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The Blurred Line between Traditional Brokerage Activities of
CTAs and IBs and the SEF Registration Requirement

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I. INTRODUCTION

The Dodd-Frank Act amended the Commodity Exchange Act (“*CEA*”) in 2010 to establish a comprehensive regulatory regime for swaps activities under the oversight of the Commodity Futures Trading Commission (“*CFTC*” or “*Commission*”). Among other changes, Dodd-Frank established a new category of organized market called a swap execution facility (“*SEF*”), and imposed registration requirements and extensive regulatory obligations on SEFs. SEFs are “registered entities” under the CEA, on the market infrastructure side of the line along with designated contract markets. Like a designated contract market, a SEF has self-regulatory responsibilities, and is required to have rules, file rules and rule changes with the CFTC, and have programs in place to monitor and enforce compliance with its rules by participants executing swaps transactions on the SEF.

The CEA also establishes an oversight framework that relies on self-regulation of industry professionals and market participants, subject to Commission oversight. The CEA sets out a number of registration categories for industry professionals that provide certain services to clients, including introducing brokers (“*IBs*”), commodity trading advisors (“*CTAs*”), commodity pool operators (“*CPOs*”), and others. As a general matter, CFTC-registered industry professionals must belong to the National Futures Association (“*NFA*”), which has self-regulatory obligations as a “registered futures association” under the CEA, to assure that such industry professionals are subject to self-regulatory oversight.

The SEF Advisory and recent CFTC enforcement order against Asset Risk Management discussed below raise the prospect that a CTA or IB could be operating in a manner that requires SEF registration. These actions have created uncertainty around the swaps execution services a CTA or IB may perform for clients, without crossing the line to become a SEF. The actions also suggest that one and the same entity could be registered both as an organized market with self-regulatory responsibilities (a SEF) and as an industry professional performing activities that the CEA relegates to independent self-regulatory oversight, without recognizing how unprecedented that would be. The Commission has not publicly considered whether the CEA’s foundational oversight framework even allows for such a combination.

II. DEFINITIONS: IB, CTA AND SEF

A. Introducing Broker (IB)

As amended by the Dodd-Frank Act, the definition of “introducing broker” in CEA section 1a(31) covers any person that “is engaged in soliciting or in accepting orders for the purchase or sale of ... swaps” and which “does not accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result

therefrom.”¹ The use of the word “broker” in the term introducing broker conveys that upon accepting an order from a client, an IB could perform a brokerage role in executing the order as the client’s agent, *e.g.*, by forwarding the order to another party to handle or by finding a matching counterparty against which to fill the order.

Certain CFTC regulations implicitly reflect that introducing brokers may have a role in execution of client orders, such as Regulations 1.35(a) and 155.4. Specific to swaps, CFTC Staff Letter 12-70, which provides relief from IB and CTA registration for persons performing certain affiliate support services for multiple affiliated swap dealers or *de minimis* swap dealers, explicitly recognizes that “soliciting, negotiating, structuring, recommending, and/or accepting as agent, swap transactions” could bring a person within the IB (or CTA) definition.²

B. Commodity Trading Advisor (CTA)

The term “commodity trading advisor” is defined in section 1a(12) of the CEA as “any person who . . . for compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value or advisability of trading in . . . any . . . swap.” Although the definition is silent with respect to executing transactions, the Commission recognizes that CTAs may execute swaps (or other commodity interest transactions) for their advisory clients, and this is an ancillary service that many CTAs provide. In this regard, the definition of introducing broker in CFTC Regulation 1.3 excludes, among others, any CTA “which, acting in its capacity as a commodity trading advisor, is not compensated on a per-trade basis or which solely manages discretionary accounts pursuant to a power of attorney.” CFTC Staff Letter 12-70, described above, also acknowledges that a CTA may perform swap execution services.

C. Swap Execution Facility (SEF)

As defined in CEA section 1a(50):

The term “swap execution facility” means a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that—

- (A) facilitates the execution of swaps between persons; and
- (B) is not a designated contract market.

The terms “trading system” and “trading platform” are not defined in the CEA, but the statute does define the term “trading facility” in section 1a(51)(A), as follows:

¹ The definition of “introducing broker” adopted by the CFTC in its Regulation 1.3 narrows the scope of the CEA definition by adding the qualification that a person is soliciting or accepting orders “for compensation or profit, whether direct or indirect.” The CFTC definition also excludes persons acting in a clerical capacity, and certain specified categories of persons.

² Division of Swap Dealer and Intermediary Oversight, CFTC Letter No. 12-70 (Dec. 31, 2012), at page 2.

The term “trading facility” means a person or group of persons that constitutes, maintains, or provides a physical or electronic facility or system in which multiple participants have the ability to execute or trade agreements, contracts, or transactions—

- (i) by accepting bids or offers made by other participants that are open to multiple participants in the facility or system; or
- (ii) through the interaction of multiple bids or multiple offers within a system with a pre-determined non-discretionary automated trade matching and execution algorithm.³

The SEF definition’s use of multiple-to-multiple terminology and the phrase “accepting bids and offers” implies that for a system, platform or facility to be covered it should facilitate the interaction of trading interest of multiple parties on both sides of a transaction. This is reinforced by the text of the trading facility definition quoted above. The Commission’s statements when it adopted the Part 37 Regulations are also consistent with that reading, for example, the statement that “one-to-one voice services and single dealer platforms do not satisfy the SEF definition because multiple participants do not have the ability to execute or trade swaps with multiple participant.”⁴

In the rulemaking for the Part 37 Regulations, the CFTC suggested that it considers trading systems and platforms to have a broader reach than the “trading facility” definition. To date, though, the Commission has not formally defined the terms nor has it provided any guidance on how it interprets them.

III. THE SEF ADVISORY

On September 29, 2021, the CFTC Division of Market Oversight (“*DMO*”) issued CFTC Letter No. 21-19 “*Staff Advisory on Swap Execution Facility Registration Requirement*,” (“*SEF Advisory*”). The SEF Advisory sets out DMO’s views on what triggers the requirement for a person to have to register under the CEA as a SEF. The SEF Advisory arguably goes beyond the Commission’s prior public statements of what triggers the SEF registration requirement, made when the Commission promulgated its Part 37 Regulations for registration and regulation of SEFs in 2013 and later when it proposed, in 2018, and partially adopted, in 2020, amendments to those regulations. Notably, the SEF Advisory calls out that an IB or CTA could be operating in a manner that requires SEF registration, depending on the facts and circumstances of its operations. As explained above, though, the CEA framework also recognizes that IBs and CTAs may perform swap execution services for clients within the ambit of those registrations. The issue is where the boundaries are drawn around permissible brokerage activities.

³ The definition contains certain exclusions in paragraph (B), including one covering “an electronic facility or system that enables participants to negotiate the terms of and enter into bilateral transactions as a result of communications exchanged by the parties and not from interaction of multiple bids and multiple offers within a predetermined, nondiscretionary automated trade matching and execution algorithm.”

⁴ *Core Principles and Other Requirements for Swap Execution Facilities*, 78 FR 33476, at 33479 (June 4, 2013).

In substance, the SEF Advisory recites the CEA definition and registration requirement, and then covers four topics:

1. **One-to-Many and One-to-One Communications.** The SEF Advisory states that facilities offering one-to-many or one-to-one communications could meet the multiple-to-multiple prong of the CEA SEF definition. It notes that DMO staff has reviewed facilities enabling market participants to communicate bids and offers using a chat function and had determined that some of the facilities met the multiple-to-multiple prong because participants could initiate one-to-one communications sending them to more than one participant.
2. **Non-MAT Swaps.** The SEF Advisory reiterates that the SEF registration requirement applies even if a facility only offers trading of swaps that are not subject to mandatory clearing and are not “made available to trade (referred to as “MAT”), *i.e.*, even if the facility only offers trading of “Permitted Transactions” as defined under the Part 37 Regulations. The Commission had expressed this position before, when it adopted the Part 37 Regulations in 2013.⁵
3. **Any Means of Interstate Commerce.** The SEF Advisory highlights that the definition is not limited to a specific method of execution of swap transactions. It further states that execution methods triggering SEF registration could be electronic or non-electronic, citing the “any means of interstate commerce” language in the statutory definition.
4. **IBs and CTAs.** The SEF Advisory explicitly states that entities registered with the CFTC in another capacity, such as IBs or CTAs, may be subject to the SEF registration requirement. The SEF Advisory notably does not state such industry professionals will trigger SEF registration solely by virtue of assisting their clients in executing their swap transactions.

As an overall theme, the SEF Advisory states in multiple places that the determination whether a person has to register as a SEF depends on evaluation of all the relevant and circumstances of its operations. The SEF Advisory encourages a person operating a facility for trading or processing swaps to contact DMO staff to discuss its potential obligation to register as a SEF, yet also cautions that the invitation is not a *de facto* safe harbor against enforcement action for past regulatory failures.

The SEF Advisory contains no discussion of what is a trading system or platform within the meaning of the SEF definition.

IV. ENFORCEMENT ACTIONS

DMO issued the SEF Advisory on the same day (September 29, 2021) the Commission announced it had settled an enforcement action against Symphony Communication Services, LLC (“*Symphony*”) for operating as a SEF without SEF registration.⁶ The enforcement order states

⁵ The CFTC states this position in its infamous footnote 88. 78 FR 33481.

⁶ In the Matter of Symphony Communication Services, LLC (CFTC Docket No. 21-35) (Sept. 29, 2021).

that Symphony provided an automated technology tool that enabled a swap market participant to populate data fields for RFQs that could be sent to multiple swap market participants. The order states that a system or platform that permits a single requestor to initiate a one-to-many RFQ communication meets the multiple-to-multiple standard when more than one participant may use that functionality.⁷ Echoing the SEF Advisory, the order contains dicta stating that a “facility that is built for the purpose of accommodating multiple one-to-one communications for a given transaction will also meet the multiple-to-multiple prong.”⁸

Around one year later, the CFTC settled an enforcement action against a CTA called Asset Risk Management (“*ARM*”) finding that ARM acted illegally as an unregistered SEF.⁹ This action appears to represent an outward push from the Symphony order in applying the SEF registration requirement. Unlike Symphony, ARM is not a technology company and did not provide a means for market participants to send automated RFQs to multiple parties. But ARM is a CTA, and the SEF Advisory explicitly raised the prospect that CTAs (and IBs) could be acting in a manner that requires SEF registration.

As recited in the enforcement order, from about September 2017 to the present, ARM often recommended that clients execute swap transactions based on natural gas, natural gas liquids, or crude oil. Following a client’s request for swap pricing ARM would then submit pricing requests to potential counterparties, certain times to multiple potential counterparties with which the client had ISDA agreements, and other times to a specific potential counterparty identified by the client. The enforcement order further states that after receiving proposed prices, ARM would if authorized by the client, approve or reject a price based on the client’s pre-approved threshold, including by communicating “done” via chat or email, to execute the transaction. ARM would also confirm the swap execution with the client. Where ARM did not have authority to execute the transaction, ARM would typically participate in the client’s phone call with the relevant counterparty during which the client would agree to terms.

It appears that the Commission found ARM to have violated the SEF registration requirement based on the asserted fact that there were times ARM requested swap pricing from multiple potential counterparties when assisting clients in executing their swap transactions. The enforcement order against ARM cites only the Advisory to support the finding that ARM operated as a SEF, without any meaningful analysis or discussion of the Commission’s rules *per se*.

The enforcement orders provide no analysis of how Symphony or ARM met the element of the SEF definition of being a trading system or platform.

V. PROCEDURAL HISTORY AND CONCERNS

When the Commission adopted the Part 37 Regulations in 2013, it described the functions that could require a person to have to register as a SEF in the adopting release. When it discussed the one-to-one issue in the context of voice services, the Commission confirmed that one-to-one voice services do not satisfy the SEF definition. The adopting release contains no discussion

⁷ *Id.* at page 3.

⁸ *Id.* at pages 3-4.

⁹ In the Matter of Asset Risk Management, LLC (CFTC Docket No. 22-36) (Sept. 26, 2022).

suggesting that swaps brokerage activities performed by an IB or a CTA could trigger an obligation to register as a SEF, or any analysis of the costs or benefits associated with imposing SEF registration on IBs or CTAs.

The Commission proposed a number of technical corrections and substantive amendments to the Part 37 Regulations in November 2018.¹⁰ Notably, the Commission proposed an expanded SEF interpretation that focused on the distinction between an IB and a SEF; the proposal did not, however, discuss at all the execution services that CTAs provide or any dividing line between a CTA and a SEF. The proposed interpretation focused on “swaps booking entities” that “facilitate swaps trading between multiple market participants” and on aggregators, and expressed that one-to-many systems could fall under the SEF definition. It did not address whether or how one-to-one communications could require SEF registration. The Commission estimated up to 60 swap brokering entities would have to register under the proposed interpretation, if adopted. It stated that it would give IBs covered under the proposed interpretation six months to comply, subject to certain proposed conditions, if the new interpretation were adopted.

The CFTC adopted the technical amendments it had proposed in the November 2018 rulemaking,¹¹ but not the more far reaching substantive changes. In February 2021 it withdrew the un-adopted portions,¹² noting that if it had adopted them, certain swaps broking entities, including interdealer brokers, and aggregators of single-dealer platforms, would have had to register as SEFs.¹³

The SEF Advisory appears to go beyond what the Commission has articulated in formal agency rulemaking as to what triggers SEF registration. DMO issued the SEF Advisory without the benefit of any public comment through the rulemaking process. Although the SEF Advisory states that it “represents only the views of DMO staff and does not necessarily represent the views of any other division or office of the Commission,” that is of scant comfort when the SEF Advisory links the invitation to consult with DMO staff with the warning that a person could be referred to enforcement for its past conduct. That stands in sharp contrast to the Commission’s earlier promise if it were to adopt a broader SEF interpretation to provide affected persons with six months to register.

VI. IMPLICATIONS FOR CTAs, IBs AND THEIR CLIENTS

The Advisory and its manifestation in the ARM enforcement action have created uncertainty around the swaps brokerage services a CTA or IB may perform for clients, within the ambit of their registrations, without being deemed to act as a SEF. If the Commission broadly imposes the SEF registration requirement, impacted CTAs and IBs will face the choice between restricting or ceasing executing swaps as agents for their clients or transforming themselves at substantial time and expense into organized markets with self-regulatory responsibilities.

¹⁰ *Swap Execution Facilities and Trade Execution Requirement*, 83 FR 61946 (Nov. 30, 2018).

¹¹ *See Post-Trade Name Give-Up on Swap Execution Facilities*, 85 FR 44693 (July 24, 2020) and *Swap Execution Facilities*, 86 FR 9224 (Feb. 11, 2021) (addressing operational issues relating to audit trail data, financial resources and chief compliance officer requirements).

¹² *Swap Execution Facilities and Trade Execution Requirement*, 86 FR 9304 (Feb. 12, 2021).

¹³ 86 FR 9304.

Some clients may find that their CTAs or IBs will restrict or eliminate valuable swap execution services they provide to avoid the risk of having to register as a SEF. Other clients may feel pressured to bring their swap transactions to a SEF for execution when they are not otherwise required to do so and would prefer not to. Certain market participants, including hedgers or other end-users, may prefer to execute their swap transactions away from a SEF for various reasons, such as to avoid SEF onboarding costs and trading fees, avoid becoming subject to a SEF's rules and self-regulatory oversight, liquidity concerns if their dealer trading counterparties are unwilling to participate on the SEF, and quality of the pricing they will receive executing bespoke transactions on a SEF.