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## By Electronic Mail

May 21, 2020

Mr. Christopher J. Kirkpatrick  
Secretary  
Commodity Futures Trading Commission  
1155 21<sup>st</sup> Street NW  
Washington DC 20581

**Re: Swap Execution Facility Requirements and Real-Time Reporting Requirements –  
RIN 3038–AE94, 85 Fed. Reg. 9407 (Feb. 19, 2020)**

Dear Mr. Kirkpatrick:

The Futures Industry Association (“**FIA**”)<sup>1</sup> is pleased to submit this letter in response to the Commodity Futures Trading Commission’s (“**Commission**”) request for comment on its proposed amendments to Parts 36, 37 and 43 of its rules, which establish certain requirements for swap execution facilities (“**SEFs**”) and real-time reporting of swaps.<sup>2</sup> Our comments are limited to the Commission’s proposed amendment to the definition of a “block trade” set out in Rule 43.2. As explained below, although we support the proposed amendment to Rule 43.2, we believe it is important that the Commission use this opportunity to clarify a clearing FCM’s obligations under Commission Rule 1.73 with regard to block trades done pursuant to the rules of a SEF that occur away from a SEF’s trading system or platform (“**SEF block trades**”) in the rule text itself or in

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<sup>1</sup> FIA is the leading global trade organization for the futures, options, and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington DC. FIA’s mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. FIA’s membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. FIA’s core constituency consists of firms that operate as clearing members in global derivatives markets, including firms registered with the Commodity Futures Trading Commission as futures commission merchants (“**FCMs**”).

<sup>2</sup> *Swap Execution Facility Requirements and Real-Time Reporting Requirements*, 85 Fed. Reg. 9407 (Feb. 19, 2020).

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the main text of the preamble to the final rule.<sup>3</sup> To that end, we have provided suggested text in appendices attached to this letter that would provide clearing FCMs with such legal clarity.

As we have explained in prior submissions to the Commission, the obligation of a clearing FCM under Commission Rule 1.73 with respect to SEF block trades is unclear.<sup>4</sup> This legal uncertainty is caused in substantial part by the staff guidance on straight-through processing issued in September 2013 (the “**Guidance**”), the terms of which conflict with the plain language of Rule 1.73(a)(2)(iii).<sup>5</sup> In brief:

- A “block trade”, as defined in current Commission Rule 43.2, requires in relevant part that the block trade must (i) involve a swap that is listed on a registered SEF, (ii) occur away from the registered SEF’s trading system or platform, and (iii) be executed pursuant to the registered SEF’s rules and procedures.
- Rule 1.73(a)(2)(iii) provides that a clearing FCM that accepts transactions that are executed bilaterally and then submitted for clearing, must establish and maintain systems of risk management controls *reasonably designed to ensure compliance with the limits*. That is, the clearing FCM is not required to screen such transactions for compliance with risk-based limits prior to execution.
- Notwithstanding the plain language of Rule 1.73(a)(2)(iii), the Guidance takes the position that for purposes of Rule 1.73(a)(2)(iii), bilateral trades executed on or pursuant to the rules of a SEF are transactions *not* intended for clearing. Therefore, the staff determined at the time of issuing the Guidance that clearing FCMs must screen SEF block trades, pursuant to either Rule 1.73(a)(2)(i) or (ii).

The result of the staff guidance is that clearing FCMs would be required to screen SEF block trades for compliance with the FCM’s risk-based limits prior to execution. However, because they occur away from a SEF’s trading system or platform, clearing FCMs have no ability to pre-screen such transactions.

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<sup>3</sup> Commission Rule 1.73 (a)(1) and (2) requires each clearing FCM to establish risk-based limits in the accounts it carries based on position size, order size, margin requirements, or similar factors and, thereafter, to screen orders for compliance with the risk-based limits. The method and timing of an FCM’s screening obligation under Rule 1.73(a)(2) depends on the nature of the trade. For example, Rule 1.73(a)(2)(i) requires an FCM to “use automated means to screen orders for compliance with the limits.” Subsections (ii) and (iii), in contrast, require an FCM only to have systems “reasonably designed to ensure compliance with the limits.”

<sup>4</sup> See Letter from Walt L. Lukken, President and Chief Executive Officer, FIA, to Christopher Kirkpatrick, Secretary of the Commission, dated March 15, 2019, available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=62059&SearchText=lukken>. The text found at pp. 1-5 of this letter is incorporated herein by reference.

<sup>5</sup> The staff guidance on straight-through processing may be found at <http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/stpguidance.pdf>.

To address this clear conflict, the Division of Market Oversight (“**DMO**”) has issued a series of no-action letters, which have provided that, subject to certain terms and conditions, FCMs are not required to screen SEF block trades “until the order for a block trade enters the SEF’s non-Order Book trading system or platform.”<sup>6</sup> Most recently, in a letter issued in November 2017 (the “**Current No-Action Letter**”), DMO confirmed that “if the parties purport to execute a block trade away from the SEF without first obtaining a credit check, an FCM clearing unit that clears such trade and does not have knowledge of such purported execution is not in violation of the pre-execution credit check requirement under Commission regulation 1.73.”<sup>7</sup> Although a step in the right direction, the Current No-Action Letter does not eliminate legal uncertainty because the letter is time-limited and currently scheduled to expire on November 15, 2020. Further, like all staff relief, it does not purport to reflect the views of the Commission or other Divisions, and can be readily modified, terminated, or restricted.

We appreciate that the Commission has taken additional steps to try to address these concerns in the instant rulemaking. First, the Commission has proposed to amend the definition of a block trade in Rule 43.2 to provide, in relevant part, that, at the parties’ election, a SEF block trade either (i) may be executed on a non-Order Book trading system or platform of a registered SEF, or (ii) may occur away from a registered SEF’s trading system or platform. The Commission notes, and we agree, that SEF block trades executed on a SEF’s non-Order Book trading system or platform would allow FCMs to conduct pre-execution risk-based limit screenings in accordance with Rule 1.73.

Second, in a footnote in the Federal Register release accompanying the proposed amendment, the Commission has acknowledged that “currently no mechanism exists to enable a pre-execution credit check where blocks are executed away from a SEF”. Consequently, “if the parties purport to execute a block trade away from the SEF without first obtaining a credit check, an FCM clearing member that clears such trade and does not have knowledge of such purported execution is not in violation of the pre-execution credit check requirement under Commission regulation 1.73.”<sup>8</sup> This marks the first time that the Commission, rather than Commission staff, has stated that an FCM would not be in violation of Rule 1.73 if it did not conduct pre-execution risk-based limit screenings in these circumstances.

The Commission’s actions, while appreciated, do not adequately address the legal uncertainty that clearing FCMs face with respect to SEF block trades. In particular, the Commission statement set out in footnote 82 does not explicitly supersede the Current No-Action Letter, which, as noted earlier, expires on November 15, 2020. Without more formal action by the Commission, therefore, upon the expiration of the Current No-Action Letter, clearing FCMs could again potentially face uncertainty as to their Rule 1.73(a)(2)(iii) obligation with respect to SEF block trades. In these

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<sup>6</sup> See, e.g., No-Action Relief for Swap Execution Facilities from Certain Block Trade Requirements in Commission Regulation 43.2, Letter No. 14-118 (DMO Sept. 19, 2014)

<sup>7</sup> Extension of No-Action Relief for Swap Execution Facilities from Certain “Block Trade” Requirements in Commission Regulation 43.2, Letter No. 17-60 at 3 n.9 (DMO Nov. 14, 2017).

<sup>8</sup> 85 Fed. Reg. at 9414 n. 82.

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circumstances, therefore, we urge the Commission to adopt an amendment to Rule 1.73 to confirm that, if the parties purport to execute a SEF block trade without first obtaining a credit check, a clearing FCM is not required to conduct a pre-execution risk-based limit screening of the SEF block trade, and instead need only screen the SEF block trade after the trade is entered into the SEF's non-Order Book trading system or platform. At Appendix A attached to this letter, we have suggested an amendment to Rule 1.73(a)(2)(iii) for the Commission's consideration.

Regardless of the Commission's decision whether to act upon an amendment to Rule 1.73(a)(2)(iii) at this time,<sup>9</sup> we urge the Commission to address this issue more formally when taking final action on the proposed rules (and in any event prior to November 15, 2020). Specifically, we urge the Commission to clarify in the preamble to the final rule in the Federal Register (or elsewhere sufficiently prominent) that, if the parties to a SEF block trade execute the trade away from the SEF without first screening the trade for compliance with the clearing FCM's risk-based limits, an FCM clearing member that clears such trade and does not otherwise have knowledge of such purported execution is not in violation of Commission Rule 1.73. Further, the Commission should make clear that its statement supersedes the time-limited relief set out in the Current No-Action Letter. At Appendix B attached to this letter, we have suggested text for the Commission's consideration.

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Thank you for your consideration of these comments. If the Commission or the staff have any questions regarding the matters discussed herein, please contact Allison Lurton, FIA's Chief Legal Officer and General Counsel, at 202.466.5460 or [alurton@fia.org](mailto:alurton@fia.org).

Respectfully submitted,



Walt L. Lukken  
President and Chief Executive Officer

cc: Honorable Heath P. Tarbert, Chairman  
Honorable Brian Quintenz, Commissioner  
Honorable Rostin Benham, Commissioner  
Honorable Dan Berkovitz, Commissioner

Dorothy DeWitt, Director, Division of Market Oversight  
Roger Smith, Special Counsel, Division of Market Oversight  
Michael Penick, Senior Economist, Office of the Chief Economist

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<sup>9</sup> For example, we appreciate that consideration of FIA's suggested amendment to Rule 1.73(a)(2)(iii) should not unnecessarily delay final action of the instant rulemaking.

## APPENDIX A

In Rule 1.73:

Revise paragraph (a)(2)(iii) to read as follows:

### **§1.73 Clearing futures commission merchant risk management.**

(a) \* \* \*

(1) \* \* \*

(2) \* \* \*

(i) - (ii) \* \* \*

(iii) When a clearing futures commission merchant accepts transactions that were executed bilaterally and then submitted for clearing, including for the avoidance of doubt, a block trade that (A) involves a swap that is listed on a registered swap execution facility or designated contract market, (B) occurs away from the registered swap execution facility's or designated contract market's trading system or platform, and (C) is executed pursuant to the registered swap execution facility's or designated contract market's rules and procedures, it shall establish and maintain systems of risk management controls reasonably designed to ensure compliance with the limits;

## APPENDIX B

### **Suggested Federal Register insert:**

*Proposed amendment to §43.2: clearing FCM risk management responsibilities.*

FIA supported the proposed amendment to the definition of a block trade in Commission Rule 43.2 and agreed that block trades executed on a SEF's non-Order Book trading system or platform would allow FCMs to conduct pre-execution risk-based limit screenings in accordance with Rule 1.73. However, FIA also encouraged the Commission to amend Rule 1.73 to confirm that clearing FCMs are not required to conduct pre-execution risk-based limit screenings with respect to transactions that are executed bilaterally away from the SEF's non-Order Book trading system or platform and then submitted for clearing.

As the Commission noted in proposing the amendments to Rule 43.2, the Commission is aware that, when block trades are executed away from a SEF's trading system or platform, a clearing FCM currently has no mechanism to conduct a pre-execution screening. Consequently, the Commission believes that if the parties purport to execute a block trade away from the SEF without first obtaining a credit check, an FCM clearing member that clears such trade and does not have knowledge of such purported execution is not in violation of the pre-execution credit check requirement under Commission regulation 1.73.

The Commission is aware that CFTC Letter No. 17-60, issued by the Division of Market Oversight ("DMO"), provides comparable relief, but only until November 15, 2020.<sup>10</sup> Given the potential conflict between the Commission's statements herein and the time-limited relief set out in Letter No. 17-60, the Commission wishes to make clear that its position herein supersedes the time-limited relief provided by DMO. That is, until such time as the Commission otherwise provides by rule, regulation or order, if the parties to a block trade purport to execute the trade away from a SEF's non-Order Book trading system or platform without subjecting the transaction to a pre-execution screening, an FCM clearing member that clears such trade and does not have knowledge of such purported execution is not in violation of screening requirements under Commission regulation 1.73.

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<sup>10</sup> Extension of No-Action Relief for Swap Execution Facilities from Certain "Block Trade" Requirements in Commission Regulation 43.2, Letter No. 17-60 at 3 n.9 (DMO Nov. 14, 2017).