See* Security-Based Swap Transactions Connected With a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent; Security-Based Swap Dealer De Minimis Exception, 81 Fed. Reg. 8598 (Feb. 19, 2016) at 8615-17, available at: https://www.govinfo.gov/content/pkg/FR-2016-02-19/pdf/2016-03178.pdf.

[24] *Id.* at 8616.

[25] Benos, E., Payne, R., and Vasios, M., Centralized trading, transparency and interest rate swap market liquidity: evidence from the implementation of the Dodd-Frank Act, Bank of England Staff Working Paper (May 2018) at page 30, available at: https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2018/centralized-trading-transparency-and-interest-rate-swap-market-liquidity-update

III. Ensuring a Level Playing Field Across Trading Venues

Under the Proposal, a national securities exchange that lists security-based swaps for trading (an "SBS exchange") would not be required to separately register as a SBSEF. As a result, it does not appear that the SBS exchange would be subject to key requirements applicable to SBSEFs, including required trading protocols (including for transactions subject to the trade execution requirement), impartial access (including the prohibition on post-trade name give-up), limits on pre-execution communications (including the 15-second cross-trade requirement), and any straight-through-processing requirements implemented pursuant to Core Principle 6.

We strongly recommend that SBS exchanges and SBSEFs be subject to equivalent requirements with respect to security-based swaps listed for trading on their platforms in order to ensure a level playing field, reduce compliance burdens for market participants, and remove any incentive to engage in regulatory arbitrage.

Recommendation: Ensure SBS exchanges and SBSEFs are subject to equivalent requirements with respect to security-based swaps listed for trading on their platforms, including with respect to required trading protocols, impartial access, limits on pre-execution communications, and any straight-through-processing requirements.

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We appreciate the opportunity to comment on this Proposal. Please feel free to contact the undersigned with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger

Managing Director

Global Head of Government & Regulatory Policy

Appendix - Summary of Recommendations

I. Issues Where Harmonization With The Existing CFTC Regime Is Critical

1. Ensuring a Robust Execution-to-Clearing Operational Workflow	Achieve harmonization with the CFTC regime by establishing straight-through-processing standards, incorporating relevant CFTC guidance, and prohibiting breakage agreements for intended to be cleared security-based swaps.
2. Effectively Implementing Impartial Access Requirements	Achieve greater harmonization with the CFTC regime by clearly setting forth how Proposed Rule 819(c) will be applied, incorporating relevant CFTC guidance.
3. Ensuring Multilateral and Transparent Execution on SBSEFs	Further clarify that the Proposal is harmonizing with CFTC rules to ensure that: • SBSEFs are required to offer multilateral trading protocols, instead of only single-dealer pages or one-to-one negotiations; and • All types of multilateral trading venues listing security-based swaps are required to register as a SBSEF, regardless of the specific trading protocol used (e.g. electronic, voice, order book, RFQ, auction).
4. Appropriately Calibrating Block Thresholds	Harmonize with the CFTC approach for calculating block trade thresholds and for applying these thresholds to package transactions.
5. Prohibiting the Practice of Post-Trade Name Give-up on SBSEFs	Maintain the proposed approach, but delete Proposed Rule 815(f)(4) or, at a minimum, remove the exemption for packages containing CFTC-regulated swaps that are intended to be cleared.
6. Appropriately Applying the SBSEF Regime to Package Transactions	Maintain the proposed approach, but with the following refinements: • Amend Proposed Rule 815(d)(2) to remove the exemption for a package containing a security-based swap that is intended to be cleared but not subject to the clearing requirement (along with a security-based swap subject to the trade execution requirement); and • Amend Proposed Rule 815(d)(3) to remove the exemption for a package containing a swap subject to the CFTC's trade execution requirement (along with a security-based swap subject to the trade execution requirement).

II. Targeted Refinements To The Existing CFTC Regime

1. Ensuring SBSEF Participants Are Aware of Competitive Firm Prices	Make the following refinements: • Amend Proposed Rule 815(a)(3)(i) to require a SBSEF to communicate any firm bid or offer pertaining to the same instrument resting on any of the SBSEF's trading systems or protocols.

	• Amend Proposed Rule 815(a)(3)(ii) to ensure that the RFQ requester has the ability to execute against all of the prices provided in connection with an RFQ on the same screen. • Amend Proposed Rule 815(a)(3) to apply to all security-based swaps transacted on SBSEFs, and not solely Required Transactions.
2. Further Safeguarding the Transparent and Competitive Execution Process By Restricting Pre-Arrangement	Make the following refinements: • For Required Transactions on an order book, supplement Proposed Rule 815(b)(1) by requiring the SBSEF to (i) provide periodic regulatory reporting around cross-trading on its platform, and (ii) demonstrate that it offers a bona fide order book in order to permit the execution of crossed orders. • For Required Transactions on an RFQ system, the Commission should require SBSEF rulebooks to prohibit pre-arrangement.
3. Requiring SBSEFs to Offer an Anonymous Order Book	Modify Proposed Rule 803(a)(2) to require a SBSEF to offer a pre-trade anonymous order book.
4. Providing the Commission a Role in the MAT Process	Modify Proposed Rule 816 to provide the Commission with the ability to make MAT determinations as well.
5. Preventing Cross-Border Evasion	Maintain the current approach in Proposed Rule 832(b)(3) to apply the trade execution requirement to ANE Transactions.

III. Ensuring a Level Playing Field Across Trading Venues

Ensure SBS exchanges and SBSEFs are subject to equivalent requirements with respect to security-based swaps listed for trading on their platforms, including with respect to required trading protocols, impartial access, limits on pre-execution communications, and any straight-through-processing requirements.