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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 37

RIN Number 3038-AD18

Core Principles and Other Requirements for Swap Execution Facilities

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission ("Commission" or "CFTC") is adopting new rules, guidance, and acceptable practices to implement certain statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The final rules, guidance, and acceptable practices, which apply to the registration and operation of a new type of regulated entity named a swap execution facility ("SEF"), implement the Dodd-Frank Act's new statutory framework that, among other requirements, adds a new section 5h to the Commodity Exchange Act ("CEA" or "Act") concerning the registration and operation of SEFs, and adds a new section 2(h)(8) to the CEA concerning the execution of swaps on SEFs.

DATES: The rules will become effective [60 DAYS AFTER THE DATE OF PUBLICATION IN THE FEDERAL REGISTER], with the exception of the 180-day time frame for the Commission's review period in regulation 37.3(b)(5) (17 CFR 37.3(b)(5)), which shall become effective [2 YEARS AFTER THE EFFECTIVE DATE OF THESE RULES]. *Compliance date*: [120 DAYS AFTER THE DATE OF PUBLICATION IN THE FEDERAL REGISTER], except that: (a) from [THE

EFFECTIVE DATE OF THESE RULES] until [1 YEAR AFTER THE COMPLIANCE DATE OF THESE RULES] market participants may comply with the minimum market participant requirement in regulation 37.9(a)(3) (17 CFR 37.9(a)(3)) by transmitting a request for a quote to no less than two market participants; and (b) each affected entity shall comply with the warning letter requirement in regulation 37.206(f) (17 CFR 37.206(f)) no later than [1 YEAR AFTER THE EFFECTIVE DATE OF THESE RULES].

FOR FURTHER INFORMATION CONTACT: Amir Zaidi, Special Counsel, 202-418-6770, azaidi@cftc.gov, Alexis Hall-Bugg, Special Counsel, 202-418-6711, ahallbugg@cftc.gov, or David Van Wagner, Chief Counsel, 202-418-5481, dvanwagner@cftc.gov, Division of Market Oversight; Michael Penick, Senior Economist, 202-418-5279, mpenick@cftc.gov, or Sayee Srinivasan, Research Analyst, 202-418-5309, ssrinivasan@cftc.gov, Office of the Chief Economist, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

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I. Background

A. Swaps and Title VII of the Dodd-Frank Act

Historically, swaps have traded in over-the-counter ("OTC") markets, rather than on regulated exchanges given their exemption from regulation.[1] The OTC swaps market is less transparent than exchange-traded futures and securities markets. This lack of transparency was a major contributor to the 2008 financial crisis because regulators and market participants lacked visibility to identify and assess the implications of swaps market exposures and counterparty relationships.[2] As a result, on July 21, 2010,

[1] See Commodity Futures Modernization Act of 2000, Pub. L. 106-554, 114 Stat. 2763 (2000).

[2] See The Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (Official Government Edition), at 299, 352, 363-364, 386, 621 n. 56 (2011), available at http://fcic-

President Obama signed the Dodd-Frank Act,[3] which tasked the Commission with overseeing a large portion of the U.S. swaps market.

Title VII of the Dodd-Frank Act[4] amended the CEA[5] to establish a comprehensive new regulatory framework for swaps and security-based swaps ("SB-swaps"). A key goal of the Dodd-Frank Act is to bring greater pre-trade and post-trade transparency to the swaps market. Pre-trade transparency with respect to the swaps market refers to making information about a swap available to the market, including bid (offers to buy) and offer (offers to sell) prices, quantity available at those prices, and other relevant information before the execution of a transaction. Such transparency lowers costs for investors, consumers, and businesses; lowers the risks of the swaps market to the economy; and enhances market integrity to protect market participants and the public. The Dodd-Frank Act also ensures that a broader universe of market participants receive pricing and volume information by providing such information upon the completion of every swap transaction (i.e., post-trade transparency).[6] By requiring the trading of swaps on SEFs and designated contract markets ("DCMs"), all market participants will benefit

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static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf. The Commission has acknowledged, however, that the benefits of enhanced market transparency are not boundless, particularly in swap markets with limited liquidity. See Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 77 FR 15460, 15466 (proposed Mar. 15, 2012). In implementing these regulations, the Commission has taken into account the benefits and concerns related to market transparency.

[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

[4] Pursuant to section 701 of the Dodd-Frank Act, Title VII may be cited as the "Wall Street Transparency and Accountability Act of 2010."

[5] 7 U.S.C. 1 et seq.

[6] See Financial Stability Board, Implementing OTC Derivatives Market Reforms, at 41 (Oct. 25, 2010), available at http://www.financialstabilityboard.org/publications/r_101025.pdf; Technical Committee of the International Organization of Securities Commissions, Transparency of Structured Finance Products Final Report, at 17, 21 (Jul. 2010), available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD326.pdf.

from viewing the prices of available bids and offers and from having access to transparent and competitive trading systems or platforms.

In addition to facilitating greater transparency and trading of swaps on SEFs, Title VII of the Dodd-Frank Act establishes a comprehensive regulatory framework, including registration, operation, and compliance requirements for SEFs.[7] For example, section 733 of the Dodd-Frank Act sets forth a broad registration provision that requires any person who operates a facility for the trading of swaps to register as a SEF or as a DCM.[8] In addition, section 721 of the Dodd-Frank Act amended the CEA to define SEF as a trading platform where multiple participants have the ability to execute swaps by accepting bids and offers made by multiple participants in the platform.[9] Furthermore, section 723 of the Dodd-Frank Act set forth a trade execution requirement, which states that swap transactions subject to the clearing requirement must be executed on a DCM or SEF, unless no DCM or SEF makes the swap available to trade or for swap transactions subject to the clearing exception under CEA section 2(h)(7).[10] Section 733 of the Dodd-Frank Act provided that to be registered and maintain registration, a SEF must comply with fifteen enumerated core principles and any requirement that the Commission may impose by rule or regulation.[11]

B. SEF Notice of Proposed Rulemaking

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[7] See CEA section 5h, as enacted by section 733 of the Dodd-Frank Act; 7 U.S.C. 7b-3. This regulatory framework includes: (i) registration, operation, and compliance requirements for SEFs and (ii) fifteen core principles. Applicants and registered SEFs are required to comply with the core principles as a condition of obtaining and maintaining their registration as a SEF.

[8] CEA section 5h(a)(1), as enacted by section 733 of the Dodd-Frank Act; 7 U.S.C. 7b-3(a)(1).

[9] CEA section 1a(50), as amended by section 721 of the Dodd-Frank Act; 7 U.S.C. 1a(50).

[10] CEA section 2(h)(8), as amended by section 723 of the Dodd-Frank Act; 7 U.S.C. 2(h)(8).

[11] CEA section 5h, as enacted by section 733 of the Dodd-Frank Act; 7 U.S.C. 7b-3.

The Dodd-Frank Act amended the CEA to provide that, under new section 5h, the Commission may in its discretion determine by rule or regulation the manner in which SEFs comply with the core principles.[12] In consideration of both the novel nature of SEFs and its experience in overseeing DCMs' compliance with core principles, the Commission carefully assessed which SEF core principles would benefit from regulations, providing legal certainty and clarity to the marketplace, and which core principles would benefit from guidance or acceptable practices, where flexibility is more appropriate. Based on that evaluation, on January 7, 2011, the Commission proposed a combination of regulations, guidance, and acceptable practices for the registration, oversight, and regulation of SEFs ("SEF NPRM").[13]

The SEF NPRM provided, among other requirements, the following:

(1) Procedures for temporary and full SEF registration.[14]

(2) A minimum trading functionality requirement that all SEFs must offer,[15] which took into account the SEF definition,[16] the core principles applicable to SEFs,[17] and the goals provided in section 733 of the Dodd-Frank Act.[18] The minimum trading functionality required a SEF to provide a centralized electronic trading screen upon which any market participant can post both executable and non-executable bids and offers that are transparent to all other

[12] CEA section 5h(f)(1); 7 U.S.C. 7b-3(f)(1).

[13] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR 1214 (proposed Jan. 7, 2011).

[14] Id. at 1238.

[15] Id. at 1241.

[16] CEA section 1a(50); 7 U.S.C. 1a(50).

[17] CEA section 5h(f); 7 U.S.C. 7b-3(f).

[18] The goals of section 733 of the Dodd-Frank Act are to promote the trading of swaps on SEFs and to promote pre-trade price transparency in the swaps market. CEA section 5h(e); 7 U.S.C. 7b-3(e).

market participants of the SEF.[19] For a trader who has the ability to execute against its customer's order or to execute two customers' orders against each other, the SEF NPRM also required the trader be subject to a 15 second time delay between the entry of those two orders.[20] In addition, the proposal allowed a Request for Quote ("RFQ") System[21] that operates in conjunction with the SEF's minimum trading functionality.[22] Finally, the SEF NPRM stated that a SEF may offer other functionalities in conjunction with the minimum trading functionality, as long as those functionalities meet the SEF definition and comply with the core principles.[23]

(3) The classification of swap transactions into two categories: Required Transactions (i.e., transactions subject to the trade execution mandate under section 2(h)(8) of the CEA and not block trades) and Permitted Transactions (i.e., transactions not subject to the clearing and trade execution mandates, illiquid or bespoke swaps, or block trades).[24] Under the SEF NPRM, Required Transactions were required to be executed on the minimum trading functionality, an Order Book meeting the minimum trading functionality, or

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[19] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1241.

[20] Id.

[21] Id.

[22] By "in conjunction with the SEF's minimum trading functionality," the Commission means that the SEF NPRM required a SEF to offer the minimum trading functionality, and if that SEF also offered an RFQ System, it was required to communicate any bids or offers resting on the minimum trading functionality to the RFQ requester along with the responsive quotes. See the discussion below regarding "Taken Into Account and Communicated" Language in the RFQ System Definition under § 37.9(a)(1)(ii) – Request for Quote System in the preamble for further details.

[23] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1220.

[24] Id. at 1241.

an RFQ System (in conjunction with the minimum trading functionality).[25] The SEF NPRM also allowed a SEF to provide additional methods of execution for Permitted Transactions, including Voice-Based Systems.[26]

(4) Regulations, guidance, and acceptable practices to implement the 15 core principles specified in section 5h(f) of the Act.[27]

The initial comment period for the SEF NPRM ended on March 8, 2011. Subsequently, the Commission reopened the comment period until June 3, 2011, as part of its global extension of comment periods for various rulemakings implementing the Dodd-Frank Act.[28] After the second comment period ended, the Commission continued to accept and consider late comments, which it did until April 30, 2013.[29] The Commission received approximately 107 comment letters on the SEF NPRM from members of the public.[30] The Chairman and Commissioners, as well as the Commission staff, participated in numerous meetings with representatives of single dealer platforms,

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[25] Id.

[26] Id.

[27] Id. at 1241-1253, 1256-1258.

[28] Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR 25274 (May 4, 2011). The Commission extended the applicable comment periods to provide the public an additional opportunity to comment on the proposed new regulatory framework. The Commission also opened an additional comment period, which ended on June 10, 2011, to provide the public an opportunity to comment on the Commission's phased implementation of the Act, as amended, including its implementation of section 733 of Dodd-Frank Act. Joint Public Roundtable on Issues Related to the Schedule for Implementing Final Rules for Swaps and Security-Based Swaps Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR 23221 (Apr. 26, 2011).

[29] The Commission also held two roundtables touching on issues related to the SEF NPRM: (1) "Available to Trade" Provision for Swap Execution Facilities and Designated Contract Markets; and (2) Proposed Regulations Implementing Core Principle 9 for Designated Contract Markets. Transcripts are available through the Commission's website at http://www.cftc.gov/PressRoom/Events/2012Events/index.htm.

[30] A list of the full names and abbreviations of commenters to the SEF NPRM is included in section IV at the end of this release. The Commission notes that many commenters submitted more than one comment letter. Additionally, all comment letters that pertain to the SEF NPRM, including those from the additional comment periods related to implementation of the final Dodd-Frank rules, are contained in the SEF rulemaking comment file and are available through the Commission's website at http://comments.cftc.gov/PublicComments/CommentList.aspx?id=955.

interdealer brokers, DCMs, trade associations, OTC market participants, potential SEF applicants, and other interested parties.[31] In addition, the Commission consulted with the Securities and Exchange Commission ("SEC") and international regulators on numerous occasions.

II. Part 37 of the Commission's Regulations – Final Rules

A. Adoption of Regulations, Guidance, and Acceptable Practices

In this final rulemaking, the Commission is adopting many of the proposed regulations that each SEF must meet in order to comply with section 5h of the CEA, both initially upon registration and on an ongoing basis, and related guidance, and acceptable practices. As a result of the written comments received and dialogue and meetings with the public, the Commission has revised or eliminated a number of regulations that were proposed in the SEF NPRM, and in a number of instances, has codified guidance and/or acceptable practices in lieu of the proposed regulations. In determining the scope and content of the final SEF regulations, the Commission has carefully considered the costs and benefits for each rule with particular attention to the public comments. Additionally, the Commission has taken into account the concerns raised by commenters regarding the potential effects of specific rules on SEFs offering different swap contracts and trading systems or platforms and the importance of the statutory differences between SEFs and DCMs. The Commission addresses these issues below in its discussion of specific rule provisions.

The Commission also notes that the SEC has proposed rules related to security-based SEFs ("SB-SEFs") as required under section 763 of the Dodd-Frank Act ("SB-SEF

[31] Meeting summaries are available through the Commission's website at http://comments.cftc.gov/PublicComments/CommentList.aspx?id=955.

NPRM").[32] Section 712(a) of the Dodd-Frank Act states that before commencing any rulemaking regarding swap execution facilities, the Commission "shall consult and coordinate to the extent possible with the Securities and Exchange Commission and the prudential regulators for the purposes of assuring regulatory consistency and comparability . . . ."[33] The Commission has also received several comments stating that the Commission and the SEC should harmonize their rules as much as possible.[34]

The Commission has coordinated with the SEC to harmonize the SEF and SB-SEF requirements to the extent possible and has taken into consideration the comments for greater harmonization between the SEF and SB-SEF regulations. However, there may be appropriate differences in the approach that each agency may take regarding the regulation of SEFs and SB-SEFs. Cognizant of the different products and markets regulated by the SEC and the Commission, the SEC recognized in its SB-SEF NPRM that there may be differences in the approach that each agency may take regarding the regulation of SEFs and SB-SEFs.[35]

Similarly, the Commission is mindful that swaps may also trade on DCMs. Thus, in addition to its efforts to coordinate its approach with the SB-SEF regulations, the Commission also seeks, where possible, to harmonize the final SEF regulations with the DCM regulations in order to minimize regulatory differences between SEFs and DCMs in those instances where Congress enacted similar core principles for the two types of registered entities. In addition, some differences in the agencies' regulatory oversight

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[32] Registration and Regulation of Security-Based Swap Execution Facilities, 76 FR 10948 (proposed Feb. 28, 2011).

[33] 15 U.S.C. 8302(a)(1).

[34] Tradeweb Comment Letter at 3-4 (Jun. 3, 2011); Reuters Comment Letter 3-4 (Mar. 8, 2011); FSR Comment Letter at 10-11 (Mar. 8, 2011); WMBAA Comment Letter at 10-11 (Mar. 8, 2011).

[35] Registration and Regulation of Security-Based Swap Execution Facilities, 76 FR at 10950.

regimes may be attributed to the fact that, unlike the SEC that is only responsible for overseeing trading in SB-swaps, such as single-name securities and narrow-based security indexes, the Commission is charged with the oversight of swaps trading over a broad range of asset categories. Consequently, the Commission has taken into account the varied characteristics of those underlying commodities in formulating the regulatory responsibilities of SEFs.

In the preamble sections below, the Commission responds to the substantive comments submitted in response to the SEF NPRM. The Commission reviewed and considered all comments in adopting this final rulemaking. Further, the final regulations include a number of technical revisions and non-substantive changes to the proposed rule text intended to clarify certain provisions, standardize terminology within this part 37, conform terminology to that used in other parts of the Commission's regulations, and more precisely state regulatory standards and requirements. For example, a minimum trading functionality requirement was in proposed § 37.9, which has been moved to the registration section under final § 37.3 to clarify that this functionality is required in order to register as a SEF. The final regulations will become effective 60 days after their publication in the Federal Register.

B. General Regulations (Subpart A)

The regulations in this final rulemaking are codified in subparts A through P under part 37 of the Commission's regulations. The general regulations consisting of §§ 37.1 through 37.9 are codified in subpart A, and the regulations applicable to each of the 15 core principles are codified in subparts B through P, respectively.[36]

[36] Subparts B through P begin with a regulation containing the language of the core principle in the Act.

1. § 37.1 – Scope

Proposed § 37.1 provided that part 37 applies to entities that are registered SEFs, have been registered SEFs, or are applying to become registered SEFs. The proposed rule also stated that part 37 does not restrict the eligibility of SEFs to operate under the provisions of parts 38 or 49 of this chapter.

(a) Commission Determination

The Commission received no comments on this section and is adopting the provision as proposed.[37]

2. § 37.2 – Applicable Provisions

Proposed § 37.2 listed the Commission regulations that, in addition to part 37, will be applicable to SEFs, including regulations that have been codified and are proposed to be codified upon the Commission's finalization of the rulemakings implemented pursuant to the Dodd-Frank Act.

(a) Commission Determination

Although it received no comments on this section, the Commission is revising proposed § 37.2 to generally state that SEFs shall comply with, in addition to part 37, all applicable Commission regulations, and to only cite those specific provisions whose applicability to SEFs may not be apparent. The Commission notes that a separate rulemaking adopted conforming changes to existing regulations to clarify the pre-Dodd Frank provisions applicable to SEFs.[38] There are, however, certain existing regulations

[37] The Commission has removed the phrase "has been registered" from proposed § 37.1 because a SEF that has been registered is the same as a SEF that is registered.

[38] Adaptation of Regulations to Incorporate Swaps, 77 FR 66288 (Nov. 2, 2012). The Commission may promulgate a second phase of conforming changes to its regulations once more rules relating to swaps are finalized.

that will apply to SEFs that the separate rulemaking did not address. Accordingly, for clarity purposes, the Commission is specifically stating that § 1.60[39] and part 9[40] of its regulations will apply to SEFs. These revisions will eliminate the need for the Commission to continually update § 37.2 when new regulations with which SEFs must comply are codified.

3. § 37.3 – Requirements for Registration[41]

Proposed § 37.3 established, among other procedures, application procedures for temporary and full registration of new SEFs, and procedures for the transfer of a registration. To assist prospective SEF applicants, the SEF NPRM included under appendix A to part 37 an application form titled Form SEF. Form SEF included information that an applicant would be required to provide to the Commission in order for the Commission to make a determination regarding the applicant's request for SEF registration.

With respect to which entities must register as a SEF, the SEF NPRM stated that in order for an entity to meet the SEF definition and satisfy the SEF registration requirements, multiple parties must have the ability to execute or trade swaps by accepting bids and offers made by multiple participants.[42] In this regard, the SEF NPRM stated 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

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[39] The term "contract market" used in § 1.60 of the Commission's regulations should be interpreted to include a SEF for purposes of applying the requirements of § 1.60 to a SEF. 17 CFR 1.60.

[40] The term "exchange" used in part 9 of the Commission's regulations should be interpreted to include a SEF for purposes of applying the requirements of part 9 to a SEF. 17 CFR part 9.

[41] The Commission is renaming the title of this section from "Requirements for Registration" to "Requirements and Procedures for Registration" to provide greater clarity. The Commission is also restructuring the order of § 37.3 to provide clarity.

[42] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1219.

with multiple participants.[43] In addition, the SEF NPRM stated that entities that operate exclusively as swap processors do not meet the SEF definition and should not be required to register.[44] Although the SEF NPRM stated that the registration provision in CEA section 5h(a)(1) could be read to require the registration of entities that solely engage in trade processing,[45] it stated that such entities do not meet the SEF definition and should not be required to register as SEFs because: (1) they do not provide the ability to execute or trade a swap as required by the SEF definition; and (2) the SEF definition does not include the term "process."[46]

The SEF NPRM also noted that CEA section 2(h)(8) requires that transactions involving swaps subject to the clearing requirement be executed on a DCM or SEF, unless no DCM or SEF makes such swaps available to trade or such swaps qualify for the clearing exception under CEA section 2(h)(7).[47] In this regard, the SEF NPRM stated that market participants may desire to avail themselves of the benefits of trading on SEFs for swaps that are not subject to the CEA section 2(h)(8) trade execution requirement, but it also acknowledged that such swaps are not required to be executed on a SEF or DCM.[48]

(a) Requirements for Registration

(1) Summary of Comments

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[43] Id.

[44] Id.

[45] CEA section 5h(a)(1) states that "[n]o person may operate a facility for the trading or processing of swaps unless the facility is registered as a swap execution facility or designated contract market . . . ." 7 U.S.C. 7b-3(a)(1).

[46] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1219.

[47] Id. at 1221-22. CEA sections 2(h)(7) and 2(h)(8); 7 U.S.C. 2(h)(7) and 2(h)(8). See discussion below under § 37.10 – Swaps Made Available for Trading in the preamble for further details regarding this process.

[48] Id. at 1222.

Several commenters asserted that the proposed rule is ambiguous as to who must register as a SEF as required under CEA section 5h(a)(1) and requested clarification.[49] For example, UBS stated that the Commission should clarify that "the SEF registration requirement in [CEA section 5h(a)(1)] only applies to platforms that meet the SEF definition."[50] In addition, Barclays commented that the language of CEA section 5h(a)(1) should not be read broadly to require SEF registration for any platform or system that executes or processes swaps to the extent it is deemed to be a "facility" without considering whether such swaps are or are not subject to the CEA section 2(h)(8) trade execution mandate.[51] Similarly, Bloomberg noted the broad language under the CEA section 5h(a)(1) registration requirement, and stated that if Congress intended that all swaps be traded on a SEF or DCM, then the trade execution mandate under CEA section 2(h)(8) would be unnecessary.[52] The Commission also received comments and specific requests for a Commission determination as to whether certain business models or services must register as a SEF, including one-to-many platforms, blind auction platforms, aggregation services or portals, portfolio compression services, risk mitigation services, and swap processing services.

(i) One-to-Many Systems or Platforms

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[49] CEA section 5h(a)(1) states that "[n]o person may operate a facility for the trading or processing of swaps unless the facility is registered as a swap execution facility or designated contract market . . . ." 7 U.S.C. 7b-3(a)(1). UBS Comment Letter at 1-2 (May 18, 2012); UBS Comment Letter at 2-3 (Nov. 2, 2011); Barclays Comment Letter at 2 (Jun. 3, 2011); Deutsche Comment Letter at 6 (Mar. 8, 2011); Bloomberg Comment Letter at 3 (Mar. 8, 2011); State Street Comment Letter at 3 (Mar. 8, 2011); CME Comment Letter at 8 (Mar. 8, 2011).

[50] UBS Comment Letter at 1 (May 18, 2012). The Commission notes that UBS submitted 2 comment letters on May 18, 2012.

[51] Barclays Comment Letter at 2 (Jun. 3, 2011).

[52] Bloomberg Comment Letter at 3 (Mar. 8, 2011).

AFR opined that single dealer or one-to-many platforms do not meet the SEF definition in CEA section 1a(50), which refers to a system in which multiple parties have the ability to execute or trade swaps by accepting bids or offers from multiple participants.[53] Similarly, IECA stated that SEFs should operate in a way that publicly reveals market prices, and that preserving the "one-to-one" pricing model of existing dealer systems is inconsistent with the SEF definition.[54]

(ii) Blind Auction Systems or Platforms

Nodal commented that a blind auction platform should be able to register as a SEF.[55] Nodal contended that its blind auction platform meets the SEF definition because multiple participants have the ability to execute swap transactions by accepting bids and offers made by multiple participants albeit without the pre-trade posting of bids or offers.[56] Nodal explained that its platform allows participants to submit firm bids and offers without the disclosure of the terms of those bids and offers to other participants, and that the auction algorithmically processes the bids and offers to match participants efficiently.[57] Nodal further explained that auction volume is awarded to participants at the same price and at a price equal to or better than the participants' auction order.[58]

(iii) Aggregation Services or Portals

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[53] AFR Comment Letter at 3-4 (Mar. 8, 2011). JP Morgan also commented that it agrees with the Commission that a single dealer platform cannot qualify as a SEF because it fails to satisfy the "multiple to multiple" language in the SEF definition. JP Morgan Comment Letter at 3 (Mar. 8, 2011).

[54] IECA Comment Letter at 3 (May 24, 2011).

[55] Nodal Comment Letter at 2-3 (Jun. 3, 2011); Nodal Comment Letter at 2-3 (Mar. 8, 2011). Nodal also expressed support for blind auction platforms in its comment letter to the Second Amendment to July 14, 2011 Order for Swap Regulation Notice of Proposed Amendment, 77 FR 28819 (proposed May 16, 2012).

[56] Nodal Comment Letter at 3 (Mar. 8, 2011).

[57] Id.

[58] Id. at 2.

UBS and Bloomberg requested clarification whether aggregator services are required to register as SEFs.[59] UBS stated that an aggregator service will provide customers with the ability to access the best available liquidity and pricing on multiple SEFs through the aggregator's screen so that customers will not have to connect to each SEF individually.[60] UBS stated that an aggregator service should not be required to register as a SEF because the transaction is executed on the relevant SEF's platform.[61]

(iv) Services Facilitating Portfolio Compression and Risk Mitigation Transactions

Several commenters sought clarification that portfolio compression and risk mitigation services are not required to register as SEFs.[62] According to TriOptima, its portfolio compression service provides a netting mechanism that reduces the outstanding trade count and outstanding gross notional value of swaps in participants' portfolios by terminating or modifying existing trades.[63] Specifically, TriOptima stated that prospective participants may sign up for a scheduled compression cycle and the participants must provide detailed data about their respective portfolios and risk tolerances.[64] Other than to update mark-to-market values shortly before the compression cycle is run, prospective participants have no further input into the compression process, which is entirely controlled by the compression algorithm.[65] On a specified date,

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[59] UBS Comment Letter at 1 (May 18, 2012); Meeting with UBS dated Mar. 27, 2012; Meeting with Bloomberg dated Jan. 18, 2012. See also UBS Comment Letter at 1 (Nov. 2, 2011).

[60] Meeting with UBS dated Mar. 27, 2012. See also UBS Comment Letter at 1 (Nov. 2, 2011).

[61] Meeting with UBS dated Mar. 27, 2012.

[62] Meeting with ICAP and TriOptima dated Sep. 6, 2012; Meeting with ICAP dated Aug. 29, 2012; Meeting with ICE dated Jul. 25, 2012; WMBAA Comment Letter at 3 (Jul. 18, 2011); ICAP Comment Letter at 2 (Jul. 7, 2011); TriOptima Comment Letter at 1 (Mar. 8, 2011).

[63] TriOptima Comment Letter at 2, 4 (Mar. 8, 2011).

[64] Id. at 2. The service does not place any constraints on the number of positions or risk tolerances of prospective participants. Id.

[65] Id. at 3.

TriOptima runs the compression cycle, which produces a set of proposed transactions for each participant.[66] The proposed transactions, if effected, would terminate or modify participants' existing trades in order to reduce the outstanding trade count and outstanding gross notional value of swaps in the participants' portfolios.[67] Each participant receives only details of the proposed compression transactions to which it is a party, but all of the compression transactions must be accepted in order for the particular compression cycle to occur.[68] If a single participant declines to agree to the proposed compression transactions, then the entire compression cycle fails and the pre-compression swap transactions remain in effect.[69] TriOptima contended that such services do not perform the role of a trade execution venue so they should not be regulated as a SEF.[70]

ICAP stated that its bulk risk mitigation service assists market participants in managing their risk exposures by identifying offsetting risk requirements and executing new offsetting trades among those participants.[71] Specifically, ICAP stated that its risk mitigation service sets the curve and price for all trades based on a survey of market making entities, such as banks, or other entities that are willing to provide quotes, as well as price quotes on DCMs.[72] All prospective participants in a particular risk mitigation run are first shown the curve and prices for transactions along the curve.[73] Subsequently,

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[66] Id.

[67] Id.

[68] Id.

[69] Id.

[70] Id.

[71] Meeting with ICAP dated Aug. 29, 2012; ICAP Comment Letter at 1, 4 (Jul. 7, 2011).

[72] Meeting with ICAP dated Aug. 29, 2012; ICAP Comment Letter at 4 (Jul. 7, 2011).

[73] Id.

the prospective participants provide ICAP with data about any of their positions of their choosing and their acceptable risk tolerances.[74] ICAP then runs a proprietary algorithm, which produces a set of proposed transactions for each participant.[75] The proposed transactions, if effected, would result in new trades for the participants that enable them to manage their exposures to market, credit, or other sources of risk.[76] All transactions must be accepted in order for a particular risk mitigation run to occur.[77] If a single participant declines to agree to the proposed risk mitigation transactions, then the entire risk mitigation run fails and the existing swap transactions remain in effect.[78] While its bulk risk mitigation services result in market participants entering into new trades, ICAP commented that such services do not meet the SEF definition because they do not permit participants to trade in real-time, negotiate price, or initiate directional trades.[79]

(v) Swap Processing Services

In its first comment letter, MarkitSERV agreed with the SEF NPRM that entities operating exclusively as swap processors should not have to register as SEFs because they only provide post-execution services that facilitate clearing and settlement, not services relating to the execution of swaps.[80] However, in a subsequent comment letter, after the SEC's proposed rule that would require certain providers of post-trade services to register with the SEC as clearing agencies, MarkitSERV recommended that the

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[74] Id. The service does not place any constraints on the number of positions or risk tolerances of prospective participants. Id.

[75] Id.

[76] Id.

[77] Id.

[78] Id.

[79] ICAP Comment Letter at 2 (Jan. 16, 2013); ICAP Comment Letter at 4 (Jul. 7, 2011).

[80] MarkitSERV Comment Letter at 6 (Mar. 8, 2011).

Commission regulate entities that perform the confirmation and processing of swaps.[81] While MarkitSERV acknowledged that the SEC's authority under the Securities and Exchange Act of 1934 to regulate swap processors as a clearing agency has no parallel in the CEA, MarkitSERV recommended that the Commission register such entities to avoid unnecessarily inconsistent regulations.[82] MarkitSERV recommended that the Commission require swap processors to register as a sub-category of SEFs because CEA section 5h(a)(1) references the processing of swaps.[83]

(2) Commission Determination

In response to commenters' requests for clarification regarding the registration requirement, the Commission is clarifying how it interprets the broad registration provision in section 5h(a)(1) of the Act in coordination with the specific requirements for a SEF's structure found in section 1a(50) of the Act and the trade execution requirement in section 2(h)(8) of the Act. As noted in the SEF NPRM, the Commission views the CEA section 5h(a)(1) registration requirement[84] as applying only to facilities that meet the SEF definition in CEA section 1a(50).[85] Section 1a(50) of the Act defines a SEF as "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—

[81] MarkitSERV Comment Letter at 1-2 (Jun. 3, 2011).

[82] Id. at 3-4.

[83] Id. at 5.

[84] CEA section 5h(a)(1) states that "[n]o person may operate a facility for the trading or processing of swaps unless the facility is registered as a swap execution facility or as a designated contract market . . . ." 7 U.S.C. 7b-3(a)(1).

[85] See Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1219 (explaining that entities that operate exclusively as swap processors do not meet the SEF definition and should not be required to register as a SEF despite the broad language in the CEA section 5h(a)(1) registration provision).

(A) facilitates the execution of swaps between persons; and (B) is not a designated contract market."[86] Accordingly, the Commission is revising proposed § 37.3 to clarify the scope of the registration requirement, which states that "[a]ny person operating a facility that offers a trading system or platform in which more than one market participant has the ability to execute or trade swaps with more than one other market participant on the system or platform shall register the facility as a swap execution facility under this part 37 or as a designated contract market under part 38 of this chapter."[87]

The Commission also clarifies that swap transactions that are not subject to the CEA section 2(h)(8) trade execution requirement may be executed on either a registered SEF (i.e., a facility that meets the SEF definition) or an alternative entity that is not required to register as a SEF (e.g., see one-to-many system or platform discussion below).[88] This clarification is consistent with the Commission's acknowledgement in the

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[86] CEA section 1a(50); 7 U.S.C. 1a(50). The Commission notes that the Secretary of the Treasury issued a written determination pursuant to CEA sections 1a(47)(E) and 1b that foreign exchange swaps and foreign exchange forwards should not be regulated as swaps under the CEA, and therefore should be exempted from the definition of the term "swap" under the CEA. See Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act, 77 FR 69694 (Nov. 20, 2012). Accordingly, if a facility offers a trading system or platform solely for the execution or trading of foreign exchange swaps or foreign exchange forwards, then the facility would not be required to register as a SEF.

[87] The Commission is adding this new provision to § 37.3(a)(1). As a result, proposed § 37.3(a) is adopted as § 37.3(b), proposed § 37.3(b) is adopted as § 37.3(c), proposed § 37.3(c) is adopted as § 37.3(d), proposed § 37.3(d) is adopted as § 37.3(e), proposed § 37.3(e) is adopted as § 37.3(f), and proposed § 37.3(f) is adopted as § 37.3(g). The SEF NPRM stated that certain entities such as one-to-one voice services and single-dealer platforms do not provide the ability for participants to conduct multiple-to-multiple execution or trading because they limit the provision of liquidity to a single liquidity provider. Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1219.

[88] The Commission notes that it is not tying the registration requirement in CEA section 5h(a)(1) to the trade execution requirement in CEA section 2(h)(8), such that only facilities trading swaps subject to the trade execution requirement would be required to register as a SEF. Therefore, a facility would be required to register as a SEF if it operates in a manner that meets the SEF definition even though it only executes or trades swaps that are not subject to the trade execution mandate. The Commission also notes that transactions involving swaps on SEFs that are subject to the trade execution mandate are considered to be "Required Transactions" under part 37 of the Commission's regulations, whereas "Permitted Transactions" are transactions not involving swaps that are subject to the trade execution mandate. As discussed further below, the regulatory obligations which pertain to Permitted Transactions differ from, and are somewhat less rigorous than, those for Required Transactions. See discussion below regarding Permitted Transactions under § 37.9(a)(1)(iv) – Required Transactions and § 37.9(a)(1)(v) – Permitted Transactions

SEF NPRM that swap transactions that are not subject to the CEA section 2(h)(8) trade execution requirement would not have to be executed on a registered SEF.[89]

The Commission believes that its interpretation of the registration provision in CEA section 5h(a)(1) is consistent with the statute and helps further the goals provided in CEA section 5h, which are to promote the trading of swaps on SEFs and to promote pre-trade price transparency in the swaps market. Although the registration provision is written in broad language and could be read to require the registration of any facility for the trading or processing of swaps, the Commission notes that other statutory provisions appear to narrow the registration requirement. For example, the CEA section 2(h)(8) trade execution requirement and CEA section 5h(d)(2), which states that "[f]or all swaps that are not required to be executed through a swap execution facility…such trades may be executed through any other available means of interstate commerce[,]"[90] when read together, contemplate alternative entities that are not required to register as SEFs and may execute those swaps that are not required to be executed on a SEF (i.e., those swaps that are not subject to the CEA section 2(h)(8) trade execution requirement). The Commission is interpreting the CEA section 5h(a)(1) registration provision in a manner that is consistent with the SEF definition in CEA section 1a(50), the trade execution requirement in CEA section 2(h)(8), and CEA section 5h(d)(2), as discussed above.

The following discussion is not intended to comprehensively cover which entities are required to register as a SEF. Whether a particular entity falls within the scope of

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in the preamble. See also Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available To Trade, 76 FR 77728 (proposed Dec. 14, 2011) (discussing the process by which a swap is determined to be subject to the trade execution requirement in CEA section 2(h)(8)).

[89] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1222.

[90] CEA section 5h(d)(2); 7 U.S.C. 7b-3(d)(2).

CEA section 5h(a)(1) depends on all of the relevant facts and circumstances of the entity's operations. The Commission is mindful that any rule attempting to capture all of the possible configurations of facilities that provide for the execution or trading of swaps may be or become over-inclusive or under-inclusive in light of technological changes and the ever evolving swaps market.[91] However, in response to commenters' requests, the Commission is providing examples of how it would interpret the CEA section 5h(a)(1) registration requirement with respect to certain categories of better understood facilities.

(i) One-to-Many Systems or Platforms

The Commission continues to believe that a one-to-many system or platform on which the sponsoring entity is the counterparty to all swap contracts executed through the system or platform would not meet the SEF definition in section 1a(50) of the Act and, therefore, would not be required to register as a SEF under section 5h(a)(1) of the Act. In the Commission's view, such a system or platform does not meet the SEF definition because it limits the provision of liquidity to a single liquidity provider (i.e., the sponsoring entity). Accordingly, market participants do not have the ability to conduct multiple-to-multiple execution or trading on such a trading system or platform. The Commission notes, however, that transactions in swaps that are subject to the trade execution mandate, under CEA section 2(h)(8), must be executed on a DCM or SEF and, accordingly, may not be executed on a one-to-many system or platform.[92]

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[91] The Commission notes that entities seeking guidance concerning their SEF registration obligations may request such further guidance from the Division of Market Oversight ("DMO").

[92] Transactions in swaps that are subject to the clearing requirement in CEA section 2(h)(1) and "made available to trade" would be subject to the trade execution requirement. See CEA sections 2(h)(1) and 2(h)(8); 7 U.S.C. 2(h)(1) and 2(h)(8). See also Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available To Trade, 76 FR 77728 (proposed Dec. 14, 2011) (discussing the process by which a swap is determined to be subject to the trade execution requirement in CEA section 2(h)(8)). The trade execution requirement provides an exception to the requirement for swap transactions subject to the clearing exception under CEA section 2(h)(7).

(ii) Blind Auction Systems or Platforms

The Commission understands from commenters that a blind auction system or platform, as described above, allows market participants to submit firm bids and offers without disclosure of the terms of those bids and offers to other participants. Such bids and offers are matched through a pre-determined algorithm. The Commission believes that an entity that provides such a blind auction system or platform would meet the SEF definition in CEA section 1a(50) because more than one market participant has the ability to execute or trade swaps with more than one other market participant on the system or platform. Accordingly, an entity that provides such a blind auction system or platform would have to register as a SEF under section 5h(a)(1) of the Act.

(iii) Aggregation Services or Portals

The Commission understands that certain entities may seek to provide their users with the ability to access multiple SEFs and the market participants thereon, but do not provide for execution on their aggregation services as execution occurs on one of those individual SEFs. The Commission believes that an entity that provides such an aggregation service would not meet the SEF definition in CEA section 1a(50) because it is only providing a portal through which its users may access multiple SEFs and swaps are not executed or traded through the service. Accordingly, an entity that provides such an aggregation service or portal would not have to register as a SEF under section 5h(a)(1) of the Act.[93] However, the Commission notes that to the extent that an aggregation service or portal itself provides a trading system or platform whereby more

[93] The Commission notes that footnote [417] below classifies aggregator platforms as a type of independent software vendor ("ISV"). Therefore, other types of ISVs would not have to register as a SEF if they only provide their users with the ability to access multiple SEFs, but do not provide for execution or trading of swaps. See discussion below regarding ISVs under § 37.202(a) – Impartial Access by Members and Market Participants in the preamble.

than one market participant has the ability to execute or trade swaps with more than one other market participant on the system or platform, the aggregation service would be required to register as a SEF.[94]

(iv) Services Facilitating Portfolio Compression and Risk Mitigation Transactions

The Commission notes that portfolio compression services provide a netting mechanism that reduces the outstanding trade count and outstanding gross notional value of swaps in two or more swap counterparties' portfolios.[95] To achieve this result, a portfolio compression service, for example, may wholly terminate or change the notional value of some or all of the swaps submitted by the counterparties for inclusion in the portfolio compression exercise and, depending on the methodology employed, replace the terminated swaps with other swaps whose combined notional value (or some other measure of risk) is less than the combined notional value (or some other measure of risk) of the terminated swaps in the compression exercise.[96] The swap counterparties' risk profiles are not materially changed as a result of the portfolio compression exercise.

The Commission does not believe that a portfolio compression service, as described above, provides for the execution or trading of swap transactions between counterparties because the compression service is providing a netting mechanism whereby the outstanding trade count and outstanding gross notional value of swaps in

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[94] For example, some aggregation services may provide their users with a portal to multiple SEFs and also execute swap transactions between their multiple users. These services would have to register as a SEF under section 5h(a)(1) of the Act. The Commission notes that if other types of ISVs provide a system or platform whereby more than one participant has the ability to execute or trade swaps with more than one other participant on the system or platform, then they would also have to register as a SEF under section 5h(a)(1) of the Act. See discussion below regarding ISVs under § 37.202(a) – Impartial Access by Members and Market Participants in the preamble.

[95] Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 FR 55904, 55932 (Sep. 11, 2012).

[96] Id. at 55960.

two or more swap counterparties' portfolios are reduced. Therefore, an entity providing such a portfolio compression service would not meet the SEF definition in section 1a(50) of the Act and would not have to register as a SEF under section 5h(a)(1) of the Act.[97]

The Commission understands from commenters that certain entities provide risk mitigation services, as described above, that operate to assist market participants in managing their exposures to market, credit, and other sources of risk. These risk mitigation services may redistribute or mitigate market participants' risks, but they do not provide a netting mechanism. To redistribute or mitigate risk, a risk mitigation service, for example, may allow market participants to identify elements of risk in their respective portfolios and to submit information about these risks to the service. The risk mitigation service may set the prices for all points along the maturity or credit curve for all trades and the service's proprietary algorithm produces a set of proposed transactions for each participant. If all participants accept the proposed transactions, then the new trades are executed.

In the Commission's view, such an entity would meet the SEF definition in CEA section 1a(50) because more than one market participant has the ability to execute swaps with more than one other market participant on the system or platform.[98] In response to

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[97] The Commission notes, however, that transactions in swaps that are subject to the trade execution mandate, under CEA section 2(h)(8), must be executed on a DCM or SEF and, accordingly, may not be executed on a portfolio compression service (unless no DCM or SEF makes the swap available to trade or the swap transaction is excepted or exempted from clearing under CEA section 2(h)(7) or as otherwise provided by the Commission).

[98] The Commission also notes that ICAP's websites for its Reset and ReMatch risk mitigation services support the notion that these services are executing trades between counterparties. ICAP's Reset website states that "[t]he new RESET matching engine allows for unilateral matching with hedging. No longer is it necessary to have an offsetting position for each trade to be executed." See http://www.reset.net/aboutus.php. A press article regarding ReMatch states that "ReMatch addresses the problem of minimal or no exit liquidity . . . [by] enabling market participants to exit positions that they may otherwise have been unable to." See http://www.icap.com/news-events/in-the-news/news/2011/rematch-expands-service-into-us-financials.aspx.

ICAP's comment that such services do not meet the SEF definition because they do not permit participants to trade in real-time, negotiate price, or initiate directional trades, the Commission notes that the SEF definition does not require any of these stated characteristics. As noted above, the outcome of a successful risk mitigation run is the execution of new trades between multiple participants at prices accepted by those multiple participants.

Additionally, the Commission notes that there are alternative avenues to managing the same risks that risk mitigation services manage, including bringing the risk mitigating orders to the open market. For instance, a market participant could assess the various risk elements in its portfolio using appropriate tools, and then decide on a set of trades to mitigate these risks. The market participant could choose to execute these trades through a risk mitigation service, a SEF, or a DCM. In fact, in the DCM context, market participants execute such risk mitigating trades on the DCM and not through a separate non-DCM service. As such, risk mitigation services are providing an alternative avenue to execute certain swap transactions between counterparties.

Furthermore, the Commission believes that the confluence of trading interests from a diverse range of motivations (e.g., risk mitigating and risk taking trades) brings depth to the marketplace and helps to build liquid markets. If the Commission did not require these risk mitigation services to register as SEFs, then market participants would be able to execute certain swap transactions away from the SEF, which would hurt liquidity and also the trading of swaps on SEFs. This would contradict one of the goals in section 5h of the Act, which is to promote the trading of swaps on SEFs.[99]

[99] CEA section 5h(e); 7 U.S.C. 7b-3(e).

For the reasons mentioned above, the Commission believes that an entity that provides such a risk mitigation service would have to register as a SEF under section 5h(a)(1) of the Act. However, the Commission notes that such entities may not have to register as a SEF if they only provide the analytical services that produce the proposed risk mitigation transactions and the execution of those transactions occurs elsewhere and, in particular, the execution of those transactions that are subject to the trade execution mandate occurs on a SEF.

(v) Swap Processing Services

As noted in the SEF NPRM, entities that solely engage in trade processing would not meet the SEF definition in CEA section 1a(50) because they do not provide the ability to execute or trade a swap as required by the definition. Accordingly, swap processing services would not have to register as a SEF under CEA section 5h(a)(1). Consistent with this distinction, the Commission declines to create a sub-category of SEFs for processing services that would be subject to some limited subset of SEF core principles as requested by MarkitSERV.

Finally, the Commission notes that platforms seeking guidance concerning the SEF registration obligations and its application to their particular operations may request informal guidance from the Division of Market Oversight ("DMO").

(b) § 37.9(b)(2) – Minimum Trading Functionality (Final § 37.3(a)(2))

To further clarify what functionalities a SEF must provide if it is required to register as a SEF, as opposed to what functionalities trigger the registration requirement, the Commission is moving proposed § 37.9(b)(2) to final § 37.3(a)(2). As discussed in the SEF NPRM, an entity that must register as a SEF under CEA section 5h(a)(1) must

ensure that its operations comply with the minimum trading functionality requirement.[100] The minimum trading functionality requirement in proposed § 37.9(b)(2) provided that an applicant seeking registration as a SEF must, at a minimum, offer trading services to facilitate Required Transactions by providing market participants with the ability to post both firm and indicative quotes on a centralized electronic screen accessible to all market participants who have access to the SEF.

(1) Summary of Comments

Several commenters stated that the minimum trading functionality is similar to an order book, which is not required by the SEF definition.[101] In this regard, Commissioner Sommers offered a dissent to the SEF NPRM, which was published as Appendix 3 to that notice.[102] Commissioner Sommers' dissent asserted that the minimum trading functionality requirement is not mandated by the Dodd-Frank Act.[103] In addition, Commissioner Sommers' dissent argued for a broader interpretation of the terms "trading system" and "platform," which are included in the statutory SEF definition so that SEFs can offer a broader model for executing swaps.[104] Many commenters also stated that the SEF definition only requires that the facility provide multiple participants with the "ability" to execute or trade swaps by accepting bids and offers made by "multiple participants" and, thus, the definition does not require making bids or offers transparent

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[100] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1219.

[101] Reuters Comment Letter at 3-4 (Dec. 12, 2011); Rosen et al. Comment Letter at 8-9 (Apr. 5, 2011); WMBAA Comment Letter at 4, 9 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 5-6 (Mar. 8, 2011); FXall Comment Letter at 4-5 (Mar. 8, 2011). Commissioner Sommers' dissent to the SEF NPRM. See Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1259.

[102] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1259.

[103] Id.

[104] Id.

to the entire market but rather to multiple participants.[105] Better Markets commented that the Commission's minimum trading functionality requirement is an overly broad interpretation of the SEF definition because it allows a SEF to be almost any type of system or platform.[106] Therefore, it recommended that the Commission narrowly interpret the multiple participant to multiple participant requirement so that the scope of acceptable execution methods has rational boundaries.[107]

Several commenters expressed concern about the requirement to post indicative quotes.[108] Nodal and other commenters expressed concern that indicative quotes could be used for manipulative purposes.[109] Tradeweb commented that, under the proposal, SEFs operating an anonymous order book system would be required to offer indicative quotes due to the minimum trading functionality requirement, which would not be suitable for anonymous order book marketplaces.[110]

(2) Commission Determination

The Commission reiterates its view in the SEF NPRM that an entity that must register as a SEF under CEA section 5h(a)(1) must ensure that its operations comply with the minimum trading functionality requirement.[111] The Commission reaffirms that an

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[105] Reuters Comment Letter at 3-4 (Dec. 12, 2011); Rosen et al. Comment Letter at 8 (Apr. 5, 2011); ISDA/SIFMA Comment Letter at 5-6 (Mar. 8, 2011); CME Comment Letter at 7-8 (Mar. 8, 2011); FXall Comment Letter at 4-5 (Mar. 8, 2011); Barclays Comment Letter at 5 (Mar. 8, 2011); MarketAxess Comment Letter at 32-33 (Mar. 8, 2011); WMBAA Comment Letter at 8 (Mar. 8, 2011).

[106] Better Markets Comment Letter at 6-7 (Mar. 8, 2011).

[107] Id.

[108] Nodal Comment Letter at 3-4 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 6 (Mar. 8, 2011); SIFMA AMG Comment Letter at 9 (Mar. 8, 2011); ICE Comment Letter at 3 (Mar. 8, 2011); Tradeweb Comment Letter at 6 (Mar. 8, 2011).

[109] Nodal Comment Letter at 3-4 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 6 (Mar. 8, 2011); SIFMA AMG Comment Letter at 9 (Mar. 8, 2011); ICE Comment Letter at 3 (Mar. 8, 2011).

[110] Tradeweb Comment Letter at 6 (Mar. 8, 2011).

[111] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1219.

acceptable SEF system or platform must provide at least a minimum functionality to allow market participants the ability to make executable bids and offers, and to display them to all other market participants on the SEF. The Commission is adopting a revised version of proposed § 37.9(b)(2), which now requires a SEF to provide an Order Book as defined in final § 37.3(a)(3) (i.e., an electronic trading facility, a trading facility, or a trading system or platform in which all market participants have the ability to enter multiple bids and offers, observe or receive bids and offers, and transact on such bids and offers) because, as noted by several commenters, the proposed minimum trading functionality description is similar to the proposed definition of an Order Book.[112] In response to comments, like the one provided by Commissioner Sommers, that an order book is not required by the SEF definition, the Commission believes that an Order Book, as defined in final § 37.3(a)(3), is consistent with the SEF definition and promotes the goals provided in section 733 of the Dodd-Frank Act.[113] This interpretation is also consistent with the SEF NPRM, as the Commission noted that it took into account these requirements when proposing the minimum trading functionality requirement.[114]

The Commission notes, however, that the final regulations provide SEFs with additional flexibility in the execution methods for Required Transactions by allowing SEFs to offer an RFQ System in conjunction with an Order Book, as described below, to permit market participants to access multiple market participants, but not necessarily the

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[112] The Commission is renumbering proposed § 37.9(b)(2) to § 37.3(a)(2).

[113] CEA section 1a(50); 7 U.S.C. 1a(50). In section 5h(e) of the Act, Congress provided a "rule of construction" to guide the Commission's interpretation of certain SEF provisions (stating that the goals of section 5h of the Act are to "promote the trading of swaps on [SEFs] and to promote pre-trade price transparency in the swaps market"). 7 U.S.C. 7b-3(e).

[114] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1219.

entire market.[115] The Commission also notes that a SEF may petition the Commission under § 13.2 of the Commission's regulations to amend its regulations to include additional execution methods for Required Transactions.[116] The final regulations further allow a SEF to utilize "any means of interstate commerce" in providing the execution methods in § 37.9(a)(2)(i)(A) or (B) (i.e., an Order Book or an RFQ System that operates in conjunction with an Order Book, as described below).[117] The Commission also notes that a SEF may provide any method of execution for Permitted Transactions.[118] By allowing SEFs to offer additional methods of execution, and permitting flexible means for executing swaps through these methods of execution, as discussed below, the Commission is effectuating the Congressional direction to allow multiple participants to execute swaps by accepting bids and offers made by multiple participants through any means of interstate commerce.[119] The Commission notes that a DCM must operate as a trading facility and in conjunction with that trading facility is also permitted to utilize additional execution methods; however, those additional execution methods are limited by the requirements set forth in DCM Core Principle 9, for which there is no identical core principle for SEFs.

Finally, given the changes to the minimum trading functionality requirement, the Commission notes that SEFs are not required to offer indicative quote functionality. The

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[115] See discussion below under § 37.9(a)(1)(ii) – Request for Quote System in the preamble.

[116] See discussion below under §§ 37.9(b)(1) and (b)(4) – Execution Methods for Required Transactions in the preamble. Section 13.2 will allow the Commission to consider if a broader model for executing on SEFs, consistent with the suggestion in Commissioner Sommers' dissent, would be appropriate on a case-by-case basis, in conformance with the CEA and the Commission's regulations. Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1259.

[117] See discussion below under §§ 37.9(b)(1) and (b)(4) – Execution Methods for Required Transactions in the preamble.

[118] See § 37.9(c)(2).

[119] CEA section 1a(50); 7 U.S.C. 1a(50).

Commission agrees with commenters that indicative quotes would not be appropriate for certain trading systems or platforms complying with the Order Book definition in final § 37.3(a)(3) (e.g., central limit order books facilitating only anonymous trading).

(c) § 37.9(a)(1)(i) – Order Book (Final § 37.3(a)(3))

The Commission is also moving proposed § 37.9(a)(1)(i) to final § 37.3(a)(3) given the relocation of, and changes to, the minimum trading functionality section as discussed above. Proposed § 37.9(a)(1)(i) defined the term "Order Book" to mean: (A) an electronic trading facility, as that term is defined in section 1a(16) of the Act;[120] (B) a trading facility, as that term is defined in section 1a(51) of the Act;[121] (C) a trading system or platform in which all market participants in the trading system or platform can enter multiple bids and offers, observe bids and offers entered by other market participants, and choose to transact on such bids and offers; or (D) any such other trading system or platform as may be determined by the Commission.

(1) Summary of Comments

Better Markets commented that the definition of an "order book" should specify that SEF systems must operate pursuant to a best price, first-in-time trade matching algorithm.[122]

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[120] The term "electronic trading facility" means "a trading facility that—(A) operates by means of an electronic or telecommunications network; and (B) maintains an automated audit trail of bids, offers, and the matching of orders or the execution of transactions on the facility." CEA section 1a(16); 7 U.S.C. 1a(16). The Commission notes that, under section 1a(16) of the Act, the term "electronic trading facility" incorporates the definition of "trading facility" as that term is defined under section 1a(51) of the Act.

[121] 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." CEA section 1a(51)(A); 7 U.S.C. 1a(51)(A).

[122] Better Markets Comment Letter at 7 (Mar. 8, 2011).

(2) Commission Determination

The Commission is adopting the rule as proposed, subject to the modification described below.[123] The Commission notes that the Dodd-Frank Act does not mandate that the Commission specify or require a particular trade-matching algorithm for modes of execution provided by SEFs. Therefore, a SEF has the discretion to use a matching algorithm such as a price-time, price-size-time, or pro-rata allocation, provided, however, that such matching algorithm is published in the SEF's rulebook and submitted to the Commission for review and approval as part of the registration application. The Commission is eliminating proposed § 37.9(a)(1)(i)(D) because, as discussed in § 37.9 below, a SEF may petition the Commission under § 13.2 to amend § 37.9(a)(2) to include additional execution methods for Required Transactions.[124]

(d) § 37.3(a) – Application Procedures[125]

Proposed § 37.3(a) set forth the application and approval procedures for the registration of new SEFs. The proposed rule required a SEF applicant to apply to the Commission by electronically filing the proposed Form SEF.[126] The proposed rule also provided that the Commission would either approve or deny the application or, if deemed appropriate, register the applicant as a SEF subject to conditions.

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[123] The Commission is renumbering proposed § 37.9(a)(1)(i) to § 37.3(a)(3). The Commission is revising the definition in proposed § 37.9(a)(1)(i)(C) by replacing the word "can" with the phrase "have the ability to" and deleting the words "choose to." The Commission is also adding the words "or receive" after the word "observe" so that the definition is technology neutral. See "Through Any Means of Interstate Commerce" Language in the SEF Definition discussion below under §§ 37.9(b)(1) and (b)(4) – Execution Methods for Required Transactions in the preamble for further details.

[124] See discussion below under §§ 37.9(b)(1) and (b)(4) – Execution Methods for Required Transactions in the preamble.

[125] The Commission is renaming the title of this section from "Application Procedures" to "Procedures for Full Registration" to provide greater clarity.

[126] Proposed Form SEF, as set forth in proposed appendix A to part 37, was to be used for initial or temporary registration as a SEF as well as for any amendments to an applicant's status otherwise not required to be submitted under part 40 of the Commission's regulations.

(1) Summary of Comments

The Commission received several comments encouraging the harmonization of the registration procedures for SEFs with the SEC's registration procedures for SB-SEFs.[127] In this regard, MarketAxess recommended that the Commission allow an SEC-registered SB-SEF to notice register with the Commission.[128] WMBAA recommended that the Commission and the SEC adopt a common application form, which would provide for a smoother, timelier transition to the new regulatory regime.[129]

Tradeweb requested that the Commission confirm that SEF applicants do not need to file separate applications for each mode of execution that it will offer to participants, provided that the application clearly identifies the different features of the separate marketplaces and that each feature is in compliance with the rules.[130] Additionally, MarketAxess requested clarification that the Commission does not intend proposed § 37.3(a)(6) to require amendments to Form SEF after the Commission approves an application.[131]

(2) Commission Determination

The Commission is adopting § 37.3(a) and Form SEF as proposed, subject to certain modifications discussed below.[132] The Commission notes that there is no CEA

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[127] See Registration and Regulation of Security-Based Swap Execution Facilities, 76 FR 10948 (proposed Feb. 28, 2011). Tradeweb Comment Letter at 3-4 (Jun. 3, 2011); MarketAxess Comment Letter at 20-21 (Mar. 8, 2011); WMBAA Comment Letter at 14 (Mar. 8, 2011); FSR Comment Letter at 10-11 (Mar. 8, 2011); Reuters Comment Letter at 3-4 (Mar. 8, 2011).

[128] MarketAxess Comment Letter at 20-21 (Mar. 8, 2011).

[129] WMBAA Comment Letter at 14 (Mar. 8, 2011).

[130] Tradeweb Comment Letter at 13 (Mar. 8, 2011).

[131] MarketAxess Comment Letter at 29 (Mar. 8, 2011).

[132] The Commission is renumbering proposed § 37.3(a) to § 37.3(b) and making several non-substantive revisions to this provision and Form SEF for clarity. The Commission is also moving proposed § 37.3(a)(7) regarding delegated authority to the Director of DMO to § 37.3(h).

provision which provides for SEF notice registration for SB-SEFs. The Commission does note, however, that section 5h(g) of the Act provides that the Commission "may exempt" a SEF from registration if the facility is subject to comparable, comprehensive supervision and regulation by the SEC, a prudential regulator, or the appropriate governmental authorities in the home country of the facility.[133] The Commission observes that the SEC and other regulators have not implemented comparable, comprehensive supervision and regulation to the Commission's SEF regulatory scheme at this time. The Commission also observes that, it must comprehensively review and understand a SEF's proposed trading models and operations, which will facilitate trading for a more diverse universe of financial instruments and underlying commodities than SB-SEFs. Therefore, at this time, the Commission is not allowing for exempt SEFs.

In response to Tradeweb's comment about separate applications, the Commission clarifies that a SEF applicant does not need to file separate applications for each mode of execution that it will offer to market participants, but its application, as noted in Exhibit Q to Form SEF, must describe each mode of execution offered.[134] Additionally, in response to MarketAxess's comment about amendments to Form SEF after the Commission registers a SEF, the Commission is revising proposed § 37.3(a)(6)[135] and Form SEF to clarify that an amended Form SEF is required for a SEF applicant amending a pending application for registration or for a SEF requesting an amendment to its order of registration. Otherwise, once registered, a SEF must file any amendments to Form

[133] CEA section 5h(g); 7 U.S.C. 7b-3(g).

[134] The Commission notes that subsequent modifications to a SEF's modes of execution or any additional SEF modes of execution would constitute rules; therefore, the SEF must submit such rules to the Commission for review pursuant to the procedures under part 40 of the Commission's regulations.

[135] The Commission is renumbering proposed § 37.3(a)(6) to § 37.3(b)(3).

SEF as a submission under part 40 of the Commission's regulations or as specified by the Commission (e.g., by filing quarterly financial resources reports pursuant to § 37.1306 or by filing an amended Form SEF). As stated in the SEF NPRM, the Commission clarifies that if any information contained in Form SEF is or becomes inaccurate for any reason, even after a SEF is registered, the SEF must promptly make the appropriate corrections with the Commission.[136]

The Commission is adding final § 37.3(b)(5) to the rule text that requires the Commission to review an application for registration as a SEF pursuant to the 180-day timeframe and procedures specified in CEA section 6(a).[137] This section will be effective for SEF applicants who submit their applications for registration as a SEF on or after two years from the effective date of part 37. The Commission is adopting this provision so that SEF applicants are treated comparably to DCM applicants who currently are subject to the 180-day Commission review period under CEA section 6(a). Although Congress did not impose a 180-day review period for SEFs, the Commission believes that harmonization of the review periods for DCM and SEF applicants is appropriate given the fact that both are registered entities for the trading of swaps. The Commission also believes that this requirement will provide greater certainty for SEF applicants regarding the time period for the Commission's review of their applications.

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[136] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1238.

[137] CEA section 6(a); 7 U.S.C. 8(a). The Commission notes that under CEA section 6(a), if the Commission notifies an applicant that its application is materially incomplete and specifies the deficiencies in the application, the running of the 180-day period is stayed from the time of such notification. The Commission also notes that if an applicant does not provide a complete Form SEF as provided for under § 37.3(b)(1)(i), the Commission will notify the applicant, pursuant to § 37.3(b)(4), that its application will not be deemed to have been submitted for purposes of the Commission's review. By "complete" Form SEF, the Commission means that the SEF applicant provides appropriately responsive answers to each of the informational and exhibit items set forth in Form SEF. The Commission notes that if the application is not deemed to have been submitted for purposes of the Commission's review, then the 180-day review period (when effective) will not have commenced.

Finally, the Commission is clarifying the standard upon which the Commission will grant or deny registration. Proposed § 37.3(a)(1) stated that "[t]he Commission shall approve or deny the application or, if deemed appropriate, register the applicant as a swap execution facility subject to conditions." In addition, proposed § 37.3(a)(2) stated that "[t]he application must include information sufficient to demonstrate compliance with the core principles specified in Section 5h of the Act." Consistent with these provisions, the Commission is clarifying in final § 37.3(b)(6) that: (i) the Commission will issue an order granting registration upon a Commission determination, in its own discretion, that the applicant has demonstrated compliance with the Act and the Commission's regulations applicable to swap execution facilities; (ii) if deemed appropriate, the Commission may issue an order granting registration subject to conditions; and (iii) the Commission may issue an order denying registration upon a Commission determination, in its own discretion, that the applicant has not demonstrated compliance with the Act and the Commission's regulations applicable to swap execution facilities.

(e) § 37.3(b) – Temporary Grandfather Relief from Registration[138]

Proposed § 37.3(b) provided that an applicant for SEF registration may request that the Commission grant the applicant temporary grandfather relief from the registration requirement. The temporary relief would allow the applicant to continue operating during the pending application review process. Under the proposed rule, to receive temporary relief, the applicant was required to provide the following information to the Commission: (1) an application for SEF registration submitted in compliance with proposed § 37.3(a); (2) a notification of its interest in operating under the temporary

[138] The Commission is renaming the title of this section from "Temporary Grandfather Relief from Registration" to "Temporary Registration" to provide greater clarity.

relief; (3) transaction data substantiating that swaps have been traded and continue to be traded on the applicant's trading system or platform at the time of its application submission; and (4) a certification that the applicant believes that it will meet the requirements of part 37 of the Commission's regulations when it operates under temporary relief.

Under proposed § 37.3(b)(2), an applicant's grant of temporary relief would expire on the earlier of: (1) the date that the Commission grants or denies SEF registration; or (2) the date that the Commission rescinds the temporary relief. Proposed § 37.3(b)(3) contained a sunset date for the temporary relief provision of 365 days following the effective date of the final SEF regulations. Finally, the Commission proposed that the SEF rules, which include the requirements for temporary relief, would be effective 90 days after their publication in the Federal Register.

(1) Summary of Comments

(i) Comments on Temporary Grandfather Relief

MarketAxess commented that the phrase "temporary grandfather relief" is ambiguous and recommended that the Commission rename "temporary grandfather relief" to "temporary registration."[139]

With respect to the substance of this provision, some commenters expressed concern that the existing trading activity requirement in proposed § 37.3(b)(1)(ii) would prevent new entities from qualifying for temporary relief.[140] In this regard, MarketAxess recommended that the Commission revise proposed § 37.3(b)(1)(ii) to permit SEF applicants, as an alternative to providing transaction data, to provide materials

[139] MarketAxess Comment Letter at 16 (Mar. 8, 2011).

[140] MarketAxess Comment Letter at 16-17 (Mar. 8, 2011); MFA Comment Letter at 4-5 (Mar. 8, 2011).

substantiating that the applicant's system is operational and therefore could facilitate trading in listed swaps upon receiving temporary registration from the Commission.[141]

Further, several commenters recommended alternative certification standards under proposed § 37.3(b)(1)(iii).[142] Bloomberg, for example, recommended that SEFs be required to certify only that they have implemented rules "reasonably designed to ensure" compliance with part 37.[143] Similarly, MarketAxess recommended a more flexible certification requirement because compliance with certain core principles will need to await the build-out functionality of third-party regulatory service providers.[144]

In addition, Phoenix commented that to avoid any market disruptions, the Commission should permit SEF applicants to operate under temporary relief while awaiting a Commission determination to either grant or deny the temporary relief request.[145] MarketAxess also noted that the Commission should not "tie its own hands" by imposing a fixed one-year post-effective time period for reviewing SEF applications.[146]

(ii) Comments on DCM Eligibility

CME commented that if a DCM has listed cleared swaps prior to the adoption of the final rules, then there is no reason to exclude them from applying for temporary

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[141] MarketAxess Comment Letter at 16-17 (Mar. 8, 2011).

[142] MarketAxess Comment Letter at 4 (Jun. 3, 2011); Bloomberg Comment Letter at 5 (Jun. 3, 2011); State Street Comment Letter at 6-7 (Mar. 8, 2011); WMBAA Comment Letter at 14-15 (Mar. 8, 2011); Tradeweb Comment Letter at 13 (Mar. 8, 2011); MarketAxess Comment Letter at 17-19 (Mar. 8, 2011).

[143] Bloomberg Comment Letter at 5 (Jun. 3, 2011).

[144] MarketAxess Comment Letter at 17-19 (Mar. 8, 2011).

[145] Phoenix Comment Letter at 2 (Mar. 7, 2011).

[146] MarketAxess Comment Letter at 20 (Mar. 8, 2011).

relief.[147] NYSE Liffe recommended that temporary relief remain available to DCMs either as long as it is available to SEF applicants or on an ongoing basis so that a DCM required under DCM Core Principle 9 to delist a futures contract at any point in the future would be allowed to seek temporary relief from registration as a SEF.[148]

(iii) Comments on 90-Day Effective Date of Regulations

Some commenters recommended a longer time period for the effective date of the final regulations to provide applicants with additional time to implement the large number of changes required.[149] Nodal commented that the short effective date will disadvantage smaller exchanges because its supporting external parties will likely prioritize compliance obligations in order to be responsive to the largest exchanges first.[150] MarketAxess and NFA recommended that the Commission provide SEF applicants 180 days after adoption of the final rules to comply with the final SEF regulations in light of forthcoming operational challenges.[151] However, SDMA supported the 90-day effective date and urged the Commission to be vigilant in preventing further delays that undermine the realization of the goals of the Dodd-Frank Act.[152]

(2) Commission Determination

(i) Temporary Grandfather Relief

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[147] CME Comment Letter at 11 (Mar. 8, 2011).

[148] NYSE Liffe Comment Letter at 3-4 (Sep. 2, 2011).

[149] AIMA Comment Letter at 3 (Jun. 10, 2011); Nodal Comment Letter at 3-5 (Jun. 3, 2011); WMBAA Comment Letter at 4-5 (Jun. 3, 2011); CME Comment Letter at 6 (Jun. 3, 2011); MarketAxess Comment Letter at 19 (Mar. 8, 2011); NFA Comment Letter at 2-3 (Mar. 8, 2011); WMBAA Comment Letter at 12-13 (Mar. 8, 2011); ICAP Comment Letter at 6 (Mar. 8, 2011); Nodal Comment Letter at 4-5 (Mar. 8, 2011).

[150] Nodal Comment Letter at 4 (Jun. 3, 2011); Nodal Comment Letter at 4 (Mar. 8, 2011).

[151] MarketAxess Comment Letter at 19 (Mar. 8, 2011); NFA Comment Letter at 2-3 (Mar. 8, 2011).

[152] SDMA Comment Letter at 12 (Mar. 8, 2011).

The Commission agrees with MarketAxess that "temporary registration" is more accurate than "temporary grandfather relief" and is accordingly making such change. Additionally, based on the comments, the Commission is adopting proposed § 37.3(b) as final § 37.3(c) subject to a number of modifications.[153]

The Commission further agrees with MarketAxess and other commenters that the trading activity requirement as proposed in § 37.3(b)(1)(ii) may limit temporary registration to incumbent platforms. Therefore, the Commission is eliminating the trading activity requirement and will permit all SEF applicants to apply for temporary registration if they meet the requirements under final § 37.3(c)(1). The Commission views the revised temporary registration provision as promoting competition between SEFs by providing fair opportunities for new entities to establish trading operations in competition with incumbents.

The Commission is deleting the certification requirement under proposed § 37.3(b)(1)(iii) because it is unnecessary. The Commission notes, as stated in the SEF NPRM, that once a SEF applicant is granted temporary registration it must comply with all provisions of the Act and the Commission's regulations that are applicable to SEFs.[154]

The Commission is revising the temporary registration provisions to clarify in final § 37.3(c)(1) that a SEF applicant may apply for temporary registration if it submits a complete Form SEF and a temporary registration notice.[155] The Commission is also revising the temporary registration provisions to require a SEF applicant that is already

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[153] The Commission is renumbering proposed § 37.3(b) to § 37.3(c) and making several non-substantive revisions for clarity.

[154] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1216.

[155] The applicant must comply with all of the requirements in final § 37.3(b)(1)(i) and must submit a temporary registration notice to the Commission to qualify for temporary registration. See Final § 37.3(c)(1) of the Commission's regulations.

operating a swaps-trading platform, in reliance upon either an exemption granted by the Commission or some form of no-action relief granted by the Commission staff, to include in the temporary registration notice a certification that it is operating pursuant to such exemption or no-action relief. The Commission also clarifies that a SEF applicant may submit such temporary registration application after the final SEF regulations are published in the Federal Register until the termination of the temporary registration provision pursuant to final § 37.3(c)(5).[156]

Pursuant to final § 37.3(c)(1), the Commission notes that it will grant a SEF applicant temporary registration upon a Commission determination that the applicant has provided a complete Form SEF as part of its registration application and submitted a notification requesting that the Commission grant temporary registration. If an applicant has not met these requirements, the Commission may deny its request for temporary registration. By "complete" Form SEF, the Commission means that the SEF applicant provides appropriately responsive answers to each of the informational and exhibit items set forth in Form SEF. The Commission notes that it will review a SEF applicant's Form SEF to ensure that it is complete, and will not conduct any substantive review of the form before granting or denying temporary registration. The Commission notes that this temporary registration process is similar to the notice registration process followed by the Commission in the context of other types of registrations.[157] The Commission will review SEF applicants' submissions on a rolling basis and the Commission will issue

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[156] The Commission notes that certain entities may continue to operate under current exemptions while their SEF applications are pending, as long as the entities submit a complete application (i.e., the SEF applicant provides substantive answers to each of the informational and exhibit items set forth in Form SEF) and temporary registration notice before the effective date of the final SEF regulations. See CFTC No-Action Letter 12-48 (Dec. 11, 2012).

[157] See discussion below regarding swap dealer and major swap participant provisional registration rules.

notices either granting or denying temporary registration.[158] The Commission believes that providing a clear and streamlined path to temporary registration will minimize the potential for regulatory arbitrage, ensure a level playing field, and promote competition among SEFs.

The Commission stresses that a grant of temporary registration does not mean that the Commission has determined that a SEF applicant is fully compliant with the Act and Commission regulations, nor does it guarantee that a SEF applicant will eventually be granted full SEF registration. After granting a SEF applicant temporary registration, the Commission will review the applicant's application to assess whether the applicant is fully compliant with the requirements of the Act and the Commission's regulations applicable to SEFs. During such assessment, the Commission may request from the SEF applicant additional information in order to make a determination whether to issue a final order of registration.

The Commission is also revising the temporary registration provisions to clarify in final § 37.3(c)(2) that an applicant cannot operate as a SEF under temporary registration until the applicant receives a notice from the Commission or the Commission staff granting temporary registration.[159] In response to Phoenix's comment about a SEF operating while its temporary registration is pending, the Commission does not believe that a SEF applicant should be allowed to operate as a SEF under temporary registration before the Commission has had a chance to review the application to ensure that it is

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[158] The Commission is delegating to the Director of DMO, upon consultation with the General Counsel, the authority to issue a notice granting or denying temporary registration. See Final § 37.3(h) of the Commission's regulations.

[159] This provision is contained in final § 37.3(c)(2) of the Commission's regulations. This rule also states that in no case may an applicant begin operating as a temporarily registered SEF until the effective date of the SEF regulations.

complete. The Commission's review is especially merited given the Commission's decision to permit temporary registration of entities that have not previously traded swaps.

The Commission believes that permitting entities to operate as temporarily registered SEFs, notwithstanding the lack of a substantive review of the SEF's application by the Commission, is not a novel concept and has been followed by the Commission in other contexts where it is important to allow entities to quickly reach the market, before an extensive Commission review. For instance, under the Commission's swap dealer and major swap participant registration rules, provisional registration is granted upon the filing of an application and documentation demonstrating compliance or the ability to comply with the CEA section 4s requirements in effect on such date – and not after review and approval of the documentation by the National Futures Association ("NFA"), as the Commission's delegee.[160] On and after the date on which NFA confirms that the applicant has demonstrated its initial compliance with the applicable requirements, the provisional registration of the applicant ceases and the applicant becomes registered as an SD or an MSP, as the case may be.

The Commission envisions the SEF temporary registration process as operating in a similar fashion, with the Commission reviewing each application for completeness alone before granting temporary registration. Subsequently, and concurrent with the temporarily registered SEF's early operations, the Commission would conduct a comprehensive review of the application for compliance with all applicable SEF requirements.

[160] Registration of Swap Dealers and Major Swap Participants, 77 FR 2613 (Jan. 19, 2012).

The Commission is revising proposed § 37.3(b)(2) regarding the expiration of temporary registration to remove the ability of the Commission to rescind temporary registration. The Commission notes that the SEF NPRM did not provide a standard for the Commission to rescind temporary registration. Instead, in final § 37.3(c)(3), the Commission may rely on its ability to deny full registration, which will also cause temporary registration to expire. Therefore, the Commission believes that the ability to rescind temporary registration is unnecessary.

The Commission is extending the 365-day sunset provision for temporary registration to two years from the effective date of these regulations in final § 37.3(c)(5).[161] Given that the projected number of temporary SEF registrations may exceed 20 and the resource constraints faced by the Commission, the Commission may not be able to complete its registration reviews, enable SEFs to remedy any identified deficiencies, and ultimately grant or deny full registration for all of the SEF applicants within the proposed 365-day period. Extending the temporary registration provision will provide the Commission with adequate time to review the SEF registration applications while ensuring that SEFs can continue their operations under temporary registration, without interruption, until the Commission decides on their application for full registration.

The Commission is also revising final § 37.3(c)(5) to state that the temporary registration provision will not terminate for an applicant who applies for temporary registration before the termination of the temporary registration provision and has not been granted or denied registration under § 37.3(b)(6) by the time of the termination of

[161] This provision is contained in final § 37.3(c)(5) of the Commission's regulations.

the temporary registration provision. In addition, final § 37.3(c)(5) states that such an applicant may operate as a SEF under temporary registration upon receipt of a notice from the Commission granting temporary registration until the Commission grants or denies full registration pursuant to § 37.3(b)(6). On the termination date of the temporary registration provision, the Commission will review such applicant's application pursuant to the 180-day Commission review period and procedures in § 37.3(b)(5). These revisions will ensure that a temporarily registered SEF who does not have a full registration in place by the time the temporary registration provision terminates will not have to stop operating on such termination date.

(ii) DCM Eligibility

The Commission is withdrawing proposed § 37.3(b)(1)(ii) regarding the existing trading activity requirement so an operational DCM that seeks to create a new SEF would be able to qualify for temporary SEF registration. In consideration of NYSE Liffe's comment that temporary SEF registration for an existing DCM should not be subject to the sunset provision, the Commission is revising proposed § 37.3(b) in final § 37.3(c)(6) to allow for such an exemption.[162] The Commission notes that a DCM is subject to a higher regulatory standard than a SEF such that a non-dormant DCM who seeks to create a new SEF in order to transfer one or more of its contracts should be able to meet many of the SEF requirements. Therefore, the Commission believes that, on an ongoing basis, an operational DCM that also seeks to register as a SEF in order to transfer one or more of its contracts (whether the transfer of the contract is motivated by DCM Core Principle 9 or another reason) may request SEF temporary registration.

[162] This provision is contained in final § 37.3(c)(6) of the Commission's regulations.

(iii) 90-Day Effective Date of Regulations

The Commission is shortening the proposed 90-day effective date to 60 days subsequent to publication in the Federal Register. In consideration of the comments received and the availability of the Commission staff resources, the Commission has determined to use its discretion to establish alternative dates for the commencement of its enforcement of regulatory provisions and is setting a general compliance date of 120 days subsequent to Federal Register publication.[163] With this use of an effective date and compliance date, a prospective SEF that is already operating a swaps-trading platform in reliance on a Commission staff relief letter (e.g., CFTC No-Action Letter 12-48) could submit a SEF application and receive temporary registration before part 37's effective date so that it might begin operating as a SEF upon that effective date.[164] Alternatively, if such a prospective SEF took additional time to prepare its SEF application, it would have the option of forestalling the submission of its application until after the effective date, so long as it submitted its SEF application by the compliance date 60 days thereafter.

The Commission believes that this combination of a 60-day effective date and a 120-day compliance date subsequent to Federal Register publication for prospective SEF applicants establishes a transition period that appropriately balances the Commission's need to provide regulatory certainty to potential applicants through issuance of final SEF regulations and the Commission's statutory directives to both promote fair competition between swaps trading venues[165] and promote the trading of swaps on SEFs.[166] The new

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[163] See Heckler v. Chaney, 470 U.S. 821 (1985).

[164] This scenario is not limited to a prospective SEF that is already operating a swaps-trading platform in reliance on a Commission staff relief letter. As noted above, all SEF applicants may apply for temporary registration if they meet the requirements udner final §37.3(c)(1).

[165] Section 3(b) of the Act lists the promotion of "fair competition among boards of trade, other markets, and market participants" as a purpose of the Act. 7 U.S.C. 5(b).

transition period ensures swaps market continuity, preserves competition between swaps trading venues, and facilitates the orderly restructuring of the swaps market in compliance with the Act and regulations thereunder. The Commission believes that the 60-day effective date and the 120-day compliance date approach will provide prospective SEF applicants with sufficient time to comply with the final regulations and, if they choose, to prepare an application for temporary registration.

(f) § 37.3(c) – Reinstatement of Dormant Registration

Proposed § 37.3(c) provided procedures for a dormant SEF to reinstate its registration. The Commission received no comments on this section and is adopting § 37.3(c) as proposed.[167]

(g) § 37.3(d) – Request for Transfer of Registration

Proposed § 37.3(d) provided procedures that a SEF must follow when seeking to transfer its registration from its current legal entity to a new legal entity as a result of a corporate event. The Commission received no comments on this section and is adopting §37.3(d) as proposed.[168]

(h) § 37.3(e) – Request for Withdrawal of Application for Registration

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[166] Section 5h(e) of the Act lists the promotion of "the trading of swaps on swap executive facilities" as one goal of the Act. 7 U.S.C. 7b-3(e).

[167] The Commission is renumbering proposed § 37.3(c) to § 37.3(d) and making several non-substantive revisions for clarity.

[168] The Commission is renumbering proposed §37.3(d) to § 37.3(e) and making several non-substantive revisions for clarity.

Proposed § 37.3(e) provided that a SEF applicant may withdraw its application for registration. The Commission received no comments on this section and is adopting § 37.3(e) as proposed.[169]

(i) § 37.3(f) – Request for Vacation of Registration

Proposed § 37.3(f) provided that a SEF may vacate its registration. The Commission received no comments on this section and is adopting § 37.3(f) as proposed.[170]

4. § 37.4 – Procedures for Listing Products and Implementing Rules

Proposed § 37.4 detailed the approval and self-certification procedures under part 40 of the Commission's regulations that SEF applicants and SEFs must follow to submit its products and rules to the Commission. Proposed § 37.4 also provided that a SEF may request that the Commission consider, under the provisions of section 15(b) of the Act,[171] any of the SEF's rules or policies.

(a) Summary of Comments

WMBAA commented that SEFs should not be required to seek Commission approval for their products and rules.[172] WMBAA recommended that SEFs be allowed to submit to the Commission a simple self-certification that they complied with the applicable requirements.[173] CME stated that the proposed procedures for listing products

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[169] The Commission is renumbering proposed § 37.3(e) to § 37.3(f) and making several non-substantive revisions for clarity.

[170] The Commission is renumbering proposed § 37.3(f) to § 37.3(g) and making several non-substantive revisions for clarity.

[171] CEA section 15(b) requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of the Act, as well as the policies and purposes of the Act. 7 U.S.C. 19(b).

[172] WMBAA Comment Letter at 15-16 (Mar. 8, 2011).

[173] Id.

would increase the burdens associated with new product submissions and rule changes and would create new and costly bureaucratic inefficiencies, competitive disadvantages in the global marketplace, and impediments to innovation.[174] MarketAxess recommended that the Commission revise proposed § 37.4 to clarify that temporarily registered SEFs may list swaps through the Commission's approval or self-certification procedures.[175]

(b) Commission Determination

The Commission is adopting proposed § 37.4 subject to certain modifications. The Commission is removing many of the details from the proposed rule, which are already contained in part 40 of the Commission's regulations, and is instead referring SEFs to part 40.[176] The Commission is also removing the CEA section 15(b) consideration provision because, when reviewing any SEF rule, the Commission is already required to take into consideration the provisions under section 15(b) of the Act.

In response to WMBAA's comments that SEFs should not be required to seek Commission approval of their products and rules, the Commission notes that a SEF is a registered entity under the Act and pursuant to section 5c(c) of the Act, registered entities must submit product terms and conditions and rules to the Commission for approval or

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[174] CME Comment Letter at 10, 13 (Feb. 22, 2011). CME also provided its comments to the rulemaking titled Provisions Common to Registered Entities, 76 FR 44776 (Jul. 27, 2011). In addition, rather than repeat its comments that pertain to both the DCM and SEF NPRMs, CME incorporated its entire DCM rulemaking comment letter dated Feb. 22, 2011 as Exhibit A to its SEF comment letter dated Mar. 8, 2011. The Commission notes these comments by referencing the Feb. 22, 2011 date of CME's DCM comment letter. The Commission is also changing CME's reference to "DCM" to "SEF" for these comments.

[175] MarketAxess Comment Letter at 19 (Mar. 8, 2011). Tradeweb similarly commented that a SEF applicant should be able to introduce new products while it is operating under temporary relief. Tradeweb Comment Letter at 13 (Mar. 8, 2011).

[176] 17 CFR part 40.

under self-certification procedures.[177] In addition, the Commission notes that CME's comments were addressed in the part 40 rulemaking and are outside the scope of this rulemaking.[178] The Commission also clarifies that temporarily registered SEFs may list swaps or submit rules through the Commission's approval or self-certification procedures under part 40 of this chapter, and that the timelines under those procedures shall apply.

5. § 37.5 – Information Relating to Swap Execution Facility Compliance

Proposed § 37.5(a) required a SEF to file with the Commission information related to its business as a SEF as specified in the Commission's request. Proposed § 37.5(b) required a SEF to file with the Commission a written demonstration of compliance with the core principles. Proposed § 37.5(d) delegated the Commission's authority to seek information as set forth in § 37.5(b) to the Director of DMO or such other employee as the Director may designate.

Proposed § 37.5(c) required a SEF to file with the Commission a notice of the transfer of ten percent or more of its equity no later than the business day following the date on which the SEF enters into a firm obligation to transfer the equity interest.[179] The proposed rule also required that the notification include any relevant agreement and a representation from the SEF that it meets all of the requirements of section 5h of the Act and Commission regulations adopted thereunder. Additionally, the proposed rule required the SEF to notify the Commission of the consummation of the transaction on the day on which it occurs. Furthermore, the proposed rule required that, upon the transfer of the equity interest, the SEF certify, no later than two business days following the date on

[177] CEA section 5c(c); 7 U.S.C. 7a-2(c).

[178] See Provisions Common to Registered Entities, 76 FR 44776 (Jul. 27, 2011).

[179] See generally Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1217 (explaining the proposed ten percent threshold).

which the change in ownership occurs, that the SEF meets all of the requirements of section 5h of the Act and Commission regulations adopted thereunder.

(a) Summary of Comments

The Commission did not receive any comments on proposed §§ 37.5(a), (b), or (d). The Commission did, however, receive comments on the equity interest transfer provisions in proposed § 37.5(c).

CME commented that the submissions required to be simultaneously filed with the initial notification of an equity interest transfer do not lend themselves to preparation within the 24-hour time frame proposed in the rules.[180] CME further commented that the representation of compliance with the requirements of CEA section 5h and the Commission's regulations adopted thereunder would be more appropriate if required upon consummation of the equity interest transfer, rather than with the initial notification.[181]

MarketAxess commented that public companies should not have to file a notice of an equity interest transfer because the ownership structure of a public company does not implicate the control and influence concerns raised by the Commission in its proposal, and shareholders are already obligated under the SEC's regulations to report threshold acquisitions of equity interests within ten days of such an acquisition.[182]

Lastly, Better Markets recognized the important implications of transferring control in a regulated marketplace and it recommended that the Commission lower the

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[180] CME Comment Letter at 13 (Feb. 22, 2011).

[181] Id.

[182] MarketAxess Comment Letter at 29 (Mar. 8, 2011).

transfer threshold for reporting to five percent as similarly required by the SEC for public equity transfers.[183]

(b) Commission Determination

The Commission is adopting §§ 37.5(a), (b), and (d) as proposed subject to certain non-substantive clarifications.[184] The Commission is adopting proposed § 37.5(c) with certain revisions discussed below.

The Commission is revising § 37.5(c) to provide that a SEF must submit to the Commission a notification of each transaction involving the transfer of fifty percent or more of the equity interest in the SEF, and that such notification must be provided at the earliest possible time, but in no event later than the open of the business day that is ten business days following the date in which the SEF enters into a firm obligation[185] to transfer the equity interest. However, in all cases, the Commission notes that a SEF must provide the Commission staff with sufficient time, prior to consummating the equity interest transfer, to review and consider the implications of the change in ownership, including whether the change in ownership will adversely impact the operations of the SEF or the SEF's ability to comply with the core principles and the Commission's regulations thereunder.

The Commission acknowledges CME's concern regarding the one business day time period for filing the supporting documents with the equity interest transfer

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[183] Better Markets Comment Letter at 21-22 (Mar. 8, 2011).

[184] The Commission is removing the reference to "information relating to data entry and trade details" in proposed § 37.5(a) because it is unnecessary. The rule text is broad enough to encompass such information as it states that, upon the Commission's request, a SEF shall file with the Commission information related to its business as a SEF.

[185] The Commission interprets "firm obligation" to mean when a SEF enters into a letter of intent or any other document that demonstrates a SEF's firm intent to transfer its equity interest as described in § 37.5(c).

notification. Thus, in addition to extending the time period to up to ten business days for a SEF to file notification with the Commission, the Commission is revising the rule to eliminate the requirement that specific documents be provided with the notification. Rather, the Commission is revising the rule text to clarify that upon receiving a notification of the equity interest transfer, the Commission may request appropriate documentation pursuant to its authority under § 37.5 of the Commission's regulations. For example, such documentation may include, but is not limited to: (i) relevant agreement(s), including any preliminary agreements (not including draft documents); (ii) associated changes to relevant corporate documents; (iii) a chart outlining any new ownership or corporate or organizational structure, if available; and (iv) a brief description of the purpose and any impact of the equity interest transfer.

The Commission is deleting the requirement for a SEF to provide a representation of compliance with section 5h of the Act and the Commission regulations thereunder with the equity interest transfer notification, as requested by CME. The Commission agrees with CME that this requirement is more appropriate upon consummation of the equity interest transfer, rather than with the initial notification. Therefore, the Commission is maintaining the certification requirement upon consummation of the equity interest transfer as proposed in the SEF NPRM.

With respect to the other comments, the Commission believes that the notice requirements should not be limited to privately-held companies as the Commission's objective is to ensure that equity transfers do not negatively impact the operations of registered entities. The Commission must oversee and ensure the continued compliance of all SEFs with the core principles and the Commission's regulations. In order to fulfill

its oversight obligations, and to ensure that SEFs maintain compliance with their self-regulatory obligations, the Commission must receive a notice of an equity interest transfer. The Commission acknowledges the suggestion by Better Markets to lower the equity interest transfer threshold to five percent; however, the Commission believes that the revisions to § 37.5(c) will still allow the Commission to fulfill its oversight obligations, while reducing the costs for SEFs to comply with the equity interest transfer requirements.

Finally, the Commission is revising the rule to remind SEFs that if any aspect of an equity interest transfer requires the SEF to file a rule as defined in part 40 of the Commission regulations, then the SEF must comply with the rule submission requirements of section 5c(c) of the CEA and part 40 of this chapter, and all other applicable Commission regulations.

6. § 37.6 – Enforceability

Section 37.6 is intended to provide market participants who execute swap transactions on or pursuant to the rules of a SEF with legal certainty with respect to such transactions. In that regard, proposed § 37.6(a) established that any transaction entered into, on, or pursuant to the rules of a SEF cannot be voided, rescinded, or held unenforceable as a result of: (1) the SEF violating any provision of section 5h of the CEA or part 37; (2) any Commission proceeding to alter or supplement a rule, term, or condition under section 8a(7) of the CEA or to declare an emergency under section 8a(9) of the CEA; or (3) any other proceeding the effect of which is to alter or supplement a specific term or condition or trading rule or procedure, or require a registered SEF to adopt a specific term or condition, trading rule or procedure, or to take or refrain from

taking a specific action. Proposed § 37.6(b) required that all transactions executed on or pursuant to the rules of a SEF include written documentation memorializing all terms of the swap transaction, the legal effect of which is to supersede any previous agreement between the counterparties. The proposed rule also required that the confirmation of all terms of the transaction take place at the same time as execution.[186]

(a) Summary of Comments

Three commenters addressed the practicality of a SEF confirming all terms of a transaction at the same time as execution. MarketAxess recommended that a SEF be responsible for confirming only the swap creation data in its possession at the time of execution, consistent with the Commission's approach in its proposed part 45 regulations.[187] MarketAxess also requested that the Commission clarify that SEFs are only responsible for producing a confirmation for swaps entered into on, and not just pursuant to the rules of, a SEF.[188]

MarkitSERV stated that when counterparties choose to execute a swap on a SEF that is not subject to the clearing mandate and not submitted for clearing to a

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[186] The Commission proposed § 37.6(b) to facilitate the process contemplated by the confirmation definition. A swap "confirmation" is defined as the consummation (electronically or otherwise) of legally binding documentation (electronic or otherwise) that memorializes the agreement of the counterparties to all of the terms of a swap. A confirmation must be in writing (whether electronic or otherwise) and must legally supersede any previous agreement (electronically or otherwise). 17 CFR 45.1; Swap Data Recordkeeping and Reporting Requirements, 77 FR 2136, 2197 (Jan. 13, 2012).

[187] MarketAxess Comment Letter at 28-29 (Mar. 8, 2011). Proposed § 45.3 required that for all transactions executed on a SEF, regardless of whether the swap was cleared, the SEF would be responsible for reporting to a swap data repository only the primary economic terms of the transaction in its possession at the time of execution, and that reporting of confirmation data consisting of all terms of the transaction would be the responsibility of either the derivatives clearing organization (if cleared) or one of the counterparties (if uncleared). Swap Data Recordkeeping and Reporting Requirements, 75 FR 76574, 76580-81 (proposed Dec. 8, 2010). As adopted by the Commission, however, § 45.3 requires a SEF to report both the primary economic terms data as well as all confirmation data consisting of all transaction terms for each swap executed on or pursuant to the rules of the SEF as soon as technologically practicable after execution of the swap. 17 CFR 45.3; Swap Data Recordkeeping and Reporting Requirements, 77 FR 2136, 2199 (Jan. 13, 2012).

[188] MarketAxess Comment Letter at 29 (Mar. 8, 2011).

clearinghouse, the parties will require a long-term credit relationship to be in place, often memorialized in an ISDA Master Agreement.[189] MarkitSERV further stated that the confirmation terms provided by a SEF may not be able to accommodate the specificity of such a master agreement, thus making the SEF's confirmation inadequate for purposes of complying with the Commission's regulations.[190]

Similarly, the Energy Working Group expressed concern over the provision's requirement that the SEF's confirmation supersede any previous agreement between the transacting parties, noting that this language appears to prevent a master agreement from operating between counterparties transacting on a SEF.[191] The Energy Working Group also stated that confirmation cannot take place at the same time as execution because they are two distinct steps in the swap transaction process.[192]

(b) Commission Determination

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[189] MarkitSERV Comment Letter at 4-5 (Mar. 8, 2011).

[190] Id. MarkitSERV also expressed concern that the SEF NPRM is conflating the concepts of confirmation and affirmation with the audit trail requirements in proposed § 37.205. For example, MarkitSERV sought clarification regarding the SEF NPRM's statement that "[v]oice transactions must be entered into some form of electronic affirmation system immediately upon execution." Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1221. Given the audit trail requirement in proposed § 37.205(b)(1), which states that SEFs that "permit intermediation must require that all orders or requests for quotes received by phone that are executable be immediately entered into the trading system or platform[,]" MarkitSERV recommended that the Commission use the term "electronic processing system" instead of "electronic affirmation system" because audit trail records and affirmation are different concepts. Id. at 1244. MarkitSERV Comment Letter at 4, 6 (Mar. 8, 2011). ABC/CIEBA also sought clarification as to whether SEFs must enter Permitted Transactions into an affirmation system, and if so, ABC/CIEBA noted that the SEF NPRM is inconsistent with other rules. ABC/CIEBA Comment Letter at 7-8 (Mar. 8, 2011). The Commission notes that the final SEF rules do not require the use of an "electronic affirmation system." The Commission also clarifies that confirmation and the creation of an audit trail in § 37.205 are two separate and distinct requirements. In addition, the Commission notes that § 37.205(b) merely establishes the requirement that SEFs must capture audit trail data for regulatory purposes and does not address affirmation, confirmation, or the public reporting or dissemination of such data.

[191] Energy Working Group Comment Letter at 5 (Mar. 8, 2011).

[192] Id.

The Commission is adopting § 37.6(a) as proposed.[193] The Commission is also adopting § 37.6(b) as proposed subject to the two revisions discussed below. Although the comments received regarding proposed § 37.6(b) did not cite ambiguity in the SEF NPRM regarding a SEF's affirmative duty to provide confirmation documentation to counterparties, the Commission has determined to revise § 37.6(b) to state explicitly that a "swap execution facility shall provide each counterparty" with written documentation of all terms of the transaction to serve as confirmation of such transaction. In response to MarketAxess's comments, the Commission notes that § 37.6(b) is consistent with the requirement in final part 45 of the Commission's regulations that a SEF report confirmation data consisting of all terms of a transaction to a swap data repository ("SDR") for each swap executed on or pursuant to the rules of the SEF.[194]

With regard to the specific comments received about the role of master agreements in the written confirmation provided by a SEF, the Commission has determined that counterparties choosing to execute a transaction not submitted for clearing on or pursuant to the rules of a SEF must have all terms, including possible long-term credit support arrangements, agreed to no later than execution, such that the SEF can provide a written confirmation inclusive of those terms at the time of execution and report complete, non-duplicative, and non-contradictory data to an SDR as soon as

[193] The Commission is making certain non-substantive revisions to § 37.6(a) for clarity.

[194] Part 45 requires a SEF to report all confirmation data and all primary economic terms data as defined in part 23 and § 45.1 of the Commission's regulations for each swap executed on or pursuant to the rules of the SEF as soon as technologically practicable after execution of the swap. 17 CFR 45.3; Swap Data Recordkeeping and Reporting Requirements, 77 FR 2136, 2199 (Jan. 13, 2012). Part 45 defines confirmation data as "all of the terms of a swap matched and agreed upon by the counterparties in confirming the swap." Id. at 2197.

technologically practicable after execution.[195] This requirement, as mentioned above, is necessary to provide market participants who execute swap transactions on or pursuant to the rules of a SEF with legal certainty with respect to such transactions, and to promote the Commission's policy goal of achieving "straight-through processing" of swap transactions in order to facilitate orderly markets, whether bilateral or facility traded.[196] Furthermore, the Commission believes that credit-support arrangements for uncleared transactions can impact the ultimate price of a swap, and thus should be agreed to no later than the time of trade execution in order to promote the statutory goal of pre-trade price transparency.[197]

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[195] The Commission notes that swap trading relationship documentation is not required for swaps cleared by a derivatives clearing organization. See § 23.504(a)(1) of the Commission's regulations. The Commission also notes that the commenters' concerns are most relevant to those transactions that are truly bespoke, not subject to the clearing mandate, and not voluntarily cleared. There is no reason why a SEF's written confirmation terms cannot incorporate by reference the privately negotiated terms of a freestanding master agreement for these types of transactions, provided that the master agreement is submitted to the SEF ahead of execution and the counterparties ensure that nothing in the confirmation terms contradict the standardized terms intended to be incorporated from the master agreement. See also Real-Time Public Reporting of Swap Transaction Data, 77 FR 1182, 1193 (Jan. 9, 2012) (discussing confirmation and incorporating documents by reference).

[196] The OTC Derivatives Supervisors' Group, a collaboration of market participant leadership headed by the Federal Reserve Bank of New York, recognized the potential of electronic trading to facilitate the objectives of straight-through processing in the wake of the 2008 financial crisis. See Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, 75 FR 81519, 81521-22 (proposed Dec. 28, 2010) (noting that "[t]imely and accurate confirmation of transactions is critical for all downstream operational and risk management processes, including the correct calculation of cash flows and discharge of settlement obligations as well as accurate measurement of counterparty credit exposures.").

[197] See CEA § 5h(e); 7 U.S.C. 7b-3(e) (stating that the goal of this section is to promote pre-trade price transparency in the swaps market). While straight-through processing may not be as relevant to credit risk associated with transactions executed on or pursuant to the rules of a SEF but not submitted for clearing, the data and real-time reporting requirements already finalized by the Commission mandate reporting by the SEF of all swap transaction terms "as soon as technologically practicable" in order to effectuate the statutory mandate of post-trade price transparency. See 17 CFR 43.3(b)(1) (real-time reporting); 17 CFR 45.3(a)(1) (swap data recordkeeping and reporting requirements). This allowance of a slight timing delay, however, is meant to account for "the prevalence, implementation and use of technology by comparable market participants," and not post-execution confirmation of other terms such as credit agreements for uncleared swaps. See, e.g., 17 CFR 43.2; Real-Time Public Reporting of Swap Transaction Data, 77 FR 1182, 1191 (Jan. 9, 2012) (discussing the definition of "as soon as technologically practicable").

Finally, in response to the Energy Working Group's comment that confirmation cannot take place at the same time as execution, the Commission is revising § 37.6(b) to state that "… specific customer identifiers for accounts included in bunched orders involving swaps need not be included in confirmations provided by a swap execution facility if the applicable requirements of section 1.35(b)(5) of this chapter are met." The Commission acknowledges that for bunched orders the post-execution allocation of trades is required for confirmation. The above revisions to § 37.6 are consistent with Commission regulation 1.35(b)(5) and provide sufficient time for the post-execution allocation of bunched orders, but allow SEFs to meet the requirement that confirmation takes place at the same time as execution.[198]

7. § 37.7 – Prohibited Use of Data Collected for Regulatory Purposes

Proposed § 37.7 prohibited a SEF from using for commercial purposes proprietary data or personal information that it obtains from or on behalf of any person for regulatory purposes. The purpose of this provision was to protect customer privacy and prevent a SEF from using such information to advance its commercial interests.[199]

(a) Summary of Comments

Several commenters recommended that the Commission adopt a more flexible approach toward the use of data collected for regulatory purposes.[200] CME, for example, stated that a SEF should be allowed to use information that is provided for both

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[198] See 17 CFR 1.35; Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 FR 21278, 21286-287, 306 (Apr. 9, 2012); Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 FR 55904, 55923 (Sep. 11, 2012) for further details.

[199] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1218 n. 34.

[200] MarketAxess Comment Letter at 31 (Mar. 8, 2011); FSR Comment Letter at 9 (Mar. 8, 2011); ICE Comment Letter at 5-6 (Mar. 8, 2011); CME Comment Letter at 14 (Feb. 22, 2011).

regulatory and non-regulatory purposes for commercial purposes, as long as transparent rules or policies are in place.[201] Some commenters believed that commercial use should be allowed, provided that market participants' identities are protected[202] or prior consent is obtained.[203] For example, FSR believed that commercial use should be allowed for aggregate data as long as the sources of the information are not revealed.[204]

However, SIFMA AMG stated that, given the broad authority under the proposed rules for SEFs to acquire information, the term "proprietary data" is too narrow to adequately protect market participants from improper disclosure.[205] Freddie Mac requested that the Commission strengthen the proposed rule to additionally prohibit any SEF from asserting ownership rights over the trading information of any transacting party.[206]

Finally, WMBAA requested that the Commission clarify the meaning of "proprietary data or personal information," and recommended limiting the rule to information obtained outside the ordinary course of trade execution and related to market surveillance activities.[207]

(b) Commission Determination

The Commission is adopting § 37.7 as proposed, subject to certain modifications. In response to the commenters, the Commission is modifying the proposed rule to allow SEFs to use proprietary data or personal information for business or marketing purposes

[201] CME Comment Letter at 14 (Feb. 22, 2011).

[202] MarketAxess Comment Letter at 31 (Mar. 8, 2011); FSR Comment Letter at 9 (Mar. 8, 2011).

[203] CME Comment Letter at 14 (Feb. 22, 2011); MarketAxess Comment Letter at 31 (Mar. 8, 2011).

[204] FSR Comment Letter at 9 (Mar. 8, 2011).

[205] SIFMA AMG Comment Letter at 15-16 (Mar. 8, 2011).

[206] Freddie Mac Comment Letter at 5 (Mar. 8, 2011).

[207] WMBAA Comment Letter at 17 (Mar. 8, 2011).

if the person from whom it collects or receives such information clearly consents to the use of its information in such manner. The Commission is also revising the proposed rule to prohibit a SEF from conditioning access to its facility based upon such consent. The Commission believes that the consent requirement will protect persons by allowing them to first weigh the benefits and consequences of allowing a SEF to make commercial use of their information. In response to CME's comment about information provided for both regulatory and non-regulatory purposes, the Commission notes that a SEF may use information that it receives for both regulatory and non-regulatory purposes for business or marketing purposes if the source of the information clearly consents to the use in such a manner.

In response to comments about the definition of "proprietary data and personal information," the Commission declines to adopt a further definition and is maintaining a flexible approach. However, the Commission notes that some examples of proprietary data and personal information would include information that separately discloses business transactions, market positions, or trade secrets. The Commission recommends that SEFs define these terms in their rulebooks, which will be subject to Commission review during the SEF registration process.

8. § 37.8 – Boards of Trade Operating Both a Designated Contract Market and a Swap Execution Facility

Proposed § 37.8(a) required that a board of trade that operates a DCM and also intends to operate a SEF must separately register the SEF under part 37, and on an ongoing basis, comply with the core principles under section 5h of the Act and the part 37 regulations issued thereunder. Proposed § 37.8(b) implemented CEA section 5h(c) by

requiring a board of trade that operates both a DCM and SEF and uses the same electronic trade execution system for executing and trading swaps on both registered entities to clearly identify to market participants for each swap whether the execution or trading of such swaps is taking place on the DCM or the SEF.[208]

(a) Summary of Comments

CME stated that the rules of a DCM and SEF would clearly identify, as necessary, the trade platform upon which a swap was being executed, rendering the requirements of proposed 37.8 unnecessary.[209] CME requested that the Commission clarify whether proposed 37.8 created additional substantive obligations on the part of DCMs and SEFs given that market participants often interface with electronic platforms via proprietary or third-party front end systems not under the control of DCMs or SEFs.[210]

(b) Commission Determination

The Commission is adopting § 37.8(a) as proposed, subject to one revision. Proposed § 37.8(a) only addressed the SEF registration and compliance of a board of trade that already operates a DCM and intends to operate a SEF. To address all situations regarding DCM and SEF registration and compliance, the Commission is revising § 37.8(a) to apply to "[a]n entity that intends to operate both a [DCM] and a [SEF]." The rule requires the entity to separately register the DCM and SEF pursuant to part 38 and part 37 of the Commission's regulations, respectively, and to comply with the applicable core principles and regulations.

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[208] CEA section 5h(c); 7 U.S.C. 7b-3(c).

[209] CME Comment Letter at 14 (Feb. 22, 2011).

[210] Id.

As to CME's comments regarding § 37.8(b), the Commission clarifies that it would not be sufficient for a board of trade that operates both a DCM and a SEF to simply have rules that identify whether a transaction is being executed on the DCM or the SEF. The Commission notes that section 5h(c) of the Act clearly requires a board of trade that operates both a DCM and a SEF to identify to market participants whether each swap is being executed on the DCM or the SEF.[211] Accordingly, a consolidated DCM/SEF trading screen must identify whether the execution is occurring on the DCM or the SEF, irrespective of how proprietary or third-party front end systems eventually present that data to market participants.[212]

9. § 37.9 – Permitted Execution Methods[213]

As mentioned above, the SEF NPRM required a SEF to offer a minimum trading functionality (i.e., a centralized electronic trading screen upon which any market participant can post both firm and indicative bids and offers that are transparent to all other market participants of the SEF). The SEF NPRM provided that Required Transactions (i.e., transactions subject to the trade execution mandate under section 2(h)(8) of the CEA and not block trades) must be executed through the SEF's minimum trading functionality, Order Book meeting the minimum trading functionality, or RFQ

[211] The Commission notes that only eligible contract participants may execute a swap on a SEF so a board of trade that operates both a DCM and a SEF must ensure that its SEF does not allow for non-eligible contract participant trading on the SEF. See CEA section 2(e); 7 U.S.C. 2(e).

[212] The Commission notes that it is not replacing the term "board of trade" in § 37.8(b) with the term "entity" as in § 37.8(a) because in § 37.8(b) only a board of trade would be able to use the same electronic trade execution system for executing and trading swaps on the DCM and on the SEF (i.e., a trading facility). The Commission also notes that § 37.8(b) implements CEA section 5h(c), which uses the term "board of trade."

[213] The Commission is renaming the title of this section from "Permitted Execution Methods" to "Methods of Execution for Required and Permitted Transactions" to provide greater clarity.

System that operates in conjunction with the SEF's minimum trading functionality.[214] The SEF NPRM made it clear that for Required Transactions, pre-trade transparency must be met.[215] The SEF NPRM also allowed a SEF to provide additional execution methods for Permitted Transactions (i.e., transactions not subject to the clearing and trade execution mandates, illiquid or bespoke swaps, and block trades), including Voice-Based System.

The Commission is restructuring the order of the rule text in § 37.9 and this corresponding preamble discussion to provide clarity. Despite the order of other preamble sections, which generally follows the order of the SEF NPRM, the Commission's preamble discussion of § 37.9 generally follows the order of the restructured rule text. Additionally, as discussed above in the registration section, the Commission is moving the minimum trading functionality and Order Book sections from proposed § 37.9 to final § 37.3.

(a) § 37.9(a)(1)(iv) – Required Transactions and § 37.9(a)(1)(v) – Permitted Transactions

Proposed § 37.9(a)(1)(iv) defined Required Transactions as transactions that are subject to the execution requirements under the Act and are made available for trading pursuant to § 37.10, and are not block trades. Proposed § 37.9(a)(1)(v) defined Permitted Transactions as transactions that meet any of the following requirements: (A) are block trades; (B) are not swaps subject to the Act's clearing and execution requirements; or (C) are illiquid or bespoke swaps.

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[214] By "in conjunction with the SEF's minimum trading functionality," the Commission means that the SEF NPRM required a SEF to offer the minimum trading functionality, and if that SEF also offered an RFQ System, it was required to communicate any bids or offers resting on the minimum trading functionality to the RFQ requester along with the responsive quotes. See the discussion below regarding "Taken Into Account and Communicated" Language in the RFQ System Definition under § 37.9(a)(1)(ii) – Request for Quote System in the preamble for further details.

[215] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1220.

(1) Summary of Comments

Several commenters recommended revisions to the definition of Permitted Transactions.[216] To ensure that there are no gaps between the definitions of Required Transactions and Permitted Transactions, MarketAxess recommended that the proposed definition of Permitted Transactions in § 37.9(a)(1)(v) be revised to include all transactions that are not Required Transactions as defined in proposed § 37.9(a)(1)(iv).[217] Freddie Mac recommended that the Commission revise the proposed definition of Permitted Transactions to incorporate hedging transactions by any end-user (i.e., non-dealer) counterparty.[218] Additionally, the Coalition commented that the Commission should define illiquid or bespoke transactions to include typical end-user trades.[219]

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[216] Additionally, WMBAA commented that the distinction between Required Transactions and Permitted Transactions is not required or authorized by the CEA. WMBAA Comment Letter at 6-7 (Mar. 8, 2011). In this regard, the Commission notes that the CEA sets out specific trading requirements for swaps that are subject to the trade execution mandate. See CEA sections 2(h)(1) and 2(h)(8); 7 U.S.C. 2(h)(1) and 2(h)(8). To meet these statutory requirements, final § 37.9(a)(1) defines these swaps as Required Transactions and provides specific methods of execution for such swaps. To distinguish these swaps from other swaps that are not subject to the trade execution mandate, the Commission defines such swaps in final § 37.9(c)(1) as Permitted Transactions and allows these swaps to be voluntarily traded on a SEF by using any method of execution. See discussion below regarding execution methods for Required and Permitted Transactions under §§ 37.9(b)(1) and (b)(4) – Execution Methods for Required Transactions and § 37.9(c) – Execution Methods for Permitted Transactions in the preamble.

[217] MarketAxess Comment Letter at 32 (Mar. 8, 2011). Similarly, ISDA/SIFMA and the Energy Working Group requested clarity regarding the definition of Permitted Transactions. ISDA/SIFMA Comment Letter at 7 (Mar. 8, 2011); Energy Working Group Comment Letter at 4 (Mar. 8, 2011).

[218] Freddie Mac Comment Letter at 3 (Mar. 8, 2011). Similarly, MFA recommended that the Commission expand the definition of Permitted Transactions to include other transactions, such as exchanges for physical, exchanges for swaps, and linked or packaged transactions. MFA Comment Letter at 8 (Mar. 8, 2011). The Commission interprets MFA's comment to be a request that the Commission create through rulemaking an exception to the CEA section 2(h)(8) trade execution requirement similar to the centralized market trading exception established by DCM Core Principle 9 for certain exchange of futures for related positions. See CEA section 5(d)(9); 7 U.S.C. 7(d)(9); see also Regulation of Noncompetitive Transactions Executed on or Subject to the Rules of a Contract Market, 63 FR 3708 (Jan. 26, 1998). The Commission notes that while DCM Core Principle 9 does permit certain exceptions to the centralized market trading requirements, such exceptions are all premised on there being some "bona fide business purpose" for the exception. MFA does not offer a specific bona fide business purpose for any of its three suggested off-exchange exceptions, nor is the Commission aware of any. In addition, MFA does not explain why an exchange of swaps for swaps transaction, where each leg of the transaction can presumably be executed on a SEF, needs to be executed off-exchange. The Commission observes that should swaps based on physical commodities become subject to the trade execution mandate, there might be some bona fide business purpose for executing exchanges of swaps for physicals transactions. However, the market participants

Several commenters also commented on the reference to block trades in the definition of Permitted Transactions.[220] ISDA/SIFMA commented that the definition of block trade in part 43 of the Commission's regulations should apply to blocks executed on a SEF.[221] Tradeweb sought confirmation that block size trades in swaps that are required to be cleared and made available to trade would not be subject to the minimum trading requirements for Required Transactions, but would be required to be reported to and processed through a SEF in a manner prescribed by the SEF.[222] Similarly, GFI requested the Commission to confirm that block transactions must be effected on a SEF, but may be subject to special rules.[223]

(2) Commission Determination

To ensure that there is consistency in the definitions, and in response to MarketAxess's comment, the Commission is: (1) revising the definition of Required Transaction to mean any transaction involving a swap that is subject to the trade

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who are most likely to engage in such transactions are also likely to be eligible for the end-user exception in CEA section 2(h)(7). As an initial matter, the Commission observes that swaps based on physical commodities may be subject to the trade execution requirement if the Commission determines that they are subject to the clearing requirement under CEA section 2(h)(1) and part 50 of the Commission's regulations. Should the circumstances arise where the Commission is determining whether physical commodity swaps should become subject to the clearing requirement and there are parties who seek to engage in exchanges of swaps for physicals transactions that are not eligible for the end-user exception, the Commission could at that time entertain requests to permit a trade execution requirement exception for swaps that are components of such exchanges of swaps for physicals transactions. However, for the above reason, the Commission believes that a broad exception for such off-exchange transactions in the absence of bona fide business purposes could undermine the trade execution requirement by allowing market participants to execute swaps subject to the trade execution requirement bilaterally rather than on a SEF or DCM.

[219] Coalition Comment Letter at 8 (Mar. 8, 2011).

[220] ISDA/SIFMA Comment Letter at 10 (Mar. 8, 2011); Tradeweb Comment Letter at 5 (Mar. 8, 2011); GFI Comment Letter at 4 (Mar. 8, 2011).

[221] ISDA/SIFMA Comment Letter at 10 (Mar. 8, 2011).

[222] Tradeweb Comment Letter at 5 (Mar. 8, 2011).

[223] GFI Comment Letter at 4 (Mar. 8, 2011).

execution requirement in section 2(h)(8) of the Act;[224] and (2) revising the definition of Permitted Transaction to mean any transaction not involving a swap that is subject to the trade execution requirement in section 2(h)(8) of the Act.[225] The Commission is not revising the definition of Permitted Transaction to explicitly include "hedging transactions involving end-users" or "typical end-user" transactions because the Commission's revisions to the definition of Permitted Transaction are consistent with the CEA section 2(h)(8) trade execution requirement.[226]

With respect to the treatment of block transactions, the Commission notes that the definition of block trade in part 43 of the Commission's regulations applies to such transactions involving swaps that are listed on a SEF.[227] The Commission also notes that the definition of block trade states, in part, that block trades occur away from the registered SEF's or DCM's trading system or platform and is executed pursuant to the registered SEF's or DCM's rules and procedures.[228] As such, block trades are not subject

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[224] The Commission is renumbering proposed § 37.9(a)(1)(iv) to § 37.9(a)(1). Several commenters requested clarification from the Commission whether inter-affiliate trades would be subject to the CEA section 2(h)(8) trade execution requirement. JP Morgan Comment Letter at 5 (Jun. 3, 2011); Rosen et al. Comment Letter at 20-21 (Apr. 5, 2011); Coalition Comment Letter at 5 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 11 (Mar. 8, 2011). See Clearing Exemption for Swaps Between Certain Affiliated Entities, 77 FR 50425 (proposed Aug. 21, 2012) for further details.

[225] The Commission is renumbering proposed § 37.9(a)(1)(v) to § 37.9(c)(1).

[226] See CEA section 2(h)(8) trade execution requirement discussion above under § 37.3 – Requirements for Registration; see also discussion below under § 37.9(c) – Execution Methods for Permitted Transactions.

[227] Section 43.2 of the Commission's regulations states that "block trade" means a publicly reportable swap transaction that: (1) Involves a swap that is listed on a registered SEF or DCM; (2) Occurs away from the registered SEF's or DCM's trading system or platform and is executed pursuant to the registered SEF's or DCM's rules and procedures; (3) Has a notional or principal amount at or above the appropriate minimum block size applicable to such swap; and (4) Is reported subject to the rules and procedures of the registered SEF or DCM and the rules described in this part, including the appropriate time delay requirements set forth in § 43.5 of this part. 17 CFR 43.2.

[228] Id.

to the execution methods for Required Transactions and Permitted Transactions in final § 37.9(a)(2) and § 37.9(c)(2), respectively.[229]

(b) § 37.9(a)(1)(ii) – Request for Quote System

Proposed § 37.9(a)(1)(ii)(A) defined an RFQ System as a trading system or platform in which a market participant must transmit a request for quote to buy or sell a specific instrument to no less than five market participants in the trading system or platform, to which all such market participants may respond. Under the proposed rule, any bids or offers resting on the trading system or platform pertaining to the same instrument must be taken into account and communicated to the requester along with the responsive quotes.

In addition, proposed § 37.9(a)(1)(ii)(B) defined an RFQ System as a trading system or platform in which multiple market participants can both: (1) view real-time electronic streaming quotes, both firm and indicative, from multiple potential counterparties on a centralized electronic screen; and (2) have the option to complete a transaction by: (i) accepting a firm streaming quote, or (ii) transmitting a request for quote to no less than five market participants, based upon an indicative streaming quote, taking into account any resting bids or offers that have been communicated to the requester along with any responsive quotes. Finally, proposed § 37.9(a)(1)(ii)(C) provided that an RFQ System means any such other trading system or platform as may be determined by the Commission.

(1) Summary of Comments

(i) Comments on RFQ System Definition and Transmission to Five Market Participants

[229] The Commission notes that the execution methods for Required Transactions in final § 37.9(a)(2) excludes block trades.

In general, some commenters stated that the Commission's definition of an RFQ System imposes rigid requirements that are not supported by the SEF definition.[230] Other commenters stated that the defined RFQ System preserves "the single-dealer status quo," threatens to diminish the transparency and efficiency of the regulated swaps market, and is inconsistent with the Dodd-Frank Act.[231]

As noted above, § 37.9(a)(1)(ii) of the SEF NPRM contained a requirement that a market participant transmit an RFQ to no less than five market participants. In the SEF NPRM, the Commission specifically asked for public comment on whether five is the appropriate minimum number of respondents that the Commission should require to potentially interact with a request for quote.[232] The Commission also asked for public comment on the appropriate minimum number, if not five.[233] The Commission received the following comments regarding the five market participant requirement and has responded to those comments below.

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[230] Rosen et al. Comment Letter at 10 (Apr. 5, 2011); Goldman Comment Letter at 2 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 2 (Mar. 8, 2011); FXall Comment Letter at 7-8 (Mar 8, 2011); SIFMA AMG Comment Letter at 4-5 (Mar. 8, 2011).

[231] IECA Comment Letter at 3 (May 24, 2011); Mallers et al. Comment Letter at 3-5 (Mar. 21, 2011); AFR Comment Letter at 4, 5 (Mar. 8, 2011). The Mallers et al. comment letter represents the view of a number of high frequency trading firms: Allston Trading, LLC, Atlantic Trading USA LLC, Bluefin Trading LLC, Chopper Trading LLC, DRW Holdings, LLC, Eagle Seven, LLC, Endeavor Trading, LLC, GETCO, Hard Eight Futures, LLC, HTG Capital Partners, IMC Financial Markets, Infinium Capital Management LLC, Kottke Associates, LLC, Liger Investments Limited, Marquette Partners, LP, Nico Holdings LLC, Optiver US LLC, Quantlab Financial, LLC, RGM Advisors, LLC, Traditum Group LLC, WH Trading, and XR Trading LLC.

[232] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1221. The Commission asked, "[i]n light of the 'multiple participant to multiple participant' requirement, the Commission has proposed that requests for quotes be requested of at least five possible respondents. Is this the appropriate minimum number of respondents that the Commission should require to potentially interact with a request for quote? If not, what is an appropriate minimum number? Some pre-proposal commenters have suggested that market participants should transmit a request for quote to 'more than one' market participant. The Commission is interested in receiving public comment on this matter." Id.

[233] Id.

Several commenters objected to the requirement in proposed § 37.9(a)(1)(ii) that a market participant transmit an RFQ to no less than five market participants.[234] The commenters raised various concerns with this requirement, including the potential for increased trading costs,[235] decreased liquidity,[236] decreased transparency,[237] and breaking trades into smaller sizes.[238] Several commenters specifically noted that the five market participant requirement may result in increased spreads for participants because non-executing market participants in the RFQ could "front run" the transaction in anticipation of the executing market participant's forthcoming and offsetting transactions.[239] Many of

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[234] Representative Garrett et al. Comment Letter at 1 (Apr. 5, 2013);Eaton Vance Comment Letter at 2 (Feb. 17, 2012); Reuters Comment Letter at 6 (Dec. 12, 2011); Tradeweb Comment Letter at 5 (Jun. 3, 2011); Traccr Limited Comment Letter at 2 (Jun. 3, 2011); FHLB Comment Letter at 12-13 (Jun. 3, 2011); AII Comment Letter at 5 (Jun. 2, 2011); Rosen et al. Comment Letter at 11 (Apr. 5, 2011); JP Morgan Comment Letter at 2-3 (Mar. 8, 2011); Bloomberg Comment Letter at 2-3 (Mar. 8, 2011); FXall Comment Letter at 8-9 (Mar. 8, 2011); Reuters Comment Letter at 3 (Mar. 8, 2011); BlackRock Comment Letter at 3-4 (Mar. 8, 2011); Tradeweb Comment Letter at 7 (Mar. 8, 2011); FSR Comment Letter at 3 (Mar. 8, 2011); MFA Comment Letter at 6 (Mar. 8, 2011); MetLife Comment Letter at 2-3 (Mar. 8, 2011); SIFMA AMG Comment Letter at 5-7 (Mar. 8, 2011); Deutsche Comment Letter at 3-4 (Mar. 8, 2011); MarketAxess Comment Letter at 31 (Mar. 8, 2011); Barclays Comment Letter at 5-6 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 3 (Mar. 8, 2011); ABC/CIEBA Comment Letter at 6 (Mar. 8, 2011); Global FX Comment Letter at 3 (Mar. 8, 2011); TruMarx Comment Letter at 6 (Mar. 8, 2011); Coalition Comment Letter at 5-7 (Mar. 8, 2011); WMBAA Comment Letter at 6 (Mar. 8, 2011); CME Comment Letter at 8 (Mar. 8, 2011); Morgan Stanley Comment Letter at 2-3 (Mar. 2, 2011); CanDeal Comment Letter at 2-3 (Feb. 25, 2011). The Commission notes that some commenters in addressing this provision used the term "liquidity providers" to refer to the minimum number of "market participants" that must receive RFQs. See, e.g., Tradeweb Comment Letter at 5 (Jun. 3, 2011); AII Comment Letter at 5 (Jun. 2, 2011); Bloomberg Comment Letter at 2 (Mar. 8, 2011); FXall Comment Letter at 9 (Mar. 8, 2011); FSR Comment Letter at 3 (Mar. 8, 2011). The Commission clarifies that the proposed five market participant requirement did not imply any requirement that the requested market participants operate in any particular manner, such as one that regularly provides liquidity or makes markets in the particular swap.

[235] Eaton Vance Comment Letter at 2 (Feb. 17, 2012); JP Morgan Comment Letter at 2-3 (Mar. 8, 2011); BlackRock Comment Letter at 4 (Mar. 8, 2011); MetLife Comment Letter at 3 (Mar. 8, 2011); Global FX Comment Letter at 3 (Mar. 8, 2011); Morgan Stanley Comment Letter at 2 (Mar. 2, 2011); CanDeal Comment Letter at 2-3 (Feb. 25, 2011).

[236] Tradeweb Comment Letter at 5 (Jun. 3, 2011); Traccr Limited Comment Letter at 2 (Jun. 3, 2011); FHLB Comment Letter at 12 (Jun. 3, 2011); JP Morgan Comment Letter at 2-3 (Mar. 8, 2011); BlackRock Comment Letter at 3 (Mar. 8, 2011); Tradeweb Comment Letter at 7 (Mar. 8, 2011); MetLife Comment Letter at 3 (Mar. 8, 2011); CanDeal Comment Letter at 2-3 (Feb. 25, 2011).

[237] Tradeweb Comment Letter at 5 (Jun. 3, 2011); MetLife Comment Letter at 3 (Mar. 8, 2011).

[238] BlackRock Comment Letter at 4 (Mar. 8, 2011).

[239] FHLB Comment Letter at 12 (Jun. 3, 2011); AII Comment Letter at 5 (Jun. 2, 2011); Bloomberg Comment Letter at 2-3 (Mar. 8, 2011); FXall Comment Letter at 8-9 (Mar. 8, 2011); BlackRock Comment

these commenters additionally noted that these risks would be most pronounced in illiquid swaps or large-sized trades (i.e., transactions approaching the block trade threshold).[240] As a result, many of the commenters noted that it will be difficult and costly to enter into hedging transactions.[241]

In this regard, some commenters noted that the SEC's SB-SEF proposal[242] permitted RFQs to be transmitted to one or more SEF participant(s).[243] Morgan Stanley commented that, given the impact of signaling transactions to multiple market participants, as trade size grows, participants may receive better execution if their RFQs are transmitted to fewer than five participants.[244] Similarly, MetLife commented that participants should have the flexibility to determine the appropriate number of

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Letter at 3-4 (Mar. 8, 2011); MetLife Comment Letter at 3 (Mar. 8, 2011); SIFMA AMG Comment Letter at 5-6 (Mar. 8, 2011); Barclays Comment Letter at 5-6 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 3 (Mar. 8, 2011); ABC/CIEBA Comment Letter at 6 (Mar. 8, 2011); Global FX Comment Letter at 3 (Mar. 8, 2011); Coalition Comment Letter at 5-6 (Mar. 8, 2011); Morgan Stanley Comment Letter at 2 (Mar. 2, 2011).

[240] FHLB Comment Letter at 12 (Jun. 3, 2011); AII Comment Letter at 5 (Jun. 2, 2011); Bloomberg Comment Letter at 2-3 (Mar. 8, 2011); FXall Comment Letter at 8-9 (Mar. 8, 2011); MetLife Comment Letter at 3 (Mar. 8, 2011); SIFMA AMG Comment Letter at 5-6 (Mar. 8, 2011); Barclays Comment Letter at 5-6 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 3 (Mar. 8, 2011); Global FX Comment Letter at 3 (Mar. 8, 2011); Coalition Comment Letter at 5-6 (Mar. 8, 2011); Morgan Stanley Comment Letter at 2 (Mar. 2, 2011).

[241] FHLB Comment Letter at 12 (Jun. 3, 2011); AII Comment Letter at 5 (Jun. 2, 2011); Bloomberg Comment Letter at 2-3 (Mar. 8, 2011); FXall Comment Letter at 8-9 (Mar. 8, 2011); BlackRock Comment Letter at 3-4 (Mar. 8, 2011); MetLife Comment Letter at 3 (Mar. 8, 2011); SIFMA AMG Comment Letter at 5-6 (Mar. 8, 2011); Barclays Comment Letter at 5-6 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 3 (Mar. 8, 2011); ABC/CIEBA Comment Letter at 6 (Mar. 8, 2011); Global FX Comment Letter at 3 (Mar. 8, 2011); Coalition Comment Letter at 5-6 (Mar. 8, 2011); Morgan Stanley Comment Letter at 2 (Mar. 2, 2011).

[242] Registration and Regulation of Security-Based Swap Execution Facilities, 76 FR 10948 (proposed Feb. 28, 2011).

[243] Reuters Comment Letter at 6 (Dec. 12, 2011); Traccr Limited Comment Letter at 2 (Jun. 3, 2011); AII Comment Letter at 5 (Jun. 2, 2011); Rosen et al. Comment Letter at 11 (Apr. 5, 2011); JP Morgan Comment Letter at 5 (Mar. 8, 2011); Reuters Comment Letter at 3 (Mar. 8, 2011); Tradeweb Comment Letter at 7 (Mar. 8, 2011); FSR Comment Letter at 3 (Mar. 8, 2011); MetLife Comment Letter at 3 (Mar. 8, 2011); SIFMA AMG Comment Letter at 5 (Mar. 8, 2011); Deutsche Comment Letter at 4 (Mar. 8, 2011); MarketAxess Comment Letter at 31 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 3 (Mar. 8, 2011); Global FX Comment Letter at 3 (Mar. 8, 2011); Goldman Comment Letter at 2 (Mar. 8, 2011); TruMarx Comment Letter at 6 (Mar. 8, 2011).

[244] Morgan Stanley Comment Letter at 2 (Mar. 2, 2011).

respondents for a particular trade, which could vary based on the size and liquidity of the trade.[245] Additionally, Commissioner Sommers' dissent suggested an alternative approach to RFQ Systems that would permit a market participant to transmit an RFQ to "more than one" potential counterparty.[246]

Other commenters, however, stated that an RFQ should be transmitted to all participants on the SEF.[247] Mallers et al. stated that participants would not be disadvantaged by disclosing an RFQ to the entire market for transactions below the block trade threshold, which would not move the market.[248] In their view, the five market participant requirement would allow a participant to conduct semi-private deals with a few favored participants to the exclusion of other market participants, which would ultimately decrease liquidity and create a substantial barrier to entry to the swaps market.[249] On the other hand, SDMA supported the five market participant requirement.[250] In its view, this requirement promotes price discovery and liquidity, whereas the single market participant model facilitates abusive trading practices, such as pre-arranged trading and "painting the screen" (i.e., posting of non-competitive quotes to confuse the market).[251]

(ii) Comments on "Taken Into Account and Communicated" Language in the RFQ System Definition

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[245] MetLife Comment Letter at 3 (Mar. 8, 2011).

[246] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1259.

[247] IECA Comment Letter at 3 (May 24, 2011); Mallers et al. Comment Letter at 4-5 (Mar. 21, 2011); Better Markets Comment Letter at 9 (Mar. 8, 2011); AFR Comment Letter at 4-5 (Mar. 8, 2011).

[248] Mallers et al. Comment Letter at 4 (Mar. 21, 2011).

[249] Id.

[250] SDMA Comment Letter at 3 (Mar. 8, 2011). See also Better Markets Comment Letter at 2 (Apr. 12, 2013) and Allston et al. Comment Letter at 1 (Feb. 28, 2013).

[251] SDMA Comment Letter at 5 (Feb. 28, 2013); SDMA Comment Letter at 3 (Mar. 8, 2011).

Some commenters recommended that the Commission delete the requirement that resting orders be "taken into account and communicated" to the RFQ requester.[252] FXall and Barclays stated that this requirement is not necessary because the RFQ requester already has the ability to view the resting orders on the SEF's minimum trading functionality or Order Book.[253] Several commenters stated that this requirement is mandating that SEFs offer RFQ systems in conjunction with the SEF's minimum trading functionality, which is not required.[254] Similarly, JP Morgan stated that the resting order functionality is not mandated by the statute.[255]

Several commenters requested clarification regarding the interaction between resting bids and offers and the RFQ system.[256] Some commenters thought that the "taken into account and communicated" language should mean that a SEF must only communicate to the RFQ requester the resting bids and offers, and that the RFQ requester has sole discretion to either respond to, or ignore, these resting bids and offers.[257] ISDA/SIFMA and SIFMA AMG requested clarification that the resting bids and offers

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[252] Tradeweb Comment Letter at 5 (Jun. 3, 2011); JP Morgan Comment Letter at 5-6 (Mar. 8, 2011); FXall Comment Letter at 9-10 (Mar. 8, 2011); SIFMA AMG Comment Letter at 9 (Mar. 8, 2011); Barclays Comment Letter at 7 (Mar. 8, 2011); Tradeweb Comment Letter at 6 (Mar. 8, 2011).

[253] FXall Comment Letter at 9 (Mar. 8, 2011); Barclays Comment Letter at 7 (Mar. 8, 2011).

[254] ISDA/SIFMA Comment Letter at 5-6 (Mar. 8, 2011); FXall Comment Letter at 4 (Mar. 8, 2011); MarketAxess Comment Letter at 33 (Mar. 8, 2011); SIFMA AMG Comment Letter at 4 (Mar. 8, 2011).

[255] JP Morgan Comment Letter at 5 (Mar. 8, 2011).

[256] Reuters Comment Letter at 1 (Jun. 13, 2012); Rosen et al. Comment Letter at 12-14 (Apr. 5, 2011); JP Morgan Comment Letter at 5-6 (Mar. 8, 2011); FXall Comment Letter at 9-10 (Mar. 8, 2011); Tradeweb Comment Letter at 8 (Mar. 8, 2011); FSR Comment Letter at 5 (Mar. 8, 2011); MetLife Comment Letter at 3 (Mar. 8, 2011); SIFMA AMG Comment Letter at 9 (Mar. 8, 2011); MarketAxess Comment Letter at 32 (Mar. 8, 2011); Barclays Comment Letter at 7 (Mar. 8, 2011); ABC/CIEBA Comment Letter at 6-7 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 3-4; Evolution Comment Letter at 5-6 (Mar. 8, 2011).

[257] JP Morgan Comment Letter at 5-6 (Mar. 8, 2011); FSR Comment Letter at 5 (Mar. 8, 2011); MetLife Comment Letter at 3 (Mar. 8, 2011); SIFMA AMG Comment Letter at 9 (Mar. 8, 2011); MarketAxess Comment Letter at 32 (Mar. 8, 2011); ABC/CIEBA Comment Letter at 6-7 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 3-4 (Mar. 8, 2011); Evolution Comment Letter at 5-6 (Mar. 8, 2011).

do not include indicative prices.[258] Several commenters also stated that SEFs should not be required to inform the providers of resting bids and offers of the RFQs; otherwise, the RFQ system would be subject to market abuse by opportunistic third parties seeking market information, and the requirement would open up RFQs beyond the minimum number of participants.[259]

(iii) Comments on RFQ Disclosure Issues

AFR and Better Markets stated that SEFs should be required to disclose RFQ responses to all market participants.[260] For example, AFR commented that responses to RFQs should be made transparent to all market participants prior to trade execution, which would serve the statutory goal of pre-trade price transparency and would increase price competition.[261] Several commenters objected to the recommendation by AFR and Better Markets.[262] Some of these commenters noted that such a requirement could raise the same information leakage concerns as with the five market participant requirement.[263]

FSR commented that market participants receiving the RFQ should have relevant information about the identity of the RFQ requester.[264] However, Tradeweb commented

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[258] ISDA/SIFMA Comment Letter at 3-4 (Mar. 8, 2011); SIFMA AMG Comment Letter at 9 (Mar. 8, 2011).

[259] FXall Comment Letter at 9-10 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 3-4 (Mar. 8, 2011); SIFMA AMG Comment Letter at 9 (Mar. 8, 2011). FSR also commented that the provider of the resting bid should not be provided with information about the identity of the RFQ requester. FSR Comment Letter at 5 (Mar. 8, 2011).

[260] AFR Comment Letter at 3 (Feb. 27, 2013); AFR Comment Letter at 5 (Mar. 8, 2011); Better Markets Comment Letter at 8 (Mar. 8, 2011).

[261] AFR Comment Letter at 5 (Mar. 8, 2011).

[262] Rosen et al. Comment Letter at 14 (Apr. 5, 2011); MarketAxess Comment Letter at 32 (Mar. 8, 2011); Barclays Comment Letter at 10 (Mar. 8, 2011); Tradeweb Comment Letter at 7-8 (Mar. 8, 2011); State Street Comment Letter at 4 (Mar. 8, 2011); Deutsche Comment Letter at 4 (Mar. 8, 2011).

[263] Tradeweb Comment Letter at 7 (Mar. 8, 2011); State Street Comment Letter at 4 (Mar. 8, 2011); Deutsche Comment Letter at 4 (Mar. 8, 2011).

[264] FSR Comment Letter at 3 (Mar. 8, 2011).

that the Commission should not impose a specific requirement that the identity of the RFQ requester be disclosed or anonymous.[265] FSR also stated that SEFs should not be required to publish RFQs until after the trade has been completed, and then only as part of aggregated disclosures.[266] Finally, State Street requested that the Commission clarify that an RFQ System is not required to provide functionality to make RFQs visible to the entire market, although it may voluntarily choose to do so.[267]

(2) Commission Determination

Based on the comments, the Commission is adopting proposed § 37.9(a)(1)(ii) as final § 37.9(a)(3), subject to a number of modifications discussed below.[268]

(i) RFQ System Definition and Transmission to Five Market Participants

The Commission is adopting the definition of RFQ System in proposed § 37.9(a)(1)(ii)(A), subject to certain modifications described below. As explained in the SEF NPRM, the Commission believes that an RFQ System, as defined in § 37.9, operating in conjunction with a SEF's minimum trading functionality (i.e., Order Book) is consistent with the SEF definition and promotes the goals provided in section 733 of the Dodd-Frank Act, which are to: (1) promote the trading of swaps on SEFs and (2) promote pre-trade price transparency in the swaps market.[269] The Commission notes that the RFQ System definition requires SEFs to provide market participants the ability to access multiple market participants, but not necessarily the entire market, in conformance with the SEF definition.

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[265] Tradeweb Comment Letter at 8 (Mar. 8, 2011).

[266] FSR Comment Letter at 3 (Mar. 8, 2011).

[267] State Street Comment Letter at 4 (Mar. 8, 2011).

[268] The Commission is renumbering proposed § 37.9(a)(1)(ii) to § 37.9(a)(3).

[269] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1220-21.

The Commission agrees with SDMA that the proposed five market participant requirement would promote pre-trade price transparency, as the RFQ requester would be required to solicit executable orders, on a pre-trade basis, from a larger group of potential responders.[270] A broader group of potential responders, in turn, encourages price competition between the potential responders to the RFQ and may provide a more reliable assessment of market value than SEF functionality that would permit a market participant to rely on a quote from a single RFQ requestee. The Commission nevertheless recognizes commenters' concerns about the proposed five market participant requirement, such as the potential for increased trading costs and information leakage to the non-executing market participants in the RFQ. To address these concerns, while still complying with the multiple-to-multiple requirement in the statutory SEF definition and promoting the goals of pre-trade price transparency and trading of swaps on SEFs provided in section 733 of the Dodd-Frank Act, the Commission is requiring that a market participant transmit an RFQ to no less than two market participants during a phase-in compliance period and, subsequent to that period, to no less than three market participants.[271] The Commission believes, as noted above, that sending an RFQ to a

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[270] The Commission notes that a SEF market participant may send an RFQ to the entire market. See id. at 1220 and discussion below. The Commission also notes that there are generally two distinct differences between the requirements finalized in this release and the RFQ-type functionality offered by DCMs. First, RFQ functionality used by DCMs disseminates RFQs to all market participants. Second, the responses to the RFQs take the form of executable bids or offers that are entered into the DCM's order book or other centralized market, such that orders from any market participant, not just the one submitting the RFQ, can be matched against such responsive bids or offers. Although the Commission considered a minimum RFQ-to-all requirement similar to the current practice in DCMs, given that swaps tend to be less standardized than futures, the Commission believes that rules pertaining to the execution methods for SEFs should provide appropriate flexibility for market participants trading swaps. The Commission notes that the less restrictive minimum market participant requirement established by part 37 reflects the more flexible statutory provisions for SEFs as compared to DCMs.

[271] The Commission clarifies that the three market participant requirement does not imply any requirement that the requested market participants operate in any particular manner, such as a requirement that such participants be dedicated liquidity providers or market makers in the particular swap. The RFQ requester

greater number of market participants increases the potential for price competition among responders and provides a more reliable assessment of market value. The Commission also believes that the three market participant requirement, with the two market participant phase-in period, appropriately balances the benefits of pre-trade price transparency and the information leakage concerns raised by commenters. The revision from five to three minimum market participants will also provide market participants with greater flexibility in sending RFQs for Required Transactions, while still complying with the statutory SEF definition and promoting pre-trade price transparency.

The Commission has also determined to clarify that the market participants required for inclusion in an RFQ in all cases may not be affiliated with or controlled by the RFQ requester and may not be affiliated with or controlled by each other, and is revising final § 37.9(a)(3) to clarify this point.[272] For an RFQ requester to send an RFQ to another entity who is affiliated with or controlled by the RFQ requester is inconsistent with the purpose of requiring that RFQs be sent to more than one market participant, as explained both in the SEF NPRM and this release. The Commission notes that if an RFQ is transmitted to one non-affiliate and two affiliates of the requester or if an RFQ is transmitted to three requestees who are affiliates of each other, then the policy objective

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may send the RFQ to any three market participants on the RFQ system, subject to the affiliate prohibition discussed below. See supra footnote 234 for further details.

[272] The Commission notes that "affiliate" means: (i) one party, directly or indirectly, holds a majority ownership interest in the other party, and the party that holds the majority interest in the other party reports its financial statements on a consolidated basis under Generally Accepted Accounting Principles or International Financial Reporting Standards, and such consolidated financial statements include the financial results of the majority-owned party; or (ii) a third party, directly or indirectly, holds a majority ownership interest in both parties, and the third party reports its financial statements on a consolidated basis under Generally Accepted Accounting Principles or International Financial Reporting Standards, and such consolidated financial statements include the financial results of both of the parties. A party or third party directly or indirectly holds a majority ownership interest if it directly or indirectly holds a majority of the equity securities of an entity, or the right to receive upon dissolution, or the contribution of, a majority of the capital of a partnership. See Commission regulation 50.52.

of promoting the goal of pre-trade price transparency and complying with the multiple-to-multiple requirement in the SEF definition could be undermined. The Commission is also concerned that such an outcome could disincentivize entities from responding to an RFQ, which would reduce price competition and liquidity.

The Commission believes, moreover, that the three market participant requirement is consistent with current market practice where, in certain markets, many market participants already choose to send an RFQ to multiple market participants. Tradeweb, for example, noted that in its experience in the U.S. Treasuries market, market participants on average send an RFQ to three market participants.[273] In addition, the Commission understands that many pension and other managed funds with fiduciary obligations routinely obtain quotes from at least three market participants in certain securities markets. The Commission believes that the three market participant requirement, with the two market participant transition period, supports a common industry practice of querying multiple market participants, while still complying with the statutory SEF definition and promoting the goals provided in section 733 of the Dodd-Frank Act.

Furthermore the Commission believes that the three minimum market participant requirement heightens the probability that multiple participants will respond to an RFQ and, thus, will facilitate the pricing improvements attendant to competition among RFQ responders. The Commission is aware of numerous legal, business, and technological issues that could prevent a market participant from responding to a specific RFQ. The Commission notes, for example, that DCM market maker programs often require

[273] Tradeweb Comment Letter at 7 (Mar. 8, 2011).

participants to quote two-sided markets for 75 to 85 percent of the trading day.[274] Therefore, a participant in the market maker program may not provide quotes for a portion of the trading day. While there is no guarantee that even a minimum market participant requirement will ensure that multiple responses are available for all RFQs, it increases the probability that the goal of pre-trade price transparency is achieved and that a competitive market exists for all market participants.

Finally, the Commission believes that setting the minimum RFQ requirement at a uniform number for all Required Transactions in all asset classes provides regulatory and market efficiencies and is appropriate for the SEF market structure at this particular time. SEFs and market participants will benefit from a clear and uniform standard that would not require them to be subject to different minimum RFQ requirements, and to monitor compliance with such requirements, for every swap or class of swaps subject to the CEA section 2(h)(8) trade execution requirement.

For the reasons discussed above, at this time, the Commission believes that the three market participant requirement implements the multiple-to-multiple requirement in the statutory SEF definition and will create an appropriate level of pre-trade price transparency for Required Transactions (i.e., transactions involving swaps that are subject to the trade execution mandate of section 2(h)(8) of the CEA) for market participants initiating RFQs. However, the Commission is also aware of the fact that a phased implementation of this requirement will assist market participants and prospective SEFs to make an efficient transition from the swap industry's current market structure to the more transparent execution framework set forth in these final rules. Therefore, to provide

[274] The Commission understands that such provisions are in place to accommodate various operational and other reasons that could cause a market participant to not comply with the quoting obligations.

market participants, SEFs, and the swaps industry with time to adapt to the new SEF regime, the Commission is phasing-in the three market participant requirement. From the effective date of the final SEF regulations until one year from the compliance date of these final regulations, a market participant transmitting an RFQ for Required Transactions under § 37.9(a)(2) must still comply with the RFQ definition in § 37.9(a)(3), but may transmit the quote to no less than two market participants.[275]

Some comments expressed support for the SEC's SB-SEF proposal, which allows for one-to-one RFQs. If the Commission eliminated the multiple market participant requirement and instead permitted RFQ requesters to send RFQs to a single market participant, then the multiple-participant-to-multiple-participant requirement in the SEF definition and the pre-trade price transparency goal would be undermined. In this regard, the Commission notes that while the SEC's SB-SEF proposal allows for one-to-one RFQs, it proposed to fulfill the multiple to multiple requirement by mandating full order interaction or best execution for RFQs.[276] Under the SEC's SB-SEF proposal, an RFQ requester must execute against the best priced orders of any size within and across a SEF's modes of execution, a requirement that the Commission is not recommending at this time.[277]

The Commission notes that some commenters expressed concerns about the risks with respect to information leakage for illiquid swaps or large-size trades, and the potential risk of a winner's curse for the market participant whose quote is accepted by the RFQ requester. According to the commenters, the other market participants in the

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[275] The Commission notes that the affiliate prohibition in § 37.9(a)(3) applies during the interim RFQ-to-2 period.

[276] Registration and Regulation of Security-Based Swap Execution Facilities, 76 FR at 10953-54, 10971-74.

[277] Id.

RFQ will be aware of the RFQ, and some or all of those participants will attempt to front-run the trades by the winning responder to hedge or layoff the risk from the RFQ transaction.[278]

With respect to commenters' concerns about the potential winner's curse for illiquid swaps, the Commission clarifies that the minimum market participant requirement only applies to RFQ Systems for Required Transactions (i.e., transactions involving swaps that are subject to the trade execution mandate of section 2(h)(8) of the CEA); such swaps generally should be more liquid than swaps that are not subject to trade execution mandate because they are subject to the clearing mandate of section 2(h)(1) of the CEA and are made available to trade.[279] In this regard, the Commission notes that the interest rate swaps and credit default swaps that the Commission has determined are required to be cleared under CEA section 2(h)(1) (and are likely to be subject to the trade execution mandate of CEA section 2(h)(8)) are some of the most liquid swaps.[280] The Commission also notes that 77 swap dealers have registered with the Commission and nearly all of them make markets in such swaps.[281] Further, SEFs may offer RFQ systems without the three market participant requirement for Permitted

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[278] To the extent such risks potentially exist for Required Transactions, the reduction of the minimum market participant requirement from the proposed five will help mitigate this risk.

[279] Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284 (Dec. 13, 2012); Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available To Trade, 76 FR 77728 (proposed Dec. 14, 2011).

[280] Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284. The Commission notes that these swaps already went through a Commission determination process that included a five factor review, including a liquidity review. Id. ISDA, in its letter requesting interpretive relief regarding the obligation to provide a pre-trade mid-market mark, recognized that many of the swaps that the Commission has determined are required to be cleared under CEA section 2(h)(1) are "highly-liquid, exhibit narrow bid-ask spreads and are widely quoted by SD/MSPs in the marketplace…" ISDA Comment Letter at 2 (Nov. 30, 2012).

[281] The Commission recognizes that not all swap dealers will be active in all Required Transactions. The Commission also notes that of the 77 currently registered swap dealers, 35 swap dealers are not affiliated with any other swap dealers.

Transactions (i.e., transactions not involving swaps that are subject to the trade execution mandate of section 2(h)(8) of the CEA).

With respect to commenters' concerns about the potential winner's curse for large-sized trades, the Commission notes that block trades would not be subject to the execution methods for Required Transactions, including the three market participant requirement.[282] Therefore, excluding block trades from the execution methods for Required Transactions will address the potential risk of a winner's curse for such trades. The Commission also clarifies that SEFs are not required to display a requester's RFQ to market participants not participating in the RFQ.[283]

The Commission believes, in response to commenters' concerns about increased trading costs, that an increased number of participants receiving and responding to RFQs will tighten the bid-ask spreads, and result in lower transaction costs for market participants. The Commission notes that the relationship between spreads and the industry practice for the minimum number of RFQ recipients will vary across swaps and over time. Further, the Commission believes that as SEFs compete to grow their swaps trading volumes and deliver improved liquidity and lower transaction costs for their customers, the final rules in this release will provide them with the flexibility to experiment with different minimum numbers of recipients that is higher than the minimum articulated in this regulation. The final RFQ requirement will provide some protection to RFQ requesters that at least a minimum number of market participants will

[282] See definition of block trade in § 43.2 of the Commission's regulations.

[283] Similarly, as noted below, SEFs are not required to display responses to an RFQ to anyone but the RFQ requester.

receive their RFQs, and thus increase the likelihood of receiving multiple, competitive quotes.

Finally, the Commission is deleting the additional definition of RFQ System in proposed § 37.9(a)(1)(ii)(B) because it is unnecessary.[284] A SEF that chooses to offer an RFQ System to facilitate Required Transactions is required to offer the RFQ System in conjunction with the SEF's Order Book, which would encompass the requirements in proposed § 37.9(a)(1)(ii)(B)(1) and (2)(i).[285] Additionally, a market participant is already required to send an RFQ to three market participants, which would also be the case if it is based upon an indicative quote as stated in proposed § 37.9(a)(1)(ii)(B)(2)(ii).[286]

(ii) "Taken Into Account and Communicated" Language in the RFQ System Definition

To address commenters' concern that the SEF NPRM was ambiguous with respect to the communication requirement, the Commission is modifying the definition of RFQ System in proposed § 37.9(a)(1)(ii)(A) to state that a SEF must provide the RFQ requester: (1) with any firm resting bid or offer in the same instrument from any of the SEF's Order Books at the same time as the first responsive bid or offer is received by the RFQ requester and (2) with the ability to execute against such firm resting bids or offers along with the responsive orders.[287] For example, a market participant transmits an RFQ

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[284] The Commission is also deleting the catch-all RFQ definition in proposed § 37.9(a)(1)(ii)(C) as it is unnecessary. As discussed below, a SEF may petition the Commission under § 13.2 to amend § 37.9(a)(2) to include additional execution methods for Required Transactions. See discussion below under §§ 37.9(b)(1) and (b)(4) – Execution Methods for Required Transactions in the preamble.

[285] See discussion below under §§ 37.9(b)(1) and (b)(4) – Execution Methods for Required Transactions in the preamble. As noted above in the registration section, a SEF is not required to offer indicative quotes.

[286] Id.

[287] The Commission is renumbering proposed § 37.9(a)(1)(ii)(A) to § 37.9(a)(3). The Commission notes that after the RFQ responses and resting bids or offers on the Order Book are communicated to the RFQ requester, the RFQ requester may make a counter request or order as long as it is submitted to 3 market participants, whether it be to the same 3 market participants as the original RFQ request, 3 different market participants, or some combination of both.

to three market participants to buy a US $1 million notional 10-year fixed-to-floating US$ LIBOR interest rate swap. Any firm offer resting on the SEF's Order Book for a 10-year fixed-to-floating US$ LIBOR interest rate swap must be transmitted to the RFQ requester at the same time that the first responsive offer is received by the RFQ requester. The SEF must provide the RFQ requester with the ability to lift the firm offers and execute against any of the responsive orders. The final rule requires that SEFs communicate any resting bid or offer pertaining to the same instrument back to the RFQ requester, while the requester retains the discretion to decide whether to execute against the resting bids or offers or responsive orders.

Similar to the three market participant requirement, the Commission believes that the communication requirement promotes pre-trade price transparency and the trading of swaps on SEFs, as the RFQ requester will have the ability to access competitive quotes and quote providers will be able to have their quotes viewed by the RFQ requester. The Commission also clarifies that the resting bids and offers being communicated are not required to include indicative prices, to the extent that indicative prices are facilitated by the Order Book, and that SEFs are not required to inform the providers of the resting bids and offers on the Order Book of the RFQs.

(iii) RFQ Disclosure Issues

The Commission is clarifying that SEFs are not required to disclose responses to RFQs to all market participants. While the Commission understands that the RFQ functionality offered by some DCMs disseminates responses to RFQs to all market participants, it also notes that the less restrictive disclosure requirement for SEFs reflects the more flexible statutory provisions for SEFs as compared to DCMs. As noted in the

SEF NPRM, a market participant may access fewer market participants than the entire market in certain situations.[288] In response to FSR's and Tradeweb's comments about the identity of the RFQ requester, the Commission clarifies that it is not imposing a specific requirement that the identity of the RFQ requester be disclosed or anonymous. The Commission is also not providing a specific requirement regarding the publishing of the "request" for a quote and notes that SEFs must comply with all reporting obligations as required in the Act and Commission's regulations. Finally, as noted in the SEF NPRM, acceptable RFQ Systems must permit RFQ requesters the option to make an RFQ visible to the entire market.[289]

(iv) Other RFQ Issues

As noted in the SEF NPRM, an acceptable RFQ System may allow for a transaction to be consummated if the original request to five potential counterparties receives fewer than five responses.[290] Although the Commission received no comment letters on this issue, some commenters in meetings asked the Commission to clarify the amount of time required to elapse before the RFQ requester can execute against the responsive quotes since fewer than five responses may be received. As such, the Commission is modifying the RFQ System definition in final § 37.9(a)(3) to state that a SEF must ensure that its trading protocols provide each of its market participants with equal priority in receiving requests for quotes and in transmitting and displaying for execution responsive orders. The SEF does not need to establish a minimum latency or

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[288] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1220 (stating that market participants may desire to interact with a limited number of market participants (i.e., fewer than the entire market) and are permitted to do so under the proposal).

[289] Id.

[290] Id.

specific period of time for the transmission of responsive orders, provided that the SEF's rulebook and prohibition on transmission and display priorities are appropriately designed to prevent market participants from seeking to avoid the three market participant requirement. A SEF's RFQ System and rulebook must account for this prohibition.

(c) § 37.9(a)(1)(iii) – Voice-Based System

Proposed § 37.9(a)(1)(iii) defined Voice-Based System as a trading system or platform in which a market participant executes or trades a Permitted Transaction using a telephonic line or other voice-based service.

(1) Commission Determination

The Commission did not receive any comments on the definition of Voice-Based System. However, the Commission is deleting the definition of Voice-Based System in proposed § 37.9(a)(1)(iii) given its decision below to allow SEFs to provide any execution method for Permitted Transactions.

(d) §§ 37.9(b)(1) and (b)(4) – Execution Methods for Required Transactions

Proposed § 37.9(b)(1) stated that Required Transactions may be executed on an Order Book or an RFQ System. As noted in the SEF NPRM, a SEF must offer the minimum trading functionality in proposed § 37.9(b)(2) (i.e., a centralized electronic screen with the ability to post both firm and indicative quotes visible to all market participants).[291] Therefore, the SEF NPRM provided that Required Transactions must be executed through the SEF's minimum trading functionality, Order Book that meets the minimum trading functionality, or RFQ System that operates in conjunction with the

[291] Id. at 1219-20.

minimum trading functionality.[292] The SEF NPRM made it clear that for Required Transactions, pre-trade transparency must be met.[293] Additionally, proposed § 37.9(b)(4) stated that the Commission may, in its discretion, require a SEF to offer a different trading method for a particular swap.

For Required Transactions, the SEF NPRM did not provide for a specific execution method incorporating voice. The proposal stated that trading systems or platforms facilitating the execution of Required Transactions via voice exclusively are not multiple participant to multiple participant and do not provide for pre-trade price transparency.[294] However, the SEF NPRM noted that, while not acceptable as the sole method of execution for Required Transactions, voice would be appropriate under certain circumstances such as for a market participant to communicate an order to a SEF's employee or for a SEF's employee to assist a market participant in executing a trade.[295] The SEF NPRM stated that the core principles and the Commission's regulations would fully apply to such communications, including, but not limited to, transparency, audit trail, impartial access, and standards for RFQs.[296]

Although the SEF NPRM did not provide for a specific execution method incorporating voice for Required Transactions, it did contemplate the possibility of certain functionalities that operate in conjunction with the SEF's minimum trading functionality.[297] In this regard, the SEF NPRM stated that, in addition to the SEF's

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[292] Id.

[293] Id. at 1220.

[294] Id. at 1221.

[295] Id.

[296] Id.

[297] Id. at 1220.

minimum trading functionality, a SEF may offer other functionalities that provide multiple participants with the ability to access multiple participants, but not necessarily the entire market, if the market participant so chooses.[298] The SEF NPRM noted that certain defined RFQ Systems or other systems that meet the SEF definition and comply with the core principles applicable to SEFs may qualify.[299]

(1) Summary of Comments

(i) Comments on Execution Methods for Required Transactions

Some commenters supported the use of order books for Required Transactions.[300] For example, Mallers et al. contended that a central order book market structure for all Required Transactions provides the most accurate valuation of the market, reduces systemic risks, and results in better prices.[301] Other commenters supported the use of order book structures and RFQ models for Required Transactions.[302] SDMA, for example, stated that all cleared swaps should be executed through a central limit order book or an RFQ System.[303]

Nodal recommended that the Commission explicitly include blind auctions as an acceptable method of execution for Required Transactions.[304] Nodal commented[305] that

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[298] Id.

[299] Id.

[300] Mallers et al. Comment Letter at 3 (Mar. 21, 2011); Better Markets Comment Letter at 5-6 (Mar. 8, 2011); AFR Comment Letter at 4 (Mar. 8, 2011). Similarly, SDMA supports the sole use of order books for certain products. SDMA Comment Letter at 2 (Apr. 30, 2013).

[301] Mallers et al. Comment Letter at 3 (Mar. 21, 2011).

[302] Tradeweb Comment Letter at 4 (Jun. 3, 2011); SDMA Comment Letter at 2 (Mar. 8, 2011); Deutsche Comment Letter at 3 (Mar. 8, 2011); MFA Comment Letter at 5-6 (Mar. 8, 2011); MetLife Comment Letter at 2 (Mar. 8, 2011); Barclays Comment Letter at 4 (Mar. 8, 2011); Bloomberg Comment Letter at 2 (Mar. 8, 2011); BlackRock Comment Letter at 4-5 (Mar. 8, 2011).

[303] SDMA Comment Letter at 2 (Mar. 8, 2011).

[304] Nodal Comment Letter at 3 (Mar. 8, 2011).

[305] Id. at 2-3; Nodal Comment Letter at 3 (Jun. 3, 2011).

pre-trade transparency for Required Transactions should not apply to blind auctions.[306] Nodal articulated its view that the twin goals of pre-trade transparency and promoting on-exchange trading of swaps on SEFs should be balanced against each other, instead of being read in conjunction with one another.[307]

(ii) Comments on "Through Any Means of Interstate Commerce" Language in the SEF Definition

Given the phrase "through any means of interstate commerce" in the CEA section 1a(50) SEF definition, many commenters supported the use of multiple methods of execution, such as voice, for Required Transactions on a SEF.[308] JP Morgan, for example, stated that the SEF NPRM assumes that SEFs will always be electronic platforms, which it contended, appears to directly contradict the phrase "through any means of interstate commerce" in the SEF definition.[309] According to WMBAA, the phrase "through any means of interstate commerce" in the SEF definition supports multiple methods of execution for Required Transactions on a SEF, including a combination of voice and electronic systems.[310] In this regard, WMBAA stated that the Commission should allow any execution method for Required Transactions as long as it

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[306] See discussion above under § 37.3 – Requirements for Registration in the preamble for a description of Nodal's blind auction.

[307] Nodal Comment Letter at 2 (Mar. 8, 2011).

[308] Representative Scott Garrett Comment Letter at 1 (Feb. 27, 2013); WMBAA Comment Letter at 2-3 (Jul. 18, 2011); WMBAA Comment Letter at 6-8 (Jun. 3, 2011); Rosen et al. Comment Letter at 15 (Apr. 5, 2011); JP Morgan Comment Letter at 6 (Mar. 8, 2011); WMBAA Comment Letter at 4-6 (Mar. 8, 2011); ICAP Comment Letter at 3, 4-5 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 4-5 (Mar. 8, 2011); CME Comment Letter at 7-8 (Mar. 8, 2011).

[309] JP Morgan Comment Letter at 6 (Mar. 8, 2011).

[310] WMBAA Comment Letter at 2 (Jul. 18, 2011).

meets the multiple participant to multiple participant requirement in the SEF definition and the other statutory requirements for SEFs.[311]

Furthermore, some members of the industry requested that the Commission clarify in the final rules whether "work-up" sessions would be considered an acceptable method of execution for Required Transactions.[312] GFI explained one example of a work-up session where, after a trade is executed on an order book, one of the counterparties to the trade may wish to buy or sell additional quantities of the same instrument at the previously executed price.[313] In this case, the parties initiate a work-up session to execute such additional quantity.[314] After the initial counterparty exercises its right of first refusal, other market participants may also join in the trade at the previously executed price.[315]

(iii) Comments on Liquidity-Based Execution Mandates

Several commenters stated that the Dodd-Frank Act does not require certain methods of trading, such as an order book, based upon the amount of trading activity in a particular instrument.[316] MarketAxess contended that nothing in the Dodd-Frank Act supports the requirement in proposed § 37.9(b)(4) that methods of execution on a SEF should be based upon characteristics of a particular swap.[317] MarketAxess stated that

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[311] WMBAA Comment Letter at 5 (Mar. 8, 2011).

[312] Meetings with ICAP dated Mar. 21, 2012, Mar. 9, 2012, Feb. 16, 2012, Feb. 14, 2012; Meetings with GFI dated Mar. 14, 2012, Feb. 16, 2012; Meeting with WMBAA dated Feb. 16, 2012; ICAP Comment Letter at 4 (Mar. 8, 2011).

[313] Meetings with GFI dated Mar. 14, 2012, Feb. 16, 2012.

[314] Id.

[315] Id.

[316] Rosen et al. Comment Letter at 10 (Apr. 5, 2011); Barclays Comment Letter at 11 (Mar. 8, 2011); ISDA/SFMA Comment Letter at 5 (Mar. 8, 2011); Tradeweb Comment Letter at 6 (Mar. 8, 2011); MarketAxess Comment Letter at 33 (Mar. 8, 2011).

[317] MarketAxess Comment Letter at 33 (Mar. 8, 2011).

such a requirement would create uncertainty regarding a SEF's operational structure[318] and, according to Tradeweb, would likely decrease the trading activity and liquidity of those swaps subject to the requirement.[319] On the other hand, AFR contended that mandatorily cleared swaps meeting a certain level of trading activity should only be traded through order book systems.[320]

(2) Commission Determination

(i) Execution Methods for Required Transactions

The Commission is revising proposed § 37.9(b)(1) as final § 37.9(a)(2) to clarify that each Required Transaction that is not a block trade as defined in § 43.2 of the Commission's regulations shall be executed on a SEF in accordance with one of the following methods of execution: (1) an Order Book as defined in § 37.3(a)(3) or (2) an RFQ System, as defined in § 37.9(a)(3), that operates in conjunction with an Order Book.[321] As explained in this final rulemaking, the Commission believes that these execution methods are consistent with the SEF definition and promote the goals provided in section 733 of the Dodd-Frank Act. The Commission notes, however, that a SEF may petition the Commission under § 13.2 of the Commission's regulations to amend § 37.9(a)(2) to include additional execution methods.[322] This ability of SEFs to petition the Commission replaces similar provisions in the SEF NPRM that were included in the

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[318] Id.

[319] Tradeweb Comment Letter at 6 (Mar. 8, 2011).

[320] AFR Comment Letter at 5-6 (Mar. 8, 2011).

[321] The Commission is renumbering proposed § 37.9(b)(1) to § 37.9(a)(2).

[322] See 17 CFR 13.2 for further details. This will allow the Commission to consider if a broader model for executing on SEFs, consistent with the suggestion in Commissioner Sommers' dissent, would be appropriate on a case-by-case basis, in conformance with the CEA and the Commission's regulations. Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1259.

Order Book and RFQ System definitions and provides SEFs with additional flexibility as existing execution methods evolve or new methods are developed.[323]

In keeping with the statutory instruction that the Dodd-Frank Act goal of SEFs is to both "promote the trading of swaps on swap execution facilities *and* to promote pre-trade price transparency in the swaps market"[324] (emphasis added), the Commission is reaffirming its view articulated in the SEF NPRM that these goals can be achieved for Required Transactions by providing for the execution of such transactions on trading systems or platforms that allow market participants to post bids and offers or accept bids and offers that are transparent to the entire market.[325] Promoting trading on a SEF should not result in eliminating the need to provide some degree of pre-trade transparency. Therefore, even when recognizing the importance of promoting the trading of swaps on SEFs, some degree of pre-trade transparency must be met for Required Transactions.[326] As a result, the Commission is declining to accept Nodal's recommendation to explicitly include blind auctions as an acceptable method of execution for Required Transactions under this rulemaking.[327]

(ii) "Through Any Means of Interstate Commerce" Language in the SEF Definition

In consideration of the comments regarding possible limitations on how the Commission interprets the phrase "through any means of interstate commerce" in the SEF definition, the Commission is revising the final rule text to clarify that in providing

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[323] See proposed § 37.9(a)(1)(i)(D) and § 37.9(a)(1)(ii)(C).

[324] CEA section 5h(e); 7 U.S.C. 7b-3(e) (emphasis added).

[325] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1220.

[326] The Commission notes below that pre-trade transparency can help promote the trading of swaps on SEFs. See the Introduction section of the Cost Benefit Considerations section for further details.

[327] The Commission further notes that this determination does not accept Nodal's assertion that "this type of blind auction trading platform is permissible on DCMs." See Nodal Comment Letter at 3 (Mar. 8, 2011).

either one of the execution methods for Required Transactions in § 37.9(a)(2)(i)(A) or (B) of this final rulemaking (i.e., Order Book or RFQ System that operates in conjunction with an Order Book), a SEF may for purposes of execution and communication use "any means of interstate commerce," including, but not limited to, the mail, internet, email, and telephone, provided that the chosen execution method satisfies the requirements provided in § 37.3(a)(3) for Order Books or in § 37.9(a)(3) for Request for Quote Systems.[328] With this use of the phrase "any means of interstate commerce," the Commission is not limiting the means of execution or communication that a SEF may utilize in implementing the required execution methods for Required Transactions in § 37.9(a)(2)(i)(A) or (B), provided that the chosen execution method satisfies the requirements provided in § 37.3(a)(3) for Order Books or in § 37.9(a)(3) for Request for Quote Systems. In this regard, the Commission notes that as the swaps market evolves, SEFs may develop new means of execution or communication for use in implementing the required execution methods. Although the Commission notes that its regulations are technology neutral given the "any means of interstate commerce" language, it also emphasizes that, regardless of the means of interstate commerce utilized, a SEF must

[328] The Commission interprets the phrase "through any means of interstate commerce" in CEA § 1a(50) to allow a SEF to utilize a variety of means of execution or communication, including, but not limited to, telephones, internet communications, and electronic transmissions. Overstreet v. North Shore Corp., 318 U.S. 125, 129-30 (1943) (in general, "instrument" of interstate commerce is to be interpreted broadly); United States v. Barlow, 568 F.3d 215, 220 (5th Cir. 2009) ("It is beyond debate that internet and email are facilities or means of interstate commerce."); United States v. Weathers, 169 F.3d 336, 341 (6th Cir. 2000) ("It is generally well established that telephones, even when used intrastate, constitute instrumentalities of interstate commerce."); SEC v. Solucorp Indus., 274 F.Supp.2d 379, 419 (S.D.N.Y. 2003) (defendants "used the means and instrumentalities of interstate commerce, including, among other things, the mails and wires, including the Internet, news wires and telephone lines" to commit securities fraud). While the Commission's interpretation of "any means of interstate commerce" allows a SEF to utilize a wide variety of execution or communication means, all SEFs, regardless of the execution or communication mean they employ, must comply with all of the substantive SEF requirements, including, but not limited to, requirements that pertain to execution. For example, a SEF using the telephone to execute Required Transactions must satisfy the execution requirements set forth in § 37.9(a)(2)(i)(A) or (B).

comply with the Act and the Commission's regulations, including the § 37.9 execution method, impartial access, audit trail, and surveillance requirements. Furthermore, all transactions on the SEF must comply with the SEF's rules.

For example, to meet the RFQ System definition for Required Transactions, a SEF must satisfy all of the following functions, and in doing so, all or some of these functions may be performed over the telephone: (1) receiving a request from a market participant to execute a trade, (2) submitting that request to at least 3 market participants in accordance with the RFQ System definition, (3) communicating the RFQ responses and resting bids or offers on the Order Book to the RFQ requester, and (4) executing the transaction. The Commission notes that regardless of the means of interstate commerce utilized, including the telephone, the SEF must submit the transaction into its system or platform so that the SEF is able to comply with the Act and the Commission's regulations, including audit trail, clearing, and reporting requirements. Given the different means of interstate commerce that a SEF may utilize for purposes of communication and execution in implementing the execution methods for Required Transactions in § 37.9(a)(2)(i)(A) or (B), the Commission notes that it must evaluate each system or platform to determine whether it meets the requirements of § 37.9(a)(2).

The Commission, in order to provide further clarity regarding the means of interstate commerce that a SEF may utilize in order to satisfy the execution methods for Required Transactions in § 37.9(a)(2), is providing the following example, which the Commission intends to be instructive, though not comprehensive. The Commission emphasizes that the following example should not be construed as bright-line rules:

- RFQ System example – a market participant calls an employee of the SEF with a request for a quote to buy or sell a swap subject to the trade execution requirement in CEA section 2(h)(8). The SEF employee disseminates the request for a quote to no less than three market participants on the SEF (directly or through other SEF employees or both) by telephone, email, instant messaging, squawk box, some other method of communication, or some combination thereof. Based on the responses of these market participants, the SEF employee communicates the responsive bids or offers and the resting bids or offers on the SEF's Order Book[329] to the RFQ requester by one of the above referenced methods of communication. The RFQ requester communicates acceptance of one of the bids or offers to the SEF employee by one of the above referenced methods of communication. The SEF employee informs those two market participants by one of the above referenced methods of communication that the swap transaction is executed. The SEF employee enters the transaction into the SEF's system or platform so that the SEF is able to comply with the Act and the Commission's regulations, including audit trail, clearing, and reporting requirements. The Commission views this example as demonstrating acceptable uses of different means of interstate commerce while meeting the RFQ System method of execution in § 37.9(a)(2).

In response to commenters, the Commission will generally allow work-up sessions if such trading protocols are utilized after a transaction is executed on the SEF's

[329] See final § 37.9(a)(3) and the preamble for details regarding the communication of the resting bids or offers on the Order Book to the RFQ requester.

Order Book or RFQ System.[330] The Commission, in order to provide further clarity regarding work-up sessions, is providing the following two examples, which the Commission intends to be instructive, though not comprehensive. The Commission notes that the following examples are two types of work-up session that may be acceptable:

- After two counterparties execute a transaction on a SEF's Order Book, the SEF may establish a short time period for a work-up session. The SEF must open up the work-up session to all market participants so that they may trade an additional quantity of the same instrument at the same price previously executed by the initial counterparties. In addition, any resting bids or offers on the SEF's Order Book equal to or better than the work-up session price must be included in the work-up session.[331] The SEF may provide the initial counterparties execution priority in the work-up session.
- After two counterparties execute a transaction on a SEF's RFQ System, the SEF may establish a short time period for a work-up session. The SEF must open up the work-up session to all market participants so that they may trade an additional quantity of the same instrument at the same price previously executed by the

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[330] The Commission notes that a work-up transaction does not qualify as a block trade even if an individual market participant's transactions as part of the work-up transaction has a notional or principal amount at or above the appropriate minimum block size applicable to such swap. The Commission believes that the concepts of work-up transactions and block trades are mutually exclusive. Block trades are executed pursuant to a SEF's rules, but negotiated and executed off of the SEF's trading platform. A work-up transaction is conducted on a SEF's trading platform. See block trade definition in § 43.2 of the Commission's regulations; see also Rules Prohibiting the Aggregation of Orders To Satisfy Minimum Block Sizes or Cap Size Requirements, and Establishing Eligibility Requirements for Parties to Block Trades, 77 FR 38229 (proposed Jun. 27, 2012). Accordingly, each individual transaction that is part of the work-up transaction must be reported as it occurs pursuant to the SEF's reporting obligations.

[331] These resting bids or offers would be included at the work-up session price. The Commission notes that "equal to or better than the work-up session price" means any resting bids that are equal to or greater than the work-up price or any resting offers that are equal to or less than the work-up price.

initial counterparties. In addition, any resting bids or offers on the SEF's Order Book equal to or better than the work-up session price must be included in the work-up session.[332] The SEF may provide the initial counterparties execution priority in the work-up session.

The SEF must have rules governing the operation of any work-up mechanism, including the length of the session, any priorities accorded the counterparties to the transaction that triggered the work-up session, and the handling of any orders submitted during the session that are not executed. A SEF must also have systems or procedures in place to ensure that a work-up session is accessible by, and work-up session information (e.g., the work-up session's trade price and ongoing volume) is available to, all market participants. The Commission believes that, if properly conducted, work-up sessions may enhance price discovery and foster liquidity.

The Commission believes that a work-up session would be a trading protocol and, thus, constitute a rule under § 40.1 of the Commission's regulations. Any such rule or amendment thereto must be codified and included in a SEF's rulebook in accordance with the rule review or approval procedures of part 40 of the Commission's regulations or during the SEF application process. Additionally, all transactions executed through a work-up session must comply with the SEF's rules. The Commission staff will provide informal guidance to SEF applicants on whether such work-up sessions are in compliance with the Act and the Commission's regulations.

(iii) Liquidity-Based Execution Mandates

[332] Id.

The Commission is deleting proposed § 37.9(b)(4). Given the incipience of the regulated swaps market, at this time, the Commission is not imposing a requirement for specific methods of execution for Required Transactions based upon the amount of trading activity in such transactions.

(e) § 37.9(b)(3) – Time Delay Requirement

Proposed § 37.9(b)(3) stated that SEFs must require that traders who have the ability to execute against a customer's order or to execute two customers against each other be subject to a 15-second timing delay between the entry of the two orders, such that one side of the potential transaction is disclosed and made available to other market participants before the second side of the potential transaction (whether for the trader's own account or for a second customer) is submitted for execution. The SEF NPRM stated that this requirement will provide other market participants the opportunity to join in the trade.[333]

(1) Summary of Comments

SDMA and Mallers et al. supported the proposed 15-second delay requirement as necessary to increase price transparency and market integrity.[334] Mallers et al. stated that the 15-second rule provides a meaningful opportunity for other SEF participants to execute against the individual sides of the cross transaction, and that such crossing delays have been successfully implemented in the futures markets.[335] However, several commenters objected to the 15-second delay requirement.[336] Some commenters stated

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[333] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1220.

[334] Mallers et al. Comment Letter at 5 (Mar. 21, 2011); SDMA Comment Letter at 4 (Mar. 8, 2011).

[335] Mallers et al. Comment Letter at 5 (Mar. 21, 2011).

[336] WMBAA Comment Letter at 3 (Jul. 18, 2011); FHLB Comment Letter at 13 (Jun. 3, 2011); WMBAA Comment Letter at 9 (Jun. 3, 2011); Rosen et al. Comment Letter at 15-16 (Apr. 5, 2011); BlackRock

that there is no statutory authority for the timing delay requirement.[337] Commenters also stated that the timing delay will increase prices and expose traders to market risk.[338] Freddie Mac, for example, stated that liquidity providers may increase prices to account for anticipated market movements.[339] Some commenters also noted that the timing delay requirement may lead to unwillingness on the part of dealers to provide liquidity because they will not know whether they will ultimately serve as their customers' principal counterparty or merely as their executing agent.[340]

ABC/CIEBA commented that the proposed rule is unclear as to what limitations, if any, apply to pre-execution communications.[341] ABC/CIEBA recommended that the Commission revise the proposed rule to permit pre-execution communications between counterparties as long as parties comply with the requirement to execute the trade on the SEF.[342]

Comment Letter at 6 (Mar. 8, 2011); Global FX Comment Letter at 3-4 (Mar. 8, 2011); JP Morgan Comment Letter at 7 (Mar. 8, 2011); Evolution Comment Letter at 6 (Mar. 8, 2011); WMBAA Comment Letter at 7 (Mar. 8, 2011); SIFMA AMG Comment Letter at 7 (Mar. 8, 2011); TruMarx Comment Letter at 7 (Mar. 8, 2011); Deutsche Comment Letter at 5 (Mar. 8, 2011); FCC Comment Letter at 2 (Mar. 8, 2011); Phoenix Comment Letter at 2-3 (Mar. 7, 2011).

[337] WMBAA Comment Letter at 3 (Jul. 18, 2011); WMBAA Comment Letter at 9 (Jun. 3, 2011); WMBAA Comment Letter at 7 (Mar. 8, 2011); SIFMA AMG Comment Letter at 8 (Mar. 8, 2011); Deutsche Comment Letter at 5 (Mar. 8, 2011); MFA Comment Letter at 8 (Mar. 8, 2011).

[338] FHLB Comment Letter at 13 (Jun. 3, 2011); BlackRock Comment Letter at 6 (Mar. 8, 2011); WMBAA Comment Letter at 7-8 (Mar. 8, 2011); SIFMA AMG Comment Letter at 7 (Mar. 8, 2011); FCC Comment Letter at 2 (Mar. 8, 2011).

[339] Freddie Mac Comment Letter at 3 (Mar. 8, 2011).

[340] WMBAA Comment Letter at 9 (Jun. 3, 2011); BlackRock Comment Letter at 6 (Mar. 8, 2011); MFA Comment Letter at 9 (Mar. 8, 2011); Phoenix Comment Letter at 3 (Mar. 7, 2011).

[341] ABC/CIEBA Comment Letter at 9 (Mar. 8, 2011).

[342] Id. at 10.

Several commenters recommended that the Commission provide flexibility with respect to the time period of the timing delay.[343] Goldman recommended that the Commission, in consultation with market participants and SEFs, set the delay at 1-3 seconds depending on the complexity of the product.[344] FXall stated that each SEF should be able to decide upon the appropriate delay, taking into account the particular characteristics of that market.[345]

Several commenters requested clarification that the 15-second delay requirement only applies to SEFs that operate an Order Book and not an RFQ System.[346] In this regard, SIFMA AMG commented that the timing delay should not apply to an RFQ System because firm quotes transmitted in response to an RFQ would already be exposed to the market.[347] However, Better Markets contended that the requirement should apply to responsive orders in RFQ systems.[348]

Finally, some commenters requested that the Commission clarify the term "trader" in the proposed rule.[349] WMBAA stated that it is not clear whether the term "trader" refers to a counterparty, broker, or another entity.[350] SIFMA AMG noted that

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[343] Reuters Comment Letter at 5 (Dec. 12, 2011); Goldman Comment Letter at 3 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 6 (Mar. 8, 2011); FXall Comment Letter at 10 (Mar. 8, 2011); MFA Comment Letter at 8-9 (Mar. 8, 2011).

[344] Goldman Comment Letter at 3 (Mar. 8, 2011).

[345] FXall Comment Letter at 10 (Mar. 8, 2011).

[346] Reuters Comment Letter at 5 (Dec. 12, 2011); Rosen et al. Comment Letter at 15-16 (Apr. 5, 2011); Goldman Comment Letter at 3 (Mar. 8, 2011); Global FX Comment Letter at 3-4 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 6 (Mar. 8, 2011); Barclays Comment Letter at 9 (Mar. 8, 2011); FSR Comment Letter at 7 (Mar. 8, 2011).

[347] SIFMA AMG Comment Letter at 7 (Mar. 8, 2011).

[348] Better Markets Comment Letter at 9 (Mar. 8, 2011).

[349] WMBAA Comment Letter at 7 (Mar. 8, 2011); SIFMA AMG Comment Letter at 8 (Mar. 8, 2011); FSR Comment Letter at 6-7 (Mar. 8, 2011).

[350] WMBAA Comment Letter at 7 (Mar. 8, 2011).

the timing delay should not apply to asset managers executing trades on behalf of their clients.[351]

(2) Commission Determination

The Commission is adopting the time delay requirement for Required Transactions in proposed § 37.9(b)(3) as final § 37.9(b)(1), subject to the modifications described below.[352] The Commission clarifies that the purpose of the time delay requirement is to ensure a minimum level of pre-trade price transparency for Required Transactions on a SEF's Order Book by allowing other market participants the opportunity to join or participate in a trade where a broker or dealer engages in some form of pre-arrangement or pre-negotiation of a transaction and then attempts, through the SEF's Order Book, to either internalize the order by executing opposite a customer or cross two customer orders.[353] In addition to ensuring a minimum level of pre-trade price transparency, the Commission believes that the time delay requirement will incentivize competition between market participants.[354] The Commission is revising proposed § 37.9(b)(3) to clarify the purpose of the time delay requirement as described above.

In response to ABC/CEIBA's comment about any limitations on pre-execution communications, the Commission notes that a SEF that allows pre-execution communications must adopt rules regarding such communications that have been

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[351] SIFMA AMG Comment Letter at 8 (Mar. 8, 2011).

[352] The Commission is renumbering proposed § 37.9(b)(3) to § 37.9(b)(1).

[353] The Commission clarifies that the exposure of "orders" subject to the 15 second time delay into the Order Book in final § 37.9(b)(1) means exposure of the price, size, and other terms of the orders.

[354] The Commission also notes that the time delay requirement is similar to certain timing delays for cross trades applicable to futures transactions executed on DCMs where one side of a potential transaction (i.e., price, size, and other terms) is exposed to the market for a certain period of time before the second side of the potential transaction is submitted for execution. See, e.g., NYMEX rule 533, which provides for a 5-second delay for futures and a 15-second delay for options, available at http://www.cmegroup.com/rulebook/NYMEX/1/5.pdf.

certified to or approved by the Commission.[355] The Commission also notes that orders that result from pre-execution communications would be subject to the time delay requirement in the final rule text. The Commission notes that pre-execution communications are communications between market participants for the purpose of discerning interest in the execution of a transaction prior to the exposure of the market participants' orders (i.e., price, size, and other terms) to the market. Any communication that involves discussion of the size, side of market, or price of an order, or a potentially forthcoming order, constitutes a pre-execution communication.

The Commission acknowledges commenters' concerns that the time delay requirement should take into account a product's characteristics. Therefore, the Commission believes that the 15-second time delay requirement should serve as a default time delay. The Commission is revising the rule to allow SEFs to adjust the time period of the delay, based upon liquidity or other product-specific considerations as stated in final § 37.9(b)(2). The Commission notes that such adjustments and accompanying justifications, as well as any establishment of a 15-second time delay requirement at a SEF, must be submitted for the Commission's review pursuant to the procedures described in part 40 of the Commission's regulations.

The Commission is clarifying that the 15-second time delay requirement is not applicable to trades that are executed through an RFQ System. As noted above, the purpose of the time delay requirement is to ensure a minimum level of pre-trade price transparency for Required Transactions on a SEF's Order Book. The Commission notes that an RFQ System already provides pre-trade price transparency to the RFQ requester

[355] See, e.g., CME Rule 539.C Pre-Execution Communications Regarding Globex Trades, available at http://www.cmegroup.com/rulebook/CME/I/5/39.html (setting forth rules regarding pre-execution communications in the DCM context).

and that a dealer attempting to cross or internalize trades through an RFQ System would be subject to such pre-trade price transparency. As such, the Commission is revising the rule text to clarify that the 15-second time delay requirement only applies to a SEF's Order Book.

Finally, the Commission is replacing the term "traders" in proposed § 37.9(b)(3) with the phrase "brokers or dealers." The Commission intended the provision to apply only to brokers or dealers attempting to internalize or cross trades through a SEF's Order Book and acknowledges that the proposal was unclear with respect to the meaning of the term "traders."[356] In response to SIFMA AMG's concern, the Commission does not have sufficient information at this time to make a determination whether asset managers executing trades on behalf of their clients would be subject to the time delay requirement. The Commission staff will work with SEFs to determine if the time delay requirement applies to asset managers or other market participants.

(f) § 37.9(c) – Execution Methods for Permitted Transactions

Proposed § 37.9(c)(1) provided that Permitted Transactions may be executed by an Order Book, RFQ System, a Voice-Based System, or any such other system for trading as may be permitted by the Commission. In addition, proposed § 37.9(c)(2) stated that a registered SEF may submit a request to the Commission to offer trading services to facilitate Permitted Transactions, and that when doing so, the SEF must certify its compliance with § 37.11 (Identification of non-cleared swaps or swaps not made available to trade). As noted in the SEF NPRM, market participants would not be

[356] For example, a futures commission merchant or other market participant acting in the role of a broker who has the ability to execute against its customer's order or to execute two of its customers' orders against each other would be subject to the time delay requirement.

required to utilize the minimum trading functionality in § 37.9(b) to execute Permitted Transactions.[357]

(1) Summary of Comments

SIFMA AMG stated that the Commission should not limit the execution modalities available to market participants who execute Permitted Transactions on a SEF.[358] SIFMA AMG also stated that no statutory basis exists for regulatory execution requirements for Permitted Transactions.[359] Additionally, several commenters stated that the Commission should not prescribe execution methods for swaps executed off a SEF.[360]

(2) Commission Determination

The Commission is revising proposed § 37.9(c)(1) to state that a SEF may offer any method of execution for each Permitted Transaction.[361] The Commission agrees that it should not limit the execution methods that are available to market participants or require market participants to utilize certain execution methods for Permitted Transactions, which are not required to be executed on a SEF. The Commission clarifies, however, that, in accordance with the minimum trading functionality requirement in final § 37.3(a)(2), a SEF must offer an Order Book for Permitted Transactions. The Commission further clarifies that a market participant has the option to utilize the Order Book or any other method of execution that a SEF provides for Permitted Transactions. Additionally, the Commission clarifies that this section only applies to Permitted

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[357] The SEF NPRM stated that pre-trade price transparency is not required for Permitted Transactions. Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1220.

[358] SIFMA AMG Comment Letter at 10 (Mar. 8, 2011).

[359] Id.

[360] Rosen et al. Comment Letter at 19-20 (Apr. 5, 2011); Deutsche Comment Letter at 6 (Mar. 8, 2011); FSR Comment Letter at 8 (Mar. 8, 2011); Global FX Comment Letter at 3 (Mar. 8, 2011); Barclays Comment Letter at 10 (Mar. 8, 2011); ABC/CIEBA Comment Letter at 7 (Mar. 8, 2011).

[361] The Commission is renumbering proposed § 37.9(c)(1) to § 37.9(c)(2).

Transactions listed or traded on a SEF, and that this section does not apply to transactions not listed or traded on a SEF.[362] Finally, the Commission is deleting proposed § 37.9(c)(2) given the deletion to proposed § 37.11 as described below.

(g) Future Review

Consistent with the Commission's practice of reviewing and monitoring its regulatory programs, the Commission directs the Commission staff to conduct a general review of SEFs' experience with the execution methods prescribed in Commission regulations 37.3(a)(2) (minimum trading functionality), 37.3(a)(3) (Order Book), and 37.9 (execution methods for Required and Permitted Transactions and time delay requirement for Required Transactions). If appropriate, the review should include any Commission staff recommendations regarding possible modifications to Commission regulations 37.3(a)(2), 37.3(a)(3), or 37.9 that are consistent with the Act (e.g., a recommendation to modify the minimum number of RFQ requestees required by the RFQ definition, including whether a trading protocol in which the minimum number of RFQ requestees differed by swap class or another category would be appropriate). The Commission staff's review should be completed within four years of the effective date of these final SEF regulations, within which time the Commission believes that staff will have gained sufficient experience and will have three years' worth of data with respect to the execution methods.

10. § 37.10 – Swaps Made Available for Trading

The Dodd-Frank Act added section 2(h)(8) of the CEA to require that transactions involving swaps subject to the clearing requirement must be executed either on a DCM or

[362] This section does not apply to those entities that do not have to register as a SEF. As noted above in the registration section, swap transactions that are not subject to the CEA section 2(h)(8) trade execution requirement would not have to be executed on a registered SEF.

SEF, unless no DCM or SEF makes the swap "available to trade" or the related transaction is subject to the clearing exception under section 2(h)(7) (i.e., the end-user exception).[363] In the SEF NPRM, the Commission proposed to require SEFs to conduct annual assessments and to submit reports to the Commission regarding whether it has made a swap available to trade.[364] In the DCM notice of proposed rulemaking ("NPRM"),[365] the Commission did not establish any obligation for DCMs under section 2(h)(8) of the Act. After reviewing the SEF NPRM comments regarding the proposed available to trade process, and in light of the fact that the DCM NPRM did not establish any obligation for DCMs under section 2(h)(8) of the CEA, the Commission determined to separately issue a further notice of proposed rulemaking to establish a process for a DCM or SEF to make a swap available to trade under section 2(h)(8) of the Act.[366] The Commission may implement the available to trade provision in a separate rulemaking.

11. § 37.11 – Identification of Non-Cleared Swaps or Swaps Not Made Available to Trade

Proposed § 37.11 required a SEF that chooses to offer swaps: (1) not subject to the clearing mandate under section 2(h) of the Act, (2) that are subject to the end-user exception from the clearing mandate under section 2(h)(7) of the Act, or (3) that have not been made available to trade pursuant to § 37.10 of the Commission's regulations to clearly identify to market participants that the particular swap is to be executed bilaterally

[363] CEA sections 2(h)(7) and 2(h)(8); 7 U.S.C. 2(h)(7) and 2(h)(8).

[364] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1241.

[365] Core Principles and Other Requirements for Designated Contract Markets, 75 FR 80572 (proposed Dec. 22, 2010).

[366] Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available To Trade, 76 FR 77728 (proposed Dec. 14, 2011).

between the parties pursuant to one of the applicable exemptions from execution and clearing.

(a) Summary of Comments

MarketAxess expressed concern that proposed § 37.11 could be read to require that all transactions described in the provision must only be executed bilaterally, and not on a SEF.[367] To address this concern, MarketAxess requested the Commission clarify that § 37.11 requires a SEF choosing to facilitate Permitted Transactions to identify to market participants why the particular swap is a Permitted Transaction (i.e., falls under one of the three categories described in the provision).[368]

(b) Commission Determination

The Commission believes that proposed § 37.11 is unnecessary and therefore is deleting it in its entirety. Market participants should have sufficient notice of the swaps subject to the clearing and trade execution requirements. Therefore, in conjunction with the definitions contained in part 37 as adopted, market participants will know which swaps are Required Transactions and which swaps are Permitted Transactions, and thus the execution methods deemed acceptable for each.

C. Regulations, Guidance, and Acceptable Practices for Compliance with the Core Principles

As noted above, this final part 37 rulemaking establishes the relevant regulations, guidance, and acceptable practices applicable to the 15 core principles that SEFs are required to comply with initially and on a continuing basis as part of the conditions of registration. The regulations applicable to the 15 core principles are set out in separate

[367] MarketAxess Comment Letter at 33-34 (Mar. 8, 2011).

[368] Id. at 34.

subparts B through P to part 37, which includes a codification within each subpart of the statutory language of the respective core principle. The guidance and acceptable practices are set out in appendix B to part 37.

1. Subpart B – Core Principle 1 (Compliance with Core Principles)

Core Principle 1 requires a SEF to comply with the core principles set forth in CEA section 5h(f) and any requirement that the Commission may impose by rule or regulation pursuant to CEA section 8a(5) as a condition of obtaining and maintaining registration as a SEF.[369] Additionally, Core Principle 1 provides a SEF with reasonable discretion in establishing the manner in which it complies with the core principles unless the Commission determines otherwise by rule or regulation.[370] In the SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 1 in proposed § 37.100, and adopts that rule as proposed.

2. Subpart C – Core Principle 2 (Compliance with Rules)

(a) § 37.200 – Core Principle 2 – Compliance with Rules

Core Principle 2 requires a SEF to establish and enforce compliance with its rules, including the terms and conditions of the swaps traded or processed on or through the SEF and any limitations on access to the SEF.[371] It also requires a SEF to establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules.[372] A SEF must also establish rules governing the operation of the facility, including rules specifying trading procedures

[369] CEA section 5h(f)(1)(A); 7 U.S.C. 7b-3(f)(1)(A).

[370] CEA section 5h(f)(1)(B); 7 U.S.C. 7b-3(f)(1)(B).

[371] CEA section 5h(f)(2)(A); 7 U.S.C. 7b-3(f)(2)(A).

[372] CEA section 5h(f)(2)(B); 7 U.S.C. 7b-3(f)(2)(B). This section also requires a SEF to provide market participants with impartial access to the market and to capture information that may be used in establishing whether rule violations have occurred.

to be used in entering and executing orders traded or posted on the facility, including block trades.[373] Finally, Core Principle 2 requires a SEF to provide by its rules that when a swap dealer or major swap participant enters into or facilitates a swap that is subject to the mandatory clearing requirement of section 2(h) of the Act, the swap dealer or major swap participant is responsible for complying with the mandatory trading requirement under section 2(h)(8) of the Act.[374] In the SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 2 in proposed § 37.200, and adopts that rule as proposed.

(1) Summary of Comments

Some commenters expressed general concerns regarding the proposed rules under Core Principle 2.[375] FXall and State Street believed that the proposed rules under Core Principle 2 would require a SEF to act as a de facto self-regulatory organization ("SRO") and impose burdens that would impede the growth of the swaps market.[376] These commenters also noted that the proposed requirements were too similar to the regulations applicable to DCMs, which would place SEFs at a disadvantage compared to DCMs given that SEFs will operate in a competitive environment while DCMs operate in a monopolistic environment.[377] ICE urged the Commission to limit its prescriptive rulemaking to issues that it believes require specific, binding rules.[378] In this regard,

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[373] CEA section 5h(f)(2)(C); 7 U.S.C. 7b-3(f)(2)(C).

[374] CEA section 5h(f)(2)(D); 7 U.S.C. 7b-3(f)(2)(D).

[375] FXall Comment Letter at 3-4, 11 (Mar. 8, 2011); State Street Comment Letter at 5-6 (Mar. 8, 2011); ICE Comment Letter at 2 (Mar. 8, 2011); WMBAA Comment Letter at 18 (Mar. 8, 2011).

[376] FXall Comment Letter at 3-4, 11 (Mar. 8, 2011); State Street Comment Letter at 5-6 (Mar. 8, 2011).

[377] Id.

[378] ICE Comment Letter at 2 (Mar. 8, 2011).

several commenters recommended that the Commission adopt greater flexibility in implementing Core Principle 2.[379]

Some commenters recommended limiting the scope of the proposed rules under Core Principle 2.[380] Specifically, WMBAA argued that SEFs may not be able to satisfy all of the requirements of the proposed rules given that SEFs cannot be held responsible for what happens on a competitor's platform.[381] Similarly, FXall believed that SEFs would not have the requisite market data to conduct meaningful compliance oversight.[382] SIFMA AMG believed that the Commission's vague use of the terms "members," "market participants," and "participants" could potentially subject dealers' customers, and thus asset managers and their clients, to "onerous" requirements of multiple SEFs.[383] Therefore, SIFMA AMG requested clarification that a SEF's rules would only regulate entities that actually execute transactions on the SEF.[384]

(2) Commission Determination

In response to comments by FXall and State Street about treating SEFs as SROs, the Commission notes that like DCMs, it views SEFs as SROs and amended the Commission's regulations to include them as SROs.[385] Treating a SEF as an SRO is

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[379] Reuters Comment Letter at 4 (Mar. 8, 2011); FXall Comment Letter at 3-4, 11 (Mar. 8, 2011); ICE Comment Letter at 2 (Mar. 8, 2011); State Street Comment Letter at 5-6 (Mar. 8, 2011).

[380] WMBAA Comment Letter at 18 (Mar. 8, 2011); FXall Comment Letter at 11 (Mar. 8, 2011); MarketAxess Comment Letter at 34 (Mar. 8, 2011); SIFMA AMG Comment Letter at 14-15 (Mar. 8, 2011).

[381] WMBAA Comment Letter at 18 (Mar. 8, 2011).

[382] FXall Comment Letter at 11 (Mar. 8, 2011).

[383] SIFMA AMG Comment Letter at 14-15 (Mar. 8, 2011).

[384] Id.

[385] See Adaptation of Regulations to Incorporate Swaps, 77 FR 66288 (Nov. 2, 2012). Section 1.3(ee) states that a self-regulatory organization "means a contract market (as defined in § 1.3(h)), a swap execution facility (as defined in § 1.3(rrrr)), or a registered futures association under section 17 of the Act." Id. at 66318.

consistent with a SEF's self-regulatory obligations pursuant to CEA section 5h(f). Therefore, where appropriate, the Commission is adopting surveillance, audit trail, investigation, enforcement, and other requirements for SEFs.

In response to commenters' concerns that the proposed requirements were similar to the regulations applicable to DCMs, the Commission believes that adopting similar requirements for both types of entities is warranted given the similar statutory self-regulatory obligations for both types of entities. Given that both DCMs and SEFs, regardless of whether they are new or existing entities, are required to fulfill similar self-regulatory functions, the Commission does not believe that this approach will adversely affect competition between DCMs and SEFs.

In response to commenters' requests for less prescriptive rules and greater flexibility in applying the rules, the Commission is moving various provisions of the proposed rules to guidance and eliminating other provisions, as discussed below. The provisions that are adopted as final rules reflect the Commission's opinion of what is required, at a minimum, for any SEF to comply with the core principles. SEFs may take any additional steps necessary, beyond the requirements of the rules, to satisfy statutory obligations.

In response to WMBAA's and FXall's comments regarding certain limitations faced by SEFs in terms of oversight, the Commission recognizes the limitations faced by SEFs with respect to position monitoring, cross-market surveillance, and rule enforcement and addresses them in the context of comments received below. In response to SIFMA AMG's comment about the ambiguous use of terms, the Commission clarifies that "market participant" when used with respect to a SEF means a person that directly or

indirectly effects transactions on the SEF. This includes persons with trading privileges on the SEF and persons whose trades are intermediated. The Commission also clarifies that "member" has the meaning set forth in CEA section 1a(34).[386]

(b) § 37.201 – Operation of Swap Execution Facility and Compliance with Rules

Proposed § 37.201(a) required a SEF to establish rules governing the operation of the SEF, including rules specifying trading procedures for entering and executing orders traded or posted on the SEF, including block trades.[387] Proposed § 37.201(b) further required a SEF to establish and impartially enforce compliance with its rules, including, but not limited to: (1) the terms and conditions of any swaps traded or processed on or through the SEF; (2) access to the SEF; (3) trade practice rules; (4) audit trail requirements; (5) disciplinary rules; and (6) mandatory clearing requirements.[388]

(1) Summary of Comments

MarketAxess recommended that the Commission withdraw proposed § 37.201(b)(6), which required a SEF to adopt and enforce mandatory clearing requirements, on the basis that clearing of a swap occurs outside of a SEF's main responsibility to facilitate the transaction.[389]

(2) Commission Determination

The Commission is adopting § 37.201 as proposed, subject to two modifications. To address the comment by MarketAxess, the Commission notes that proposed §

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[386] CEA section 1a(34) defines "member" as "an individual, association, partnership, corporation, or trust—(A) owning or holding membership in, or admitted to membership representation on, the registered entity . . . or (B) having trading privileges on the registered entity . . . ." 7 U.S.C. 1a(34).

[387] The Commission notes that § 37.201(a) codifies CEA section 5h(f)(2)(C). 7 U.S.C. 7b-3(f)(2)(C).

[388] The Commission notes that § 37.201(b) codifies certain sections of CEA section 5h(f)(2). 7 U.S.C. 7b-3(f)(2).

[389] MarketAxess Comment Letter at 34 (Mar. 8, 2011).

37.201(b)(6) contained a drafting error, and therefore is replacing the term "mandatory clearing" with "mandatory trading." The Commission also notes that the citation to "part 45" in proposed § 37.201(a) should instead cite to "part 43." Therefore, the Commission is modifying the final rule to include these technical changes.

Additionally, the Commission notes that a SEF must establish and enforce rules for its employees. These rules must be reasonably designed to prevent violations of the Act and the rules of the Commission.[390] Towards that end, the Commission also notes that a SEF must have systems in place reasonably designed to ensure that its employees are operating in accordance with the SEF's rules.[391] For example, a SEF that is utilizing an RFQ System in conjunction with an Order Book for Required Transactions must establish rules specifying order handling procedures for its employees who receive and execute orders over the telephone, email, instant messaging, squawk box, some other method of communication, or some combination thereof so that the employees may comply with the RFQ System requirements as specified in final § 37.9(a)(3).[392]

Furthermore, the Commission notes that a SEF's employees have certain obligations under the Commission's existing regulations. For example, under § 1.59, a SEF's employees are prohibited from disclosing for any purpose inconsistent with the

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[390] The Commission notes that under § 37.1501(d), a duty of the Chief Compliance Officer is to establish and administer written policies and procedures reasonably designed to prevent violations of the Act and the rules of the Commission.

[391] The Commission notes that under § 37.1501(d), a duty of the Chief Compliance Officer is to take reasonable steps to ensure compliance with the Act and the rules of the Commission, and to establish and administer a compliance manual designed to promote compliance with applicable laws, rules, and regulations.

[392] See WMBAA Comment Letter at 2 (Feb. 15, 2013) (explaining that employees of a SEF provide services such as disseminating bids and offers, helping to understand market conditions, and executing transactions between counterparties).

performance of its official duties any material, non-public information obtained through special access related to the performance of its duties.[393]

Finally, the Commission notes that under § 1.2 of the Commission's regulations, a SEF is liable for the acts, omissions, or failures of its employees acting within the scope of their employment.[394]

(c) § 37.202 – Access Requirements

Proposed § 37.202 addressed Core Principle 2's requirements that SEFs provide market participants with impartial access to the market and that SEFs adopt and enforce rules with respect to any limitations placed on access to the SEF.[395]

(1) § 37.202(a) – Impartial Access by Members and Market Participants[396]

Proposed § 37.202(a) required that a SEF provide any eligible contract participant ("ECP") and any independent software vendor ("ISV") with impartial access to its market(s) and market services (including any indicative quote screens or any similar pricing data displays), providing: (1) access criteria that are impartial, transparent, and applied in a fair and nondiscriminatory manner; (2) a process for confirming ECP status prior to being granted access to the SEF; and (3) comparable fees for participants receiving comparable access to, or services from, the SEF.

(i) Summary of Comments

Several commenters sought clarification that SEFs would be permitted to use their own reasonable discretion to determine individual access criteria, provided that the

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[393] Commission regulation 1.59(d).

[394] Commission regulation 1.2.

[395] CEA section 5h(f)(2)(A)(ii) and (2)(B)(i); 7 U.S.C. 7b-3(f)(2)(A)(ii) and (2)(B)(i).

[396] The Commission is renaming the title of this section from "Impartial Access by Members and Market Participants" to "Impartial Access to Markets and Market Services" to provide greater clarity.

criteria are impartial, transparent, and applied in a fair and non-discriminatory manner.[397] In this regard, ISDA/SIFMA commented that a SEF should be able to limit access to its trading systems or platforms to certain types of market participants in order to maintain the financial integrity and operational safety of the trading platform.[398] JP Morgan also stated that a SEF should be able to limit access to certain types of market participants such as swap dealers.[399] JP Morgan commented, however, that the SEF NPRM's preamble language about financial and operational soundness is problematic because it would not allow SEFs to limit access to certain types of market participants.[400] This could disrupt business models such as that of inter-dealer brokers whose model is intimately tied to the idea of serving as an intermediary to wholesale liquidity providers.[401] Similarly, Rosen et al. recommended that SEFs should be able to use selective access criteria such as objective minimum capital or credit requirements or limits on participation to objective classes of sophisticated market participants.[402] MarketAxess commented that the meaning of the term "impartial" is unclear and recommended that the Commission revise proposed § 37.202(a)(1) as follows: "Criteria that are transparent and objective and are applied in a fair and nondiscriminatory manner[.]"[403] Tradeweb noted that, because it offers multiple marketplaces, its access criteria may reasonably differ for each mode of execution and within one mode of

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[397] Reuters Comment Letter at 5 (Mar. 8, 2011); Goldman Comment Letter at 4 (Mar. 8, 2011); Tradeweb Comment Letter at 10 (Mar. 8, 2011).

[398] ISDA/SIFMA Comment Letter at 11 (Mar. 8, 2011).

[399] JP Morgan Comment Letter at 11 (Mar. 8, 2011).

[400] Id.

[401] Id.

[402] Rosen et al. Comment Letter at 17 (Apr. 5, 2011).

[403] MarketAxess Comment Letter at 23-24 (Mar. 8, 2011).

execution given that each market will offer different services and may have different types of participants.[404]

Mallers et al. supported the impartial access requirement and its purpose of preventing a SEF's owners or operators from using discriminatory access requirements as a competitive tool against certain participants.[405] Mallers et al. stated that impartial access is a prerequisite to having an open market in which ECPs can compete on a level playing field, and that the participation of additional liquidity providers will improve the pricing and efficiency of the market and reduce systemic risk.[406] SDMA also supported the impartial access requirement and stated that the ability to obtain intellectual property licenses and the amount of royalties for intellectual property licenses should be fair and not used to create anticompetitive advantages for a particular SEF or group of market participants.[407] UBS requested that the Commission clarify in the final rulemaking that SEFs may not exclude or discriminate against participants providing agency services solely as a result of engaging in these activities.[408]

MarketAxess and WMBAA stated that a SEF should be able to restrict access to ISVs because the Dodd-Frank Act does not require SEFs to provide ISVs with impartial access.[409] MarketAxess further commented that the Commission must permit a SEF to restrict access to an ISV who would use such direct access to provide a competitive

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[404] Tradeweb Comment Letter at 10 (Mar. 8, 2011).

[405] Mallers et al. Comment Letter at 2-3 (Mar. 21, 2011).

[406] Id. at 3.

[407] SDMA Comment Letter at 4-5 (Mar. 8, 2011).

[408] UBS Comment Letter II at 1 (May 18, 2012). UBS submitted two comment letters on May 18, 2012. The Commission is referencing UBS's comment letter regarding impartial access as "UBS Comment Letter II."

[409] MarketAxess Comment Letter at 24 (Mar. 8, 2011); WMBAA Comment Letter at 19 (Mar. 8, 2011).

advantage to another SEF or DCM.[410] Similarly, WMBAA stated that SEFs could qualify as ISVs in order to seek access to competitors' trading systems or platforms, which would defeat the existing structure of competitive sources of liquidity.[411] Bloomberg commented that the SEF NPRM's characterization of ISV is too broad;[412] therefore, an ISV may be able to replicate the services of a SEF without having to register as a SEF.[413] Bloomberg also requested that the Commission clarify that a user of an ISV service must be a participant of a SEF in order to access the SEF's data and/or to execute swap transactions on that SEF.[414]

Under proposed § 37.202(a)(2), MarketAxess recommended that SEFs be permitted to rely on a written or electronically signed representation by a participant seeking access to the SEF regarding its status as an ECP.[415] MarketAxess stated that SEFs may then adopt rules to require that the participant notify the SEF immediately of any change to its status after the participant makes the representation.[416]

Better Markets commented that proposed § 37.202(a)(3) should make clear that any form of preferential access to a SEF through fee arrangements should not be allowed because it would defeat the goal of impartial access.[417] However, MarketAxess stated that SEFs should be able to provide their market participants with volume discounts and

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[410] MarketAxess Comment Letter at 25 (Mar. 8, 2011).

[411] WMBAA Comment Letter at 19 (Mar. 8, 2011).

[412] See Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1222 n. 53 (providing examples of ISVs).

[413] Meeting with Bloomberg dated Jan. 18, 2012.

[414] Id.

[415] MarketAxess Comment Letter at 25 (Mar. 8, 2011).

[416] Id.

[417] Better Markets Comment Letter at 11-12 (Mar. 8, 2011).

other pricing arrangements as long as such discounts and arrangements are based upon objective criteria that are applied uniformly.[418]

(ii) Commission Determination

The Commission is adopting § 37.202(a) as proposed, subject to the modifications discussed below.[419] The Commission does not believe that the statute allows a SEF to adopt rules that limit access as requested by ISDA/SIFMA, JP Morgan, and Rosen et al. The statutory language of Core Principle 2 requires that SEFs establish and enforce participation rules, including means to provide market participants with impartial access to the market, and that SEFs adopt and enforce rules with respect to any limitations they place on access (emphasis added).[420] As stated in the SEF NPRM, the Commission reiterates that the purpose of the impartial access requirements is to prevent a SEF's owners or operators from using discriminatory access requirements as a competitive tool against certain ECPs or ISVs. The Commission also agrees with Mallers et al. who stated that the impartial access requirement allows ECPs to compete on a level playing field, and that the participation of additional liquidity providers will improve the pricing and efficiency of the market and reduce systemic risk. As such, the Commission believes that access to a SEF should be determined, for example, based on a SEF's impartial evaluation of an applicant's disciplinary history and financial and operational soundness against objective, pre-established criteria. As one example of such criteria, any ECP should be able to demonstrate financial soundness either by showing that it is a clearing member of a derivatives clearing organization ("DCO") that clears products traded on

[418] MarketAxess Comment Letter at 25 (Mar. 8, 2011).

[419] The Commission is also making certain non-substantive clarifications to the rule.

[420] CEA sections 5h(f)(2)(A)(ii) and (2)(B)(i); 7 U.S.C. 7b-3(f)(2)(A)(ii) and (2)(B)(i).

that SEF or by showing that it has clearing arrangements in place with such a clearing member.

In this regard, the Commission believes that the impartial access requirement of Core Principle 2 does not allow a SEF to limit access to its trading systems or platforms to certain types of ECPs or ISVs as requested by some commenters.[421] The Commission notes that the rule states "impartial" criteria and not "selective" criteria as recommended by some commenters. The Commission is using the term "impartial" as intended in the statute. "Impartial" should be interpreted in the ordinary sense of the word: fair, unbiased, and unprejudiced. Subject to these requirements, a SEF may use its own reasonable discretion to determine its access criteria, provided that the criteria are impartial, transparent and applied in a fair and non-discriminatory manner, and are not anti-competitive.

In response to Tradeweb's comment about different access criteria for different markets, the Commission notes that a SEF may establish different access criteria for each of its markets. Core Principle 2 does not specify whether impartial access criteria must be the same for all of a SEF's markets or may differ for each market. Therefore, the Commission believes that it is within its discretion to allow a SEF to establish different access criteria for each of its markets. However, the Commission reiterates that the access criteria must be impartial and must not be used as a competitive tool against certain ECPs or ISVs. The Commission also reiterates that each similarly situated group of ECPs and ISVs must be treated similarly.

[421] In this regard, the Commission is clarifying in response to UBS's comment that a SEF may not exclude or discriminate against a market participant providing agency services subject to any limitation on such services contained in this final rulemaking.

In response to MarketAxess's and WMBAA's comments regarding ISVs, the Commission notes that Congress required SEFs to establish participation rules, including means to provide market participants with impartial access to the market.[422] The Commission believes that ISVs[423] provide market participants with additional opportunities to access SEFs and that, similar to ECPs, SEFs should apply impartial criteria in a fair and non-discriminatory manner when deciding whether or not to grant an ISV access. In response to MarketAxess's and WMBAA's comments regarding ISVs providing a competitive advantage to other SEFs, the Commission notes that SEFs may set rules for ISVs so they do not misuse data, for example, by providing the data to another SEF for purely competitive reasons to the exclusion of market participants. The Commission also notes that SEFs may charge fees to ISVs based on the access or services they receive from the SEF.

In response to Bloomberg's comments, the Commission agrees that ISVs should not be able to replicate the services of a SEF without having to register as a SEF. The Commission notes that an ISV that merely provides a service to SEFs will not, merely

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[422] CEA section 5h(f)(2)(B)(i); 7 U.S.C. 7b-3(f)(2)(B)(i). WMBAA also commented that ISVs should comply with a SEF's rules, the SEF core principles, and the oversight or supervision by the SEF in the same manner as a market participant. WMBAA Comment Letter at 19 (Mar. 8, 2011). The Commission disagrees with WMBAA's comment because ISVs provide market participants with greater options to access SEFs and ISVs are not executing swaps on a SEF as are market participants. Therefore, the Commission believes that ISVs should not be subject to the same requirements as market participants.

[423] The Commission notes that examples of independent software vendors include: smart order routers, trading software companies that develop front-end trading applications, and aggregator platforms. Smart order routing generally involves scanning of the market for the best-displayed price and then routing orders to that market for execution. Software that serves as a front-end trading application is typically used by traders to input orders, monitor quotations, and view a record of the transactions completed during a trading session. As noted above in the registration section, aggregator platforms generally provide a portal to market participants so that they can access multiple SEFs, but do not provide for execution as execution remains on SEFs. Aggregator platforms may also provide access to news and analytics. The Commission believes that transparency and trading efficiency would be enhanced as a result of innovations in this field for market services. For instance, certain providers of market services with access to multiple trading systems or platforms could provide consolidated transaction data from such trading systems or platforms to market participants.

because it provides such a service, be deemed to be a SEF as defined in CEA section 1a(50). However, pursuant to the registration requirements in final § 37.3(a), if an ISV offers a trading system or platform in which more than one market participant has the ability to execute or trade swaps with more than one other market participant on that system or platform, then the ISV has to register as a SEF.[424] The Commission also notes that the user of an ISV must have been granted access by a SEF in order to access that SEF's data and/or to execute a swap transaction on that SEF through the ISV.[425]

The Commission notes that under § 37.202(a)(2), a SEF that is determining whether to grant an ECP access to its facilities may rely on a signed representation of its ECP status.[426] By not prescribing a process, the Commission is providing SEFs with flexibility and discretion on how to meet this requirement. The Commission also notes that for SEFs that permit intermediation, customers of ECPs must also be ECPs.[427] In this regard, a SEF must obtain a signed representation from an intermediary that its customers are ECPs.

To address comments submitted in connection with proposed § 37.202(a)(3) regarding fees, the Commission clarifies that § 37.202(a)(3) neither sets nor limits the fees that SEFs may charge. A SEF may establish different categories of ECPs or ISVs

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[424] See Aggregation Services or Portals discussion above under § 37.3 – Requirements for Registration in the preamble. The Commission notes that footnote [417] above classifies aggregator platforms as a type of ISV so the discussion in this section regarding ISVs also applies to aggregator platforms.

[425] The Commission notes, however, that the user of an ISV may not need to have been granted access to the SEF if the ISV is only providing a composite quote or top level quote for multiple SEFs.

[426] The Commission is replacing the term "participant" in proposed § 37.202(a)(2) with the term "eligible contract participant" in final § 37.202(a)(2) because the term "participant" was not defined in the SEF NPRM and the revised term more clearly communicates the persons to whom this rule applies. In this regard, the Commission notes that, prior to granting a person access to its facility, a SEF must obtain confirmation from the person of its ECP status.

[427] For example, the Commission notes that a customer of a futures commission merchant must be an ECP and a customer of a broker must be an ECP.

seeking access to, or services from, the SEF, but may not discriminate with respect to fees within a particular category.[428] The Commission notes that § 37.202(a)(3) is not designed to be a rigid requirement that fails to take into account legitimate business justifications for offering different fees to different categories of entities seeking access to the SEF. For example, a SEF may consider the services it receives from members such as market making services when it determines its fee structure.

(2) § 37.202(b) – Jurisdiction

Proposed § 37.202(b) required that prior to granting any ECP access to its facilities, a SEF must require that the ECP consents to its jurisdiction.

(i) Summary of Comments

CME recommended that the Commission withdraw the proposed rule.[429] CME contended that requiring clearing firms to obtain every customer's consent to the regulatory jurisdiction of each SEF would be costly.[430] Moreover, CME commented that even if such consent were obtained, the proposed rule would be entirely ineffective in achieving the Commission's desired outcome.[431] CME explained that if a non-member, who had consented to the SEF's jurisdiction under the proposed rule, committed a rule violation and subsequently elected not to cooperate in the investigation or disciplinary process, the SEF's only recourse would be to deny the non-member access and, if

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[428] The Commission is replacing the term "participant" in proposed § 37.202(a)(3) with the terms "eligible contract participants" and "independent software vendors" in final § 37.202(a)(3) because the term "participant" was not defined in the SEF NPRM and the revised terms more clearly communicates the persons to whom this rule applies.

[429] CME Comment Letter at 17 (Feb. 22, 2011).

[430] Id. at 16.

[431] Id.

appropriate, refer the matter to the Commission.[432] CME further explained that a SEF's enforcement options, and the regulatory outcomes, do not change based on whether or not there is a record of the non-member consenting to jurisdiction, but rather depend on whether the non-member chooses to participate in the SEF's investigative and disciplinary processes.[433]

Similarly, Bloomberg requested that the Commission clarify that proposed § 37.202(b) would only apply to a SEF's members and not customers of members whose orders are executed on a SEF.[434] Bloomberg stated that, rather than subject all market participants to a SEF's jurisdiction, it would be sufficient and more practical for each SEF member to provide to the SEF specific information about its customers.[435] WMBAA noted that a SEF may only exercise jurisdiction over a market participant with respect to its own rules and that the SEF's ultimate sanction would be to ban a market participant from its trading system or platform.[436] WMBAA also stated that prohibiting a market participant from trading on one particular SEF has little utility because a market participant could continue to execute swaps on other SEFs.[437]

(ii) Commission Determination

The Commission is adopting § 37.202(b) as proposed. While acknowledging the comments described above, the Commission believes that § 37.202(b) codifies jurisdictional requirements necessary to effectuate the statutory mandate of Core

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[432] Id.

[433] Id.

[434] Bloomberg Comment Letter at 6 (Mar. 8, 2011).

[435] Id.

[436] WMBAA Comment Letter at 19 (Mar. 8, 2011).

[437] Id.

Principle 2 that a SEF shall have the capacity to detect, investigate, and enforce rules of the SEF.[438] In the Commission's view, jurisdiction must be established by a SEF prior to granting eligible contract participants access to its markets in order to effectively investigate and sanction persons that violate SEF rules. In particular, a SEF should not be in the position of asking market participants to voluntarily submit to its jurisdiction and cooperate in investigatory proceedings after a potential rule violation has been found. Similarly, market participants should have advanced notice that their trading practices are subject to the rules of a SEF, including rules that require cooperating in investigatory and disciplinary processes.

For the avoidance of doubt, the Commission clarifies that the scope of § 37.202(b) is not limited to members. To the contrary, all members and market participants of a SEF, as defined above under § 37.200, are within the scope of § 37.202(b).

In response to CME's and WMBAA's comments, the Commission notes that a SEF's ultimate recourse against a market participant is to deny such market participant access to the SEF and, if appropriate, refer the market participant to the Commission. The Commission has the authority to issue broader sanctions for market participants who commit SEF rule violations that also violate the CEA and Commission regulations. Therefore, the Commission expects that a SEF would not only sanction market participants as appropriate, but also refer matters to the Commission for additional action when necessary. The Commission does not agree that this action absolves SEFs from their responsibility to establish jurisdiction over members and market participants.

[438] CEA section 5h(f)(2)(B); 7 U.S.C. 7b-3(f)(2)(B).

(3) § 37.202(c) – Limitations on Access

Proposed § 37.202(c) required a SEF to establish and impartially enforce rules governing any decision to allow, deny, suspend, or permanently bar participants' access to the SEF, including when such decisions are made as part of a disciplinary or emergency action taken by the SEF.

(i) Commission Determination

Although no comments were received on § 37.202(c), the Commission is adopting the proposed rule subject to one modification.[439] The Commission is replacing the term "participant" with "eligible contract participant" because the term "participant" was not defined in the SEF NPRM and the revised term more clearly communicates the persons to whom this rule applies.[440] The Commission notes that § 37.202(c) implements Core Principle 2's requirement regarding limitations on access to the SEF.[441]

(d) § 37.203 – Rule Enforcement Program

Proposed § 37.203 required a SEF to establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules.[442]

(1) § 37.203(a) – Abusive Trading Practices Prohibited

Proposed § 37.203(a) required a SEF to prohibit certain abusive trading practices, including front-running, wash trading, pre-arranged trading, fraudulent trading, money passes, and any other trading practices that the SEF deems to be abusive. The proposed

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[439] The Commission is making certain non-substantive clarifications to the rule.

[440] For the avoidance of doubt, the Commission notes that this rule applies to the SEF's members and market participants.

[441] CEA section 5h(f)(2)(A)(ii); 7 U.S.C. 7b-3(f)(2)(A)(ii).

[442] The Commission notes that § 37.203 codifies CEA section 5h(f)(2)(B). 7 U.S.C. 7b-3(f)(2)(B).

rule further obligated a SEF to "prohibit any other manipulative or disruptive trading practices prohibited by the Act or by the Commission pursuant to Commission regulations." SEFs permitting intermediation were required to prohibit additional trading practices, such as trading ahead of customer orders, trading against customer orders, accommodation trading, and improper cross trading. As explained in the SEF NPRM, prohibited trading practices include those proscribed by section 747 of the Dodd-Frank Act.[443]

(i) Summary of Comments

CME and ABC/CIEBA commented that the proposed rule is problematic because it enumerated prohibited trade practices without specifically defining them.[444] CME stated that SEFs should have reasonable discretion to establish rules appropriate to their markets that are consistent with the CEA and that satisfy the core principles.[445] CME questioned, in particular, how to interpret the proposed prohibition on pre-arranged trading with respect to rules that allow for block trading, exchange for related position transactions, and pre-execution communications subject to specified conditions.[446]

WMBAA contended that the enumerated abusive trading practices appear more commonly in markets with retail participants, and therefore are more likely to occur on a

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[443] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1223 n.61. Section 747 of the Dodd-Frank Act amended CEA section 4c(a) to make it unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity that—(A) violates bids or offers; (B) demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or (C) is, is of the character of, or is commonly known to the trade as, spoofing (bidding or offering with the intent to cancel the bid or offer before execution). See Antidisruptive Practices Authority, 76 FR 14943 (proposed Mar. 18, 2011) for proposed interpretive guidance on these three new statutory provisions of CEA section 4c(a)(5).

[444] ABC/CIEBA Comment Letter at 9 (Mar. 8, 2011); CME Comment Letter at 17-18 (Feb. 22, 2011).

[445] CME Comment Letter at 17 (Feb. 22, 2011).

[446] Id. at 17-18.

DCM rather than a SEF.[447] Accordingly, WMBAA recommended that the Commission include in the final rule abusive trading practices that are more likely to occur on a SEF.[448] Finally, Better Markets recommended that the Commission expand its list of prohibited trade practices to ban certain high-frequency trading practices, including exploiting a large quantity or block trade, price spraying (which it views as a form of front-running), rebate harvesting, and layering the market (which it analogizes to spoofing).[449]

(ii) Commission Determination

The Commission is adopting proposed § 37.203(a), subject to one modification described below. In response to CME's and ABC/CIEBA's comments regarding the perceived vagueness of the enumerated trading practices, the Commission notes that the enumerated abusive trading practices reflect the trading practices that are typically accepted as prohibited conduct by regulators and derivatives exchanges in the industry. In the SEF NPRM, the Commission stated that the proposed prohibited trading practices are a compilation of abusive trading practices that DCMs already prohibit.[450] The Commission also noted in the final DCM rulemaking that the prohibited trading practices are typically already prohibited in DCM rulebooks.[451] Although the Commission believes, as noted by CME, that a SEF should have reasonable discretion to establish

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[447] WMBAA Comment Letter at 20 (Mar. 8, 2011).

[448] Id.

[449] Better Markets Comment Letter at 13-17 (Mar. 8, 2011).

[450] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1223.

[451] Core Principles and Other Requirements for Designated Contract Markets, 77 FR 36612, 36626 (Jun. 19, 2012).

rules for its markets, the Commission believes, at a minimum, that a SEF must prohibit the abusive trading practices identified in the rule.

In response to CME's comment about how to interpret the prohibition on pre-arranged trading with respect to rules that allow for block trading and other types of trading, the Commission is amending proposed § 37.203(a) to clarify that a SEF must prohibit pre-arranged trading, except for block trades permitted under part 43 of the Commission's regulations or other types of transactions certified to or approved by the Commission pursuant to the procedures under part 40 of the Commission's regulations. This change clarifies that these types of transactions will not be subject to the prohibition on pre-arranged trading. The Commission also clarifies, as discussed above under the time delay requirement, that the prohibition on pre-arranged trading does not limit pre-execution communications between market participants, subject to the rules of the SEF. Accordingly, SEFs that permit pre-execution communications must establish and enforce rules relating to such communications.

In response to WMBAA's comment that the enumerated abusive trading practices are more suited to DCMs rather than SEFs, the Commission believes that similar prohibitions are necessary to promote consistent protection for all market participants across the swaps market. Therefore, the Commission believes that the enumerated abusive trading practices should be prohibited by DCMs and SEFs. The Commission notes that requiring SEFs to proscribe trading practices which are prohibited by the Act and Commission regulations does not create any additional obligations beyond the existing statutory and regulatory requirements applicable to all SEFs.

The Commission agrees with WMBAA and Better Markets that other abusive trading practices may exist. In this regard, § 37.203(a) provides a non-exhaustive, non-exclusive list. The regulations adopted in this final release provide a SEF with reasonable discretion to establish rules that prohibit additional abusive trading practices. Additionally, not only must a SEF prohibit any other trading practices that a SEF deems abusive,[452] it must also establish and enforce rules that will deter abuses under statutory Core Principle 2.[453] Therefore, if a SEF identifies additional abusive trading practices that are likely to occur on its trading systems and platforms, then the SEF is required, by statute and Commission regulation, to prohibit such abusive trading practices. The Commission anticipates that as SEFs gain experience with exchange-listed swaps, it may periodically revisit the list of prohibited abusive trading practices under § 37.203(a).

(2) § 37.203(b) – Capacity to Detect and Investigate Rule Violations

Proposed § 37.203(b) required a SEF to have arrangements and resources for effective rule enforcement, which included a SEF's authority to collect information and examine books and records of SEF members and market participants. As discussed in the preamble to the SEF NPRM, the Commission believes that a SEF can best administer its compliance and rule enforcement obligations by having the ability to reach the books and records of all market participants.[454] Proposed § 37.203(b) also required a SEF's arrangements and resources to facilitate the direct supervision of the market and the analysis of data collected to determine whether a rule violation has occurred.

(i) Summary of Comments

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[452] See Final § 37.203(a) in the Commission's regulations.

[453] CEA section 5h(f)(2); 7 U.S.C. 7b-3(f)(2).

[454] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1223.

FXall and CME requested that the Commission clarify the provision in proposed § 37.203(b) that requires a SEF to have the authority to examine the books and records of its members and market participants.[455] Specifically, CME expressed concern that the proposed rule would subject non-registered market participants to recordkeeping requirements that currently apply only to member, registrants, and direct access clients of its platform, which it does not believe would be effective.[456] CME also commented that the proposed rule does not detail which books, records, and information a SEF must be able to obtain from its non-member market participants.[457] FXall expressed concern that the requirement for a SEF to have the authority to examine the books and records of its members and market participants could be interpreted to require a SEF to conduct a full regulatory examination program.[458] FXall, therefore, recommended that the Commission clarify that this requirement only applies as may be necessary for a SEF to investigate a specific potential rule violation that the SEF has detected in the ordinary course of its trade practice surveillance routine or has otherwise been brought to its attention.[459]

(ii) Commission Determination

The Commission is adopting § 37.203(b) as proposed, subject to the following modification. To address CME's concerns about the scope of proposed § 37.203(b), the Commission is replacing the term "market participant" with "persons under investigation." The Commission recognizes that using the term "market participant" could significantly increase the regulatory responsibilities for SEFs. Thus, the

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[455] FXall Comment Letter at 11-12 (Mar. 8, 2011); CME Comment Letter at 18 (Feb. 22, 2011).

[456] CME Comment Letter at 18 (Feb. 22, 2011).

[457] Id.

[458] FXall Comment Letter at 11-12 (Mar. 8, 2011).

[459] Id.

Commission clarifies that § 37.203(b) places upon a SEF an affirmative obligation to have the authority to examine books and records from its members and from any persons under investigation for effective enforcement of its rules. The Commission also notes that the books and records collected by the SEF should encompass all information and documents that are necessary to detect and prosecute rule violations. In response to FXall's comment, the Commission clarifies that the requirement for a SEF to have the authority to examine books and records does not require a SEF to conduct a full regulatory examination program. However, the Commission notes that in addition to the SEF's obligations pursuant to § 37.203(b), the audit trail requirements in § 37.205(c)(2) require a SEF to establish a program for effective enforcement of its audit trail and recordkeeping requirements, which would require the examination of books and records.

(3) § 37.203(c) – Compliance Staff and Resources

Proposed § 37.203(c)(1) provided that a SEF must establish and maintain sufficient compliance staff and resources to conduct a number of enumerated tasks, such as audit trail reviews, trade practice surveillance, market surveillance, and real-time monitoring. Proposed § 37.203(c)(2) required a SEF to continually monitor the size and workload of its compliance staff and, on at least an annual basis, formally evaluate the need to increase its compliance staff and resources. The proposed rule also set forth certain factors that a SEF should consider in determining the appropriate level of compliance staff and resources.

(i) Summary of Comments

Two commenters sought clarification regarding a SEF's compliance resources.[460] WMBAA requested that the Commission clarify whether the resources and staff of a compliance department may be shared with affiliates or between multiple SEFs, and if so, how these shared resources would be considered in meeting the requirements for sufficient compliance staff and resources.[461] WMBAA also requested clarification as to whether a SEF could consider its third party service provider's resources and staff for purposes of evaluating the adequacy of its compliance staff and resources.[462] MarketAxess believed that the process by which a SEF must conduct a formal evaluation of its compliance resources was unclear.[463] MarketAxess also noted that while the findings of such an evaluation could result in the need to increase a SEF's compliance staff and resources, it could also result in a decrease.[464] Accordingly, MarketAxess suggested that the Commission remove the term "formally" and clarify that the evaluation of compliance resources could result in either an increase or decrease in compliance staff and resources.[465]

(ii) Commission Determination

The Commission is adopting § 37.203(c) as proposed, subject to one modification discussed below.[466] The Commission agrees in part with WMBAA's recommendation that some SEF compliance staff can be shared among affiliated entities under the

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[460] WMBAA Comment Letter at 21 (Mar. 8, 2011); MarketAxess Comment Letter at 35 (Mar. 8, 2011).

[461] WMBAA Comment Letter at 21 (Mar. 8, 2011).

[462] Id.

[463] MarketAxess Comment Letter at 35 (Mar. 8, 2011).

[464] Id.

[465] Id.

[466] The Commission is making certain non-substantive clarifications to proposed § 37.203(c)(1). The Commission is also renumbering proposed § 37.203(c)(1) to § 37.203(c).

appropriate circumstances. However, such arrangements would require prior review by the Commission staff and appropriate legal documentation between the affiliated entities with respect to any shared staff (e.g., secondment or regulatory services agreements that define responsibilities; establish decision-trees for matters of regulatory consequence; and provide for exclusive authority and responsibility by each SEF with respect to matters on its markets). The Commission also emphasizes that any sharing of compliance staff does not diminish each SEF's obligation to maintain sufficient staff to meet its own regulatory needs. The Commission believes that compliance resources may not be shared between non-affiliated SEFs given potential conflict issues. However, the Commission recognizes that a SEF may provide regulatory services to a non-affiliated SEF pursuant to a regulatory services agreement.

The Commission believes that a SEF may take into consideration the staff and resources of its regulatory service provider when evaluating the sufficiency of its own compliance staff. Regardless of whether a SEF utilizes a regulatory service provider or shares its compliance staff with an affiliate, the Commission emphasizes that the SEF must maintain sufficient internal compliance staff to oversee the quality and effectiveness of the regulatory services provided and to make certain regulatory decisions, as required by § 37.204.

Finally, the Commission is deleting proposed § 37.203(c)(2), which required that a SEF monitor the size and workload of its compliance staff on a continuous basis and, on at least an annual basis, formally evaluate the need to increase its compliance resources and staff. The Commission believes that the obligation that a SEF monitor the adequacy of its compliance staff and resources are implicit in proposed § 37.203(c)(1).

The final rule provides greater flexibility to SEFs in determining their approach to monitoring their compliance resources.

(4) § 37.203(d) – Automated Trade Surveillance System

Proposed § 37.203(d) required a SEF to maintain an automated trade surveillance system capable of detecting and investigating potential trade practice violations. The proposed rule also required that an acceptable automated trade surveillance system must have the capability to generate alerts on a trade date plus one day (T+1) basis to assist staff in detecting potential violations. The automated trade surveillance system, among other requirements, must maintain all trade and order data, including order modifications and cancellations, and must have the capability to compute, retain, and compare trading statistics; compute trade gains and losses; and reconstruct the sequence of trading activity.

(i) Summary of Comments

CME and WMBAA expressed concern about the capabilities required of an automated trade surveillance system under the proposed rule.[467] Specifically, CME stated that it has been unable to design an automated surveillance system that automates the actual investigation of potential trade practice violations.[468] CME also challenged the use of what it deemed as "broad and ambiguous" terms to describe the required capabilities of such a system, and recommended that the Commission consider applying a more flexible, core principles-based approach to implementing the requirement.[469] WMBAA argued that it would be impossible to create an automated trade surveillance

[467] CME Comment Letter at 19-20 (Feb. 22, 2011); WMBAA Comment Letter at 21 (Mar. 8, 2011).

[468] CME Comment Letter at 19-20 (Feb. 22, 2011).

[469] Id. at 20.

system with the capabilities described in the proposed rule without knowledge of a participant's complete trading activity, including trading activity that takes place on other SEFs.[470]

Better Markets recommended that data recorded by an automated trade surveillance system be time-stamped at intervals consistent with the capabilities of high-frequency traders that will transact on SEFs.[471]

(ii) Commission Determination

The Commission is adopting proposed § 37.203(d), subject to two modifications discussed below. First, the Commission is moving the requirement that an automated trade surveillance system maintain all data reflecting the details of each order entered into the trading system to final § 37.205(b). The Commission believes that § 37.205(b) is a more logical place in the Commission's rules to address this aspect of a SEF's automated surveillance system because it also specifies the requirements for a SEF's audit trail program, including a history of all orders and trades.

Second, the Commission is deleting the word "investigating" from proposed § 37.203(d) to remove any confusion, as noted by CME. The Commission notes, in response to CME's comment, that the final rules do not require a SEF's automated trade surveillance system to conduct the actual investigations. The Commission believes that the actual investigation would be carried out by a SEF's compliance staff with the assistance of automated surveillance tools.

In response to CME's comment pertaining to the breadth of the rule, the Commission believes that effective surveillance of trading markets requires that a SEF

[470] WMBAA Comment Letter at 21 (Mar. 8, 2011).

[471] Better Markets Comment Letter at 18 (Mar. 8, 2011).

maintain an automated trade surveillance system capable of detecting trade practice violations to assist compliance staff in analyzing large data sets and investigating patterns of conduct that may go otherwise unnoticed. The Commission also believes that the analytical tools enumerated in the rule are a necessary component of an effective trade surveillance system. This rule, as modified, therefore fulfills the statutory requirement of Core Principle 2 by assisting the SEF in detecting, investigating, and enforcing trading rules that will deter abuses.[472]

The Commission acknowledges the inter-SEF surveillance limitations expressed by WMBAA. The Commission notes that the purpose of § 37.203(d) is to ensure that a SEF's compliance staff has the necessary tools to detect, analyze, and investigate potential trade practice violations on the SEF's trading systems or platforms; it does not obligate a SEF to establish a cross-market trade practice surveillance program.

Although the Commission acknowledges the merits of the recommendation by Better Markets to include time stamps at intervals consistent with the capabilities of high-frequency traders, the Commission does not believe that it is necessary to modify § 37.203(d) to address this concern. As discussed in § 37.401 below, there are efforts underway both within and outside of the Commission to define and develop approaches for better monitoring of high-frequency and algorithmic trading.[473] However, while the rule does not specify the granularity of time-stamped data, a SEF's automated trade surveillance system should have the ability to readily determine the sequence in which orders are entered. This reflects the Commission's belief that an automated trade

[472] CEA section 5h(f)(2)(B); 7 U.S.C. 7b-3(f)(2)(B).

[473] See discussion below regarding high-frequency trading under § 37.401 – General Requirements in the preamble.

surveillance system should time-stamp data with the granularity necessary to conduct effective surveillance of all trade-related activity, including high-frequency trading, while leaving the details of the system to the SEF.

The Commission notes that the accurate time-stamping of data is particularly important for SEFs that use an RFQ System, including an RFQ System with a voice component. For such SEFs, the accurate time-stamping of both their Order Book and RFQ System activity is critical for ensuring both that the SEF itself has a robust surveillance system and that the Commission is able to monitor the SEF's adherence to part 37's Order Book-RFQ System integration requirements.

(5) § 37.203(e) – Real-Time Market Monitoring

Proposed § 37.203(e) required a SEF to conduct real-time market monitoring of all trading activity on its electronic trading platform to ensure orderly trading and to identify market or system anomalies. The proposed rule further required a SEF to have the authority to adjust prices and cancel trades when needed to mitigate "market disrupting events" caused by platform malfunctions or errors in orders submitted by market participants. In addition, proposed § 37.203(e) required that any trade price adjustments or trade cancellations be transparent to the market and subject to standards that are clear, fair, and publicly available.

(i) Summary of Comments

CME stated that the proposed standards would be difficult for any SEF to reasonably meet because they require monitoring of all trading activity on a platform to ensure orderly trading.[474] CME also reiterated its belief that the proposed rules are overly

[474] CME Comment Letter at 21 (Feb. 22, 2011).

prescriptive and recommended that the Commission provide application guidance instead of a rule.[475] WMBAA requested clarification that a SEF's obligation to conduct real-time market monitoring does not include the requirement to conduct automated trade surveillance under § 37.203(d).[476]

Two commenters opined on the requirement for a SEF to modify or cancel a swap transaction.[477] SIFMA AMG argued that a SEF should not be able to modify or cancel a swap transaction under any circumstances without the express consent of the counterparties.[478] SIFMA AMG also stated that if counterparties consent to an adjustment, then clearing entities, executing brokers, DCMs, and middleware platforms should also make the appropriate adjustment.[479] ISDA/SIFMA recommended that the Commission adopt a uniform standard for "market disrupting events."[480]

Better Markets stated that a SEF's obligation to conduct real-time market monitoring should include monitoring orders and cancellations that are time-stamped at intervals consistent with the capabilities of high-frequency traders to identify abusive high frequency trading strategies.[481]

(ii) Commission Determination

The Commission is adopting proposed § 37.203(e), subject to one modification. The Commission agrees with CME that real-time market monitoring cannot "ensure"

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[475] Id. at 20-21.

[476] WMBAA Comment Letter at 21 (Mar. 8, 2011).

[477] SIFMA AMG Comment Letter at 14 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 13 (Mar. 8, 2011).

[478] SIFMA AMG Comment Letter at 14 (Mar. 8, 2011).

[479] Id.

[480] ISDA/SIFMA Comment Letter at 13 (Mar. 8, 2011).

[481] Better Markets Comment Letter at 18 (Mar. 8, 2011).

orderly trading at all times, but the Commission believes that such monitoring must identify disorderly trading when it occurs. Accordingly, the Commission is modifying proposed § 37.203(e) to require a SEF to conduct real-time market monitoring "to identify disorderly trading," instead of "to ensure orderly trading."

In response to CME's comment that the rule is overly prescriptive, the Commission believes that § 37.203(e) grants a SEF the flexibility to determine the best way to conduct real-time market monitoring so that it can effectively monitor its markets. The Commission also believes that the rule correctly mandates that a SEF conduct real-time market monitoring of all trading activity that occurs on its system or platform in order to detect disorderly trading and market or system anomalies, and take appropriate regulatory action. The Commission believes that this rule fulfills the statutory requirement of Core Principle 2, which requires a SEF to have the capacity to detect, investigate, and enforce trading rules that will deter abuses.[482]

In response to WMBAA's comment, the Commission clarifies that a SEF's obligation to conduct real-time market monitoring does not encompass the automated trade surveillance requirement in § 37.203(d). The Commission notes that while real-time market monitoring and trade practice surveillance are both self-regulatory functions assigned to all SEFs, these functions are generally independent and serve different purposes. As discussed in the SEF NPRM, market monitoring is conducted on a real-time basis so that a SEF can take mitigating action against any market or system anomalies on its trading system or platform.[483] Trade practice surveillance, on the other hand, involves reconstructing and analyzing order, trade, and other data post-execution to

[482] CEA section 5h(f)(2)(B); 7 U.S.C. 7b-3(f)(2)(B).

[483] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1224.

identify potential violations and anomalies found in trade data.[484] Further, as noted in the SEF NPRM, the automated trade surveillance system typically differs from the system used to conduct real-time market monitoring.[485]

The Commission disagrees with SIFMA AMG's comment that a SEF should not be able to modify or cancel a swap transaction under any circumstances without the express consent of the counterparties. The Commission believes that a SEF should have the authority to modify or cancel a swap transaction without the consent of the counterparties under certain limited circumstances. For example, a SEF should be able to cancel a trade when such trade was executed due to a technological error on the part of the SEF. Further, the Commission believes that the rule's requirement that any modifications or cancellations by the SEF be transparent to the market and subject to standards that are clear, fair, and publicly available will provide protection to counterparties. The Commission also acknowledges the validity of SIFMA AMG's concern that any adjustment to a swap transaction should also be reflected by entities involved in the clearing and processing of the swap. However, since imposing such a requirement on entities involved in the clearing and processing of swaps is outside the scope of this SEF rulemaking, the Commission declines to address this issue in these final rules.

The Commission also rejects ISDA/SIFMA's recommendation to define the term "market disrupting events," as it does not believe that a rule definition could reasonably capture the universe of potentially market disrupting events. The Commission notes that industry definitions for terms such as "market disrupting events" generally only establish

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[484] Id. at 1223-24.

[485] Id. at 1224.

a process or framework for counterparties and other third parties to determine whether such an event has occurred and can be subject to challenge, resulting in delayed determinations with limited utility for effective trade monitoring. Although the Commission believes that coordination among SEFs regarding market disrupting events may be appropriate, and encourages SEFs to do so, the Commission is not defining "market disrupting events" at this time. The Commission may provide examples at a later time once it gains further knowledge regarding the types of market disrupting events that are likely to occur on a SEF.

In response to the comment by Better Markets about high-frequency trading, the Commission declines to modify proposed § 37.203(e) to include concepts related specifically to high-frequency trading at this time.[486] The Commission believes that a SEF's real-time market monitoring system should be structured to conduct effective market monitoring for all order and trade types, including, but not limited to, high frequency trading.

(6) § 37.203(f) – Investigations and Investigation Reports

Proposed § 37.203(f) required a SEF to establish procedures for conducting investigations, provided timelines for completing such investigations, detailed the requirements of an investigation report, and provided for warning letters.

(i) § 37.203(f)(1) – Procedures

Proposed § 37.203(f)(1) required a SEF to have procedures that require its compliance staff to conduct investigations of possible rule violations. The proposed rule required that an investigation be commenced upon the Commission staff's request or

[486] See discussion below regarding high-frequency trading under § 37.401 – General Requirements in the preamble.

upon discovery of information by the SEF indicating a possible basis for finding that a violation has occurred or will occur.

(A) Summary of Comments

CME argued that the proposed rule diminishes a SEF's discretion to determine the matters that warrant a formal investigation because at the time of discovery or upon receipt of information, and before any review has occurred, there will always be "a possible basis" that a violation has occurred or will occur.[487] CME agreed that formal written referrals from the Commission, law enforcement authorities, other regulatory agencies, or other SROs should result in a formal investigation in every instance.[488] However, CME contended that a SEF should have reasonable discretion to determine how it responds to complaints, leads, and other types of referrals, including the discretion to follow-up with a less formal inquiry in certain situations.[489]

MarketAxess expressed concern that the proposed rule is not clear as to whether a SEF can contract its investigations to its regulatory service provider.[490] MarketAxess recommended that the Commission modify the proposed rule by replacing "compliance staff" with "swap execution facility" to clarify that a regulatory service provider that is responsible for a SEF's rule enforcement program can conduct investigations on behalf of the SEF.[491]

(B) Commission Determination

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[487] CME Comment Letter at 21 (Feb. 22, 2011).

[488] Id.

[489] Id.

[490] MarketAxess Comment Letter at 35 (Mar. 8, 2011).

[491] Id. at 35-36.

The Commission is adopting § 37.203(f)(1) as proposed, subject to certain modifications described below. The Commission confirms that in certain circumstances a SEF should have reasonable discretion regarding whether or not to open an investigation, as noted by CME. Accordingly, the Commission is amending proposed § 37.203(f)(1) to provide that an investigation must be commenced by the SEF upon the receipt of a request from Commission staff or upon the discovery or receipt of information that indicates a "reasonable basis" for finding that a violation may have occurred or will occur.

In response to MarketAxess's comment that the proposed rule is unclear, the Commission confirms that a SEF may contract with a regulatory service provider, as provided for under § 37.204, whose staff may perform the functions assigned to a SEF's compliance staff under this rule. In this regard, the Commission also notes that the SEF must maintain sufficient internal compliance staff to oversee the quality and effectiveness of the regulatory services provided on its behalf, and to make certain regulatory decisions, as required by § 37.204.

(ii) § 37.203(f)(2) – Timeliness

Under proposed § 37.203(f)(2), the Commission required that investigations be completed in a timely manner, defined as 12 months after an investigation is opened, absent enumerated mitigating circumstances.

(A) Summary of Comments

CME generally supported the proposed rule, but recommended that the list of possible mitigating circumstances also include the domicile of the subjects and cooperative enforcement matters since the SEF may not have independent control over

the pace of the investigation.[492] CME also requested that the Commission clarify that the twelve month period for completing an investigation referenced in proposed § 37.203(f)(2) is separate from the time period necessary to prosecute an investigation.[493]

(B) Commission Determination

The Commission is adopting § 37.203(f)(2) as proposed. The Commission believes that a 12-month period to complete an investigation is appropriate and timely. Although the Commission agrees with CME that additional mitigating factors could justifiably contribute to a delay in completing an investigation within a 12-month period, the Commission notes that the factors included in the proposed rule were not intended to be an exhaustive list of mitigating circumstances. In the Commission's view, the factors listed in the proposed rule represent some of the more common examples that could delay completion of an investigation within the 12-month period. The Commission also confirms that § 37.203(f)(2) only applies to the investigation phase of a matter, and is separate from the time period necessary to prosecute an investigation.

(iii) § 37.203(f)(3) – Investigation Reports When a Reasonable Basis Exists for Finding a Violation

Proposed § 37.203(f)(3) required a SEF's compliance staff to submit an investigation report for disciplinary action any time staff determined that a reasonable basis existed for finding a rule violation. The proposed rule also enumerated the items that must be included in the investigation report, including the market participant's disciplinary history.

(A) Summary of Comments

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[492] CME Comment Letter at 21 (Feb. 22, 2011).

[493] Id. at 21-22.

CME and ICE commented on the requirement that a respondent's disciplinary history be included in the investigation report that is submitted to a Review Panel.[494] CME asserted that a respondent's disciplinary history would only be relevant if a prior offense is an element of proof for the potential rule violation under review.[495] ICE commented that only substantive violations in the respondent's history would be relevant to the Review Panel's deliberations.[496]

CME commented that rule violations can range from very minor to egregious and not every rule violation merits formal disciplinary action.[497] CME argued that warning letters are sufficient to address minor rule violations, rather than the issuance of a formal investigatory report.[498]

MarketAxess stated that the proposed rule does not specify to whom the investigation reports must be submitted, and recommended that the reports be submitted to the SEF's Chief Compliance Officer, consistent with Core Principle 15.[499]

(B) Commission Determination

The Commission is adopting § 37.203(f)(3) as proposed, subject to one modification. The Commission agrees with CME and ICE that a respondent's disciplinary history is not always relevant to the determination of whether the respondent has committed a further violation of a SEF's rules. Accordingly, the Commission is removing this requirement from the final rule. The Commission notes, however, that all

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[494] ICE Comment Letter at 7 (Mar. 8, 2011); CME Comment Letter at 22, 35 (Feb. 22, 2011).

[495] CME Comment Letter at 35 (Feb. 22, 2011).

[496] ICE Comment Letter at 7 (Mar. 8, 2011).

[497] CME Comment Letter at 22 (Feb. 22, 2011).

[498] Id.

[499] MarketAxess Comment Letter at 36 (Mar. 8, 2011).

disciplinary sanctions, including sanctions imposed pursuant to an accepted settlement offer, must take into account the respondent's disciplinary history.

The Commission confirms, as recommended by CME, that "minor transgressions" can be addressed by a SEF's compliance staff with the issuance of warning letters as discussed below in § 37.203(f)(5). However, as further discussed below in § 37.203(f)(5), no more than one warning letter may be issued to the same person or entity found to have committed the same rule violation more than once within a rolling 12-month period.[500]

Finally, the Commission clarifies that a SEF's compliance staff should submit all completed investigation reports to the member or members of the SEF's compliance department responsible for reviewing such reports and determining the next steps in the process, such as whether to refer the matter to the SEF's disciplinary panel or authorized compliance staff under § 37.206(c).

(iv) § 37.203(f)(4) – Investigation Reports When No Reasonable Basis Exists for Finding a Violation

Proposed § 37.203(f)(4) required compliance staff to prepare an investigation report upon concluding an investigation and determining that no reasonable basis exists for finding a rule violation. If the investigation report recommended that a disciplinary panel should issue a warning letter, then the investigation report must also include a copy of the warning letter and the market participant's disciplinary history, including copies of warning letters.

[500] The Commission notes that a SEF's issuance of a warning letter for the violation of a SEF rule neither precludes the Commission from taking an enforcement action against the recipient of the warning letter based upon the same underlying conduct, nor does it provide a defense against any such Commission enforcement action.

(A) Summary of Comments

CME noted that its Market Regulation Department currently has the authority to administratively close a case and issue a warning letter without disciplinary committee approval.[501] Accordingly, CME recommended that the Commission amend the proposed rule to reflect that a SEF will also have such authority.[502]

(B) Commission Determination

The Commission is adopting § 37.203(f)(4) as proposed, subject to one modification.[503] The Commission is eliminating the provision that discussed the concept of warning letters because the Commission does not believe that a SEF would need to limit the number of warning letters that can be issued when a rule violation has not been found. The Commission notes, however, that this modification does not impact the limitation on the number of warning letters that may be issued by a disciplinary panel or by compliance staff to the same person or entity for the same violation committed more than once in a rolling 12-month period when a rule violation has been found. The Commission clarifies, in response to CME's comment, that a SEF may authorize its compliance staff to close a case administratively and issue a warning letter without disciplinary panel approval when a reasonable basis does not exist for finding a rule violation.

(v) § 37.203(f)(5) – Warning Letters

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[501] CME Comment Letter at 21 (Feb. 22, 2011).

[502] Id.

[503] Similar to § 37.203(f)(3), the Commission notes that a SEF's compliance staff should submit all completed investigation reports to the member or members of the SEF's compliance department responsible for reviewing such reports and determining the next steps to take.

Proposed § 37.203(f)(5) provided that a SEF may authorize its compliance staff to issue a warning letter or to recommend that a disciplinary committee issue a warning letter. The proposed rule also prohibited a SEF from issuing more than one warning letter to the same person or entity for the same potential violation during a rolling 12-month period.

(A) Summary of Comments

Some commenters opposed the proposed limitation on the number of warning letters issued during a rolling 12-month period.[504] CME contended that the rule does not consider important factors that are relevant to a SEF when evaluating potential sanctions in a disciplinary matter.[505] CME believed that the SEF should have discretion to determine the appropriate actions in all cases based on the "totality of the circumstances."[506] ICE stated that this limitation would discourage self-reporting of violations because of the lack of discretion in a resulting penalty assessment.[507] MarketAxess requested that the Commission adopt a more uniform approach with respect to warning letters, permitting them to be issued as a sanction or an indication of a finding of a violation in all SEF contexts.[508]

(B) Commission Determination

The Commission is adopting proposed § 37.203(f)(5), subject to certain modifications, including converting a portion of the rule to guidance in appendix B to part 37.

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[504] ICE Comment Letter at 7 (Mar. 8, 2011); CME Comment Letter at 22 (Feb. 22, 2011).

[505] CME Comment Letter at 22 (Feb. 22, 2011).

[506] Id.

[507] ICE Comment Letter at 7 (Mar. 8, 2011).

[508] MarketAxess Comment Letter at 36 (Mar. 8, 2011).

The Commission is maintaining in the final rule the limitation on the number of warning letters issued. The Commission acknowledges the comments from CME and ICE concerning the issuance of warning letters, but believes that to ensure that warning letters serve as effective deterrents and to preserve the value of disciplinary sanctions, no more than one warning letter may be issued to the same person or entity found to have committed the same rule violation more than once within a rolling 12-month period.[509] As discussed in the SEF NPRM, while a warning letter may be appropriate for a first-time violation, the Commission does not believe that more than one warning letter in a rolling 12-month period for the same violation is ever appropriate.[510] Further, a policy of issuing repeated warning letters, rather than issuing meaningful sanctions, to market participants who repeatedly violate the same rules reduces the effectiveness of a SEF's rule enforcement program.[511]

However, in response to commenters' concerns, the Commission is narrowing the application of this rule to warning letters that contain an affirmative finding that a rule violation has occurred. Therefore, the Commission is removing the provision in the proposed rule that a warning letter issued in accordance with this section is not a penalty or an indication that a finding of a violation has been made. To remain consistent with the modifications to proposed §§ 37.203(f)(3) and (f)(4), the Commission is also deleting the proposed requirement that investigation reports required by paragraphs (f)(3) and (f)(4) of this section must include a copy of the warning letter issued by compliance staff.

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[509] For purposes of this rule, the Commission does not consider a "reminder letter" or such other similar letter to be any different than a warning letter.

[510] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1224.

[511] Id.

As noted above, the Commission agrees with CME's comment that minor transgressions can be addressed by a SEF's compliance staff issuing a warning letter. Accordingly, in order to provide a SEF with flexibility in this regard, the Commission is moving this provision of the rule to the guidance in appendix B to part 37. The text of the guidance provides that the rules of a SEF may authorize its compliance staff to issue a warning letter to a person or entity under investigation or to recommend that a disciplinary panel take such action.

(7) § 37.203(g) – Additional Rules Required

Proposed § 37.203(g) required a SEF to adopt and enforce any additional rules that it believes are necessary to comply with the requirements of § 37.203.

(i) Commission Determination

The Commission did not receive any comments on proposed § 37.203(g); however, the Commission is moving this rule to the guidance in appendix B to part 37. The Commission believes that this requirement is already implicit in Core Principle 2 and need not be addressed separately as a final rule. Additionally, moving proposed § 37.203(g) to guidance provides SEFs with added flexibility in adopting additional rules that it believes are necessary to comply with the rules related to Core Principle 2. Consistent with this determination, the Commission is replacing proposed § 37.203(g) with final § 37.203(g) (titled "Additional sources for compliance") that simply permits SEFs to rely upon the guidance in appendix B to part 37 to demonstrate to the Commission compliance with § 37.203.

(e) § 37.204 – Regulatory Services Provided by a Third Party

(1) § 37.204(a) – Use of Third-Party Provider Permitted[512]

Proposed § 37.204(a) allowed a SEF to contract with a registered futures association or another registered entity to assist in complying with the SEF core principles, as approved by the Commission. The proposed rule also stated that a SEF that elects to use the services of a regulatory service provider must ensure that such provider has the capacity and resources to provide timely and effective regulatory services. The proposed rule further stated that a SEF will at all times remain responsible for the performance of any regulatory services received, for compliance with the SEF's obligations under the Act and Commission regulations, and for the regulatory service provider's performance on its behalf.

(i) Summary of Comments

Commenters generally supported the Commission's proposal to allow third parties to provide regulatory services.[513] However, MarketAxess argued that the Commission should permit an entity that is not a registered futures association or another registered entity with the Commission to perform regulatory services on behalf of a SEF, such as the Financial Industry Regulatory Authority ("FINRA").[514] In the alternative, MarketAxess recommended that the Commission should permit SEFs, if desired, to form a joint venture to create a special regulatory service provider for SEFs that would not be a registered entity.[515] Similarly, several commenters supported a centralized, common regulatory organization ("CRO") that would facilitate compliance with SEF core

[512] The Commission is renaming the title of this section from "Use of Third-Party Provider Permitted" to "Use of Regulatory Service Provider Permitted" to provide greater clarity.

[513] MarketAxess Comment Letter at 14-15 (Mar. 8, 2011); Reuters Comment Letter at 5 (Mar. 8, 2011); Bloomberg Comment Letter at 4-5 (Mar. 8, 2011); NFA Comment Letter at 1 (Mar. 8, 2011).

[514] MarketAxess Comment Letter at 15 (Mar. 8, 2011).

[515] Id.

principles.[516] In this regard, WMBAA stated that a CRO would establish a uniform SEF standard of conduct, streamline the Commission's evaluation of each SEF registration application, and conduct effective surveillance of fungible swap products trading on multiple SEFs.[517]

MarketAxess and Tradeweb requested clarification on how the Commission will assess and approve regulatory service providers.[518] In this regard, Tradeweb commented that SEFs should have flexibility in contracting with third party service providers, so long as the SEF uses reasonable diligence and acts in a manner consistent with market practice.[519]

(ii) Commission Determination

The Commission is adopting § 37.204(a) as proposed, subject to two modifications. In response to MarketAxess's comment about non-registered entities performing regulatory services, the Commission is revising the proposed rule to allow FINRA to assist SEFs in complying with the core principles. The Commission notes that FINRA has provided similar regulatory services for the securities industry for many years and may serve as a self-regulatory organization for SB-SEFs. Therefore, the Commission believes that allowing FINRA to serve as a regulatory service provider for SEFs is appropriate because FINRA is likely to have the qualifications, capacity, and resources to provide timely and effective regulatory services for SEFs.

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[516] Parity Energy Comment Letter at 5 (Mar. 25, 2011); WMBAA Comment Letter at 22 (Mar. 8, 2011); FXall Comment Letter at 12 (Mar. 8, 2011).

[517] WMBAA Comment Letter at 22 (Mar. 8, 2011).

[518] MarketAxess Comment Letter at 15 (Mar. 8, 2011); Tradeweb Comment Letter at 10 (Mar. 8, 2011).

[519] Tradeweb Comment Letter at 10 (Mar. 8, 2011).

The Commission recognizes the concerns that WMBAA and others have with respect to SEFs conducting market-wide surveillance activities. As discussed elsewhere in this final rulemaking,[520] an individual SEF may have limited ability to monitor trading activities across markets since individual swaps may be listed on multiple SEFs (as well as any DCMs listing swaps). The Commission clarifies that a SEF (or a regulatory service provider on a SEF's behalf), under Core Principle 2 and the Commission's regulations thereunder, is only responsible for surveillance and rule enforcement of the SEF's systems and platforms, and Core Principle 2 does not impose a cross-market surveillance requirement on a SEF.[521] Therefore, the final rules do not require the use of a single industry-wide CRO to assist SEFs with cross-market surveillance. While not requiring it, the final rules also do not prohibit the use of a single industry-wide CRO.

In response to MarketAxess's and Tradeweb's comments regarding the Commission's assessment and approval of regulatory service providers, the Commission notes that it will assess and approve the use of such service providers during the full registration process. The Commission also notes that Exhibit N to Form SEF requests executed or executable copies of any agreements with regulatory service providers.

Finally, the Commission is modifying § 37.204(a) to make clear that a SEF may use the services of a regulatory service provider for the provision of services to assist the SEF in complying with "the Act and Commission regulations thereunder" rather than simply the SEF core principles as stated in proposed § 37.204(a). The modification

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[520] See, e.g., discussion under § 37.203(d) – Automated Trade Surveillance System and Core Principle 6 – Position Limits or Accountability in the preamble.

[521] The Commission notes that other core principles, such as Core Principle 4, and the Commission's regulations thereunder may require SEFs to conduct certain cross-market monitoring.

aligns the rule text with what the Commission has always intended to be the range of a SEF's self-regulatory obligations.

(2) § 37.204(b) – Duty to Supervise Third Party[522]

Proposed § 37.204(b) required that a SEF maintain sufficient compliance staff to supervise any services performed by a regulatory service provider. The proposed rule also required that the SEF hold regular meetings with its regulatory service provider to discuss current work and other matters of regulatory concern, as well as conduct periodic reviews of the adequacy and effectiveness of services provided on its behalf. In addition, proposed § 37.204(b) required a SEF to carefully document the reviews and make them available to the Commission upon request.

(i) Summary of Comments

Two commenters recommended that the Commission adopt a more flexible rule with respect to a SEF's duty to supervise its regulatory service provider.[523] In this regard, NFA recommended that the Commission provide flexibility to a SEF and its regulatory service provider to mutually determine the necessary process for a SEF to supervise its regulatory service provider.[524] CME recommended that the Commission move the rule to guidance or acceptable practices.[525] In particular, CME pointed to the requirements that a SEF conduct periodic reviews of the services provided and hold regular meetings with the regulatory service provider to discuss ongoing investigations, trading patterns, market

[522] The Commission is renaming the title of this section from "Duty to Supervise Third Party" to "Duty to Supervise Regulatory Service Provider" to provide greater clarity.

[523] NFA Comment Letter at 2 (Mar. 8, 2011); CME Comment Letter at 18-19 (Feb. 22, 2011).

[524] NFA Comment Letter at 2 (Mar. 8, 2011).

[525] CME Comment Letter at 19 (Feb. 22, 2011).

participants, and any other matters of regulatory concern.[526] CME stated that "[w]hile it may well be that it is constructive for the [SEF] to hold regular meetings with its service provider and 'discuss market participants,' the core principle should stand on its own and the [SEF] should have the flexibility to determine how best to demonstrate compliance with the core principle."[527]

(ii) Commission Determination

The Commission is adopting § 37.204(b) as proposed.[528] The Commission acknowledges the commenters' desire for a flexible approach, but notes that a SEF that elects to use a regulatory service provider remains responsible for the regulatory services received and for compliance with the Act and Commission regulations. The SEF therefore must properly supervise the quality and effectiveness of the regulatory services provided on its behalf. The Commission believes that proper supervision will require that a SEF have complete and timely knowledge of relevant work performed by the SEF's regulatory service provider on its behalf. The Commission also believes that this knowledge can only be acquired through periodic reviews and regular meetings required under § 37.204(b).

(3) § 37.204(c) – Regulatory Decisions Required from the SEF

Proposed § 37.204(c) required a SEF that utilizes a regulatory service provider to retain exclusive authority over all substantive decisions made by its regulatory service provider, including the cancellation of trades, issuance of disciplinary charges, denials of access to the trading platform for disciplinary reasons, and any decision to open an

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[526] Id. at 18-19.

[527] Id. at 19.

[528] The Commission is making certain non-substantive clarifications to § 37.204(b).

investigation into a possible rule violation. Further, the proposed rule required a SEF to document any instance where its actions differed from those recommended by its regulatory service provider.

(i) Summary of Comments

CME objected to the idea that all decisions concerning the cancellation of trades remain in the exclusive authority of the SEF.[529] CME contended that a SEF may be better served by granting such authority to a regulatory service provider because such decisions require prompt decision-making.[530]

(ii) Commission Determination

The Commission is adopting § 37.204(c) as proposed, subject to two modifications. First, the Commission is removing the requirement that a decision to open an investigation reside exclusively with the SEF. The final rule grants a SEF the latitude to determine whether investigations will be opened by the SEF, by its regulatory service provider, or some combination of the two. The Commission believes that opening investigations is an administrative task and does not necessarily imply the threat of formal disciplinary action or sanctions against a market participant. Second, the Commission is amending the rule to clarify that when a SEF documents instances when its actions differ from those recommended by its regulatory service provider, the SEF must include the reasons for the course of action recommended by the regulatory service provider and the reasons why the SEF chose a different course of action.

The Commission disagrees with CME's comment concerning the "cancellation of trades" and believes that a SEF must retain exclusive authority in this regard. Cancelling

[529] CME Comment Letter at 19 (Feb. 22, 2011).

[530] Id.

trades is an important exercise of a SEF's authority over its markets and market participants. Cancelled trades may have meaningful economic consequences to the swap counterparties involved in the transaction, and may be the subject of contention between the counterparties if they do not both agree to the cancellation. The Commission emphasizes that permanent, consequential decisions must remain with the SEF.

(f) § 37.205 – Audit Trail

Proposed § 37.205 implements Core Principle 2's requirement that SEFs capture information that may be used in establishing whether rule violations have occurred.[531] Accordingly, proposed § 37.205 required a SEF to establish procedures to capture and retain information that may be used in establishing whether rule violations have occurred. The proposed rule, along with its subparts, established the requirements of an acceptable audit trail program and the enforcement of such program.

(1) § 37.205(a) – Audit Trail Required

Proposed § 37.205(a) required a SEF to capture and retain all audit trail data so that the SEF has the ability to detect, investigate, and prevent customer and market abuses. The proposed rule also provided that the audit trail data must be sufficient to reconstruct all transactions within a reasonable period of time and to provide evidence of any rule violations that may have occurred. Proposed § 37.205(a) further provided that the audit trail must permit the SEF to track a customer order from the time of receipt through fill, allocation, or other disposition, and must include both order and trade data.

(i) Summary of Comments

[531] CEA section 5h(f)(2)(B)(ii); 7 U.S.C. 7b-3(f)(2)(B)(ii).

WMBAA requested that the Commission establish a common format for audit trail data to ensure consistency among all SEFs and to make the information easier for the Commission to use and review when investigating customer and market abuses.[532]

(ii) Commission Determination

The Commission is adopting § 37.205(a) as proposed, subject to the modifications described below.[533] The Commission believes that the requirement that SEFs capture and retain all audit trial data is essential to ensuring that SEFs can capture information to establish whether rule violations have occurred, as required by Core Principle 2.[534] Additionally, the creation and retention of a comprehensive audit trail will enable SEFs to properly reconstruct any and all market and trading events and to conduct a thorough forensic review of all market information. The Commission believes that the ability to reconstruct markets in such a manner is a fundamental element of a SEF's surveillance and rule enforcement programs. Consistent with these principles, the Commission is modifying § 37.205(a) to clarify that the audit trail data must be sufficient to reconstruct trades and sufficient to reconstruct indications of interest, requests for quotes, and orders within a reasonable period of time.

Both the proposed and final rules in § 37.205(a) require that a SEF "capture and retain <u>all</u> audit trail data necessary to detect, investigate, and prevent customer and market abuses" (emphasis added). The Commission notes that information required to detect abuses may in some cases include all communications between market participants and a SEF's trading system or platform. The Commission also notes that a SEF's

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[532] WMBAA Comment Letter at 22-23 (Mar. 8, 2011).

[533] The Commission is making certain non-substantive clarifications to § 37.205(a).

[534] CEA section 5h(f)(2)(B)(ii); 7 U.S.C. 7b-3(f)(2)(B)(ii)

obligation to capture in its audit trail all data necessary to detect, investigate, and prevent customer and market abuses is not altered by the nature of the trading system or platform that a SEF may choose to utilize, including a system or platform that, for example, utilizes the telephone. For example, an acceptable audit trail for a SEF with a telephone component should include communications between the SEF's employees and their customers, as well as any communications between employees as they work customer indications of interest, requests for quotes, orders, and trades. An acceptable audit trail must capture the totality of communications (including, but not limited to, telephone, instant messaging, email, written records, and electronic communications within a trading system or platform) that could be necessary to detect, investigate, and prevent customer and market abuses, as required by both proposed and final § 37.205(a).

The Commission believes that WMBAA's suggestion to establish a common format for audit trail data may provide some value for SEFs that wish to coordinate and establish such a standard. However, the intent of the final rules is to require that a SEF establish and maintain an effective audit trail program, not to dictate the method or form for maintaining such information. Importantly, the rule, by not being prescriptive, provides SEFs with flexibility to determine the manner and the technology necessary and appropriate to meet the requirements. The Commission notes, nevertheless, that staff from the Commission's Office of Data and Technology will coordinate with SEFs to establish standards for the submission of audit trail data to the Commission.

(2) § 37.205(b) – Elements of an Acceptable Audit Trail Program

Proposed § 37.205(b)(1) required a SEF's audit trail to include original source documents, on which trade execution information was originally recorded, as well as

records for customer orders, whether or not they were filled. The proposed rule also required that a SEF that permits intermediation must require all executable orders or RFQs received over the telephone to be immediately entered into the trading system or platform. Proposed § 37.205(b)(2) required that a SEF's audit trail program include a transaction history database and specified the trade information required to be included in the database. Proposed § 37.205(b)(3) required the audit trail program to also have electronic analysis capability for the transaction history database. Proposed § 37.205(b)(4) required the audit trail program to include the ability to safely store all audit trail data and to retain it in accordance with the recordkeeping requirements of SEF Core Principle 10 and its associated regulations.

(i) Summary of Comments

WMBAA commented that the requirement for records to be retained for customer orders should not apply to indications of interest because it would extend beyond the Commission's statutory authority and the audit trail requirements currently in place in other financial markets, and would be unnecessarily costly and burdensome.[535] WMBAA also commented that the audit trail requirements must permit the retention of relevant information through various modes because SEFs may operate trade execution platforms "through any means of interstate commerce."[536] Better Markets commented that audit trail records, such as records of customers' orders and their disposition, must be time-stamped at intervals that are consistent with the capabilities of high-frequency traders that use SEFs.[537]

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[535] WMBAA Comment Letter at 23 (Mar. 8, 2011).

[536] Id.

[537] Better Markets Comment Letter at 18 (Mar. 8, 2011).

(ii) Commission Determination

The Commission is adopting proposed § 37.205(b), subject to the modifications discussed below. The Commission is clarifying that "time of trade execution" must be included in the data points of an acceptable audit trail, and is noting this clarification in final § 37.205(b)(1). The Commission is also revising proposed § 37.205(b)(2) to specify that a transaction history database must include a history of "all indications of interest, requests for quotes, orders, and trades entered into a [SEF's] trading system or platform, including all order modifications and cancellations." Further, the Commission is revising proposed § 37.205(b)(3) to specifically state that a SEF's electronic analysis capability must provide it with the "ability to reconstruct indications of interest, requests for quotes, orders, and trades, and identify possible trading violations." The revisions to §§ 37.205(b)(2) and (b)(3), subject to the additions of the indications of interest and requests for quotes language, reflect regulatory requirements previously proposed as part of § 37.203(d), but, as noted above, the Commission is moving these requirements to final § 37.205(b). Additionally, the Commission is revising proposed § 37.205(b)(2) by replacing the customer type indicators listed in the proposed rule with the term "customer type indicator code."

In response to WMBAA's comment regarding indications of interest, the Commission believes that retaining information about indications of interest provides another important detail of an audit trail, just as information of filled, unfilled, or cancelled orders provides important information for the SEF. This information enables a SEF to fulfill its statutory duty under Core Principle 2, which requires a SEF to capture

information that may be used in establishing whether rule violations have occurred.[538] Absent this information, SEFs would be limited in their ability to monitor their markets and to detect, investigate, and prevent customer and market abuses and trading rule violations. However, as discussed above, the Commission has removed the requirement for SEFs to offer indicative quote functionality, which should reduce the costs of complying with the audit trail requirements.[539]

In response to WMBAA's comment about the flexibility of audit trail requirements to accommodate various methods of execution, the Commission notes that proposed § 37.205(b) did not discriminate based on the method of execution. Given the Commission's clarification that a SEF may utilize any means of interstate commerce in providing the execution methods in § 37.9(a)(2)(i)(A) or (B), the Commission emphasizes that no matter how an indication of interest, request for quote, or order is communicated or a trade is executed, an audit trail that satisfies the requirements set forth in § 37.205 must be created.

The Commission is also making certain conforming changes to § 37.205(b)(1) to harmonize its provisions with the Commission's determination that a SEF may utilize any means of interstate commerce in providing the execution methods in § 37.9(a)(2)(i)(A) or (B). First, the Commission is adding "indications of interest" to the items that must be immediately captured in the audit trail pursuant to § 37.205(b)(1). Second, while proposed § 37.205(b)(1) required that all executable orders or requests for quotes "be immediately entered into the trading system or platform," § 37.205(b)(1) as adopted

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[538] CEA section 5h(f)(2)(B)(ii); 7 U.S.C. 7b-3(f)(2)(B)(ii).

[539] See discussion above regarding Minimum Trading Functionality under § 37.3 – Requirements for Registration in the preamble.

requires that such information be immediately "captured in the audit trail." This approach more accurately reflects the intent of § 37.205, whose purpose is to ensure an adequate audit trail, rather than to address the operation of a SEF's trading system or platform.

Accordingly, the final rules in § 37.205(b)(1) include conforming changes that remove the reference in proposed § 37.205(b)(1) to orders or requests for quotes "that are executable," and also remove the qualification that a SEF's obligation to capture information in the audit trail is dependent on whether the SEF permits intermediation. Finally, the final rules remove the additional audit trail requirement in proposed § 37.205(b)(1) for orders and requests for quotes that cannot be immediately entered into the trading system or platform. These clarifications are consistent with the Commission's intention in § 37.205(a) that a SEF's audit trail "capture and retain all audit trail data necessary to detect, investigate, and prevent customer and market abuses." It is the Commission's intent throughout § 37.205 to ensure that all SEFs' audit trails are equally comprehensive and effective regardless of the means of interstate commerce that a SEF may provide to meet the execution methods in § 37.9(a)(2)(i)(A) or (B).

Although § 37.205 sets forth a unified set of audit trail requirements for all methods of execution, the Commission notes that a SEF, for example, that utilizes the telephone as a means of interstate commerce in providing the execution methods in § 37.9(a)(2)(i)(A) or (B) may comply with the audit trail requirements by utilizing different technologies than a SEF that does not utilize the telephone. For example, the Commission believes that a SEF that utilizes the telephone may comply with the audit trail requirements in § 37.205(a) for oral communications by recording all such

communications that relate to swap transactions, and all communications that may subsequently result in swap transactions. Such recordings must allow for reconstruction of communications between the SEF and its customers; reconstruction of internal and external communications involving SEF employees who are ascertaining or providing indications of interest, requests for quotes, or orders; reconstruction of executed transactions; provide evidence of any rule violations; track a customer's order; and capture order and trade data as required under § 37.205(a).

The Commission also believes that a SEF that utilizes the telephone may comply with the original source document requirement in § 37.205(b)(1) for oral communications by retaining each recording's original media. By storing the recordings in a digital database and supplementing it with additional data as necessary, the Commission believes that a SEF that utilizes the telephone may comply with the transaction history database requirement in § 37.205(b)(2) for oral communications. Additionally, the Commission believes that a SEF that utilizes the telephone may comply with the electronic analysis capability in § 37.205(b)(3) for oral communications by ensuring that its digital database of recordings is capable of being searched and analyzed. The Commission notes, however, that § 37.205(b) does not establish an affirmative requirement to create recordings of oral communications if the audit trail requirements are met through other methods. The discussion above regarding the applicability of audit trail requirements to SEFs that utilize the telephone in providing the execution methods in § 37.9(a)(2) applies equally to SEFs that use non-telephonic means of communication (e.g., instant messaging or e-mail). In all cases, the operative requirement is to capture in

the audit trail and the transaction history database the totality of communications that could be necessary to detect, investigate, and prevent customer and market abuses.

The Commission acknowledges the comment by Better Markets regarding time-stamping audit trail records at intervals that are consistent with the capabilities of high-frequency traders. While the audit trail rules do not specify the granularity of time-stamped data, the Commission believes that the audit trail rules adopted herein, particularly the requirements that a SEF retain and maintain all data necessary to permit it to reconstruct trading, will help to ensure that audit trail records are time-stamped with the granularity necessary to reconstruct trades and investigate possible trading violations, including for high-frequency trading.[540]

(3) § 37.205(c) – Enforcement of Audit Trail Requirements

Proposed § 37.205(c)(1) required that a SEF conduct reviews, at least annually, of its members and market participants to verify their compliance with the SEF's audit trail and recordkeeping requirements. Proposed § 37.205(c)(1) also set forth minimum review criteria. Proposed § 37.205(c)(2) required that a SEF develop a program for effective enforcement of its audit trail and recordkeeping requirements, including a requirement that a SEF levy meaningful sanctions when deficiencies are found. Proposed § 37.205(c)(2) also stated that sanctions may not include more than one warning letter for the same violation within a rolling twelve-month period.

(i) Summary of Comments

[540] The Commission notes, as stated above under § 37.203(d) – Automated Trade Surveillance System in the preamble, that the accurate time stamping of data is particularly important for SEFs that use an RFQ System, including an RFQ System with a voice component. For such SEFs, the accurate time stamping of both their Order Book and RFQ System activity is critical for ensuring both that the SEF itself has a robust audit trail system and that the Commission is able to monitor the SEF's adherence to part 37's Order Book-RFQ System integration requirements.

Some commenters stated that annual audits are unnecessary and unduly burdensome.[541] CME commented that annual audits of all SEF market participants would be costly and unproductive, and should instead apply at the clearing firm level.[542] MarketAxess recommended that the Commission require a single entity or self-regulatory organization, such as FINRA or NFA, to conduct the audit of each SEF market participant.[543] Tradeweb commented that the proposed annual audit review requirement is not required of DCMs and, as such, should not be required of SEFs.[544]

(ii) Commission Determination

The Commission is adopting § 37.205(c) as proposed, subject to certain modifications as discussed below. The Commission disagrees with commenters who assert that the annual audit review requirement is unnecessary, unduly burdensome, costly, and unproductive. Through its experience with DCMs and DCOs, the Commission has learned that sampling-based reviews of audit trail and recordkeeping requirements are inadequate to ensure compliance with audit trail rules. The Commission believes that the requirements under § 37.205(c) are necessary to ensure that SEFs have accurate and consistent access to all data needed to reconstruct all transactions in their markets and to provide evidence of customer and market abuses. Absent reliable audit trail data, a SEF's ability to detect or investigate customer or market abuses may be severely diminished.

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[541] Tradeweb Comment Letter at 6 (Jun. 3, 2011); MarketAxess Comment Letter at 22 (Mar. 8, 2011); CME Comment Letter at 33 (Feb. 22, 2011).

[542] CME Comment Letter at 33 (Feb. 22, 2011).

[543] MarketAxess Comment Letter at 22 (Mar. 8, 2011).

[544] Tradeweb Comment Letter at 6 (Jun. 3, 2011).

However, in response to commenters' concerns that the rule is burdensome, the Commission is narrowing the scope of the proposed rule by removing the reference to "market participants" and instead stating that the annual audit review requirement only applies to members and those persons and firms that are subject to the SEF's recordkeeping rules. As a result of this revision, the Commission declines to adopt CME's recommendation to require annual audit trail reviews only at the clearing firm level.

The Commission is maintaining proposed § 37.205(c)(2) as a rule to ensure that SEFs impose meaningful sanctions for violations of audit trail and recordkeeping rules. However, the Commission is revising the rule to clarify that the limit on warning letters only applies where a SEF's compliance staff finds an actual rule violation, rather than just the suspicion of a violation. This change is consistent with the revisions in other sections discussing warning letters.[545]

In response to MarketAxess's recommendation that a single entity conduct the audit of each SEF market participant, the Commission believes that a SEF can monitor market participants on its own platform without relying upon a single cross-market self-regulatory organization. However, a SEF may use a regulatory service provider pursuant to § 37.204 to assist it in complying with the requirements under § 37.205(c).

In response to Tradeweb's comment that the annual audit review requirement is not required of DCMs, the Commission notes that it adopted a similar requirement for DCMs under § 38.553 of the Commission's regulations, to apply to all members and

[545] See, e.g., discussion above under § 37.203(f)(5) – Warning Letters in the preamble.

persons and firms subject to the DCM's recordkeeping rules.[546] The Commission believes that similar requirements are appropriate because, as noted above, SEFs, like DCMs, must have accurate and consistent access to all data needed to reconstruct all transactions in their markets, including indications of interest, requests for quotes, orders, and trades, and to detect, investigate, and prevent customer and market abuses.

(g) § 37.206 – Disciplinary Procedures and Sanctions

(1) § 37.206 – Disciplinary Procedures and Sanctions

Proposed § 37.206 addressed SEF Core Principle 2's requirement that SEFs establish and enforce trading, trade processing, and participation rules to deter abuse, and have the capacity to investigate and enforce such abuses.[547] Proposed § 37.206 provided that SEFs must establish trading, trade processing, and participation rules that will deter abuses and have the capacity to enforce such rules through prompt and effective disciplinary action.

(i) Summary of Comments

Some commenters generally stated that the proposed disciplinary procedures go beyond the statute and intent of Congress.[548] In this regard, FXall stated that, unlike DCMs, retail customers will not be participants on SEFs; therefore, the same level of protection afforded to DCM participants is not required for SEFs.[549] Some commenters recommended that the proposed disciplinary procedures should be streamlined through

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[546] Core Principles and Other Requirements for Designated Contract Markets, 77 FR at 36704.

[547] CEA section 5h(f)(2)(B); 7 U.S.C. 7b-3(f)(2)(B).

[548] MarketAxess Comment Letter at 23 (Mar. 8, 2011); ABC/CIEBA Comment Letter at 11 (Mar. 8, 2011); FXall Comment Letter at 12 (Mar. 8, 2011); ICAP Comment Letter at 5-6 (Mar. 8, 2011); State Street Comment Letter at 5 (Mar. 8, 2011).

[549] FXall Comment Letter at 12 (Mar. 8, 2011).

the use of a staff summary fine program.[550] Some commenters also requested that SEFs be granted greater flexibility to establish their own disciplinary procedures.[551] Tradeweb stated that the proposed disciplinary procedures would impose significant costs on SEFs and should be contracted to a central, third-party self-regulatory organization.[552]

(ii) Commission Determination

The Commission's evaluation of public comments with respect to proposed § 37.206 is based on its understanding that a SEF's obligation to establish adequate disciplinary rules is implicit in the statutory language of Core Principle 2, which requires, in part, that a SEF establish and enforce trading, trade processing, and participation rules to deter abuse and have the capacity to investigate and enforce such rules.[553] The Commission also takes note of public comments requesting greater flexibility in the application of SEF disciplinary rules. Accordingly, consistent with both its statutory mandate and its evaluation of the public comments received, the Commission is adopting elements of § 37.206 as proposed, while also moving to guidance or eliminating other parts of the proposed rules.[554]

The Commission believes that the specific disciplinary rules retained in the final rules are those that are essential to the promotion of market integrity by ensuring that

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[550] MarketAxess Comment Letter at 23 (Mar. 8, 2011), WMBAA Comment Letter at 24 (Mar. 8, 2011); FXall Comment Letter at 12 (Mar. 8, 2011).

[551] FXall Comment Letter at 12 (Mar. 8, 2011); ICAP Comment Letter at 6 (Mar. 8, 2011); Reuters Comment Letter at 4 (Mar. 8, 2011); WMBAA Comment Letter at 23 (Mar. 8, 2011); State Street Comment Letter at 5 (Mar. 8, 2011).

[552] Tradeweb Comment Letter at 10 (Mar. 8, 2011). Parity Energy also commented that the proposed disciplinary rules will impose unnecessary costs and create unnecessary duplication and the possibility of conflicting rules. Parity Energy Comment Letter at 4 (Mar. 25, 2011).

[553] CEA section 5h(f)(2)(B); 7 U.S.C. 7b-3(f)(2)(B).

[554] The Commission is also revising § 37.206 to include the term "member" in addition to the term "market participant" in order to provide greater detail and clarity. The Commission notes, as described above in § 37.200, that the term "market participant" encompasses SEF "members."

SEF markets are free of fraud or abuse, and also helping to provide basic procedural fairness for SEF disciplinary respondents. While the SEF NPRM noted that the SEF disciplinary procedures parallel those for DCMs,[555] the Commission has determined that the level of protection offered by the proposed rules was more appropriate for markets that include retail participants, in contrast to SEFs, whose participants are limited to ECPs.[556] Consequently, the Commission is moving to guidance numerous procedural protections set forth in the proposed rules that are more tailored to retail participants, including the requirements relating to the issuance of a notice of charges, and a respondent's right to representation, right to answer charges, and right to request a hearing.

The remaining final rules provide an essential framework that the Commission believes adequately ensures the effectiveness of a SEF's disciplinary program. Accordingly, the Commission is maintaining the proposed disciplinary rules that represent the most critical components of a disciplinary program, including the requirements that a SEF: (1) establish disciplinary panels that meet certain composition requirements; (2) levy meaningful disciplinary sanctions to deter recidivism; and (3) issue no more than one warning letter per rolling 12-month period for the same violation by the same respondent. The Commission believes that with these modifications, § 37.206 strikes the appropriate balance between providing the flexibility requested by the commenters and ensuring that SEFs comply with their statutory obligation under Core Principle 2.

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[555] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1225 n. 73.

[556] The Commission also believes that guidance is more appropriate for the SEF disciplinary procedures because the SEF core principles do not have a parallel to DCM Core Principle 13, which specifically discusses disciplinary procedures.

Some commenters recommended that the proposed disciplinary procedures should be streamlined through the use of a summary fine program. The Commission believes that, while summary fines may be appropriate for some disciplinary matters, such as recordkeeping violations, many disciplinary matters are dynamic and require the balancing of multiple unique facts and circumstances, which cannot be addressed through a summary fine program. Therefore, the Commission declines to adopt a summary fine program in lieu of disciplinary procedures.

In response to Tradeweb's comment about contracting out certain aspects of a SEF's disciplinary functions to a central third-party, the Commission notes that it views SEFs as SROs,[557] with all the attendant self-regulatory responsibilities to establish and enforce rules necessary to promote market integrity and the protection of market participants. Such responsibilities include the adherence to, and maintenance of, disciplinary procedures. The Commission notes that a SEF may utilize the services of a third-party regulatory service provider for assistance in performing its self-regulatory functions, as provided for in § 37.204.

(2) § 37.206(a) – Enforcement Staff

Proposed § 37.206(a) required that a SEF establish and maintain sufficient enforcement staff and resources to effectively and promptly prosecute possible rule violations within the SEF's jurisdiction. Proposed § 37.206(a) also required a SEF to monitor the size and workload of its enforcement staff annually. In addition, proposed §

[557] See Adaptation of Regulations to Incorporate Swaps, 77 FR 66288 (Nov. 2, 2012). Section 1.3(ee) states that a self-regulatory organization "means a contract market (as defined in § 1.3(h)), a swap execution facility (as defined in § 1.3(rrrr)), or a registered futures association under section 17 of the Act." Id. at 66318.

37.206(a) included provisions to ensure the independence of the enforcement staff and to help promote disciplinary procedures that are free of potential conflicts of interest.

(i) Commission Determination

In response to the general comments requesting greater flexibility regarding disciplinary procedures, the Commission is moving all of the requirements of proposed § 37.206(a) to guidance, except for the critical requirement that a SEF maintain sufficient enforcement staff and resources. The Commission believes that sufficient enforcement staff and resources are essential to the effective performance of a SEF's disciplinary program and are necessary to comply with Core Principle 2. Without a sufficient enforcement staff and resources, a SEF would be unable to promptly investigate and adjudicate potential rule violations and deter future violations. To maintain consistency with the revisions to proposed § 37.203(c)(2), the Commission is deleting from the rule the reference that a SEF monitor the size and workload of its enforcement staff annually to provide greater flexibility to SEFs in determining their approach to monitoring their enforcement resources. Nonetheless, the Commission believes that a SEF's obligation to monitor its enforcement staff and resources is implicit in the requirement to maintain adequate enforcement staff and resources.

(3) § 37.206(b) – Disciplinary Panels

Proposed § 37.206(b)(1) required a SEF to establish one or more Review Panels and one or more Hearing Panels. The composition of both panels was required to meet the composition requirements of proposed § 40.9(c)(3)(ii)[558] and could not include any

[558] Section 40.9(c)(3)(ii), as proposed, in the separate release titled Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, provided that "Each Disciplinary Panel shall include at least one person who would not be disqualified from serving as a Public Director by § 1.3(ccc)(1)(i)–(vi) and (2) of this chapter (a

members of the SEF's compliance staff or any person involved in adjudicating any other stage of the same proceeding. Proposed § 37.206(b)(2) provided that a Review Panel must be responsible for determining whether a reasonable basis exists for finding a violation of SEF rules and for authorizing the issuance of a notice of charges. If a notice of charges is issued, proposed § 37.206(b)(3) provided that a Hearing Panel must be responsible for adjudicating the matter and issuing sanctions.

(i) Summary of Comments

MetLife supported the proposed rule and agreed that SEFs should maintain a clear separation between disciplinary bodies that recommend the issuance of charges and those responsible for adjudicating matters.[559] CME stated that the Commission should not require a prescriptive approach to disciplinary panels, as SEFs may develop structures that clearly satisfy the objective of the core principle, but that may not precisely comply with the rule text.[560] CME illustrated two practices it believed may be precluded by the text of proposed § 37.206(b): (1) CME's Market Regulation staff determines whether certain non-egregious rule violations merit referral to a Review Panel and they issue warning letters on an administrative basis; and (2) CME's hearing panel adjudicates a disciplinary case prior to the issuance of charges pursuant to a supported settlement agreement.[561]

"Public Participant"). Such Public Participant shall chair each Disciplinary Panel. In addition, any registered entity specified in paragraph (c)(3)(i) of this section shall adopt rules that would, at a minimum: (A) Further preclude any group or class of participants from dominating or exercising disproportionate influence on a Disciplinary Panel and (B) Prohibit any member of a Disciplinary Panel from participating in deliberations or voting on any matter in which the member has a financial interest." 75 FR 63732, 63752 (proposed Oct. 18, 2010).

[559] MetLife Comment Letter at 6 (Mar. 8, 2011).

[560] CME Comment Letter at 35 (Feb. 22, 2011).

[561] Id.

(ii) Commission Determination

The Commission is adopting § 37.206(b) as proposed, subject to certain modifications described below. The Commission considered commenters' views and believes that the proposed rule can be modified to provide additional flexibility without diminishing its purpose. Accordingly, final § 37.206(b) will require SEFs to have one or more disciplinary panels, without imposing a specific requirement for SEFs to maintain a Review Panel and a Hearing Panel.[562] However, even under this single-panel approach, individuals who determine to issue charges in a particular disciplinary matter may not also adjudicate the matter. Therefore, final § 37.206(b) permits flexibility in the structure of SEFs' disciplinary bodies, but not in the basic prohibition, supported by MetLife, against vesting the same individuals with the authority to both issue and adjudicate charges in the same matter.

The modifications reflected in final § 37.206(b), together with the revisions made to the text of proposed § 37.206(d) that will now be included as guidance, as discussed below, provide additional flexibility by permitting SEFs to rely on their authorized compliance staff, rather than on a disciplinary panel, to issue disciplinary charges. However, the Commission notes that the adjudication of charges must still be performed by a disciplinary panel.

Finally, the Commission is adopting the composition and conflicts requirements for disciplinary panels with one modification, by replacing the reference to § 40.9(c)(3)(ii) with a reference to the more general "part 40 of this chapter" to

[562] The Commission notes that it is replacing specific panel names (i.e., Review Panel and Hearing Panel) with a generic reference to the "disciplinary panel" throughout part 37.

accommodate any re-enumeration that may occur with respect to proposed § 40.9(c)(3)(ii).

(4) § 37.206(c) – Review of Investigation Report

Proposed § 37.206(c) required a Review Panel to promptly review an investigation report received pursuant to proposed § 37.203(f)(3), and to take one of the following actions within 30 days of receipt: (1) promptly direct compliance staff to conduct further investigation if the Review Panel determined that additional investigation or evidence was needed, (2) direct that no further action be taken if the Review Panel determined that no reasonable basis existed for finding a violation or that prosecution was unwarranted, or (3) direct that the person or entity alleged to have committed a violation be served with a notice of charges if the Review Panel determined that a reasonable basis existed for finding a violation and adjudication was warranted.

(i) Summary of Comments

CME agreed that an investigation report should include the subject's disciplinary history; however, CME disagreed with the requirement in proposed § 37.203(f) that the disciplinary history be included in the version of the investigation report sent to the Review Panel.[563] CME believed that the disciplinary history should not be considered by the Review Panel at all when determining whether to issue formal charges, arguing that a participant's disciplinary history is not relevant to the consideration of whether it committed a further violation of SEF rules.[564]

(ii) Commission Determination

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[563] CME Comment Letter at 35 (Feb. 22, 2011).

[564] Id. While the Commission largely agrees with CME's comment, the Commission directs interested parties to § 37.203(f) for a further discussion of the required components of investigation reports.

In response to the general comments requesting greater flexibility, the Commission is eliminating all of proposed § 37.206(c) except for paragraph (3) of the proposed rule. In addition, the Commission is adding language to paragraph (3) to provide SEFs with the flexibility to allow authorized compliance staff to review an investigation report and determine whether a notice of charges should be issued in a particular matter. The Commission is also revising the text of paragraph (3) to follow the single-panel approach provided for in § 37.206(b). Proposed § 37.206(c)(3), with the revisions described above, is being incorporated into proposed § 37.206(d). As described below, all of proposed § 37.206(d) is being moved to the guidance in appendix B to part 37.

(5) § 37.206(d) – Notice of Charges

Proposed § 37.206(d) described the minimally acceptable contents of a notice of charges issued by a Review Panel. Specifically, proposed § 37.206(d) provided that a notice of charges must adequately state the acts, conduct, or practices in which the respondent is alleged to have engaged; state the rule(s) alleged to have been violated; advise the respondent that he is entitled, upon request, to a hearing on the charges; and prescribe the period within which a hearing may be requested. Paragraphs (1) and (2) of the proposed rule permitted a SEF to adopt rules providing that: (1) the failure to request a hearing within the time prescribed in the notice, except for good cause, may be deemed a waiver of the right to a hearing; and (2) the failure to answer or expressly deny a charge may be deemed to be an admission of such charge.

(i) Commission Determination

Although no comments were received on proposed § 37.206(d), the Commission believes that it can provide SEFs with additional flexibility by moving the entire rule to the guidance in appendix B to part 37.[565] Moreover, since paragraphs (1) and (2) of proposed § 37.206(d) allowed, but did not require, a SEF to issue rules regarding failures to request a hearing and expressly answer or deny a charge, the Commission believes that the language in these paragraphs is better suited as guidance rather than a rule.

(6) § 37.206(e) – Right to Representation

Proposed § 37.206(e) provided for a respondent's right, upon receiving a notice of charges, to be represented by legal counsel or any other representative of its choosing in all succeeding stages of the disciplinary process.

(i) Summary of Comments

CME commented that this rule should be limited to avoid conflicts of interest in representation and, accordingly, requested that the rule be revised to clarify that a respondent may not be represented by: (1) a member of the SEF's disciplinary committees; (2) a member of the SEF's Board of Directors; (3) an employee of the SEF; or (4) a person substantially related to the underlying investigation, such as a material witness or other respondent.[566]

(ii) Commission Determination

The Commission is moving proposed § 37.206(e) in its entirety to the guidance in appendix B to part 37, subject to the following modification. The Commission is amending the language to incorporate CME's recommendation. The guidance states that

[565] As mentioned above, the Commission is moving paragraph (3) of proposed § 37.206(c) to the text of proposed § 37.206(d) that will now be included as guidance.

[566] CME Comment Letter at 35 (Feb. 22, 2011).

upon being served with a notice of charges, a respondent should have the right to be represented by legal counsel or any other representative of its choosing in all succeeding stages of the disciplinary process, except by any member of the SEF's board of directors or disciplinary panel, any employee of the SEF, or any person substantially related to the underlying investigations, such as a material witness or respondent. The Commission believes that this revision appropriately addresses the conflicts of interest noted by CME.

(7) § 37.206(f) – Answer to Charges

Proposed § 37.206(f) required that a respondent be given a reasonable period of time to file an answer to a notice of charges. The proposed rule also provided that the rules of a SEF may prescribe certain aspects of the answer, which were enumerated in paragraphs (1) through (3).[567]

(i) Commission Determination

Although no comments were received on proposed § 37.206(f), the Commission is moving the entire rule to the guidance in appendix B to part 37, with certain modifications, in order to provide SEFs with greater flexibility to adopt their own disciplinary procedures. The Commission is also condensing the guidance by replacing paragraphs (1) through (3) with language making clear that any rules adopted by a SEF governing the requirements and timeliness of a respondent's answer to a notice of charges should be "fair, equitable, and publicly available."

(8) § 37.206(g) – Admission or Failure to Deny Charges

[567] These aspects were that: (1) the answer must be in writing and include a statement that the respondent admits, denies, or does not have and is unable to obtain sufficient information to admit or deny each allegation; (2) failure to file an answer on a timely basis shall be deemed an admission of all allegations in the notice of charges; and (3) failure in an answer to deny expressly a charge shall be deemed to be an admission of such charge.

Proposed § 37.206(g) provided that a SEF may adopt rules whereby a respondent who admits or fails to deny any of the charges alleged in the notice of charges may be found by the Hearing Panel to have committed the violations charged. If a SEF adopted such rules, paragraphs (1) through (3) of the proposed rule provided that: (1) the Hearing Panel must impose a sanction for each violation found to have been committed; (2) the Hearing Panel must promptly notify the respondent in writing of any sanction to be imposed and advise the respondent that it may request a hearing on such sanction within a specified period of time; and (3) the rules of the SEF may provide that if the respondent fails to request a hearing within the period of time specified in the notice, then the respondent will be deemed to have accepted the sanction.

(i) Commission Determination

Although the Commission did not receive comments on proposed § 37.206(g), the Commission is moving the entire rule, with certain modifications, to the guidance in appendix B to part 37.[568] Given that proposed § 37.206(g) allowed, but did not require, a SEF to issue rules regarding a respondent's admission or failure to deny charges, the Commission believes that the proposed rule is better suited as guidance rather than a rule. The Commission also believes that adopting the proposed rule as guidance, rather than a rule, will provide SEFs greater flexibility in administering their obligations, consistent with the general comments seeking the same. Furthermore, the Commission is modifying the text of proposed § 37.206(g)(2) that will now be included as guidance to clarify that a respondent may request a hearing "within the period of time, which should be stated in the notice."

[568] The Commission notes that the text that will now be included as guidance is being modified to reflect the single-panel approach adopted in § 37.206(b), replacing specific panel names with a generic reference to the "disciplinary panel."

(9) § 37.206(h) – Denial of Charges and Right to Hearing

Proposed § 37.206(h) required that in every instance where a respondent has requested a hearing on a charge that is denied, or on a sanction set by the Hearing Panel pursuant to proposed § 37.206(g), the respondent must be given the opportunity for a hearing in accordance with the requirements of proposed § 37.206(j). Proposed § 37.206(h) also gave SEFs the option to adopt rules that provided, except for good cause, the hearing must be concerned only with those charges denied and/or sanctions set by the Hearing Panel under proposed § 37.206(g) for which a hearing has been requested.

(i) Commission Determination

The Commission received no comments on proposed § 37.206(h), but is moving the entire rule, with certain modifications, to the guidance in appendix B to part 37.[569] In order to provide SEFs with further flexibility, even within the guidance, the Commission is also removing the proposed rule's reference to a SEF's ability to limit hearings to only those charges denied and/or sanctions set by the Hearing Panel under proposed § 37.206(g) for which a hearing has been requested.

(10) § 37.206(i) – Settlement Offers

Proposed § 37.206(i) provided the procedures that a SEF must follow if it permits the use of settlements to resolve disciplinary cases. Paragraph (1) of the proposed rule stated that the rules of a SEF may permit a respondent to submit a written offer of settlement any time after the investigation report is completed. The proposed rule also permitted the disciplinary panel presiding over the matter to accept the offer of

[569] The Commission is revising the proposed rule to reflect the single-panel approach adopted in § 37.206(b), replacing specific panel names with a generic reference to the "disciplinary panel." The Commission is also removing the references to proposed §§ 37.206(g) and (j) given that the Commission is moving proposed § 37.206(g) to guidance, and either eliminating or moving certain provisions of proposed § 37.206(j) to guidance.

settlement, but prohibited the panel from altering the terms of the offer unless the respondent agreed. In addition, paragraph (2) of the proposed rule provided that the rules of the SEF may allow a disciplinary panel to permit the respondent to accept a sanction without admitting or denying the rule violations upon which the sanction is based.

Paragraph (3) of the proposed rule stated that a disciplinary panel accepting a settlement offer must issue a written decision specifying the rule violations it has reason to believe were committed, and any sanction imposed, including any order of restitution where customer harm has been demonstrated. Paragraph (3) also provided that if an offer of settlement is accepted without the agreement of a SEF's enforcement staff, then the decision must adequately support the Hearing Panel's acceptance of the settlement. Finally, paragraph (4) of the proposed rule allowed a respondent to withdraw his or her offer of settlement at any time before final acceptance by a disciplinary panel. If an offer is withdrawn after submission, or is rejected by a disciplinary panel, the respondent must not be deemed to have made any admissions by reason of the offer of settlement and must not be otherwise prejudiced by having submitted the offer of settlement.

(i) Commission Determination

Although the Commission received no comments on proposed § 37.206(i), the Commission is moving the entire rule, with certain modifications, to the guidance in appendix B to part 37.[570] The Commission believes that adopting the proposed rule as guidance, rather than a rule, will provide SEFs greater flexibility in administering their obligations, consistent with the general comments seeking the same. Furthermore, the

[570] The Commission notes that the text that will now be included as guidance is being modified to reflect the single-panel approach adopted in § 37.206(b), replacing specific panel names with a generic reference to the "disciplinary panel."

Commission is revising the guidance text to make it consistent with its modifications to the customer restitution provisions adopted below with respect to proposed § 37.206(n).

(11) § 37.206(j) – Hearings

Proposed § 37.206(j) required a SEF to adopt rules that provide certain minimum procedural safeguards for any hearing conducted pursuant to a notice of charges. In general, proposed §§ 37.206(j)(1)(i) through (j)(1)(vii) required the following: (i) a fair hearing; (ii) authority for a respondent to examine evidence relied on by enforcement staff in presenting the charges; (iii) the SEF's enforcement and compliance staffs to be parties to the hearing and the enforcement staff to present its case on the charges and sanctions; (iv) the respondent to be entitled to appear personally at the hearing, to cross-examine and call witnesses, and to present evidence; (v) the SEF to require persons within its jurisdiction who are called as witnesses to participate in the hearing and produce evidence; (vi) a copy of the hearing be made and be a part of the record of the proceeding if the respondent requested the hearing; and (vii) the rules of the SEF may provide that the cost of transcribing the record be borne by the respondent in certain circumstances. Additionally, proposed § 37.206(j)(2) specified that the rules of the SEF may provide that a sanction be summarily imposed upon any person within its jurisdiction whose actions impede the progress of a hearing.

(i) Summary of Comments

CME recommended that proposed § 37.206(j)(1)(ii) be revised so that a respondent may not access protected attorney work product, attorney-client

communications, and investigative work product (e.g., investigation and exception reports).[571]

(ii) Commission Determination

The Commission is partially adopting proposed § 37.206(j), and is either eliminating or moving to guidance the remaining portion of the rule. The Commission is maintaining as a rule the provisions requiring the following: (1) hearings must be fair; and (2) if a respondent requested a hearing, a copy of the hearing be made and be a part of the record of the proceeding.[572] The Commission is eliminating proposed § 37.206(j)(1)(vii), a discretionary rule that in certain cases allowed for the cost of transcribing the record of the hearing to be borne by the respondent. The Commission is moving the remainder of proposed § 37.206(j) to the guidance in appendix B to part 37. The Commission believes that these revisions are appropriate given commenters' requests for greater flexibility to establish their own disciplinary procedures.

The Commission agrees with CME's comment that a SEF should be permitted to withhold certain documents from a respondent in certain circumstances. Therefore, the Commission is revising the text of proposed § 37.206(j)(1)(ii), which will now be included in guidance, to provide that a SEF may withhold documents that: (i) are privileged or constitute attorney work product; (ii) were prepared by an employee of the SEF but will not be offered in evidence in the disciplinary proceedings; (iii) may disclose

[571] CME Comment Letter at 36 (Feb. 22, 2011).

[572] The Commission is renumbering proposed § 37.206(j) to § 37.206(c). The Commission is also revising the proposed rule to reflect the single-panel approach adopted in § 37.206(b), replacing specific panel names with a generic reference to the "disciplinary panel." The Commission is also revising the reference to § 37.206(l) in proposed § 37.206(j)(1)(vi) given that it is moving proposed § 37.206(l) to guidance.

a technique or guideline used in examinations, investigations, or enforcement proceedings; or (iv) disclose the identity of a confidential source.

(12) § 37.206(k) – Decisions

Proposed § 37.206(k) required a Hearing Panel, promptly following a hearing conducted in accordance with proposed § 37.206(j), to render a written decision based upon the weight of the evidence and to provide a copy to the respondent. Paragraphs (1) through (6) detailed the items to be included in the decision.

(i) Commission Determination

The Commission received no comments on proposed § 37.206(k) and is adopting the rule as proposed with certain non-substantive clarifications.[573]

(13) § 37.206(l) – Right to Appeal

Proposed § 37.206(l) provided the procedures that a SEF must follow in the event that the SEF's rules permit an appeal. For SEFs that permit appeals, the language in paragraphs (1) through (4) of proposed § 37.206(l) generally required the SEF to: (1) establish an appellate panel; (2) ensure that the appellate panel composition is consistent with § 40.9(c)(iv) and not include any members of the SEF's compliance staff or any person involved in adjudicating any other stage of the same proceeding; (3) conduct the appeal solely on the record before the Hearing Panel, except for good cause shown; and (4) issue a written decision of the board of appeals and provide a copy to the respondent.

(i) Commission Determination

[573] The Commission is renumbering proposed § 37.206(k) to § 37.206(d). The Commission is also revising the reference to § 37.206(j) in proposed § 37.206(k) given that the Commission has either eliminated or moved to guidance many of the provisions of proposed § 37.206(j). The Commission is also revising the proposed rule to reflect the single-panel approach adopted in § 37.206(b), replacing specific panel names with a generic reference to the "disciplinary panel."

Although the Commission received no comments on proposed § 37.206(l), the Commission is moving the entire rule to the guidance in appendix B to part 37.[574] Given that proposed § 37.206(l) allowed, but did not require, a SEF to issue rules regarding a respondent's right to appeal, the Commission believes that the proposed rule is better suited as guidance rather than a rule. The Commission also believes that adopting the proposed rule as guidance, rather than a rule, will provide SEFs greater flexibility in administering their obligations, consistent with the general comments seeking the same.

(14) § 37.206(m) – Final Decisions

Proposed § 37.206(m) required that each SEF establish rules setting forth when a decision rendered under § 37.206 will become the final decision of the SEF.

(i) Commission Determination

Although the Commission received no comments on proposed § 37.206(m), the Commission is moving the entire rule to the guidance in appendix B to part 37. The Commission believes that adopting the proposed rule as guidance rather than a rule provides a SEF with additional flexibility to establish disciplinary procedures to meet its obligations pursuant to Core Principle 2.

(15) § 37.206(n) – Disciplinary Sanctions

Proposed § 37.206(n) required that disciplinary sanctions imposed by a SEF must be commensurate with the violations committed and must be clearly sufficient to deter

[574] The Commission notes that the reference to § 40.9(c)(iv) in the proposed rule was a technical error. Instead, proposed § 37.206(l) should have referenced the composition requirements of an appellate panel outlined in proposed § 40.9(c)(3)(iii). However, to accommodate any re-enumeration that may occur with respect to proposed § 40.9(c)(3)(iii), the Commission is replacing the mistaken reference to § 40.9(c)(iv) with a more general reference to part 40 in the guidance text. See Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 FR 63732, 63752 (proposed Oct. 18, 2010). The Commission is also revising the reference to § 37.206(k) in proposed § 37.206(l)(4) to § 37.206(d) given the renumbering in § 37.206. Finally, the Commission is revising the proposed rule to reflect the single-panel approach adopted in § 37.206(b), replacing specific panel names with a generic reference to the "disciplinary panel."

recidivism or similar violations by other market participants. In addition, the proposed rule required that a SEF take into account a respondent's disciplinary history when evaluating appropriate sanctions. The proposed rule further required that in the event of demonstrated customer harm, any disciplinary sanction must include full customer restitution.

(i) Summary of Comments

WMBAA recommended that any limitation of a market participant's access to a SEF imposed in response to a rule violation should be recognized and enforced consistently among all SEFs.[575] WMBAA also recommended that any disciplinary sanction imposed by a SEF should be published and made available to market participants.[576] Such requirements, WMBAA argued, are necessary in order to prevent market participants from gaming the system and maintaining access to markets after violations.[577]

(ii) Commission Determination

The Commission is adopting proposed § 37.206(n), subject to certain modifications.[578] The Commission is revising proposed § 37.206(n) to clarify that a respondent's disciplinary history should be taken into account in all sanction determinations, including sanctions imposed pursuant to an accepted settlement offer. Furthermore, the Commission is revising proposed § 37.206(n) so that it does not require

[575] WMBAA Comment Letter at 23 (Mar. 8, 2011).

[576] Id.

[577] Id. at 24.

[578] The Commission is renumbering proposed § 37.206(n) to § 37.206(e).

customer restitution if the amount of restitution or the recipient cannot be reasonably determined.[579]

The Commission acknowledges WMBAA's comment that disciplinary sanctions may not be recognized and enforced consistently across SEFs. However, each SEF is a distinct entity with its own rulebook and set of disciplinary procedures. Therefore, each SEF must determine the sanctions that are appropriate for its own market and thus the same conduct may result in different sanctions at different SEFs. The Commission does not believe that such sanction variation supports the mandatory recognition of sanctions across SEFs. However, if a SEF believes that it is important to recognize and enforce sanctions against market participants imposed by other SEFs or DCMs, then the SEF may implement appropriate rules.

The Commission agrees with WMBAA that any disciplinary sanction imposed by a SEF should be published and made available to market participants. Commission Regulation 9.11(a) requires that "[w]henever an exchange decision pursuant to which a disciplinary action or access denial action is to be imposed has become final, the exchange must, within thirty days thereafter, provide written notice of such action to … the Commission…."[580] The Commission has issued guidance that an exchange may comply with § 9.11(a) by transmitting or delivering the notice to NFA to be included in NFA's Background Affiliation Status Information Center database, which is available to

[579] The Commission notes that commenters to the DCM rulemaking requested this change and, after considering the comments, the Commission believes that this revision should also be applicable to SEFs. Core Principles and Other Requirements for Designated Contract Markets, 77 FR at 36654-55.

[580] Section 37.2 states that a SEF shall comply with part 9 of the Commission's regulations.

the public online.[581] The Commission also notes that a SEF may adopt rules regarding the publishing of disciplinary sanctions imposed by the SEF.

(16) § 37.206(o) – Summary Fines for Violations of Rules Regarding Timely Submission of Records

Proposed § 37.206(o) permitted a SEF to adopt a summary fine schedule for violations of rules relating to the timely submission of accurate records required for clearing or verifying each day's transactions. Under the proposed rule, a SEF may permit its compliance staff to summarily impose minor sanctions against persons within the SEF's jurisdiction for violating such rules. The proposed rule made clear that a SEF's summary fine schedule must not permit more than one warning letter in a rolling 12-month period for the same violation before sanctions are imposed and must provide for progressively larger fines for recurring violations.

(i) Summary of Comments

CME objected to the restriction of one warning letter per rolling 12-month period.[582] MarketAxess also requested that the Commission adopt a uniform approach with respect to warning letters, either permitting warning letters as a sanction or an indication of a finding of a violation in all SEF contexts.[583]

(ii) Commission Determination

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[581] NFA's Background Affiliation Status Information Center database is available at http://www.nfa.futures.org/basicnet/.

[582] CME Comment Letter at 36 (Feb. 22, 2011).

[583] MarketAxess Comment Letter at 36 (Mar. 8, 2011).

The Commission is partially adopting proposed § 37.206(o) and is converting the remaining portion of the rule to guidance in appendix B to part 37.[584] The Commission is maintaining as a rule the provision in the proposed rule that prohibits a SEF from issuing more than one warning letter per rolling 12-month period for the same violation. As discussed above, the Commission believes that in order to ensure that warning letters serve as effective deterrents, and to preserve the value of disciplinary sanctions, no more than one warning letter may be issued to the same person or entity found to have committed the same rule violation within a rolling 12-month period.[585] While a warning letter may be appropriate for a first-time violation, the Commission does not believe that more than one warning letter in a rolling 12-month period for the same violation is ever appropriate.[586]

However, in response to MarketAxess's comment, the Commission is narrowing the application of this rule to warning letters that contain an affirmative finding that a rule violation has occurred. Additionally, in order to provide flexibility, the compliance date of this rule will be one year from the effective date of the final SEF rules so that persons and entities may adapt to the new SEF regime. The Commission is converting the remainder of proposed § 37.206(o) to guidance in appendix B to part 37 because the proposed rule allowed, but did not require, a SEF to adopt a summary fine schedule.

(17) § 37.206(p) – Emergency Disciplinary Actions

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[584] The Commission is renumbering proposed § 37.206(o) to § 37.206(f). The Commission is also retitling this section as "Warning letters."

[585] For purposes of this rule, the Commission does not consider a "reminder letter" or such other similar letter to be any different than a warning letter.

[586] See Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1224.

Proposed § 37.206(p) provided that a SEF may impose a sanction, including a suspension, or take other summary action against a person or entity subject to its jurisdiction upon a reasonable belief that such immediate action is necessary to protect the best interest of the marketplace. The proposed rule also provided that any emergency action taken by the SEF must be in accordance with certain procedural safeguards as enumerated in the proposed rule.[587]

(i) Commission Determination

Although the Commission received no comments on proposed § 37.206(p), the Commission is moving the entire rule to the guidance in appendix B to part 37 because it is a discretionary rule.[588] The Commission also believes that adopting the proposed rule as guidance, rather than a rule, will provide SEFs greater flexibility in administering their obligations, consistent with the general comments seeking the same.

The Commission is also codifying new § 37.206(g)[589] (titled "Additional sources for compliance") that permits SEFs to refer to the guidance and/or acceptable practices in appendix B to part 37 to demonstrate to the Commission compliance with the requirements of § 37.206.

(h) § 37.207 – Swaps Subject to Mandatory Clearing

Proposed § 37.207 required that a SEF provide rules that when a swap dealer or major swap participant enters into or facilitates a swap transaction subject to the mandatory clearing requirement under section 2(h) of the Act, the swap dealer or major

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[587] The Commission notes that, pursuant to § 9.11 and § 37.2, SEFs must provide the Commission with notice of any disciplinary actions that they take, including emergency disciplinary actions.

[588] The Commission is also revising the reference to § 37.206(j) in proposed § 37.206(p)(ii) given that the Commission has either eliminated or moved to guidance many of the provisions of proposed § 37.206(j).

[589] The Commission notes that this paragraph's numbering is due to the renumbering of § 37.206.

swap participant shall be responsible for complying with the mandatory trading requirement under section 2(h)(8) of the Act.

(1) Summary of Comments

FXall stated that proposed § 37.207 could be read to require a SEF to be responsible for policing the conduct of swap dealers and major swap participants generally, and not only with respect to their trading on such SEF.[590] In this regard, MarketAxess stated that a SEF's obligation to require swap dealers and major swap participants to comply with the mandatory trading requirement should only extend to swaps that are executed pursuant to its own rules.[591] MarketAxess also noted that proposed § 37.207 is identical to proposed § 37.200(d) and therefore is unnecessary.[592] WMBAA commented that there is no statutory basis to impose the requirement in proposed § 37.207.[593]

(2) Commission Determination

The Commission agrees with MarketAxess that proposed § 37.207 is identical to § 37.200(d) and is therefore eliminating proposed § 37.207. In response to WMBAA's comment, the Commission notes that § 37.200(d) recites the statutory text of Core Principle 2 and thus provides the statutory basis for codification of the statutory text as a regulation.[594] To address FXall's and MarketAxess's concerns, the Commission clarifies that a SEF's rules pursuant to § 37.200(d) need only apply to swaps executed on or pursuant to the rules of that SEF.

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[590] FXall Comment Letter at 11 (Mar. 8, 2011).

[591] MarketAxess Comment Letter at 34 (Mar. 8, 2011).

[592] Id.

[593] WMBAA Comment Letter at 24 (Mar. 8, 2011).

[594] CEA section 5h(f)(2)(D); 7 U.S.C. 7b-3(f)(2)(D).

3. Subpart D – Core Principle 3 (Swaps Not Readily Susceptible to Manipulation)

Core Principle 3 requires that a SEF permit trading only in swaps that are not readily susceptible to manipulation.[595] In the SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 3 in proposed § 37.300, and adopts that rule as proposed.

To demonstrate to the Commission compliance with Core Principle 3, proposed § 37.301 required a SEF to submit new swap contracts in advance to the Commission pursuant to part 40 of the Commission's regulations, and provide to the Commission the information required under appendix C to part 38. The Commission also proposed guidance for compliance with Core Principle 3 under appendix B to part 37, which noted the importance of the reference price for a swap contract. The guidance also stated that Core Principle 3 requires that the reference price used by a swap not be readily susceptible to manipulation.

(a) Summary of Comments[596]

Reuters generally supported Core Principle 3, and the requirement that SEFs should have in place appropriate systems and controls to identify and manage situations where the market or individual swap contract may be susceptible to manipulation or

[595] CEA section 5h(f)(3); 7 U.S.C. 7b-3(f)(3).

[596] The Commission notes that in Argus's joint DCM and SEF rulemaking comment letter dated Feb. 22, 2011, it commented on Core Principle 3 and specifically, the Commission's guidance in appendix C to part 38 – Demonstration of Compliance That a Contract is Not Readily Susceptible to Manipulation. The Commission has addressed Argus's comments in the DCM final rulemaking, Core Principles and Other Requirements for Designated Contract Markets, 77 FR at 36633-34. The Commission also notes that in CME's SEF rulemaking comment letter dated Mar. 8, 2011 and DCM rulemaking comment letter dated Feb. 22, 2011, it commented on the Commission's guidance in appendix C to part 38. The Commission has also addressed CME's comments in the DCM final rulemaking, Core Principles and Other Requirements for Designated Contract Markets, 77 FR at 36632-34.

fraud.[597] GFI commented that once the Commission has declared a swap subject to mandatory clearing, a SEF should not be required to ensure that the contract is not readily susceptible to manipulation since such activity would be redundant.[598] According to GFI, the Commission would not make a swap subject to mandatory clearing unless it believed that the swap is not subject to manipulation.[599]

(b) Commission Determination

The Commission is adopting § 37.301 as proposed, subject to certain modifications for clarity. The Commission is deleting from the rule the references to prior approval or self-certification for new product submissions under part 40 of the Commission's regulations because those details are covered under § 37.4 and part 40. The Commission is also adding to the rule a reference to the guidance and/or acceptable practices in appendix B to part 37. This reference was inadvertently omitted from the SEF NPRM.

In response to GFI's comments, the Commission notes that section 5h of the Act requires that a SEF permit trading only in swaps that are not readily susceptible to manipulation.[600] The Commission notes that this is a separate and distinct requirement for a SEF to comply with, as opposed to the Commission determination as to whether a swap is subject to mandatory clearing. The Commission does not have the authority under CEA section 4(c)(1) to exempt SEFs from complying with the core principles.

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[597] Reuters Comment Letter at 5 (Mar. 8, 2011).

[598] GFI Comment Letter at 4-5 (Mar. 8, 2011).

[599] Id. at 5.

[600] CEA section 5h(f)(3); 7 U.S.C. 7b-3(f)(3).

The Commission notes that the requirement that a SEF permit trading in swaps that are not readily susceptible to manipulation requires a SEF to be responsible for the terms and conditions of the swap contracts which trade on its facility. To meet this requirement, the guidance includes items that a SEF should consider in developing swap contract terms and conditions for both physical delivery and cash-settled contracts. The Commission recognizes that a SEF may permit trading in a wide range of swaps, some standardized and others customized and complex. The Commission staff is available to consult with SEFs should questions arise regarding the information that SEFs should submit to the Commission to satisfy the requirements of Core Principle 3, especially for the SEF's more customized and complex swap contracts. The Commission will take into account these considerations when determining whether a SEF satisfies the requirements of Core Principle 3.

4. Subpart E – Core Principle 4 (Monitoring of Trading and Trade Processing)

Under Core Principle 4, a SEF must establish and enforce rules or terms and conditions defining, or specifications detailing trading procedures to be used in entering and executing orders traded on or through the facilities of the SEF and procedures for trade processing of swaps on or through the facilities of the SEF.[601] Core Principle 4 also requires a SEF to monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.[602] In the

[601] CEA section 5h(f)(4); 7 U.S.C. 7b-3(f)(4).

[602] Id.

SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 4 in proposed § 37.400, and adopts that rule as proposed.

As discussed above under Core Principle 3, the Commission recognizes that a SEF may permit trading in a wide range of swaps, some standardized and others customized and complex. The Commission staff is available to consult with SEFs should questions arise regarding how to satisfy the requirements of Core Principle 4, especially for the SEF's more customized and complex swap contracts. The Commission will take into account these considerations when determining whether a SEF satisfies the requirements of Core Principle 4.

(a) § 37.401 – General Requirements

Proposed § 37.401(a) required a SEF to collect and evaluate data on individual traders' market activity on an ongoing basis in order to detect and prevent manipulation, price distortions and, where possible, disruptions of the delivery or cash-settlement process. Proposed § 37.401(b) required a SEF to monitor and evaluate general market data in order to detect and prevent manipulative activity that would result in the failure of the market price to reflect the normal forces of supply and demand. Proposed § 37.401(c) required a SEF to have the capacity to conduct real-time monitoring of trading and comprehensive and accurate trade reconstruction. Further, the proposed rule required that intraday trade monitoring must include the capacity to detect abnormal price movements, unusual trading volumes, impairments to market liquidity, and position-limit violations. Finally, proposed § 37.401(d) required a SEF to have either manual processes or automated alerts that are effective in detecting and preventing trading abuses. The Commission noted in the SEF NPRM preamble that it would be difficult, if not

impossible, for a SEF to monitor for market disruptions in markets with high transaction volume and a large number of trades unless the SEF installed automated trading alerts.[603]

(1) Summary of Comments

Several commenters sought clarification that proposed § 37.401 limits a SEF's oversight of market participant activity to its own SEF.[604] Tradeweb, for example, commented that a SEF cannot ensure that a marketplace other than its own has not been manipulated to affect the SEF's swaps because the SEF will not have enough information about the other marketplaces.[605]

WMBAA requested that the Commission clarify what it means by "individual traders" and "market activity" in proposed § 37.401(a).[606] WMBAA also sought clarification regarding what constitutes "general market data" in proposed § 37.401(b).[607]

CME commented that the Commission's requirements for real-time monitoring in proposed § 37.401(c) are overly broad, and stated that requiring real-time monitoring capabilities across every instrument for vague terms such as "abnormal price movements," "unusual trading volumes," and "impairments to market liquidity" does not provide a SEF with sufficient clarity with respect to what specific capabilities satisfy the standard.[608] Similarly, ICE requested that the Commission delete the phrase

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[603] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1227.

[604] Bloomberg Comment Letter 3-4 (Jun. 3, 2011); Parity Energy Comment Letter at 4 (Mar. 25, 2011); Tradeweb Comment Letter at 11 (Mar. 8, 2011); MarketAxess Comment Letter at 22 (Mar. 8, 2011); WMBAA Comment Letter at 25 (Mar. 8, 2011).

[605] Tradeweb Comment Letter at 11 (Mar. 8, 2011).

[606] WMBAA Comment Letter at 25 (Mar. 8, 2011).

[607] Id.

[608] CME Comment Letter at 24 (Feb. 22, 2011).

"impairments to market liquidity" from the rule, arguing that the wording is vague and has no foundation in the core principle.[609]

ICE and CME also expressed concern regarding the real-time monitoring of position limits.[610] ICE stated that real-time monitoring of position limits may be flawed given that option deltas change throughout the day, the destination of allocated and give-up transactions are not immediately known, and off-exchange transactions may not be reported in real-time.[611] CME stated that effective real-time monitoring of position limits is challenging given that the identical contract will frequently trade in multiple competitive venues.[612]

In response to the Commission's questions in the SEF NPRM regarding high frequency trading, CME raised concerns over the absence of a definition for high frequency trading, which CME claimed can include many different trading strategies.[613] CME questioned whether the Commission had unique concerns about high frequency traders, and further remarked that the Commission has not articulated what purpose would be served by singling out high frequency trading for special monitoring.[614] CME stated, however, that it has the capability to monitor the messaging frequency of participants in their markets and can quickly and easily identify which participants generate high messaging traffic.[615] With respect to the ability of automated trading systems to detect and flag high frequency trading anomalies, CME commented that it is

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[609] ICE Comment Letter at 4 (Mar. 8, 2011).

[610] ICE Comment Letter at 4 (Mar. 8, 2011); CME Comment Letter at 24 (Feb. 22, 2011).

[611] ICE Comment Letter at 4 (Mar. 8, 2011).

[612] CME Comment Letter at 24 (Feb. 22, 2011).

[613] Id. at 25.

[614] Id.

[615] Id.

unclear what specific types of anomalies would be uniquely of concern in the context of a high frequency trader as opposed to any other type of trader.[616] CME noted that its systems were designed to identify anomalies or transaction patterns that violate their rules or might otherwise be indicative of some other risk to the orderly functioning of the markets.[617]

(2) Commission Determination

The Commission is adopting § 37.401 as proposed, subject to certain modifications, including converting portions of the rule to guidance in appendix B to part 37.[618]

To address commenters concerns whether § 37.401 requires a SEF to monitor market activity beyond its own market, the Commission notes that the Act requires a SEF to monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process.[619] Given this statutory requirement, there are certain instances where a SEF must monitor market activity beyond its own market.[620] As noted below, a SEF must assess whether trading in a third-party index or instrument used as a reference price or the underlying commodity for its listed swaps is being used to affect prices on its market.[621] The Commission, however, provides flexibility to SEFs by not prescribing in the regulations the specific methods for monitoring. To provide

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[616] Id.

[617] Id.

[618] The Commission is moving proposed § 37.401(d) to the guidance in appendix B to part 37 and moving the "trade reconstruction" language in proposed § 37.401(c) to final § 37.401(d).

[619] CEA section 5h(f)(4)(B); 7 U.S.C. 7b-3(f)(4)(B).

[620] Refer to the guidance under Core Principle 4 in appendix B to part 37 for examples of methods for monitoring market activity beyond a SEF's own market.

[621] See discussion below under § 37.403 – Additional Requirements for Cash-Settled Swaps and § 37.404 – Ability to Obtain Information in the preamble.

additional flexibility, in instances where a SEF can demonstrate to the Commission that trading activity off the SEF's facility is not relevant to threats of manipulation, distortion, or disruption for trading conducted on its own facility, then the SEF may limit monitoring to trading activity on its own facility.

In response to WMBAA's concerns regarding the clarification of certain terms in § 37.401(a), the Commission is revising the rule text to change the term "individual traders" to "market participants" as "individual traders" was meant to apply to a SEF's market participants. The Commission also clarifies that "market activity" means its market participants' "trading" activity. In § 37.401(b), "general market data" means that a SEF shall monitor and evaluate general market conditions related to its swaps. For example, a SEF must monitor the pricing of the underlying commodity or a third-party index or instrument used as a reference price for its swaps as compared to the prices on its markets.

The Commission is also revising the rule to clarify that: (a) real-time monitoring is to detect and, when necessary, resolve abnormalities; and (b) reconstructing trading activity is to detect instances or threats of manipulation, price distortion, and disruptions.

In the guidance, the Commission is clarifying that monitoring of trading activity in listed swaps should be designed to prevent manipulation, price distortion, and disruptions. The Commission believes that SEFs should have rules in place that allow it to intervene to prevent or reduce market disruptions given such requirement in Core Principle 4. The Commission also notes that once a threatened or actual disruption is detected, the SEF should take steps to prevent the disruption or reduce its severity.

In the guidance, the Commission is also clarifying what activities should be included in real-time monitoring as compared to what activities may be done on a T+1 basis. The Commission believes that monitoring of price movements and trading volumes in order to detect, and when necessary, resolve abnormalities should be accomplished in real time in order to achieve, as much as possible, the statute's emphasis on preventive actions. It is acceptable, however, to have a program that detects instances or threats of manipulation, price distortion, and disruptions on at least a T+1 basis, incorporating any additional data that is available on such T+1 basis, including trade reconstruction data. The Commission notes that it dropped the requirements for a SEF to monitor for "impairments to market liquidity" and "position limit violations" given commenters' concerns about the difficulty of such monitoring.

The Commission is moving to guidance the requirement to have automated alerts in proposed § 37.401(d). The Commission believes that automated trading alerts, preferably in real time, are the most effective means of detecting market anomalies. However, a SEF may demonstrate that its manual processes are effective.

As for the Commission's inquiry in the SEF NPRM about requiring additional monitoring of high frequency trading, the Commission believes that a SEF should be capable of monitoring all types of trading that may occur on its facility, including trading that may be characterized as "high frequency." The Commission has decided not to implement, at this time, further rules pertaining to the monitoring of high frequency trading. The Commission is encouraged that there are efforts underway both within and outside of the Commission, to define and develop approaches for better monitoring of high-frequency and algorithmic trading. This is particularly evident from recent work

done at the request of the Commission's Technology Advisory Committee ("TAC").[622] Further, the United Kingdom government's Foresight Project also commissioned a recently released report on the future of computer trading in financial markets, which aims to assess the risks and benefits of automated buying and selling.[623] These efforts may assist the Commission's further development of a regulatory framework for high frequency trading activities.

(b) § 37.402 – Additional Requirements for Physical-Delivery Swaps

Proposed § 37.402 required, for physical-delivery swaps, that a SEF monitor each swap's terms and conditions, monitor the adequacy of deliverable supplies, assess whether supplies are available to those making physical delivery and saleable by those taking delivery, and monitor the ownership of deliverable supplies. Proposed § 37.402 also required that a SEF address any conditions that are causing price distortions or market disruptions.

(1) Summary of Comments

CME commented that proposed § 37.402 should be an acceptable practice instead of a prescriptive rule.[624] Parity Energy commented that in a market where numerous SEFs permit trading in identical swaps, requiring each SEF to monitor the adequacy, size, and ownership of deliverable supply as well as the delivery locations and commodity

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[622] See, e.g., "Recommendations on Pre-Trade Practices for Trading Firms, Clearing Firms and Exchanges involved in Direct Market Access," Pre-Trade Functionality Subcommittee of the CFTC's Technology Advisory Committee (Mar. 1, 2011) ("TAC Subcommittee Recommendations"), available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/tacpresentation030111_ptfs2.pdf . The Commission notes that the subcommittee report was submitted to the TAC and made available for public comment, but no final action has been taken by the full committee.

[623] See UK Government Office for Science, Foresight Project, The Future of Computer Trading in Financial Markets (working paper), available at http://www.bis.gov.uk/foresight/our-work/projects/current-projects/computer-trading/working-paper.

[624] CME Comment Letter at 25 (Feb. 22, 2011).

characteristics is duplicative, unmanageable, and creates the risk of conflicting conclusions.[625]

(2) Commission Determination

The Commission is adopting § 37.402 as proposed, subject to certain modifications, including converting portions of the rule to guidance in appendix B to part 37.[626] In response to comments and to provide SEFs with greater flexibility, the Commission is revising the requirement in proposed § 37.402(a)(2)[627] so that SEFs only have to monitor the "availability" of the commodity supply instead of monitoring whether the supply is "adequate." The Commission is also removing from proposed § 37.402 the requirements that SEFs monitor specific details of the supply, marketing, and ownership of the commodity to be physically delivered. Instead, appendix B to part 37 lists guidance for monitoring conditions that may cause a physical-delivery swap to become susceptible to price manipulation or distortion, including monitoring the general availability of the commodity specified by the swap, the commodity's general characteristics, the delivery locations, and, if available, information on the size and ownership of deliverable supplies. Moving these specific details to guidance will provide SEFs with additional flexibility in meeting their monitoring obligations associated with physical-delivery swaps.

(c) § 37.403 – Additional Requirements for Cash-Settled Swaps

Proposed § 37.403(a) required, for cash-settled swaps, that a SEF monitor: (a) the availability and pricing of the commodity making up the index to which the swap is

[625] Parity Energy Comment Letter at 4 (Mar. 25, 2011).

[626] The Commission is renumbering proposed §37.402(a)(1) and (a)(2) to § 37.402(a) and (b), respectively. The Commission is deleting or moving to guidance proposed § 37.402(a)(3), (a)(4), and (b).

[627] Proposed § 37.402(a)(2) is now final § 37.402(b).

settled and; (b) the continued appropriateness of the methodology for deriving the index for SEFs that compute their own indices. Where a swap is settled by reference to the price of an instrument traded in another venue, proposed § 37.403(b) required that the SEF either have an information sharing agreement with the other venue or be able to independently determine that positions or trading in the reference instrument are not being manipulated to affect positions or trading in its swap.

(1) Summary of Comments

Argus expressed concern regarding the requirement in proposed § 37.403(a)(1) for a SEF to monitor the availability and pricing of the commodity making up the index to which the swap will be settled, particularly where an index price is published based upon transactions that are executed off the SEF.[628] Argus noted that if a SEF is required to perform this monitoring function, a SEF may choose not to list the swap and market participants would not have a hedging instrument.[629] Argus also commented that the cost to monitor transactions that are executed off of the SEF could be prohibitive.[630]

Several commenters expressed concern about the requirement in proposed § 37.403(b) that a SEF have an information sharing agreement with, or monitor positions or trading in, another venue when a swap listed on the SEF is settled by reference to the price of an instrument traded on another venue.[631] ICE stated that the proposal places an undue burden on SEFs to monitor positions held at other trading venues, and that this requirement would be more efficiently facilitated by a central regulatory body such as the

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[628] Argus Comment Letter at 6 (Feb. 22, 2011).

[629] Id.

[630] Id. at 7.

[631] Parity Energy Comment Letter at 5 (Mar. 25, 2011); ICE Comment Letter at 4-5 (Mar. 8, 2011); Nodal Comment Letter at 5 (Mar. 8, 2011); CME Comment Letter at 11 (Mar. 8, 2011).

Commission.[632] Similarly, CME stated that the Commission is uniquely situated to add regulatory value to the industry by reviewing for potential cross-venue rule violations because the Commission is the central repository for position information delivered to it on a daily basis in a common format across all venues.[633] CME asserted that the SEF NPRM's proposed alternative of requiring SEFs and their customers to report information that the Commission already receives or will be receiving is an onerous burden.[634] CME further asserted that the SEF NPRM's other proposed alternative, that the SEF enter into an information-sharing agreement with the other venue, will result in additional costs to both entities and that it may not be practical or prudent for a SEF to enter into such an agreement with the other venue.[635] Finally, Nodal stated that a SEF that is a party to an industry agreement such as the International Information Sharing Memorandum of Understanding and Agreement should satisfy the information sharing requirement in the proposed rule by virtue of such agreement.[636]

(2) Commission Determination

The Commission is adopting § 37.403 as proposed, subject to certain modifications, including converting portions of the rule to guidance in appendix B to part 37.[637] The Act requires SEFs to monitor trading in swaps to prevent disruptions of the cash settlement process.[638] However, in response to Argus's comment about the costs of

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[632] ICE Comment Letter at 4-5 (Mar. 8, 2011).

[633] CME Comment Letter at 11 (Mar. 8, 2011).

[634] Id.

[635] Id.

[636] Nodal Comment Letter at 5 (Mar. 8, 2011).

[637] The Commission is renumbering proposed § 37.403(a)(1) and (a)(2) to §37.403(a), (b), and (c). The Commission is moving proposed § 37.403(b) to § 37.404(a).

[638] CEA section 5h(f)(4)(B); 7 U.S.C. 7b-3(f)(4)(B).

proposed § 37.403(a)(1), the Commission has removed from the rule the requirement that a SEF monitor the availability and pricing of the commodity making up the index to which the swap will be settled. Section 37.403(a)[639] now requires that a SEF monitor the pricing of the reference price used to determine cash flows or settlement. The Commission believes that SEFs must monitor the pricing of the reference price in order to comply with Core Principle 4's requirement to prevent manipulation, price distortion, and disruptions of the cash settlement process. As noted in the SEF NPRM, market participants may have incentives to disrupt or manipulate reference prices for cash-settled swaps.[640]

Although no comments were received on proposed § 37.403(a)(2),[641] the Commission is revising the rule so that the requirement for monitoring the continued appropriateness of the methodology for deriving the reference price only applies when the reference price is formulated and computed by the SEF. In order to reduce the burden on SEFs, the Commission is clarifying in new § 37.403(c) that when the reference price relies on a third-party index or instrument, including an index or instrument traded on another venue, the SEF must only monitor the "continued appropriateness" of the index or instrument as opposed to specifically monitoring the "continued appropriateness of the methodology" for deriving the index. To provide SEFs with greater flexibility, the Commission is moving the other requirements for monitoring in proposed § 37.403(a)(2) to the guidance in appendix B to part 37. Specifically, the guidance notes that if a SEF computes its own reference price, it should promptly amend any methodologies or

[639] Final § 37.403(a) was proposed § 37.403(a)(1).

[640] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1228.

[641] The Commission is renumbering proposed § 37.403(a)(2) to § 37.403(b).

impose new methodologies as necessary to resolve threats of disruption or distortions. For reference prices that rely upon a third-party index or instrument, the Commission notes in the guidance that the SEF should conduct due diligence to ensure that the reference price is not susceptible to manipulation.

With respect to commenters' concerns about the requirement in proposed § 37.403(b) for a SEF to have an information-sharing agreement with, or monitor positions or trading in, another venue when a swap listed on the SEF is settled by reference to the price of an instrument traded on another venue, the Commission notes that the Act requires SEFs to monitor trading in swaps to prevent disruptions of the cash settlement process.[642] Given this statutory requirement, the Commission believes that a SEF must have access to sufficient information to determine whether trading in the instrument or index used as a reference price for its listed swaps is being used to affect prices on its market. The Commission is adopting this general requirement, but is moving it to § 37.404 where it more logically belongs.

Although, as CME noted, the Commission does obtain certain position information in the large-trader reporting systems for swaps, the Commission may not routinely obtain such position information, including where a SEF's swap settles to the price of a non-U.S. index or instrument. However, in response to ICE's and CME's concerns and to reduce the burden on SEFs, the Commission is removing from the rule text the requirement for SEFs to assess "positions" and is moving it to the guidance in appendix B to part 37. The Commission is also moving to the guidance the specific methods for a SEF to obtain information to assess whether trading in the reference market

[642] CEA section 5h(f)(4)(B); 7 U.S.C. 7b-3(f)(4)(B).

is being used to affect prices on its market. The guidance also allows SEFs to limit such information gathering to market participants that conduct substantial trading on its facility.

(d) § 37.404 – Ability to Obtain Information

Proposed § 37.404(a) provided that a SEF must have rules that require traders in its swaps to keep and make available records of their activity in underlying commodities and related derivatives markets and swaps. Proposed § 37.404(b) required that a SEF with customers trading through intermediaries have a large-trader reporting system or other means to obtain position information.

(1) Summary of Comments

CME commented that the Commission should specify in acceptable practices the types of records that traders are required to keep under proposed § 37.404(a).[643] WMBAA commented that the requirement for a SEF to force traders to maintain trading and financial records is not required under the CEA.[644]

(2) Commission Determination

The Commission is adopting § 37.404 as proposed, subject to certain modifications, including providing guidance in appendix B to part 37.[645] As noted above in the discussion of § 37.403, the Commission is moving to § 37.404 the requirement for a SEF to assess whether trading in swaps listed on its market, in the index or instrument

[643] CME Comment Letter at 26 (Feb. 22, 2011).

[644] WMBAA Comment Letter at 26 (Mar. 8, 2011).

[645] The Commission is changing the phrase "traders in its swaps" to "its market participants" to provide clarity.

used as a reference price, or in the underlying commodity for its swaps is being used to affect prices in its market.[646]

With respect to CME's and WMBAA's comments on proposed § 37.404(a),[647] the Commission disagrees that this rule is unnecessary or that the requirements should instead be codified as acceptable practices. Core Principle 4 requires a SEF to monitor trading in swaps to prevent manipulation, price distortion, and disruptions.[648] In its experience regulating the futures market, the Commission has found market participants' records to be an invaluable tool in its surveillance efforts, and believes that a SEF should have direct access to such information in order to discharge its obligations under the SEF core principles, including Core Principle 4. However, the Commission notes that in the guidance for this rule, a SEF may limit the application of this requirement to those market participants who conduct substantial trading activity on its facility, which is consistent with the Commission's similar requirements that large traders keep records for futures trading under § 18.05 and for swaps trading under § 20.6 of the Commission's regulations. The Commission also notes that the requirement for market participants to keep such records is sound commercial practice, and that market participants are likely already maintaining such trading records. In response to CME's comment, the Commission notes that the nature of records covered varies with the type of market and a market participant's involvement, but would generally include purchases, sales, ownership, production, processing, and use of swaps, the underlying commodity, and

[646] The Commission notes that this requirement is now in § 37.404(a).

[647] The Commission notes that this requirement is now in § 37.404(b).

[648] CEA section 5h(f)(4)(B); 7 U.S.C. 7b-3(f)(4)(B).

other derivatives that have some relationship to, or effect on, the market participant's trading in the listed swap.

The Commission is also deleting the requirements under proposed § 37.404(b) and replacing it, in the guidance, with a more general requirement for a SEF to demonstrate that it can obtain position and trading information directly from market participants or, if not available from them, through information-sharing agreements. Moreover, the guidance for this rule allows a SEF to limit the acquisition of such information to those market participants who conduct substantial trading on its facility. The Commission is making this change in response to commenters' concerns, as noted in other sections, about obtaining position information because a SEF will not have the capability to monitor trading activities conducted on other trading venues.[649]

(e) § 37.405 – Risk Controls for Trading

Proposed § 37.405 required that a SEF have risk controls to reduce the potential risk of market disruptions, including, but not limited to, market restrictions that pause or halt trading in market conditions prescribed by the SEF. Additionally, the rule provided that where a SEF's swap is linked to, or a substitute for, other swaps on the SEF or on other trading venues, including where a swap is based on the level of an equity index, such risk controls must be coordinated with those on the similar markets or trading venues, to the extent possible.

The preamble of the SEF NPRM recognized that pauses and halts are only one category of risk controls, and that additional controls may be necessary to further reduce

[649] See, e.g., comments below under Core Principle 6 – Position Limits or Accountability in the preamble.

the potential for market disruptions.[650] The SEF NPRM preamble specifically listed several risk controls that the Commission believed may be appropriate, including price collars or bands, maximum order size limits, stop loss order protections, kill buttons, and any others that may be suggested by commenters.[651]

(1) Summary of Comments

Several commenters asserted that a SEF should have some discretion to determine the specific risk controls that are implemented within its markets.[652] CME commented that the marketplace would benefit from some standardization of the types of pre-trade risk controls employed by SEFs and other trading venues, and expressed support for an acceptable practices framework that includes pre-trade quantity limits, price banding, and messaging throttles, but argued that the specific parameters of such controls should be determined by each SEF.[653] ICE recommended that the Commission take a flexible approach to risk controls so as not to hinder innovation in developing new mechanisms to prevent market disruptions.[654] ICE did, however, recommend that the Commission expressly require a SEF to have pre-trade risk controls or checks, which are especially important in thinly traded markets where RFQs are more common.[655]

SDMA supported the requirement in proposed § 37.405, but noted that the rule should include pre-trade and post-trade risk control requirements that are uniform across

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[650] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1228.

[651] Id.

[652] ICE Comment Letter at 5 (Mar. 8, 2011); Tradeweb Comment Letter at 11 (Mar. 8, 2011); CME Comment Letter at 27 (Feb. 22, 2011).

[653] CME Comment Letter at 27 (Feb. 22, 2011).

[654] ICE Comment Letter at 5 (Mar. 8, 2011).

[655] Id.

the market.[656] SDMA noted that a uniform approach would create a much needed single regulatory approach to risk management across the derivatives market, enhance market integrity, and decrease systemic risk.[657] SDMA agreed with the best practices for pre-trade and post-trade risk controls as noted in the Pre-Trade Functionality Subcommittee of the CFTC TAC's Recommendations on Pre-Trade Practices for Trading Firms, Clearing Firms and Exchanges involved in Direct Market Access.[658]

Finally, CME objected to the requirement to coordinate risk controls.[659] CME stated that a SEF should retain the flexibility to determine and implement risk controls that it believes are necessary to protect the integrity of its markets.[660] CME recommended that the Commission work constructively with registered entities to facilitate coordination.[661]

(2) Commission Determination

The Commission is adopting proposed § 37.405, subject to certain modifications, including converting a portion of the rule to the guidance in appendix B to part 37. As stated in the SEF NPRM, the Commission believes that pauses and halts are effective risk management tools that must be implemented by a SEF to facilitate orderly markets.[662] Automated risk control mechanisms, including pauses and halts, have proven to be

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[656] SDMA Comment Letter at 5 (Mar. 8, 2011).

[657] Id. at 6.

[658] Id. See TAC Subcommittee Recommendations (Mar. 1, 2011). The report recommended several pre-trade risk controls for implementation at the exchange level, which were largely consistent with the pre-trade controls listed in the preamble to the SEF NPRM.

[659] CME Comment Letter at 26 (Feb. 22, 2011).

[660] Id.

[661] Id.

[662] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1228.

effective and necessary in preventing market disruptions in the futures market and, therefore, will remain as part of the rule.

As noted by SDMA, the Pre-Trade Functionality Subcommittee of the TAC issued a report that recommended the implementation of several trade risk controls at the exchange level.[663] The controls recommended in the Subcommittee report were consistent, in large part, with the trade controls referenced in the preamble to the SEF NPRM, and which are being adopted in the guidance in appendix B to part 37.[664] The TAC accepted the Subcommittee report, which specifically recommended that exchanges implement pre-trade limits on order size, price collars around the current price, intraday position limits (of a type that represent financial risk to the clearing member), message throttles, and clear error-trade and order-cancellation policies.[665] The Subcommittee report also noted that "[s]ome measure of standardization of pre-trade risk controls at the exchange level is the cheapest, most effective and most robust path to addressing the Commission's concern [for preserving market integrity]."[666]

The Commission believes that the implementation of specific types of other risk controls is generally desirable, but also recognizes that such risk controls should be adapted to the unique characteristics of the markets to which they apply. A SEF implementing any such additional risk controls should consider the balance between

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[663] TAC Subcommittee Recommendations (Mar. 1, 2011).

[664] The preamble to the SEF NPRM specifically mentioned daily price limits, order size limits, trading pauses, stop logic functionality, among others. Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1228.

[665] TAC Subcommittee Recommendations at 4-5 (Mar. 1, 2011). The TAC discussed this report's findings at its meeting on March 1, 2011. See Transcript of Third Meeting of Technology Advisory Committee (Mar. 1, 2011) available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/tac_030111_transcript.pdf.

[666] TAC Subcommittee Recommendations at 4 (Mar. 1, 2011).

avoiding a market disruption while not impeding a market's price discovery function. Controls that unduly restrict a market's ability to respond to legitimate market events will interfere with price discovery. Accordingly, consistent with many of the comments on this subject, the Commission is enumerating specific types of risk controls, in addition to pauses and halts, that a SEF may implement in the guidance rather than in the rule, in order to provide a SEF with greater discretion to select among the enumerated risk controls, or to create new risk controls that meet the unique characteristics of its markets. A SEF will also have discretion in determining the parameters for the selected controls.

Additionally, in response to CME's concern about the requirement to coordinate risk controls, the Commission is moving this language from proposed § 37.405 to the guidance. Specifically, a SEF with a swap that is fungible with, linked to, or a substitute for other swaps on the SEF or on other trading venues, should, to the extent practicable, coordinate its risk controls with any similar controls placed on those other swaps. The guidance also states that if a SEF's swap is based on the level of an equity index, such risk controls should, to the extent practicable, be coordinated with any similar controls placed on national security exchanges.

(f) § 37.406 – Trade Reconstruction

Under Core Principle 4, Congress required that a SEF have the ability to comprehensively and accurately reconstruct all trading on its facility.[667] Proposed § 37.406 set forth this requirement, including the requirement that audit-trail data and reconstructions be made available to the Commission in a form, manner, and time as determined by the Commission.

[667] CEA section 5h(f)(4)(B); 7 U.S.C. 7b-3(f)(4)(B).

(1) Summary of Comments

CME commented that audit trail data is extremely detailed and voluminous and that SEFs should be given adequate time to prepare the trading data before it is supplied to the Commission.[668] In this regard, CME recommended that the wording "in a form, manner, and time as determined by the Commission" be replaced with "such reasonable time as determined by the Commission."[669]

(2) Commission Determination

The Commission is revising the rule so that a SEF shall be required to make audit trail data and reconstructions available to the Commission "in a form, manner, and time that is acceptable to the Commission." The Commission notes that it will work with SEFs to provide them with adequate time to supply such information to the Commission.

(g) § 37.407 – Additional Rules Required

Proposed § 37.407 required a SEF to adopt and enforce any additional rules that it believes are necessary to comply with the requirements of subpart E of part 37.

(1) Commission Determination

Although the Commission did not receive any comments on the proposed rule, the Commission is revising the rule to state that applicants and SEFs may refer to the guidance and/or acceptable practices in appendix B to part 37 to demonstrate to the Commission compliance with the requirements of section 37.400. The Commission is also moving proposed § 37.407 to new § 37.408, titled "Additional sources for compliance."

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[668] CME Comment Letter at 27 (Feb. 22, 2011).

[669] Id.

In new § 37.407, titled "Regulatory service provider," the Commission is clarifying that a SEF can comply with the regulations in subpart E through a dedicated regulatory department or by contracting with a regulatory service provider pursuant to § 37.204.

5. Subpart F – Core Principle 5 (Ability to Obtain Information)

Core Principle 5 requires a SEF to: (a) establish and enforce rules that will allow the facility to obtain any necessary information to perform any of the functions described in section 5h of the Act, (b) provide the information to the Commission on request, and (c) have the capacity to carry out international information-sharing agreements as the Commission may require.[670] In the SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 5 in proposed § 37.500, and adopts that rule as proposed.

(a) § 37.501 – Establish and Enforce Rules

Proposed § 37.501 required a SEF to establish and enforce rules that will allow the SEF to have the ability and authority to obtain sufficient information to allow it to fully perform its operational, risk management, governance, and regulatory functions and any requirements under part 37, including the capacity to carry out international information-sharing agreements as the Commission may require.

(1) Commission Determination

The Commission received no comments on proposed § 37.501 and is adopting the rule as proposed. The Commission believes that § 37.501 appropriately implements the requirement in Core Principle 5 for a SEF to establish and enforce rules that will allow

[670] CEA section 5h(f)(5); 7 U.S.C. 7b-3(f)(5).

the SEF to obtain any necessary information to perform any of its functions described in section 5h of the Act.[671]

(b) § 37.502 – Collection of Information

Proposed § 37.502 required a SEF to have rules that allow it to collect information on a routine basis, allow for the collection of non-routine data from its participants, and allow for its examination of books and records kept by the traders on its facility.

(1) Summary of Comments

WMBAA commented that aside from participants who contractually agree to provide information, a SEF does not possess the legal authority to obtain such information.[672] Additionally, WMBAA stated that the burden to collect information should be placed upon counterparties.[673] In the alternative, WMBAA stated that the Commission should require a SEF and its participants to enter into third party service provider agreements for the collection of the required information.[674] MarketAxess commented that it is not clear what is meant by "non-routine data" in proposed § 37.502 and that the rule should make clear that a SEF is only required to collect and maintain participant information that is directly related to such participants' activity conducted pursuant to the SEF's rules.[675]

(2) Commission Determination

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[671] CEA section 5h(f)(5)(A); 7 U.S.C. 7b-3(f)(5)(A).

[672] WMBAA Comment Letter at 26 (Mar. 8, 2011).

[673] Id.

[674] Id.

[675] MarketAxess Comment Letter at 37 (Mar. 8, 2011).

The Commission is adopting § 37.502 as proposed.[676] In response to WMBAA's and MarketAxess's comments, the Commission notes that Core Principle 5 requires a SEF to establish and enforce rules that will allow it to obtain any necessary information to perform any of its functions described in section 5h of the Act. The Act and the Commission's regulations provide a SEF with the legal authority to collect such information. As mentioned in § 37.204 above, a SEF may contract with a regulatory service provider to perform regulatory services on behalf of a SEF. Thus, a SEF may enter into a third party regulatory service provider agreement for the collection of information under § 37.502. Additionally, as mentioned in § 37.404 above, the Act requires SEFs to monitor trading in swaps to prevent manipulation, price distortion, and disruptions through surveillance, compliance, and disciplinary practices and procedures.[677] The Commission believes that market participant records are a valuable tool in conducting an effective surveillance program; thus, a SEF should have direct access to such information in order to discharge its obligations under the core principles. The Commission notes that market participants are likely maintaining trading records as part of sound business practices so requiring SEFs to have rules that allow them to access such information should not present a burden. To address MarketAxess's comment about "non-routine data," the Commission clarifies that "non-routine data" means the collection of data on an ad-hoc basis, such as data that may be collected during an investigation.

(c) § 37.503 – Provide Information to the Commission

[676] The Commission is changing the terms "participants" and "traders" to "market participants" to provide clarity.

[677] CEA section 5h(f)(4)(B); 7 U.S.C. 7b-3(f)(4)(B).

Proposed § 37.503 required a SEF to provide information in its possession to the Commission upon request, in a form and manner that the Commission approves.

(1) Commission Determination

The Commission received no comments on proposed § 37.503 and is adopting the rule as proposed. The Commission believes that § 37.503 appropriately implements the requirement in Core Principle 5 for a SEF to provide information to the Commission on request.[678]

(d) § 37.504 – Information-Sharing Agreements

Proposed § 37.504 required a SEF to share information with other regulatory organizations, data repositories, and reporting services as required by the Commission or as otherwise necessary and appropriate to fulfill its self-regulatory and reporting responsibilities. The proposed rule also stated that appropriate information-sharing agreements can be established with such entities or the Commission can act in conjunction with the SEF to carry out such information sharing.

(1) Summary of Comments

WMBAA commented that the proposed rule could be interpreted to require a SEF to share information with its competitors, unless the information is disseminated by a neutral third party pursuant to a services agreement.[679] WMBAA also requested clarification regarding the circumstances in which the Commission would determine to carry out information sharing itself, as opposed to a SEF entering into information-sharing agreements with the relevant entity.[680]

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[678] CEA section 5h(f)(5)(B); 7 U.S.C. 7b-3(f)(5)(B).

[679] WMBAA Comment Letter at 27 (Mar. 8, 2011).

[680] Id.

(2) Commission Determination

The Commission is adopting § 37.504 as proposed, subject to one modification. The Commission is revising the rule to change the term "reporting services" to "third party data reporting services." The Commission clarifies that the term "reporting services" was meant to refer to independent third parties that would provide trading data on a public basis and was not meant to include competitor SEFs. To address WMBAA's comment about information sharing, the Commission clarifies that a SEF may work with the Commission to fulfill its information sharing requirements in the absence of agreements with SDRs, regulatory bodies, or third party data reporting services. Given that each SEF is unique, a particular SEF would need to contact the Commission to discuss how the information sharing requirements could be fulfilled.

6. Subpart G – Core Principle 6 (Position Limits or Accountability)

Core Principle 6 requires that a SEF adopt for each swap, as is necessary and appropriate, position limits or position accountability to reduce the potential threat of market manipulation or congestion.[681] In addition, Core Principle 6 requires that for any contract that is subject to a federal position limit under CEA section 4a(a), the SEF set its position limits at a level no higher than the position limitation established by the Commission and monitor positions established on or through the SEF for compliance with the limit set by the Commission and the limit, if any, set by the SEF.[682] In the SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 6 in proposed § 37.600, and adopts that rule as proposed. Proposed § 37.601 repeated the

[681] CEA section 5h(f)(6); 7 U.S.C. 7b-3(f)(6).

[682] Id.

requirements in § 37.600 and required that SEFs establish position limits in accordance with the requirements set forth in part 151 of the Commission's regulations.

(a) Summary of Comments

Several commenters stated that SEFs will have difficulty enforcing position limitations.[683] Many of these commenters noted that SEFs will lack knowledge of a market participant's activity on other venues, and that will prevent a SEF from being able to calculate the true position of a market participant.[684] In this regard, Phoenix stated that market participants will be allowed to trade on multiple SEFs so any one SEF's information concerning a market participant's position will be virtually meaningless, as the market participant may sell a large position on one SEF and simultaneously buy the same amount of the instrument on another SEF.[685] WMBAA recommended that a common regulatory organization or third party regulatory service provider monitor position limits because they will have the capability to ensure coordinated oversight of the trading activity on multiple SEFs and the ability to implement disciplinary action if needed.[686] Reuters and Phoenix recommended that the Commission or its designee monitor position limits.[687] Alice recommended that, for cleared swaps, DCOs maintain position limits, and when a swap is cleared by multiple DCOs, one DCO would be the

[683] Bloomberg Comment Letter at 3-4 (Jun. 3, 2011); Alice Comment Letter at 5 (May 31, 2011); Rosen et al. Comment Letter at 22 (Apr. 5, 2011); WMBAA Comment Letter at 27 (Mar. 8, 2011); Tradeweb Comment Letter at 11 (Mar. 8, 2011); Reuters Comment Letter at 6 (Mar. 8, 2011); Phoenix Comment Letter at 3 (Mar. 7, 2011).

[684] WMBAA Comment Letter at 2 (Apr. 11, 2013); Bloomberg Comment Letter at 3-4 (Jun. 3, 2011); Rosen et al. Comment Letter at 22 (Apr. 5, 2011); WMBAA Comment Letter at 27 (Mar. 8, 2011); Tradeweb Comment Letter at 11 (Mar. 8, 2011); Phoenix Comment Letter at 3 (Mar. 7, 2011).

[685] Phoenix Comment Letter at 3-4 (Mar. 7, 2011).

[686] WMBAA Comment Letter at 27 (Mar. 8, 2011).

[687] Reuters Comment Letter at 6 (Mar. 8, 2011); Phoenix Comment Letter at 4 (Mar. 7, 2011).

primary for a given participant and the other DCOs would report positions to that DCO.[688]

Despite the concerns raised by other commenters, Phoenix noted that, if required, a SEF can monitor position limits of market participants based upon the trading activity that takes place only on the SEF's platform.[689] Tradeweb also requested confirmation from the Commission that a SEF must only monitor its market participants' position limits or positions in particular instruments with respect to positions entered into on its own platforms.[690]

(b) Commission Determination

In response to commenters concerns about monitoring position limits, the Commission is removing the requirements in § 37.601. Instead, final § 37.601 states that until such time that compliance is required under part 151 of this chapter,[691] a SEF may refer to the guidance and/or acceptable practices in appendix B to part 37 to demonstrate to the Commission compliance with the requirements of § 37.600.

The guidance provides a SEF with reasonable discretion to comply with § 37.600, including considering part 150 of the Commission's regulations.[692] The guidance also states that for Required Transactions as defined in § 37.9, a SEF may demonstrate compliance with § 37.600 by setting and enforcing position limitations or position accountability levels only with respect to trading on the SEF's own market. For example, a SEF could satisfy the position accountability requirement by setting up a compliance

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[688] Alice Comment Letter at 5 (May 31, 2011).

[689] Phoenix Comment Letter at 4 (Mar. 7, 2011).

[690] Tradeweb Comment Letter at 11 (Mar. 8, 2011).

[691] See Position Limits for Derivatives, 76 FR 4752 (proposed Jan. 26, 2011).

[692] Part 150 of the Commission's regulations contains the current position limits regime.

program that continuously monitors the trading activity of its market participants and has procedures in place for remedying any violations of position levels. For Permitted Transactions as defined in § 37.9, a SEF may demonstrate compliance with § 37.600 by setting and enforcing position accountability levels or sending the Commission a list of Permitted Transactions traded on the SEF. Therefore, a SEF is not required to monitor its market participants' activity on other venues with respect to monitoring position limits.

In response to comments that a common regulatory organization or the Commission should monitor position limits, the Commission notes that Core Principle 6 places the responsibility on a SEF to adopt and monitor position limits. The Dodd-Frank Act does not mandate that a common regulatory organization or the Commission monitor position limits. The Dodd-Frank Act also does not provide the Commission with the authority to exempt a SEF from certain core principles. Therefore, the Commission is providing a SEF with flexibility to adopt and monitor position limits as described above.

7. Subpart H – Core Principle 7 (Financial Integrity of Transactions)

Core Principle 7 requires a SEF to establish and enforce rules and procedures for ensuring the financial integrity of swaps entered on or through the facilities of the SEF, including the clearance and settlement of the swaps pursuant to section 2(h)(1) of the Act.[693] In the SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 7 in proposed § 37.700, and adopts that rule as proposed.

(a) § 37.701 – Mandatory Clearing[694]

[693] CEA section 5h(f)(7); 7 U.S.C. 7b-3(f)(7).

[694] The Commission is renaming the title of this section from "Mandatory Clearing" to "Required Clearing" to be consistent with terminology used in the CEA and the Commission's regulations.

Proposed § 37.701 required transactions executed on or through a SEF to be cleared through a Commission registered DCO unless the transaction is excepted from clearing under section 2(h)(7) of the Act or the swap is not subject to the clearing requirement under section 2(h)(1) of the Act.

(1) Summary of Comments

ISDA/SIFMA commented that section 2(h)(1) of the CEA provides that swaps subject to the clearing requirement must be submitted for clearing to a registered DCO or a DCO that is exempt from registration; however, proposed § 37.701 requires that transactions executed through a SEF be cleared only through a Commission-registered DCO.[695] ISDA/SIFMA recommended that the rule be amended to permit the use of exempt DCOs.[696] MarketAxess recommended that proposed § 37.701 be revised to permit a SEF to rely on a representation from an end-user that it qualifies for the section 2(h)(7) exemption.[697]

(2) Commission Determination

The Commission is adopting § 37.701 as proposed, subject to certain revisions. The Commission is modifying § 37.701 to state that "[t]ransactions executed on or through the swap execution facility that are required to be cleared under section 2(h)(1)(A) of the Act or are voluntarily cleared by the counterparties shall be cleared through a Commission-registered derivatives clearing organization, or a derivatives clearing organization that the Commission has determined is exempt from registration." The Commission is deleting proposed § 37.701(a), which referred to the end-user

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[695] ISDA/SIFMA Comment Letter at 13 (Mar. 8, 2011).

[696] Id.

[697] MarketAxess Comment Letter at 38 (Mar. 8, 2011).

exception under CEA section 2(h)(7) because, as modified, the final rule text clarifies that any swaps that are required to be cleared or that are voluntarily cleared must be cleared through a registered DCO, or a DCO that the Commission has determined is exempt from registration. The Commission notes that swaps that are subject to the clearing requirement must be submitted for clearing, except where the swap may be eligible for an exception or exemption from the clearing requirement pursuant to either the exception provided under section 2(h)(7) of the Act and § 50.50 of the Commission's regulations, or an exemption provided under part 50 of the Commission's regulations. The rule also provides that counterparties that elect to clear a swap that is not required to be cleared may do so voluntarily through a Commission-registered DCO, or a DCO that the Commission has determined is exempt from registration.

In response to ISDA/SIFMA's recommendation that the rule be amended to permit the use of exempt DCOs, the Commission is mindful that CEA section 2(h)(1) provides that swaps subject to the clearing requirement must be submitted for clearing to a registered DCO or a DCO that is exempt from registration under the Act. The Commission further notes that under CEA section 5b(h), the Commission has discretionary authority to exempt DCOs, conditionally or unconditionally, from the applicable DCO registration requirements.[698] Specifically, section 5b(h) of the Act provides that "[t]he Commission may exempt, conditionally or unconditionally, a derivatives clearing organization from registration under this section for the clearing of swaps if the Commission determines that the [DCO] is subject to comparable, comprehensive supervision and regulation by the Securities and Exchange Commission

[698] CEA section 5b(h); 7 U.S.C. 7a-1(h).

or the appropriate government authorities in the home country of the organization."[699] Thus, the Commission has discretion to exempt from registration DCOs that, at a minimum, are subject to comparable and comprehensive supervision by another regulator.

The Commission notes that it has not yet exercised its discretionary authority to exempt DCOs from registration. Notwithstanding that there are no exempt DCOs at this time, the Commission has determined to revise the rule text as suggested by ISDA/SIFMA. If the Commission determines to exercise its authority to exempt DCOs from applicable registration requirements, the Commission would likely address, among other things, the conditions and limitations applicable to clearing swaps for customers subject to section 4d(f) of the Act.[700]

Until such time as the Commission determines to exercise its authority to exempt DCOs from the applicable registration requirement, SEFs must route all swaps through registered DCOs, which are the appropriate entities to perform the clearing functions under CEA section 2(h)(1) at this time. Registered DCOs are subject to the CEA, the Commission's regulations, and its regulatory programs. Among other things, registered DCOs are supervised for compliance with the Commission's regulations, and subjected to ongoing risk surveillance and regular examinations.

In consideration of MarketAxess's comment that a SEF should be able to rely on a representation from an end-user that it qualifies for the CEA section 2(h)(7) exception,

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[699] Id.

[700] The Commission will address any necessary revisions to part 37 at such time as it determines to exercise its discretionary authority to exempt DCOs from certain DCO registration requirements. For example, if exempt DCOs are limited to clearing for only certain types of market participants, then the Commission will take action to ensure that SEF market participants have impartial access to swap clearing through registered DCOs.

the Commission clarifies that a SEF is not obligated to make any determinations with respect to applicability of the exceptions to the clearing requirement.

(b) § 37.702 – General Financial Integrity

Proposed § 37.702(a) required a SEF to provide for the financial integrity of its transactions by establishing minimum financial standards for its members. At a minimum, a SEF would have to ensure that its members meet the definition of "eligible contract participant" under CEA section 1(a)(18). Proposed § 37.702(b) required a SEF, for transactions cleared by a DCO, to have the capacity to route transactions to the DCO in a manner acceptable to the DCO for purposes of ongoing risk management. In proposed § 37.702(c), for transactions that are not cleared by a DCO, a SEF must require members to demonstrate that they: (1) have entered into credit arrangement documentation for the transaction, (2) have the ability to exchange collateral, and (3) meet any credit filters that the SEF may adopt. Proposed § 37.702(d) required a SEF to implement any additional safeguards that may be required by Commission regulations.

(1) Summary of Comments

Bloomberg commented, with respect to proposed § 37.702(a), that a SEF should be able to determine a market participant's ability to meet any minimum financial standards by virtue of confirming that the participant has access to a DCO either as a member or through an intermediary.[701] According to Bloomberg, it is not necessary to set separate, duplicative financial requirements at the SEF level that are redundant to the exhaustive financial requirements that will be associated with access to a DCO.[702]

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[701] Bloomberg Comment Letter at 5 (Mar. 8, 2011).

[702] Id.

With respect to proposed § 37.702(b), Reuters agreed that SEFs should assure the secure and prompt routing to a DCO for swap transactions subject to the clearing requirement.[703] MarketAxess commented that SEFs should be able to send a trade to the DCO via an affirmation hub.[704] Use of affirmation hubs, according to MarketAxess, would allow SEFs to enjoy lower costs and is preferred by its clients.[705]

The Commission received several comments with regard to proposed § 37.702(c). The Energy Working Group noted that proposed § 37.702(c) should be narrower in scope and that a SEF should be able to fulfill its obligation by ensuring that the counterparties have entered into bilateral credit support arrangements.[706] MarketAxess wrote that a SEF is not in a position to determine whether members' credit filters or exchanges of collateral are sufficient.[707] Reuters noted that the existence of credit and/or collateral arrangements should be primarily a matter between the counterparties.[708] ISDA/SIFMA commented that the Commission should not create new collateral requirements for end-users transacting through a SEF.[709] ABC/CIEBA commented that proposed § 37.702(c) would impose costly burdens on SEFs.[710]

Goldman noted that there are circumstances where a swap that is subject to the clearing requirement may not be accepted for clearing for credit or other reasons.[711] In

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[703] Reuters Comment Letter at 6 (Mar. 8, 2011).

[704] MarketAxess Comment Letter at 35 (Mar. 8, 2011).

[705] Id.

[706] Energy Working Group Comment Letter at 5 (Mar. 8, 2011).

[707] MarketAxess Comment Letter at 37 (Mar. 8, 2011).

[708] Reuters Comment Letter at 6 (Mar. 8, 2011).

[709] ISDA/SIFMA Comment Letter at 13 (Mar. 8, 2011).

[710] ABC/CEIBA Comment Letter at 11 (Mar. 8, 2011).

[711] Goldman Comment Letter at 5 (Mar. 8, 2011).

such cases and depending on the SEF's rules under Core Principle 7, parties that execute through the SEF either would face one another in an uncleared, bilateral transaction or would potentially owe amounts arising from the trade not being accepted for clearing.[712] Therefore, Goldman recommended that parties should be able to learn the identities of their counterparty when transacting in cleared and uncleared swaps.[713]

(2) Commission Determination

The Commission has considered the comments received and is adopting § 37.702(a) as proposed. In response to Bloomberg's comment about setting financial requirements at the SEF level, the Commission disagrees that a SEF should be able to determine a member's ability to meet any minimum financial standards by virtue of confirming that the member has access to a DCO. The Commission notes that a DCO only screens clearing members, and not customers, according to financial standards. Therefore, unless a SEF member is also a clearing member, the SEF will not be able to determine the member's ability to meet any minimum financial standards by virtue of confirming that the member has access to a DCO. The Commission also notes that there is no affirmative obligation for a DCO to ensure that its members, customers, or counterparties are ECPs. Therefore, a SEF must ensure that its members qualify as ECPs and may rely on representations from its members to fulfill this requirement.[714]

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[712] Id.

[713] Id.

[714] The Commission notes that under § 37.202(a)(2), a SEF that permits intermediation must also obtain signed representations from intermediaries that their customers are ECPs.

Last year, the Commission adopted rules regarding the processing of cleared trades.[715] In that rulemaking, the Commission proposed a new § 37.702(b)[716] and adopted a revised § 37.702(b)[717] regarding cleared swaps traded through a SEF. That final rule required a SEF to provide for the financial integrity of its transactions that are cleared by a DCO: (a) by ensuring that it has the capacity to route transactions to the DCO in a manner acceptable to the DCO for purposes of clearing; and (b) by coordinating with each DCO to which it submits transactions for clearing, in the development of rules and procedures to facilitate prompt and efficient transaction processing in accordance with the requirements of § 39.12(b)(7) of the Commission's regulations.[718]

In response to MarketAxess's comment about affirmation hubs, the Commission notes that § 37.702(b), as adopted in April 2012, requires a SEF to route a swap to a DCO in a manner acceptable to the DCO.[719] If the DCO views the use of an affirmation hub as an acceptable means for routing the swap, the routing otherwise complies with § 37.702(b), and the trade is processed in accordance with the standards set forth in §§ 1.74, 39.12, 23.506, and 23.610 of the Commission's regulations, then the use of an affirmation hub for routing a swap to a DCO for clearing would be permissible.

In consideration of the comments with respect to uncleared swaps, the Commission is eliminating proposed § 37.702(c). The Commission agrees with

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[715] Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 FR 21278 (Apr. 9, 2012).

[716] Requirements for Processing, Clearing, and Transfer of Customer Positions, 76 FR 13101, 13109-10 (proposed Mar. 10, 2011).

[717] Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 FR at 21309.

[718] Id.

[719] Id.

commenters that requiring SEFs to monitor the credit and collateral arrangements of parties transacting uncleared swaps goes beyond the scope of what should be expected of a SEF. To address Goldman's comments requesting that the Commission mandate that a SEF's rules require identification of the counterparties prior to a swap transaction, the Commission believes that a SEF should retain discretion in this regard. Finally, the Commission is deleting proposed § 37.702(d) as it is unnecessary because a SEF must already implement safeguards as required by Commission regulations.

(c) § 37.703 – Monitoring for Financial Soundness

Proposed § 37.703 required a SEF to monitor its members' compliance with the SEF's minimum financial standards and routinely receive and promptly review financial and related information from its members.

(1) Summary of Comments

ABC/CIEBA commented that this requirement would create significant barriers to entry, stifle competition, and lead to higher transaction costs.[720] FXall commented that like DCMs, SEFs should be permitted to delegate their financial surveillance functions to the Joint Audit Committee to the extent that its members are registered with NFA.[721] For non-NFA members, FXall recommended that SEFs be permitted to delegate financial surveillance obligations to the members' primary financial regulator or otherwise outsource such duties to a third party service provider.[722]

(2) Commission Determination

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[720] ABC/CEIBA Comment Letter at 11 (Mar. 8, 2011).

[721] FXall Comment Letter at 13 (Mar. 8, 2011).

[722] Id.

The Commission agrees with the commenters that burdensome financial surveillance obligations may lead to higher transaction costs. Therefore, in consideration of the comments, the Commission is revising § 37.703 to state that a SEF must monitor its members to ensure that they continue to qualify as ECPs. With regard to the comment requesting delegation of the proposed § 37.703 responsibilities to the Joint Audit Committee, the Commission notes that final § 37.703, as revised, obviates the need for any such delegation. Under final § 37.703, a SEF need only ensure that its members remain ECPs and may rely on representations from its members.

8. Subpart I – Core Principle 8 (Emergency Authority)

Core Principle 8 requires a SEF to adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, as is necessary and appropriate, including the authority to liquidate or transfer open positions in any swap or to suspend or curtail trading in a swap.[723] In the SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 8 in proposed § 37.800, and adopts that rule as proposed.[724]

(a) § 37.801 – Additional Sources for Compliance

Proposed § 37.801 referred applicants and SEFs to the guidance and/or acceptable practices in appendix B to part 37 to demonstrate compliance with Core Principle 8. The guidance reflected the Commission's belief that the need for emergency action may also arise from related markets traded on other platforms and that there should be an increased

[723] CEA section 5h(f)(8); 7 U.S.C. 7b-3(f)(8).

[724] The Commission notes that Commission regulation 40.6(a)(6)(i) provides that any SEF rule that establishes general standards or guidelines for taking emergency actions must be submitted to the Commission pursuant to regulation 40.6(a). Relatedly, Commission regulation 40.6(a)(6)(ii) provides particular emergency actions shall be filed with the Commission "prior to [its] implementation, or, if not practicable, . . . at the earlier possible time after implementation, but in no event more than twenty-four hours after implementation."

emphasis on cross-market coordination of emergency actions. In that regard, the proposed guidance provided that, in consultation and cooperation with the Commission, a SEF should have the authority to intervene as necessary to maintain markets with fair and orderly trading and to prevent or address manipulation or disruptive trading practices, whether the need for intervention arises exclusively from the SEF's market or as part of a coordinated, cross-market intervention. The proposed guidance also provided that in situations where a swap is traded on more than one platform, emergency action to liquidate or transfer open interest must be as directed, or agreed to, by the Commission or the Commission's staff. The proposed guidance also clarified that the SEF should have rules that allow it to take market actions as may be directed by the Commission.

In addition to providing for rules, procedures, and guidelines for emergency intervention, the guidance noted that SEFs should provide prompt notification and explanation to the Commission of the exercise of emergency authority, and that information on all regulatory actions carried out pursuant to a SEF's emergency authority should be included in a timely submission of a certified rule.

(1) Summary of Comments

Several commenters expressed concern about a SEFs ability to liquidate or transfer open positions.[725] Bloomberg stated that, because a SEF will not hold a participant's swap positions, the Commission should only require that a SEF adopt rules requiring it to coordinate with a DCO to facilitate the liquidation or transfer of positions during an emergency.[726] Similarly, WMBAA noted that a SEF will not maintain

[725] Bloomberg Comment Letter at 4 (Jun. 3, 2011); Bloomberg Comment Letter at 5-6 (Mar. 8, 2011); WMBAA Comment Letter at 28 (Mar. 8, 2011); Reuters Comment Letter at 7 (Mar.8, 2011).

[726] Bloomberg Comment Letter at 4 (Jun. 3, 2011); Bloomberg Comment Letter at 5-6 (Mar. 8, 2011).

counterparty positions and thus it may not possess the ability to liquidate or transfer those positions.[727] Reuters stated that liquidating open positions does not fall within a trading platform's traditional role in the market.[728]

CME stated that SEFs must have the flexibility and independence necessary to address market emergencies.[729] Alternatively, ISDA/SIFMA commented that the Core Principle 8 rules should adopt uniform standards and that those standards must consider the interaction between SEFs, DCMs, clearing organizations, swap data repositories, and other market-wide institutions.[730]

(2) Commission Determination

The Commission is adopting § 37.801 as proposed, with certain modifications to the guidance in appendix B to part 37. The Commission acknowledges commenters concerns regarding a SEF's ability to liquidate or transfer open positions; however, the statute requires a SEF to have the authority to liquidate or transfer open positions.[731] The Commission expects that SEFs would establish such authority over open positions through their rules and/or participant agreements and that the exercise of any such authority would, consistent with the statute, be done in coordination with the Commission and relevant DCOs.

The Commission is making slight revisions to the guidance to clarify that SEFs retain the authority to independently respond to emergencies in an effective and timely manner consistent with the nature of the emergency, as long as all such actions taken by

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[727] WMBAA Comment Letter at 28 (Mar. 8, 2011).

[728] Reuters Comment Letter at 7 (Mar. 8, 2011).

[729] CME Comment Letter at 28 (Feb. 22, 2011).

[730] ISDA/SIFMA Comment Letter at 13 (Mar. 8, 2011).

[731] CEA section 5h(f)(8); 7 U.S.C. 7b-3(f)(8).

the SEF are made in good faith to protect the integrity of the markets. The Commission believes that market emergencies can vary with the type of market and any number of unusual circumstances so SEFs need flexibility to carry out emergency actions. The Commission believes that the guidance strikes a reasonable balance between the need for flexibility and the need for standards in the case of coordinated cross-market intervention.

9. Subpart J – Core Principle 9 (Timely Publication of Trading Information)

Core Principle 9 requires a SEF to make public timely information on price, trading volume, and other trading data on swaps to the extent prescribed by the Commission.[732] It also requires a SEF to have the capacity to electronically capture and transmit trade information for those transactions that occur on its facility.[733] In the SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 9 in proposed § 37.900. Proposed § 37.901 required that, for swaps traded on or through a SEF, the SEF report specified swap data as provided under part 43[734] and part 45[735] of the Commission's regulations and meet the requirements of part 16 of the Commission's regulations. Proposed § 37.902 required a SEF to have the capacity to electronically capture trade information with respect to transactions executed on the facility.

(a) Summary of Comments

In response to the Commission's questions in the SEF NPRM about end-of-day price reporting for interest rate swaps and the Commission's proposed revisions to §

[732] CEA section 5h(f)(9); 7 U.S.C. 7b-3(f)(9).

[733] Id.

[734] 17 CFR part 43; Real-Time Reporting of Swap Transaction Data, 77 FR 1182 (Jan. 9, 2012).

[735] 17 CFR part 45; Swap Data Recordkeeping and Reporting Requirements, 77 FR 2136 (Jan. 13, 2012).

16.01,[736] Eris stated the following: (1) it is reasonable to require a market to report publicly each trade (including instrument, price, and volume) intra-day, as soon as the trade occurs; (2) daily open interest should be published publicly in a summary fashion and should be grouped in maturity buckets based on the remaining tenor of each instrument; (3) as to end-of-day pricing, a clearing house will settle contracts based upon a market-driven curve, and the methodology, as well as the inputs and components, of the curve should be made transparent to the full trading community; and (4) the clearing house should publish the specific settlement value applied to each cleared swap in the daily mark-to-market process.[737] Eris also stated that SEFs and DCMs should be held to the same reporting standard in this respect.[738]

MarketAxess commented that proposed § 37.900(b) and § 37.902 are duplicative and that proposed § 37.902 should be withdrawn.[739]

(b) Commission Determination

The Commission is adopting § 37.900 and § 37.901 as proposed. The Commission acknowledges MarketAxess's comment that § 37.902 is duplicative to § 37.900(b) and thus is withdrawing § 37.902. In response to Eris's comment about the same reporting standards for SEFs and DCMs that list swaps, the Commission notes that a SEF, similar to a DCM, must meet the same requirements under part 16 of the

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[736] The Commission proposed certain revisions to § 16.01 in the DCM NPRM. See Core Principles and Other Requirements for Designated Contract Markets, 75 FR 80572 (proposed Dec. 22, 2010) for further details.

[737] Eris Comment Letter at 5 (Mar. 8, 2011).

[738] Id.

[739] MarketAxess Comment Letter at 39 (Mar. 8, 2011).

Commission's regulations for swaps reporting.[740] The Commission also notes that it codified § 16.01 in the final DCM rulemaking, and in that rulemaking, the Commission states that it considered the proposed reporting standard put forth by Eris, but the Commission believes that the more detailed reporting obligations under § 16.01 are warranted at this time in light of the novelty of swaps trading on regulated exchanges.[741]

10. Subpart K – Core Principle 10 (Recordkeeping and Reporting)

Core Principle 10 establishes recordkeeping and reporting requirements for SEFs.[742] In the SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 10 in proposed § 37.1000, and adopts that rule as proposed.

Proposed § 37.1001 required a SEF to maintain records of all business activities, including a complete audit trail, investigatory files, and disciplinary files, in a form and manner acceptable to the Commission for at least five years in accordance with the requirements of section 1.31 and part 45 of this chapter. Proposed § 37.1002 required a SEF to report to the Commission such information that the Commission determines to be necessary or appropriate for it to perform its duties. Proposed § 37.1003 required a SEF to keep records relating to swaps defined in section 1a(47)(A)(v) of the CEA open to inspection and examination by the SEC.

(a) Summary of Comments

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[740] The Commission notes that § 16.00 is applicable to a SEF only to the extent that such SEF has clearing members and lists options on physicals for trading. Section 16.01 is applicable to a SEF for all swaps and options traded thereon. Section 16.02 is applicable to a SEF only to the extent that such SEF lists options for trading.

[741] Core Principles and Other Requirements for Designated Contract Markets, 77 FR 36612, 36642 (Jun. 19, 2012).

[742] CEA section 5h(f)(10); 7 U.S.C. 7b-3(f)(10).

MarketAxess stated that a SEF should be permitted to use a regulatory service provider with respect to its recordkeeping and reporting requirements.[743] CME commented that proposed § 37.1003 does not provide any guidance as to what records will need to be retained and for how long they must be retained.[744]

(b) Commission Determination

The Commission is adopting § 37.1001 as proposed. The Commission is also withdrawing proposed § 37.1002 and § 37.1003 because they are repetitive of paragraphs (a)(2) and (a)(3) of § 37.1000. In response to MarketAxess's comment, the Commission notes that a SEF may utilize the services of a regulatory service provider pursuant to § 37.204 to assist the SEF in complying with its responsibilities under Core Principle 10. In response to CME's comment, the Commission notes that in accordance with Core Principle 10 and § 1.31 of the Commission's regulations, a SEF should retain "any" records relevant to swaps defined in section 1a(47)(A)(v) of the Act and that the SEF should leave such records open to inspection and examination for a period of five years. The Commission staff also consulted with representatives from the SEC, who confirmed that the SEC's relevant recordkeeping requirements typically extend for a period of five years.[745]

11. Subpart L – Core Principle 11 (Antitrust Considerations)

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[743] MarketAxess Comment Letter at 39 (Mar. 8, 2011).

[744] CME Comment Letter at 38 (Feb. 22, 2011).

[745] See Registration and Regulation of Security-Based Swap Execution Facilities, 76 FR at 10982, 11063 (Proposed Rule 818(b) requires SB-SEFs to keep books and records "for a period of not less than five years, the first two years in an easily accessible place). Rule 17a-1(b) (240.17a-1(b) requires national securities exchanges, among others, to keep books and records for a period of not less than five years, the first two years in an easily accessible place, subject to a destruction and disposition provisions, which allows exchanges to destroy physical documents pursuant to an effective and approved plan regarding such destruction and transferring/indexing of such documents onto some recording medium.). 17 CFR 240.17a-1(b).

Core Principle 11 governs the antitrust obligations of SEFs.[746] In the SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 11 in proposed § 37.1100, and adopts that rule as proposed. Additionally, proposed § 37.1101 referred applicants and SEFs to the guidance in appendix B to part 37 for purposes of demonstrating compliance with proposed § 37.1100.

(a) Summary of Comments

NGSA commented that if SEFs are allowed to select the SDR to which SEF-executed swaps are reported, there is a threat of anticompetitive tying of swap data reporting services from a particular SDR to the SEF's services, which may harm competition among SDRs.[747] Accordingly, NGSA recommended that the Commission amend the proposed rules to explicitly prohibit a SEF from tying the swap data reporting services of a particular SDR to the swap execution services provided by such SEF and from entering into an exclusive agreement with any SDR to report all swaps to such SDR.[748]

(b) Commission Determination

The Commission is adopting § 37.1101 and the corresponding guidance in appendix B to part 37 as proposed and declines to revise the proposed rules as NGSA recommends. The Commission notes that under Core Principle 11, SEFs may not adopt any rule or take any action that results in any unreasonable restraint of trade or impose any material anticompetitive burden on trading or clearing. The Commission believes that Core Principle 11 adequately addresses NGSA's concern. The Commission also

[746] CEA section 5h(f)(11); 7 U.S.C. 7b-3(f)(11).

[747] NGSA Comment Letter at 2 (Jun. 8, 2012). DTCC also raised this concern in its comment letter. DTCC Comment Letter at 3 (Jun. 10, 2011).

[748] NGSA Comment Letter at 5 (Jun. 8, 2012).

notes that it has not limited a SEF's choice of DCOs. The Commission believes that SDRs and DCOs should be able to compete for a SEF's business subject to the anticompetitive considerations under Core Principle 11. Additionally, the Commission notes that multiple SEFs are likely to trade the same swap contracts so market participants will be able to choose the appropriate SEF to trade swaps based on SDR and other considerations.

12. Subpart M – Core Principle 12 (Conflicts of Interest)

Core Principle 12 governs conflicts of interest.[749] In the SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 12 in proposed § 37.1200, and adopts that rule as proposed. As noted in the SEF NPRM, the substantive regulations implementing Core Principle 12 were proposed in a separate release titled "Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest."[750] Until such time as the Commission may adopt the substantive rules implementing Core Principle 12, SEFs have reasonable discretion to comply with this core principle as stated in § 37.100.

13. Subpart N – Core Principle 13 (Financial Resources)

Core Principle 13 requires a SEF to have adequate financial, operational, and managerial resources to discharge each of its responsibilities.[751] In particular, Core Principle 13 states that a SEF's financial resources are considered to be adequate if the

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[749] CEA section 5h(f)(12); 7 U.S.C. 7b-3(f)(12).

[750] Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 FR 63732 (proposed Oct. 18, 2010).

[751] CEA section 5h(f)(13); 7 U.S.C. 7b-3(f)(13).

value of such resources exceeds the total amount that would enable the SEF to cover its operating costs for a period of at least one year, calculated on a rolling basis.[752] In the SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 13 in proposed § 37.1300, and adopts that rule as proposed.

(a) § 37.1301 – General Requirements

Proposed § 37.1301 set forth the financial resources requirements for SEFs in order to implement Core Principle 13. Proposed § 37.1301(a) required a SEF to maintain financial resources sufficient to enable it to perform its functions in compliance with the SEF core principles. Proposed § 37.1301(b) required an entity operating as both a SEF and a DCO to comply with both the SEF financial resources requirements and the DCO financial resources requirements in § 39.11.[753] Proposed § 37.1301(c) stated that financial resources would be considered sufficient if their value is at least equal to a total amount that would enable the SEF, or applicant for designation as such, to cover its operating costs for a period of at least one year, calculated on a rolling basis.

(1) Summary of Comments

Several commenters raised concerns about the financial resources requirement to cover one year of operating costs. Parity Energy recommended that the Commission interpret "operating costs of a swap execution facility for a 1-year period" to be the cost to the SEF of an orderly wind-down of operations, where the SEF is one of many

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[752] Id.

[753] See Derivatives Clearing Organization General Provisions and Core Principles, 76 FR 69334 (Nov. 8, 2011). Commission regulation § 39.11 establishes requirements that a DCO will have to meet in order to comply with DCO Core Principle B (Financial Resources), as amended by the Dodd-Frank Act. Amended Core Principle B requires a DCO to possess financial resources that, at a minimum, exceed the total amount that would enable the DCO to meet its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible conditions; and enable the DCO to cover its operating costs for a period of one year, as calculated on a rolling basis.

execution avenues for standardized, cleared swaps and its failure would have minimal impact on market risk or stability.[754] Phoenix recommended that because a SEF does not take or hold positions in any of the products traded on it, an orderly wind-down of a SEF should take six months so SEFs should be required to maintain financial resources to cover six months of its operating costs.[755] Similarly, TruMarx contended that SEFs should not have such stringent financial resources standards because a SEF is a trading platform and, therefore, will not carry on its books the risks of positions and trades executed on it.[756] Rather, TruMarx stated that risk will be borne by the principals entering into the transactions, their clearing brokers, and clearing houses.[757]

Alternatively, SDMA noted that it would be disruptive to the market if a SEF went into bankruptcy.[758] Therefore, it contended that 12 months of working capital is the absolute minimum amount of financial resources that SEFs should have, and recommend that the Commission require that SEFs have 18 months of working capital.[759]

(2) Commission Determination

The Commission is adopting § 37.1301 as proposed.[760] To address the concerns about the financial resources requirement, the Commission notes that Core Principle 13

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[754] Parity Energy Comment Letter at 6 (Mar. 25, 2011).

[755] Phoenix Comment Letter at 4 (Mar. 7, 2011).

[756] TruMarx Comment Letter at 7 (Mar. 8, 2011).

[757] Id.

[758] SDMA Comment Letter at 12 (Mar. 8, 2011).

[759] Id.

[760] The Commission is making a technical change due to the fact that the cross reference in § 37.1301(b) should include "of this chapter" at the end of the reference in order to comply with federal regulatory guidelines. Accordingly, the Commission is revising § 37.1301(b) to read: "An entity that operates as both a swap execution facility and a derivatives clearing organization shall also comply with the financial resources requirements of section 39.11 of this chapter." The Commission is also removing the phrase "or applicant for designation as such" from § 37.1301(c) because it is unnecessary. Section 37.3 and Form SEF read together make clear that an applicant must comply with the financial resources requirement.

requires each SEF to maintain adequate financial resources to discharge its responsibilities.[761] In order to fulfill this responsibility, the core principle states that the financial resources of a SEF shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the SEF to cover its operating costs for a period of one year, calculated on a rolling basis.[762]

In response to comments that Core Principle 13 should be interpreted to mean the cost to wind-down a SEF's operations, the Commission notes that such an interpretation would require SEFs to have significantly less financial resources. The Commission believes that a SEF's financial strength is vital to ensure that the SEF can discharge its core principle responsibilities in accordance with the CEA and that those costs are greater than the cost to wind-down operations. Based on its experience regulating DCMs and DCOs, the Commission has learned that financial strength is vital to market continuity and the ability of an entity to withstand unpredictable market events, and believes that one year of operating expenses on a rolling basis is appropriate. For these reasons, the Commission also disagrees with TruMarx's argument that SEFs should not have such stringent financial resources standards because they will not hold the risks of positions and trades.

(b) § 37.1302 – Types of Financial Resources

Proposed § 37.1302 set forth the type of financial resources available to satisfy the requirements of proposed § 37.1301. The proposed rule stated that financial resources may include: (a) The SEF's own capital; and (b) Any other financial resource

[761] CEA section 5h(f)(13)(A); 7 U.S.C. 7b-3(f)(13)(A).

[762] CEA section 5h(f)(13)(B); 7 U.S.C. 7b-3(f)(13)(B).

deemed acceptable by the Commission. The Commission invited comment regarding particular financial resources to be included in the final regulation.[763]

(1) Summary of Comments

Several commenters recommended that the Commission include specific examples of financial resources that might satisfy the requirement. Phoenix recommended that the Commission include in final § 37.1302 the following financial resources: assets of a parent company that wholly owns the SEF, and, subject to § 37.1304 (Valuation of financial resources), the SEF's accounts receivable from SEF members.[764] Phoenix contended that as long as the parent company has committed to guarantee the financial resource obligations of the SEF, those assets should be available to the SEF, and that amounts owed to a SEF by its customers are easily obtainable by a SEF.[765] CME believed that Congress intended the term "financial resources" to be construed broadly and include anything of value at the SEF's disposal, including operating revenues.[766] Reuters recommended that assets of affiliated entities within a corporate group should be acceptable types of financial resources.[767]

(2) Commission Determination

The Commission is revising proposed § 37.1302(a) to state that a SEF's own capital means its assets minus its liabilities calculated in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"). The Commission believes that if a particular financial resource is an asset under GAAP, then it is appropriate for inclusion in the

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[763] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1230.

[764] Phoenix Comment Letter at 5 (Mar. 7, 2011).

[765] Id.

[766] CME Comment Letter at 37 (Feb. 22, 2011).

[767] Reuters Comment Letter at 8 (Mar. 8, 2011).

calculation for this rule. If a particular financial resource is not an asset under GAAP, but based upon the facts and circumstances a SEF believes that the particular financial resource should be acceptable, the Commission staff will work with the SEF to determine whether such resource is acceptable. In this regard, the Commission is clarifying that the language in final § 37.1302(b) is intended to provide flexibility to both SEFs and the Commission in determining other acceptable types of financial resources on a case-by-case basis.

Finally, the Commission notes that it may not have jurisdiction over a SEF's parent company or its affiliates; therefore, the Commission cannot consider the parent company's or affiliates' financial resources in determining whether the SEF possesses adequate financial resources.

(c) § 37.1303 – Computation of Financial Resource Requirement[768]

Proposed § 37.1303 required a SEF, each fiscal quarter, to make a reasonable calculation of its projected operating costs over a twelve-month period to determine the amount needed to meet the requirements of proposed § 37.1301. Proposed § 37.1303 provided SEFs with reasonable discretion to determine the methodology used to compute such projected operating costs. The proposed rule authorized the Commission to review the methodology and require changes as appropriate.

(1) Summary of Comments

MarketAxess noted that the proposed regulations do not prescribe specific methodologies for computing projected operating costs and recommended that the Commission provide a safe harbor for specific methodologies.[769]

[768] The Commission is renaming the title of this section from "Computation of Financial Resource Requirement" to "Computation of Projected Operating Costs to Meet Financial Resource Requirement" to provide greater clarity.

(2) Commission Determination

The Commission is adopting § 37.1303 as proposed because it provides flexibility to both SEFs and the Commission regarding the calculation of projected operating costs.[770] This flexibility would be limited if the Commission prescribed specific methodologies for computing projected operating costs in the rule text. In response to MarketAxess's comment, the Commission notes that SEFs may work with the Commission staff to create an appropriate methodology for computing such operating costs.

(d) § 37.1304 – Valuation of Financial Resources

Proposed § 37.1304 required a SEF, not less than quarterly, to compute the current market value of each financial resource used to meet its obligations under proposed § 37.1301. The proposed rule required SEFs to perform the valuation at other times as appropriate. As stated in the SEF NPRM, the rule is designed to address the need to update valuations in circumstances where there may have been material fluctuations in market value that could impact a SEF's ability to meet its obligations under proposed § 37.1301.[771] The proposed rule required that, when valuing a financial resource, the SEF reduce the value, as appropriate, to reflect any market or credit risk specific to that particular resource (i.e., apply a haircut).[772] The SEF NPRM stated that

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[769] MarketAxess Comment Letter at 39 (Mar. 8, 2011).

[770] The Commission is revising the language of § 37.1303 for clarity.

[771] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1231.

[772] A "haircut" is a deduction taken from the value of an asset to reserve for potential future adverse price movements in such asset.

the Commission would permit SEFs to exercise discretion to determine applicable haircuts, which would be subject to Commission review and acceptance.[773]

(1) Summary of Comments

MarketAxess commented that proposed § 37.1304 did not prescribe specific methodologies for valuing financial resources and recommended that the Commission provide a safe harbor for specific methodologies.[774]

(2) Commission Determination

The Commission is adopting § 37.1304 as proposed.[775] As with § 37.1303, § 37.1304 provides flexibility to both SEFs and the Commission regarding the valuation of financial resources. This flexibility would be limited if the Commission prescribed specific methodologies for valuing financial resources in the rule text. In response to MarketAxess's comment, the Commission notes that SEFs may work with the Commission staff to create an appropriate methodology for valuing such financial resources.

(e) § 37.1305 – Liquidity of Financial Resources

Proposed § 37.1305 required a SEF's financial resources to include unencumbered, liquid financial assets (i.e., cash and/or highly liquid securities) equal to at least six months' operating costs. As noted in the SEF NPRM, the Commission believes that the requirement to have six months' worth of unencumbered, liquid financial assets would provide a SEF time to liquidate the remaining financial assets it

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[773] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1231 n. 102.

[774] MarketAxess Comment Letter at 39 (Mar. 8, 2011).

[775] MarketAxess noted that § 37.1304 contains a typographical error as it mistakenly cross-references proposed § 37.701, which relates to the mandatory clearing requirement, instead of proposed § 37.1301. The Commission has made this technical change in the final rule. Additionally, the Commission is revising the language of § 37.1304 for clarity.

would need to continue operating for the last six months of the required one-year period.[776] The proposed rule stated that if any portion of such financial resources is not sufficiently liquid, the SEF may take into account a committed line of credit or similar facility to satisfy this requirement. As stated in the SEF NPRM, a SEF may only use a committed line of credit or similar facility to meet the liquidity requirements set forth in § 37.1305.[777] Accordingly, the SEF NPRM stated that a committed line of credit or similar facility is not available to a SEF to satisfy the financial resources requirements of § 37.1301.[778]

(1) Summary of Comments

Several commenters recommended alternate liquidity requirements to the six months of operating costs. CME commented that the liquidity measurement is only relevant in the context of winding-down operations, and claimed that a three-month period, rather than a six-month period, is a more accurate assessment of how long it would take for a SEF to wind down.[779] Similarly, Phoenix recommended that a SEF be required to maintain liquid assets equal to three months of operating expenses.[780] Parity Energy commented that the Commission should tailor financial requirements to a SEF's size and market impact and recommended limiting the six month liquid asset requirement to only those SEFs whose failure could impact market stability.[781] SDMA, however,

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[776] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1231.

[777] Id.

[778] Id.

[779] CME Comment Letter at 37 (Feb. 22, 2011).

[780] Phoenix Comment Letter at 4 (Mar. 7, 2011).

[781] Parity Energy Comment Letter at 6 (Mar. 25, 2011).

recommended that the Commission require SEFs to have at least 12 months of unencumbered capital.[782]

(2) Commission Determination

The Commission is adopting § 37.1305 as proposed. The Commission views a six month period as appropriate for a wind down period and notes that commenters did not provide any support for alternative time frames. In response to Parity Energy's comment, the Commission notes that the purpose of the liquidity requirement is so that all SEFs have liquid financial assets to allow them to continue to operate and to wind down in an orderly fashion. Therefore, the Commission is not limiting the liquidity requirement to only those SEFs whose failure could impact market stability. In this regard, the Commission notes that the statutory financial resources requirements apply to all SEFs and are necessary to ensure core principle compliance. The statute does not distinguish SEFs' financial resources based on their market impact.

The Commission also notes that it is using the term "unencumbered" in § 37.1305 in the normal commercial sense to refer to assets that are not subject to a security interest or other adverse claims. By "committed line of credit or similar facility," the Commission means a committed, irrevocable contractual obligation to provide funds on demand with preconditions limited to the execution of appropriate agreements. For example, a facility with a material adverse financial condition restriction would not be acceptable. The purpose of this requirement is for a SEF to have no impediments to accessing its line of credit at the time it needs liquidity. Further, SEFs are encouraged to

[782] SDMA Comment Letter at 12 (Mar. 8, 2011).

periodically check their line of credit arrangements to confirm that no operational difficulties are present.

(f) § 37.1306 – Reporting Requirements[783]

Proposed § 37.1306(a)(1) required that, at the end of each fiscal quarter, or at any time upon Commission request, a SEF report to the Commission: (i) the amount of financial resources necessary to meet the requirements of § 37.1301; and (ii) the value of each financial resource available to meet those requirements. Proposed § 37.1306(a)(2) required a SEF to provide the Commission with a financial statement, including balance sheet, income statement, and statement of cash flows of the SEF or of its parent company. Proposed § 37.1306(b) required calculations to be made on the last business day of the SEF's fiscal quarter.

Proposed § 37.1306(c) required a SEF to provide the Commission with sufficient documentation explaining the methodology it used to calculate its financial requirements and the basis for its valuation and liquidity determinations. The proposed rule also required the SEF to provide copies of any agreements establishing or amending a credit facility, insurance coverage, or any similar arrangement that evidences or otherwise supports its conclusions.

Finally, proposed § 37.1306(d) required SEFs to file the report no later than 17 business days[784] from the end of its fiscal quarter but allowed SEFs to request an extension of time from the Commission.

(1) Summary of Comments

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[783] The Commission is renaming the title of this section from "Reporting Requirements" to "Reporting to the Commission" to provide greater clarity.

[784] This filing deadline is consistent with the deadline imposed on FCMs for the filing of monthly financial reports. See 17 CFR 1.10(b) for further details.

CME wrote that it would not be feasible for SEFs to comply with the proposed filing deadline of 17 business days from the end of a SEF's fiscal quarter.[785] CME recommended a reporting deadline of 40 calendar days after the end of each fiscal quarter and 60 calendar days after the end of the fiscal year, which it noted is consistent with the SEC's reporting requirements.[786] CME also sought clarification that consolidated financial statements covering multiple registered entities satisfy the reporting requirements.[787]

MarketAxess stated that the proposed reporting requirements are unnecessary and burdensome, and recommended that the Commission allow a senior officer of the SEF to represent to the Commission that the SEF satisfies the financial resources requirements.[788]

Two commenters discussed disclosure of the reports. CME recommended that the Commission clarify that filings made in compliance with the proposed financial resources regulations are confidential.[789] However, SIFMA AMG commented that SEFs should submit to the Commission and make available for public comment evidence demonstrating sufficient resources.[790]

(2) Commission Determination

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[785] CME Comment Letter at 38 (Feb. 22, 2011).

[786] Id.

[787] Id.

[788] MarketAxess Comment Letter at 40 (Mar. 8, 2011).

[789] CME Comment Letter at 38 (Feb. 22, 2011).

[790] SIMFA AMG Comment Letter at 13 (Mar. 8, 2011).

The Commission is adopting § 37.1306 as proposed, subject to certain amendments to the filing deadlines.[791] The Commission agrees with CME that the proposed 17 business day filing deadline may be burdensome. In the final rule, the Commission is extending the 17 business day proposed filing deadline to 40 calendar days for the fiscal quarter reports and to 60 calendar days for the fiscal year-end report, which will also harmonize the filing deadlines with the SEC's requirements for its Form 10-Q and Form 10-K. The Commission also clarifies that consolidated financial statements must disclose all relevant and appropriate figures such that a determination of the sufficiency of financial resources of a SEF can be made without additional requests for information from the entity. In such case, consolidated financial statements would comply with the reporting requirements.

In response to MarketAxess's comment that the reporting requirements are unnecessary and burdensome, the Commission believes that prudent financial management requires SEFs to prepare and review financial reports on a regular basis and expects that SEFs would regularly review their finances. In this regard, the Commission notes that because of the importance of this requirement, a mere representation by a senior officer is insufficient for verification that the SEF meets its financial obligations. The quarterly reporting required by § 37.1306 will adequately provide the Commission with assurance that a SEF satisfies its financial resources requirements. The Commission notes that DCMs and DCOs have similar financial resources reporting obligations and does not believe that SEFs should be treated differently. The Commission also believes that much of the information required by the reports should be readily available to a

[791] The Commission is also making certain non-substantive clarifications to § 37.1306.

sophisticated organization, which the Commission expects would regularly account for its financial resources. As such, the Commission notes that the cost of submitting these reports to the Commission would be de minimis.

The Commission further clarifies that it does not intend to make financial resources reports public. However, where such information is, in fact, confidential, the Commission encourages SEFs to submit a written request for confidential treatment of such filings under the Freedom of Information Act ("FOIA"), pursuant to the procedures established in section 145.9 of the Commission's regulations.[792] The determination of whether to disclose or exempt such information in the context of a FOIA proceeding would be governed by the provisions of part 145 and any other relevant provision.

Finally, the Commission is adding new § 37.1307 titled "Delegation of Authority" to the final SEF rules to delegate authority to the Director of DMO to perform certain functions that are reserved to the Commission under subpart N.

14. Subpart O – Core Principle 14 (System Safeguards)

Core Principle 14 pertains to the establishment of system safeguards and requires SEFs to: (1) establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk through the development of appropriate controls and procedures and the development of automated systems that are reliable, secure, and have adequate scalable capacity; (2) establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for the timely recovery and resumption of operations and the fulfillment of the responsibilities and obligations of the SEF; and (3) periodically conduct tests to verify that backup resources are sufficient to

[792] 17 CFR 145.9.

ensure continued order processing and trade matching, price reporting, market surveillance, and maintenance of a comprehensive and accurate audit trail.[793] In the SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 14 in proposed § 37.1400, and adopts that rule as proposed.

(a) § 37.1401 – Requirements

Proposed § 37.1401(a) required a SEF to: establish and maintain a program of risk analysis and oversight; establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery; and periodically conduct tests to verify that backup resources are sufficient. Proposed § 37.1401(b) required that a SEF's program of risk analysis and oversight address six categories of risk analysis and oversight, including: information security; business continuity-disaster recovery ("BC-DR") planning and resources; capacity and performance planning; systems operations; systems development and quality assurance; and physical security and environmental controls. Proposed § 37.1401(c) suggested that a SEF follow generally accepted standards and best practices when addressing the categories of risk analysis and oversight.

Proposed § 37.1401(d) and (e) also required each SEF to maintain a BC-DR plan, BC-DR resources, emergency procedures, and backup facilities sufficient to enable timely recovery and resumption of its operations and ongoing fulfillment of its responsibilities and obligations as a SEF following any disruption, either through sufficient infrastructure and personnel resources of its own or through sufficient contractual arrangements with other SEFs or disaster recovery service providers. If the Commission determines that a SEF is a critical financial market, then that SEF would be

[793] CEA section 5h(f)(14); 7 U.S.C. 7b-3(f)(14).

subject to more stringent requirements, set forth in § 40.9 of the Commission's regulations.

The proposed rule also required each SEF to notify the Commission staff of various system security-related events, including prompt notice of all electronic trading halts and systems malfunctions (proposed § 37.1401(f)(1)), cyber-security incidents (proposed § 37.1401(f)(2)), and any activation of the SEF's BC-DR plan (proposed § 37.1401(f)(3)). In addition, the proposed rule required each SEF to provide the Commission staff with timely advance notice of all planned changes to automated systems that may impact the reliability, security, or adequate scalable capacity of such systems (proposed § 37.1401(g)(1)) and planned changes to programs of risk analysis and oversight (proposed § 37.1401(g)(2)).

The proposed rule also required each SEF to provide relevant documents to the Commission (proposed § 37.1401(h)) and to conduct regular, periodic, objective testing and review of its automated systems (proposed § 37.1401(i)). Moreover, proposed § 37.1401(j) required each SEF, to the extent practicable, to coordinate its BC-DR plan with those of the market participants upon whom it depends to provide liquidity, to initiate coordinated testing of such plans, and to ensure that its BC-DR plan takes into account the BC-DR plans of relevant telecommunications, power, water, and other essential service providers. Finally, proposed § 37.1401(k) stated that part 46 of the Commission's regulations governs the obligations of entities determined to be critical financial markets, with respect to maintenance and geographical dispersal of disaster recovery resources.

(1) Summary of Comments

CME objected to what it considers to be an overly broad requirement in proposed § 37.1401(f)(1) to notify the Commission staff promptly of all electronic trading halts and systems malfunctions.[794] CME stated that the required reporting should be limited only to material system failures.[795] CME also objected to proposed § 37.1401(g)(1), stating that the requirement that SEFs provide the Commission with timely advance notice of all planned changes to automated systems that may impact the reliability, security, or adequate scalable capacity of such systems is overly burdensome, and not cost effective.[796] Additionally, CME stated that the proposed § 37.1401(g)(2) requirement that SEFs provide timely advance notice of all planned changes to their program of risk analysis and oversight is too broad and generally unnecessary.[797] Finally, CME noted that it does not control, or generally have access to, the details of the disaster recovery plans of its major vendors.[798]

MarketAxess and WMBAA sought clarification of the criteria used to determine which SEFs are "critical financial markets," as referenced in proposed § 37.1401(d).[799]

(2) Commission Determination

As noted in the SEF NPRM, automated systems play a central and critical role in today's electronic financial market environment, and the oversight of core principle compliance by SEFs with respect to automated systems is an essential part of effective

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[794] CME Comment Letter at 36 (Feb. 22, 2011).

[795] Id.

[796] Id. at 37.

[797] Id.

[798] Id.

[799] MarketAxess Comment Letter at 40 (Mar. 8, 2011); WMBAA Comment Letter at 28 (Mar. 8, 2011).

oversight of swaps market.[800] Advanced computer systems are fundamental to a SEF's ability to meet its obligations and responsibilities under the core principles.[801] Accordingly, the Commission is adopting § 37.1401 as proposed, subject to the modifications described below.

Although the Commission did not receive related comments, the Commission is eliminating proposed § 37.1401(a) because this paragraph is repetitious of proposed rule § 37.1400. The Commission is also moving the following portions of proposed § 37.1401 to the guidance in appendix B to part 37 because the rules as proposed provided SEFs with a degree of discretion: (1) proposed § 37.1401(c) suggesting that a SEF follow generally accepted standards and best practices in addressing the categories of its risk analysis and oversight program; (2) the portion of proposed § 37.1401(i) suggesting that a SEF's testing of its automated systems and BC-DR capabilities be conducted by qualified, independent professionals; and (3) proposed § 37.1401(j) suggesting that a SEF coordinate its BC-DR plan with those of others.[802] Given that these proposed provisions provided SEFs with a degree of discretion, the Commission believes that they are better suited as guidance rather than rules, and as guidance, SEFs will have greater flexibility in administering their obligations.

In response to CME's comments, the Commission is revising proposed § 37.1401(f)(1) to provide that SEFs only need to promptly notify the Commission staff of all material system malfunctions. With respect to planned changes to automated systems

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[800] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1231.

[801] Id.

[802] As a result of these changes, proposed section (b) is adopted as section (a), proposed section (d) is adopted as section (b), proposed section (e) is adopted as section (c), proposed section (f) is adopted as section (d), proposed section (g) is adopted as section (e), proposed section (h) is adopted as section (f), proposed section (i) is adopted as section (g), and proposed section (k) is adopted as section (h).

or programs of risk analysis and oversight, the Commission is revising proposed § 37.1401(g) to require timely advance notification of all material changes to automated systems and to programs of risk analysis and oversight. The Commission believes that these revisions are appropriate because the scope of the proposed rules may have been too broad as CME noted. The Commission notes that proposed § 37.1401(j) does not require SEFs to control or have access to the details of the disaster recovery plans of its major vendors. Rather, the requirement in the proposed rule, which is being adopted as guidance, suggests coordination to the extent possible.

In response to comments from WMBAA and MarketAxess, the Commission is revising proposed § 37.1401(d) to include a reference to appendix E to part 40 of the Commission's regulations, which describes the Commission's criteria for determining whether a SEF is a critical financial market.[803] Appendix E to part 40 describes the evaluation and notification process for SEFs once designated as a critical financial market.[804]

With respect to the references to § 40.9 regarding critical financial markets in proposed §§ 37.1401(d) and 37.1401(k), the Commission notes that § 40.9, which was proposed in a separate rulemaking,[805] is not yet final. However, SEFs deemed critical financial markets will be subject to the requirements set forth in § 40.9 upon its effective date. The Commission further notes that the reference to part 46 in proposed § 37.1401(k) was a technical error. Instead, the proposed rule should have referenced part

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[803] Business Continuity and Disaster Recovery, 75 FR 42633 (proposed Jul. 22, 2010). The Commission notes that this rulemaking is not yet final.

[804] Id. at 42639.

[805] Id. at 42638-39.

40. Accordingly, the Commission is replacing the mistaken reference to part 46 with a reference to part 40.

15. Subpart P – Core Principle 15 (Designation of Chief Compliance Officer)

Core Principle 15 establishes the position and duties of chief compliance officer ("CCO").[806] Core Principle 15 also requires the CCO to design procedures to establish the handling, management response, remediation, retesting, and closing of noncompliance issues.[807] The statute also requires a CCO to prepare and sign an annual compliance report that is filed with the Commission.[808] In addition, Core Principle 15 requires the CCO to include in the report a certification that, under penalty of law, the report is accurate and complete.[809] In the SEF NPRM, the Commission proposed to codify the statutory text of Core Principle 15 in proposed § 37.1500, and adopts that rule as proposed.

(a) § 37.1501 – Chief Compliance Officer

Proposed § 37.1501 implemented the statutory provisions of Core Principle 15 and granted CCOs the authority necessary to fulfill their responsibilities.

(1) § 37.1501(a) – Definition of Board of Directors

Proposed § 37.1501(a) defined "board of directors" as the board of directors of a swap execution facility or for those swap execution facilities whose organizational structure does not include a board of directors, a body performing a function similar to a board of directors.

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[806] CEA section 5h(f)(15); 7 U.S.C. 7b-3(f)(15).

[807] Id.

[808] Id.

[809] Id.

(i) Commission Determination

The Commission received no comments on § 37.1501(a) and is adopting the rule as proposed.

(2) § 37.1501(b) – Designation and Qualifications of Chief Compliance Officer

Proposed § 37.1501(b)(1) required a SEF to establish a CCO position and to designate an individual to serve in that capacity. Proposed § 37.1501(b)(1)(i) required that a SEF provide its CCO with the authority and resources to develop and enforce policies and procedures necessary to fulfill its statutory and regulatory duties. In addition, proposed § 37.1501(b)(1)(ii) provided that CCOs must have supervisory authority over all staff acting in furtherance of the CCO's statutory, regulatory, and self-regulatory obligations.

Proposed § 37.1501(b)(2) required that a CCO have the appropriate background and skills to fulfill the responsibilities of the position. Proposed § 37.1501(b)(2)(i) prohibited anyone who would be disqualified from registration under CEA sections 8a(2) or 8a(3) from serving as a CCO.[810] Proposed § 37.1501(b)(2)(ii) prohibited a CCO from being a member of the SEF's legal department or its general counsel.[811]

(i) Summary of Comments

Some commenters stated that by mandating that the CCO have the authority and resources to "enforce" a SEF's policies and procedures, the proposed rules change the traditional role of a CCO and give the CCO authority that should be reserved for senior

[810] See Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1232 (discussing the reasons for this requirement).

[811] Id.

management.[812] These commenters stated that the traditional and proper role of a CCO is to advise management on compliance issues and that management has the authority to enforce compliance policies and procedures.[813] The commenters recommended that the Commission revise the proposed rules to give effect to the well-established and critical distinction between a CCO and management.[814]

Some commenters stated that the proposed rules should not prohibit a CCO from serving as the SEF's general counsel or as a member of the SEF's legal department.[815] WMBAA noted that it is not uncommon for a company's CCO to be its general counsel.[816] Similarly, CME noted that many CCOs have certain other job responsibilities, most typically in related "control areas" such as the Legal Department or Internal Audit.[817] Additionally, MarketAxess stated that this prohibition could prevent a smaller SEF from structuring its internal management in the most efficient manner.[818] Parity Energy recommended that this requirement only apply to SEFs that could have a

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[812] WMBAA Comment Letter II at 2-6 (Mar. 8, 2011); FXall Comment Letter at 14-15 (Mar. 8, 2011); CME Comment Letter at 5-6 (Feb. 7, 2011). WMBAA submitted two comment letters to the SEF rulemaking comment file on Mar. 8, 2011. The second comment letter referred to herein as "WMBAA Comment Letter II" only pertains to the SEF NPRM's proposed CCO provisions. Additionally, rather than repeat its comments regarding the CCO provisions that pertain to both the DCO and SEF NPRMs, CME incorporated its entire DCO rulemaking comment letter regarding CCOs dated Feb. 7, 2011 as Exhibit B to its SEF comment letter dated Mar. 8, 2011. The Commission notes these comments by referencing the Feb. 7, 2011 date of CME's DCO comment letter regarding CCOs. The Commission is also changing CME's reference to "DCO" to "SEF" for these comments.

[813] WMBAA Comment Letter II at 2-6 (Mar. 8, 2011); FXall Comment Letter at 14-15 (Mar. 8, 2011); CME Comment Letter at 5-6 (Feb. 7, 2011).

[814] WMBAA Comment Letter II at 6 (Mar. 8, 2011); FXall Comment Letter at 14-15 (Mar. 8, 2011); CME Comment Letter at 6 (Feb. 7, 2011).

[815] WMBAA Comment Letter II at 6-7 (Mar. 8, 2011); MarketAxess Comment Letter at 27 (Mar. 8, 2011); ICE Comment Letter at 6-7 (Mar. 8, 2011); CME Comment Letter at 3 (Feb. 7, 2011).

[816] WMBAA Comment Letter II at 6 (Mar. 8, 2011).

[817] CME Comment Letter at 3 (Feb. 7, 2011).

[818] MarketAxess Comment Letter at 27 n. 31 (Mar. 8, 2011).

substantial impact on market risk and stability if they were to fail.[819] However, Tradeweb and Better Markets expressed support for a dedicated CCO position independent of a SEF's legal department.[820] Better Markets also commented that in situations where there are a number of affiliated organizations, a single senior CCO should have overall responsibility for each affiliated and controlled entity, even if the individual entities have CCOs.[821]

(ii) Commission Determination

The Commission is adopting § 37.1501(b) as proposed, subject to two modifications described below. In general, the Commission disagrees with the commenters who believe that a CCO's function is solely to monitor and advise on compliance issues. These commenters do not provide any statutory support for this view and their position appears to conflict with the statutory responsibilities of a CCO as set forth in the Act. In particular, CEA section 5h(f)(15)(B) requires a CCO to "resolve any conflicts of interest that may arise" and to "ensure compliance with this Act."[822] These duties suggest that a CCO is intended to be more than just an advisor, and must have the appropriate authority to enforce policies and procedures related to his or her areas of responsibility. The Commission believes that such authority is particularly important for a SEF CCO, given the CCO's responsibility in overseeing a SEF's self-regulatory programs.

However, to clarify the CCO's supervisory authority, the Commission is

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[819] Parity Energy Comment Letter at 6 (Mar. 25, 2011).

[820] Tradeweb Comment Letter at 12 (Mar. 8, 2011); Better Markets Comment Letter at 19 (Mar. 8, 2011).

[821] Better Markets Comment Letter at 19 (Mar. 8, 2011).

[822] CEA sections 5h(f)(15)(B)(iii) and (v); 7 U.S.C. 7b-3(f)(15)(B)(iii) and (v).

amending proposed § 37.1501(b)(1)(ii) to state that "[t]he chief compliance officer shall have supervisory authority over all staff acting at the direction of the chief compliance officer" (emphasis added). This modification provides greater clarity as to the SEF staff that must be under the managerial oversight of a CCO by emphasizing that such staff includes persons necessary for SEFs to fulfill their self-regulatory obligations, including compliance staff (e.g., trade practice and market surveillance staff and enforcement staff). The Commission notes that other SEF staff are not captured by the requirements of § 37.1501(b)(1).

The Commission is withdrawing proposed § 37.1501(b)(2)(ii), which prohibits the CCO from serving as a SEF's general counsel or as a member of its legal department. In the SEF NPRM, the Commission noted that there is potentially a conflict of interest present if a CCO serves as a SEF's general counsel or as a member of its legal department.[823] However, the Commission has determined that the potential costs of hiring additional staff to satisfy the requirement in proposed § 37.1501(b)(2)(ii) may impose an excessive burden on SEFs, particularly smaller SEFs.

Although the Commission is eliminating proposed § 37.1501(b)(2)(ii) from the final SEF rules, the Commission notes that a conflict of interest may compromise a CCO's ability to effectively fulfill his or her responsibilities as a CCO, and that such conflicts may be more likely to arise when a CCO is also employed as the SEF's general counsel or within its legal department. Therefore, the Commission expects that as soon as any conflict of interest becomes apparent, a SEF will immediately implement contingency measures. For example, a SEF may reassign the conflicted matter to an

[823] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1232, n. 103.

alternate employee who does not report to the CCO and who does not possess a conflict of interest. The Commission believes that a SEF's Regulatory Oversight Committee ("ROC")[824] should regularly monitor for potential conflicts of interest in its oversight of the CCO, and should be particularly involved in the oversight of any matter in which a CCO was recused.

The Commission disagrees with the recommendation by Better Markets to require a single senior CCO to have responsibility over multiple affiliated registered entities, some of which would be required by the CEA and Commission regulations to have their own CCOs. Such a situation might cause unnecessary confusion and dilute CCO accountability at the individual entity level. Additionally, the Commission believes that the proposed rule is sufficient to manage instances where there are a number of affiliated organizations within a corporate family. In these instances, each SEF would be required to appoint its own CCO.

(3) § 37.1501(c) – Appointment, Supervision, and Removal of Chief Compliance Officer

Proposed § 37.1501(c)(1) required that a CCO's appointment and compensation be approved by a majority of the SEF's board of directors or its senior officer. Proposed § 37.1501(c)(1) also required a CCO to meet with the SEF's board of directors at least annually and the ROC at least quarterly, and to provide any information requested regarding the SEF's regulatory program. In addition, proposed § 37.1501(c)(1) required a SEF to notify the Commission of the appointment of a new CCO within two business days of such appointment. Proposed § 37.1501(c)(2) required a CCO to report directly to

[824] See Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 FR 63732, 63747-48 (proposed Oct. 18, 2010). Proposed § 37.19(b) describes the role of the ROC. The Commission notes that this rule is not yet final.

the board of directors or to the senior officer of the SEF, at the SEF's discretion. Proposed § 37.1501(c)(3) required approval of a majority of a SEF's board of directors to remove a CCO. If a SEF does not have a board of directors, the proposed rule provided that the CCO may be removed by its senior officer. Proposed § 37.1501(c)(3) also required a SEF to notify the Commission of, and explain the reasons for, the departure of the CCO within two business days. In addition, proposed § 37.1501(c)(3) required a SEF to immediately appoint an interim CCO, to appoint a permanent CCO as soon as reasonably practicable, and to notify the Commission within two business days of appointing any new interim or permanent CCO.

(i) Summary of Comments

Some commenters requested that the Commission define the term "senior officer" and provided recommendations.[825] FXall recommended that the Commission define the term "senior officer" to include the SEF's president, chief executive officer, chief legal officer, or other officer with ultimate supervisory authority for the SEF entity.[826] CME recommended that the term "senior officer" be defined to include the senior officer of a division that is engaged in SEF activities rather than the senior officer of a larger corporation.[827]

Commenters also requested that the Commission grant a SEF greater flexibility in determining how a CCO is appointed, compensated, supervised, and removed.[828] In this regard, WMBAA stated that a CCO should be permitted to satisfy the statutory

[825] FXall Comment Letter at 14 (Mar. 8, 2011); Tradeweb Comment Letter at 12 n.8 (Mar. 8, 2011); CME Comment Letter at 2-3 (Feb. 7, 2011).

[826] FXall Comment Letter at 14 (Mar. 8, 2011).

[827] CME Comment Letter at 2-3 (Feb. 7, 2011).

[828] Tradeweb Comment Letter at 6 (Jun. 3, 2011); MarketAxess Comment Letter at 26 (Mar. 8, 2011); WMBAA Comment Letter II at 7 (Mar. 8, 2011); Tradeweb Comment Letter at 12 (Mar. 8, 2011).

requirement of reporting to the board of directors or a senior officer by reporting to a ROC.[829] MarketAxess commented that the proposed requirements for a majority of the board of directors to approve the appointment, compensation, and removal of the CCO go beyond the statutory mandate and would effectively place the CCO at the same level as the SEF's senior officer.[830] CME argued that each SEF should be given the flexibility to take additional steps beyond those required in the proposed rule, based on the SEF's particular corporate structure, size, and complexity, to ensure an appropriate level of independence for its CCO.[831]

AFR and Better Markets recommended, however, that the rules for CCO's appointment, compensation, supervision, and removal be strengthened.[832] AFR recommended that CCOs be responsible only to a SEF's ROC.[833] It argued that CCO independence may only be ensured by vesting oversight of the position exclusively in public directors.[834] Similarly, Better Markets recommended that decisions relating to a CCO's designation, compensation, and termination should be the sole responsibility of the independent members of the board of directors.[835]

(ii) Commission Determination

The Commission is adopting § 37.1501(c) as proposed, subject to several modifications described below.[836] In response to commenters' requests to define the term

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[829] WMBAA Comment Letter II at 7 (Mar. 8, 2011).

[830] MarketAxess Comment Letter at 26 (Mar. 8, 2011).

[831] CME Comment Letter at 9 (Feb. 7, 2011).

[832] AFR Comment Letter at 6 (Mar. 8, 2011); Better Markets Comment Letter at 19-20 (Mar. 8, 2011).

[833] AFR Comment Letter at 6 (Mar. 8, 2011).

[834] Id.

[835] Better Markets Comment Letter at 19-20 (Mar. 8, 2011).

[836] The Commission is making certain non-substantive revisions to § 37.1501(c) for clarity.

"senior officer," the Commission believes, based on the statutory language that requires a CCO to report directly to the "board or to the senior officer," that "senior officer" would only include the most senior executive officer of the legal entity that is registered as a SEF.

In response to the commenters' requests for greater flexibility, the Commission believes that proposed § 37.1501(c) generally strikes the appropriate balance between flexibility and ensuring that a SEF's CCO is insulated from day-to-day commercial pressures. The proposed rules provide a degree of flexibility by allowing a SEF's board of directors or senior officer to appoint, set the compensation of, and supervise the CCO. The proposed rules also protect the CCO from undue influence by requiring that the board of directors or the senior officer (if the SEF does not have a board of directors) be responsible for removing the CCO and that the CCO meet with the board of directors at least annually and with the ROC at least quarterly. In response to CME's comment about additional flexibility beyond the rules, the Commission notes that § 37.1501(c) sets forth minimum standards so a SEF may implement additional measures if it deems doing so necessary to insulate the CCO from undue influence. The Commission encourages SEFs to review and enact conflict mitigation procedures as appropriate for their specific corporate and/or organizational structure.

However, the Commission is revising proposed § 37.1501(c) in six respects. First, the Commission is modifying proposed § 37.1501(c)(1) to more clearly state that the CCO is obligated to meet with the board of directors at least annually and with the ROC at least quarterly, even if the CCO was appointed by, or is supervised by, the senior officer of the facility. Second, to clarify a CCO's duty to provide information to a SEF's

board of directors or ROC, the Commission is modifying proposed § 37.1501(c)(1) to state that "[t]he chief compliance officer shall provide any information regarding the swap execution facility's self-regulatory program that is requested by the board of directors or the regulatory oversight committee" (emphasis added). Third, the Commission is eliminating the requirement in proposed § 37.1501(c)(1) that a CCO's appointment and compensation require the approval of a majority of a SEF's board of directors. The Commission believes that board of director approval is a sufficient requirement for appointment, and that a SEF should have appropriate discretion to determine the voting percentage necessary to appoint a CCO or determine salary. Fourth, the Commission is eliminating the requirement in proposed § 37.1501(c)(3) that a SEF explain the reason for the departure of a CCO within two business days. The Commission believes that the specific reason for the departure may be unnecessary in most instances. However, the Commission will have the opportunity to investigate the reason for the departure if it so desires because a SEF must notify the Commission of a CCO's departure within two business days. Fifth, the Commission is eliminating the requirement in proposed § 37.1501(c)(3) that a SEF immediately appoint an interim CCO, and appoint a new permanent CCO as soon as reasonably practicable, upon the removal of a CCO. The Commission believes that the requirement to appoint a new CCO is implicit in § 37.1501(b)(1), which requires that a SEF designate an individual to serve as CCO. Finally, the Commission is eliminating the requirement in proposed § 37.1501(c)(3) that a SEF notify the Commission within two business days of appointing a new CCO because this requirement is already included in § 37.1501(c)(1).

(4) § 37.1501(d) – Duties of Chief Compliance Officer

Proposed § 37.1501(d) generally listed the following CCO duties: (1) overseeing and reviewing compliance with section 5h of the CEA and related Commission regulations; (2) in consultation with the board of directors or the senior officer, resolving any conflicts of interest that may arise; (3) establishing and administering written policies and procedures reasonably designed to prevent violations of the CEA and Commission regulations; (4) ensuring compliance with the CEA and Commission regulations relating to agreements, contracts, or transactions, and with Commission regulations issued under section 5h of the CEA; (5) establishing procedures for the remediation of noncompliance issues identified by the CCO; (6) establishing and following appropriate procedures for noncompliance issues; (7) establishing a compliance manual and administering a code of ethics; (8) supervising a SEF's self-regulatory program; and (9) supervising the effectiveness and sufficiency of any regulatory services provided to the SEF.

(i) Summary of Comments

Better Markets and CME commented on proposed § 37.1501(d)(2) regarding conflicts of interest.[837] Better Markets recommended that the Commission revise proposed § 37.1501(d)(2) to require a CCO to consult with both the independent members of the board of directors and the senior officer when resolving conflicts of interest, which are particularly contentious.[838] CME requested that the Commission revise proposed § 37.1501(d)(2) to require a CCO to establish policies and procedures reasonably designed to resolve any conflicts of interest that may arise.[839] Although CME conceded that the language in proposed § 37.1501(d)(2) mirrors the language in the Act,

[837] Better Markets Comment Letter at 20 (Mar. 8, 2011); CME Comment Letter at 6 (Feb. 7, 2011).

[838] Better Markets Comment Letter at 19, 20 (Mar. 8, 2011).

[839] CME Comment Letter at 6 (Feb. 7, 2011).

it believes that Congress did not intend for the CCO to resolve conflicts in the executive or managerial sense.[840]

Several commenters argued that proposed § 37.1501(d)(4), requiring a CCO to "ensure" compliance with the Act and Commission regulations, is an impracticable standard.[841] Instead, many of these commenters recommended alternative language, which generally stated that the CCO put in place policies and procedures that reasonably ensure compliance with the Act and Commission regulations.[842]

CME also took issue with the requirement in proposed § 37.1501(d)(6), which requires a CCO to "follow" appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.[843] CME requested that the Commission eliminate this requirement, which it believes is a function of senior management.[844] Additionally, WMBAA recommended that the Commission delete proposed §§ 37.1501(d)(8) and (d)(9), regarding the supervision of a SEF's self-regulatory program and any regulatory service provider, because these functions should be the responsibility of management.[845]

(ii) Commission Determination

The Commission is adopting § 37.1501(d) as proposed, subject to certain modifications described below. The Commission is revising proposed § 37.1501(d)(2) to

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[840] Id.

[841] Tradeweb Comment Letter at 6-7 (Jun. 3, 2011); WMBAA Comment Letter II at 5-6 (Mar. 8, 2011); MarketAxess Comment Letter at 26 (Mar. 8, 2011); Tradeweb Comment Letter at 12 (Mar. 8, 2011); CME Comment Letter at 4 (Feb. 7, 2011).

[842] Tradeweb Comment Letter at 6-7 (Jun. 3, 2011); Tradeweb Comment Letter at 12 (Mar. 8, 2011); CME Comment Letter at 4 (Feb. 7, 2011).

[843] CME Comment Letter at 6 (Feb. 7, 2011).

[844] Id.

[845] WMBAA Comment Letter II at 6 (Mar. 8, 2011).

clarify that the list of enumerated conflicts of interest is not exhaustive.[846] The Commission is not adopting the recommendation by Better Markets to require the CCO to consult with both the independent members of the board of directors and the senior officer when resolving conflicts of interest. Considering the statutory provisions of CEA section 5h, the Commission believes that it is unnecessary to require the CCO to do so. However, the Commission notes that § 37.1501(d)(2) sets forth minimum standards so a SEF may institute higher standards, such as requiring its CCO to consult with both the independent members of the board of directors and the senior officer when resolving conflicts of interest. The Commission also declines to adopt CME's recommendation regarding conflicts of interest. As CME acknowledged, the Commission is following the statutory language in its implementation of § 37.1501(d)(2).

In response to commenters' concerns about the requirement to "ensure" compliance in proposed § 37.1501(d)(4), the Commission is modifying the rule to state that the CCO shall take "reasonable steps to ensure compliance with the Act and the rules of the Commission." The Commission understands that a single individual cannot guarantee compliance with the CEA and Commission regulations. The Commission believes that this modification is responsive to commenters' concerns and is consistent with the final rules for other registered entities.[847] The Commission is also removing the

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[846] The Commission notes that the preamble to the SEF NPRM already clarified this point. To provide additional clarity, the Commission is clarifying this point in the final rule by adding the word "including" before the list of enumerated conflicts of interest. See Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1233.

[847] See, e.g., Swap Data Repositories: Registration Standards, Duties and Core Principles, 76 FR 54538, 54584 (Sept. 1, 2011) (stating that the duties of an SDR's CCO include "[t]aking reasonable steps to ensure compliance with the Act and Commission regulations . . ."); Derivatives Clearing Organization General Provisions and Core Principles, 76 FR 69334, 69434 (Nov. 8, 2011) (stating that the duties of a DCO's CCO include "[t]aking reasonable steps to ensure compliance with the Act and Commission regulations . . .").

reference to "agreements, contracts, or transactions" in proposed § 37.1501(d)(4) to more closely follow the language in the Act. In making this modification, the Commission does not intend to modify any substantive obligations of the CCO with regard to agreements, contracts, or transactions to the extent that these documents implicate the Act or Commission regulations under the Act.

In order to clarify differences between the SEF NPRM's preamble and rule text regarding proposed § 37.1501(d)(7), the Commission is revising the rule to state that the CCO's duties include "[e]stablishing <u>and administering</u> a compliance manual designed to promote compliance with the applicable laws, rules, and regulations . . ." (emphasis added). The Commission also disagrees with CME and WMBAA that the requirements in proposed §§ 37.1501(d)(6), (d)(8), and (d)(9) are functions of management. These provisions, as discussed above, require a CCO to establish and follow appropriate procedures regarding noncompliance issues, supervise the SEF's self-regulatory program, and supervise the effectiveness and sufficiency of any regulatory service provider. As noted above, the Commission disagrees with the commenters who believe that a CCO's function is solely to monitor and advise on compliance issues. Finally, the Commission is revising proposed § 37.1501(d)(9) to remove the references to "registered futures association" and "other registered entity" and, instead, adding a reference to "regulatory service provider" given the inclusion of FINRA as a regulatory service provider under § 37.204.

(5) § 37.1501(e) – Annual Compliance Report Prepared by Chief Compliance Officer[848]

[848] The Commission is renaming the title of this section from "Annual Compliance Report Prepared by Chief Compliance Officer" to "Preparation of Annual Compliance Report."

Proposed § 37.1501(e) generally enumerated the following information that must be included in the annual compliance report: (1) a description of the SEF's written policies and procedures, including the code of ethics and conflicts of interest policies; (2) a detailed review of the SEF's compliance with CEA section 5h and Commission regulations, which, among other requirements, identifies the policies and procedures that ensure compliance with the core principles; (3) a list of any material changes to the compliance policies and procedures since the last annual compliance report; (4) a description of staffing and resources set aside for the SEF's compliance program; (5) a description of any material compliance matters, including instances of noncompliance; (6) any objections to the annual compliance report by those persons who have oversight responsibility for the CCO; and (7) a certification by the CCO that, to the best of his or her knowledge and reasonable belief, and under penalty of law, the annual compliance report is accurate and complete.

(i) Summary of Comments

FXall and CME asserted that the information required to be included in the annual compliance report is too detailed.[849] FXall, for example, commented that the requirements for the annual compliance report go beyond those set forth in the Dodd-Frank Act and that producing the report will consume considerable resources.[850] FXall proposed alternative requirements, which it believes would be more in-line with the requirements in the Dodd-Frank Act.[851]

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[849] FXall Comment Letter at 16-17 (Mar. 8, 2011); CME Comment Letter at 7-8 (Feb. 7, 2011).

[850] FXall Comment Letter at 16 (Mar. 8, 2011).

[851] See id. for details regarding FXall's proposed alternatives.

With respect to the requirement in proposed § 37.1501(e)(2)(i) to identify policies and procedures that "ensure" compliance with the core principles, FXall and CME stated that policies and procedures cannot "ensure" or guaranty compliance, but can only be reasonably designed to result in compliance.[852] CME also recommended that the requirement in proposed § 37.1501(e)(5) to describe any material compliance matters be revised to require the report to identify "any material non-compliance issues that were not properly addressed."[853] MarketAxess recommended that the Commission remove proposed § 37.1501(e)(6) because in its opinion other persons should be able to correct the CCO's annual report.[854]

MarketAxess and FSR expressed their concern that the CCO's certification of the annual compliance report in proposed § 37.1501(e)(7) may impose strict liability on a CCO where the report contains even a minor and insignificant error.[855] These commenters recommended adding a materiality qualifier to the certification.[856] Additionally, both FXall and CME recommended that the SEF's senior officer, not the CCO, certify the accuracy of the annual compliance report.[857]

(ii) Commission Determination

The Commission is adopting § 37.1501(e) as proposed, subject to certain modifications described below. The Commission disagrees with the comments from FXall and CME regarding the complexity and the burden of the annual compliance

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[852] FXall Comment Letter at 17 (Mar. 8, 2011); CME Comment Letter at 7 (Feb. 7, 2011).

[853] CME Comment Letter at 7-8 (Feb. 7, 2011).

[854] MarketAxess Comment Letter at 26 (Mar. 8, 2011).

[855] MarketAxess Comment Letter at 26 (Mar. 8, 2011); FSR Comment Letter at 10 (Mar. 8, 2011).

[856] Id.

[857] FXall Comment Letter at 15 (Mar. 8, 2011); CME Comment Letter at 8 (Feb. 7, 2011).

report. The annual compliance report is meant to provide the Commission with a detailed account of a SEF's compliance with the CEA and Commission regulations, as well as a detailed account of a SEF's self-regulatory program. The Commission believes that the level of detail the proposed rules require, including the requirement that the annual report include a description of all noncompliance issues identified, is necessary to ensure that the Commission can determine the effectiveness of a SEF's compliance and self-regulatory programs.[858]

However, in response to comments, the Commission is revising proposed § 37.1501(e)(2)(i) to require that the annual compliance report identify "the policies and procedures that <u>are designed to</u> ensure compliance with each subsection and core principle, including each duty specified in section 5h(f)(15)(B) of the Act . . ." (emphasis added). The Commission is also removing proposed § 37.1501(e)(6), which requires the annual compliance report to include any objections by those persons who oversee the CCO.[859] The Commission believes that the board of directors[860] may append its own comments if desired, but the statutory text and the Commission's implementing regulations do not require it.

The Commission disagrees with the comments from MarketAxess and FSR regarding the inclusion of a materiality qualifier to the certification requirement. The Commission believes that the current certification sufficiently protects the CCO from being held strictly liable for any minor inaccuracies because it includes a "knowledge"

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[858] In this regard, the Commission disagrees with CME's recommendation regarding proposed § 37.1501(e)(5).

[859] As a result of this deletion, the Commission is adopting proposed § 37.1501(e)(7) as § 37.1501(e)(6).

[860] If a SEF does not have a board of directors, then the senior officer of the SEF may append his or her own comments if desired.

and "reasonable belief" qualifier. The Commission also disagrees with CME's and FXall's comments to have the SEF's CEO, instead of the CCO, certify the accuracy of the annual compliance report. While the CEA does not explicitly require that the CCO certify the report, it does require that the CCO "annually prepare and sign" the report, and that the report "include a certification that, under penalty of law, the compliance report is accurate and complete."[861] The Commission believes that these two requirements read together provide sufficient basis for the CCO to certify that the report is accurate and complete. However, the Commission is modifying § 37.1501(e) to explicitly state that the CCO "sign" the annual compliance report in order to follow the statutory text more closely.

(6) § 37.1501(f) – Submission of Annual Compliance Report by Chief Compliance Officer to the Commission[862]

Proposed § 37.1501(f)(1) required, among other items, that the CCO provide the annual compliance report to the board of directors or the senior officer for review, prior to submission to the Commission. The proposed rule also stated that the board of directors or the senior officer may not require the CCO to make any changes to the report. Proposed § 37.1501(f)(2) required that the annual compliance report be electronically provided to the Commission not more than 60 days after the end of the SEF's fiscal year. Proposed § 37.1501(f)(3) required the CCO to promptly file an amendment to an annual compliance report upon discovery of any material error or omission. Proposed § 37.1501(f)(4) allowed a SEF to request an extension of time to file

[861] CEA section 5h(f)(15)(D); 7 U.S.C. 7b-3(f)15)(D).

[862] The Commission is renaming the title of this section from "Submission of Annual Compliance Report by Chief Compliance Officer to the Commission" to "Submission of Annual Compliance Report."

its compliance report based on substantial, undue hardship. Finally, proposed § 37.1501(f)(5) stated that annual compliance reports will be treated as exempt from mandatory public disclosure for purposes of FOIA[863] and the Sunshine Act[864] and parts 145 and 147 of the Commission's regulations.

(i) Summary of Comments

Some commenters stated that proposed § 37.1501(f)(1) should be modified to allow the board of directors or the senior officer to make changes to the annual compliance report.[865] These commenters generally argued that the CCO should be accountable to management and, by not permitting the board of directors or the senior officer to revise the report, the proposed rule undermines the authority of the board of directors.[866] Better Markets recommended that the CCO should be required to present his or her finalized report to the board of directors and executive management prior to its submission.[867] Better Markets further recommended that the independent directors and/or the Audit Committee, as well as the entire board of directors, review and approve the report or detail where and why it disagrees with any provision before submission to the Commission.[868]

With respect to proposed § 37.1501(f)(5), CME recommended that the Commission expressly state that annual compliance reports are confidential documents

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[863] 5 U.S.C. 552.

[864] 5 U.S.C. 552b(b).

[865] FXall Comment Letter at 17-18 (Mar. 8, 2011); WMBAA Comment Letter II at 7 (Mar. 8, 2011); MarketAxess Comment Letter at 26 (Mar. 8, 2011).

[866] Id.

[867] Better Markets Comment Letter at 20 (Mar. 8, 2011).

[868] Id.

that are not subject to public disclosure by listing such reports as a specifically exempt item in Commission regulation 145.5.[869]

(ii) Commission Determination

The Commission is adopting § 37.1501(f) as proposed, subject to two modifications described below. The Commission has determined not to adopt the commenters' recommendation to allow the board of directors or the senior officer to make changes to the annual compliance report. The Commission believes that allowing the board of directors or the senior officer to make changes to the report would prevent the CCO from making a complete and accurate assessment of a SEF's compliance program. The Commission has determined not to adopt the recommendation by Better Markets that the board of directors approve the annual compliance report or detail any disagreement. The Commission believes that requiring the board of directors to approve the report increases the risk that the CCO would be subject to undue influence by the board or by management. The Commission notes that the board of directors may include its own opinion of the annual compliance report if it disagrees with the CCO's assessment. The Commission believes that the rule strikes the appropriate balance between ensuring that the board of directors cannot adversely influence the content of the annual compliance report and granting the board the opportunity to express its opinion of the report to the Commission.

The Commission is revising proposed § 37.1501(f)(2) to clarify that a SEF shall submit its annual compliance report to the Commission concurrently with the SEF's filing of its fourth fiscal quarter financial report pursuant to § 37.1306. The Commission

[869] CME Comment Letter at 9 (Feb. 7, 2011).

is making this technical correction because CEA section 5h(f)(15)(D)(ii) sets forth such a requirement, which was inadvertently omitted from the proposed rules.[870]

Additionally, the Commission is withdrawing proposed § 37.1501(f)(5). The Commission acknowledges CME's concern regarding the public release of annual compliance reports and clarifies that the Commission does not intend to make annual compliance reports public. However, where such information is, in fact, confidential, the Commission encourages SEFs to submit a written request for confidential treatment of such filings under FOIA, pursuant to the procedures established in section 145.9 of the Commission's regulations.[871] The determination of whether to disclose or exempt such information in the context of a FOIA proceeding would be governed by the provisions of part 145 and any other relevant provision.

(7) § 37.1501(g) – Recordkeeping

Proposed § 37.1501(g)(1) generally stated that a SEF must maintain the following records: (i) a copy of written policies and procedures adopted in furtherance of compliance with the Act and Commission regulations; (ii) copies of all materials created in furtherance of the CCO's duties listed in paragraphs (d)(6) and (d)(7) of proposed § 37.1501; (iii) copies of all materials in connection with the review and submission of the annual compliance report; and (iv) any records relevant to a SEF's annual report. Proposed § 37.1501(g)(2) required a SEF to maintain these records in accordance with § 1.31 and part 45 of the Commission's regulations.

(i) Summary of Comments

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[870] CEA section 5h(f)(15)(D)(ii); 7 U.S.C. 7b-3(f)(15)(D)(ii).

[871] 17 CFR 145.9.

MarketAxess commented that the final rule should provide an exception for legally privileged materials.[872] MarketAxess argued that it is unreasonable for the Commission to take the position that a CCO should not be able to receive privileged advice from counsel in an effort to comply with these new, complex, and uncertain rules.[873]

(ii) Commission Determination

The Commission is adopting § 37.1501(g) as proposed.[874] The Commission does not believe that § 37.1501(g) changes existing Commission policies regarding the assertion of attorney-client privilege by registrants. As stated in the SEF NPRM, the Commission designed § 37.1501(g) to ensure that the Commission staff would be able to obtain the necessary information to determine whether a SEF has complied with the CEA and applicable regulations.[875] The Commission believes that proposed § 37.1501(g) properly accomplishes this goal.

Finally, the Commission is adding new § 37.1501(h) titled "Delegation of authority" to the final SEF rules to delegate authority to the Director of DMO to grant or deny a swap execution facility's request for an extension of time to file its annual compliance report under paragraph (f)(4) of § 37.1501.

III. Related Matters

A. Regulatory Flexibility Act

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[872] MarketAxess Comment Letter at 27 (Mar. 8, 2011).

[873] Id.

[874] The Commission is making certain non-substantive clarifications to § 37.1501(g). In addition, the Commission is revising the citation to paragraphs "(d)(6) and (d)(7)" in proposed § 37.1501(g)(1)(ii) to cite to paragraphs "(d)(8) and (d)(9)." The Commission notes that this was a drafting error.

[875] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1235.

The Regulatory Flexibility Act ("RFA")[876] requires federal agencies, in promulgating regulations, to consider the impact of those regulations on small entities. The regulations adopted herein will affect SEFs. The Commission has previously established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its regulations on small entities in accordance with the RFA.[877] In addition, the Commission has previously determined that DCMs, derivatives transaction execution facilities ("DTEFs"), exempt commercial markets ("ECMs"), exempt boards of trade ("EBOTs"), and DCOs are not small entities for the purpose of the RFA.[878]

While SEFs are new entities to be regulated by the Commission pursuant to the Dodd-Frank Act,[879] in the SEF NPRM the Commission proposed that SEFs should not be considered as small entities for the purpose of the RFA for essentially the same reasons that DCMs and DCOs have previously been determined not to be small entities.[880] The Commission received no comments on the impact of the rules contained herein on small entities. Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the regulations will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

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[876] 5 U.S.C. 601 et seq.

[877] See 47 FR 18618-21 (Apr. 30, 1982).

[878] See 47 FR 18618, 18619 (Apr. 30, 1982) discussing DCMs; 66 FR 42256, 42268 (Aug. 10, 2001) discussing DTEFs, ECMs, and EBOTs; and 66 FR 45604, 45609 (Aug. 29, 2001) discussing DCOs.

[879] Dodd Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

[880] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1235.

The Paperwork Reduction Act ("PRA")[881] imposes certain requirements on federal agencies in connection with their conducting or sponsoring any collection of information as defined by the PRA. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number issued by the Office of Management and Budget ("OMB"). This final rulemaking contains new collection of information requirements within the meaning of the PRA. Accordingly, in connection with the SEF NPRM, the Commission submitted an information collection request, titled "Core Principles and Other Requirements for Swap Execution Facilities," to OMB for its review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. Additionally, pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission, in the SEF NPRM, requested comments from the public on the proposed information collection requirements in order to, among other items, evaluate the necessity of the proposed collections of information and minimize the burden of the information collection requirements on respondents.[882]

On April 28, 2011, OMB assigned control number 3038-0074 to this collection of information, but withheld final approval pending the Commission's resubmission of the information collection, which includes a description of the comments received on the collection and the Commission's responses thereto. The Commission has revised some of its proposed estimates of the number of mandatory responses in order to clarify the Commission's original intent; otherwise, the proposed burden hour estimates are being adopted as discussed herein. The Commission has submitted the revised information

[881] 44 U.S.C. 3501 et seq.

[882] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1236.

collection request to OMB for its review, which will be made available by OMB at http://www.reginfo.gov/public/do/PRAMain.

As noted in the SEF NPRM, the Commission will protect proprietary information according to the Freedom of Information Act and 17 CFR part 145, "Commission Records and Information." In addition, section 8(a)(1) of the CEA strictly prohibits the Commission, unless specifically authorized by the CEA, from making public "data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers."[883] The Commission is also required to protect certain information contained in a government system of records according to the Privacy Act of 1974.[884]

1. Proposed Collection of Information

In the SEF NPRM, the Commission estimated that each SEF respondent would have an average annual reporting burden of 308 hours.[885] In deriving this estimate, the Commission compared the reporting requirements for other entities that fall under the Commission's regulatory oversight, such as an Exempt Commercial Market with a significant price discovery contract ("SPDC ECM"), a DTEF, and a DCM.[886] Specifically, the Commission estimated that a SEF will have more reporting requirements than a SPDC ECM and a DTEF, but fewer reporting requirements than a DCM (as most recently calculated).[887] The Commission employed an average of its most recent hourly

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[883] 7 U.S.C. 12(a)(1).

[884] 5 U.S.C. 552a.

[885] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1236.

[886] Id.

[887] Id. SPDC ECMs were subject to 9 core principles, DTEFs were subject to 9 core principles, and DCMs are subject to 23 core principles. SEFs will be subject to 15 core principles. Id. at 1236 n. 124.

burdens for DCMs, DTEFs, and SPDC ECMs.[888] Those hourly burdens provided in the SEF NPRM are noted below:

Current estimate of DCM's annual burden:	*440 hours per DCM*[889]
Initial estimate of DTEF's annual burden:	*200 hours per DTEF*[890]
Initial estimate of SPDC ECM's annual burden:	*233 hours per ECM*[891]

In the SEF NPRM, the Commission estimated that 30 to 40 SEFs will register with the Commission as a result of the Dodd-Frank Act.[892] Therefore, the Commission estimated the annual aggregate hour burden for all respondents to be 10,780 hours.[893] Based on an hourly rate of $52,[894] the Commission estimated that respondents may expend up to $16,016 annually to comply with the proposed regulations.[895] This would

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[888] Id. at 1236.

[889] After passage of the Commodity Futures Modernization Act of 2000 and a switch to the core principles framework for DCMs, the Commission estimated that the recordkeeping and reporting obligations imposed by part 38 would total 300 burden hours per DCM. See A New Regulatory Framework for Trading Facilities, Intermediaries and Clearing Organizations, 66 FR 42256, 42268 (Aug. 10, 2001); 66 FR 14262, 14268 (proposed Mar. 9, 2001). In 2007, the Commission amended the acceptable practices in part 38 for minimizing conflicts of interest, estimating that the amendments would increase the information collection and reporting burden by an additional 70 hours per DCM. See Conflicts of Interest in Self-Regulation and Self-Regulatory Organizations ("SROs"), 72 FR 6936, 6957 (Feb. 14, 2007); 71 FR 38740, 38748 (proposed Jul. 7, 2006). Most recently, the Commission adopted revisions to part 38 to implement the Dodd-Frank Act, estimating that the revisions would increase the information collection and reporting burden by an additional 70 hours per DCM. See Core Principles and Other Requirements for Designated Contract Markets, 77 FR 36612, 36662 (Jun. 19, 2012). The average for purposes of the initial burden hour estimate for SEFs averages both initial estimates for DCMs with the other most recent estimates.

[890] A New Regulatory Framework for Trading Facilities, Intermediaries and Clearing Organizations, 66 FR at 42268; 66 FR at 14268.

[891] Significant Price Discovery Contracts on Exempt Commercial Markets, 74 FR 12178, 12187 (Mar. 23, 2009); 73 FR 75888, 75902 (proposed Dec. 12, 2008).

[892] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1236. For hourly reporting requirements, an average of 35 SEFs was used for calculation purposes. Id. at 1236 n. 125.

[893] Id. at 1236.

[894] In arriving at a wage rate for the hourly costs imposed, the Commission consulted the Management and Professional Earnings in the Securities Industry Report, published in 2010 by the Securities Industry and Financial Markets Association (SIFMA Report). The wage rate is a composite (blended) wage rate arrived at by averaging the mean annual salaries of an Assistant/Associate General Counsel, an Assistant Compliance Director, a Senior Programmer, and a Senior Treasury/Cash Management Manager as published in the SIFMA Report and dividing that figure by 2,000 annual work hours to arrive at the hourly rate of $52.

[895] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1236.

result in an aggregate cost across all SEF respondents of $560,560 per annum (35 respondents x $16,016).[896] The SEF NPRM also provided the following summary of estimates:

Estimated number of respondents:	*35*
Annual responses by each respondent:	*1*
Total annual responses:	*35*
Quarterly responses by each respondent:	*4*
Total quarterly responses:	*140*
Estimated average hours per response:	*308*
Aggregate annual reporting hours burden:	*10,780*[897]

2. Summary of Comments and Commission Response

While no commenter directly addressed the proposed aggregate burden hour estimate, the Commission did receive comments related to the costs of various recordkeeping and reporting requirements in the proposed rules.

(a) § 37.3 – Requirements and Procedures for Registration

WMBAA commented that the Commission could reduce the regulatory burden of the registration procedures by reconciling its Form SEF with the SEC's registration form such that a potential SEF will have to fill out only one form.[898] Similarly, MarketAxess stated that it is costly and inefficient for a SEF that is required to be registered by both the Commission and SEC to go through two full registration processes, and that the Commission instead should permit "notice" or "passport" registration of an SB-SEF already registered with the SEC.[899] While the Commission acknowledges notice registration under section 5h(g) of the Act, it notes that the registration requirements for

[896] Id.

[897] 308 average hours per respondent x 35 respondents = 10,780 total hours/year. Id.

[898] WMBAA Comment Letter at 14 (Mar. 8, 2011).

[899] MarketAxess Comment Letter at 20-21 (Mar. 8, 2011).

SEFs may differ from the registration requirements for SB-SEFs and thus the Commission must conduct an independent review of a SEF applicant's registration application to ensure that the potential SEF's proposed trading models and operations comply with the Commission's requirements. Given such differing requirements, the Commission also notes that Form SEF may differ from the SEC's registration form.

With respect to temporary registration, the Commission has eliminated the requirement from the SEF NPRM that an applicant provide transaction data that substantiates that the execution or trading of swaps has occurred and continues to occur on the applicant's trading system or platform at the time the applicant submits its temporary registration request. The Commission has also eliminated the certification requirement that an applicant believes that when it operates under temporary registration it will meet the requirements of part 37 of the Commission's regulations. Instead, the Commission has revised the temporary registration provisions to require a SEF applicant that is already operating a swaps-trading platform, in reliance upon either an exemption granted by the Commission or some form of no-action relief granted by the Commission staff, to include in the temporary registration notice a certification that it is operating pursuant to such exemption or no-action relief. The Commission believes that these revisions will not materially affect the proposed part 37 information collection estimate.

(b) § 37.4 – Procedures for Listing Products and Implementing Rules

CME commented that the proposed product and rule certification process substantially increased the documentation burden, which in turn would increase the cost and amount of time it takes to list new products and implement new rules, with no

corresponding benefit to the public.[900] While CME cited the 8,300 additional aggregate hours that product and rule submissions were estimated to impose on all registered entities,[901] the Commission notes that this figure was already accounted for in the Commission's information collection estimate in the part 40 rulemaking titled "Provisions Common to Registered Entities."[902] Therefore, the burden associated with that information collection is not duplicated here.

(c) § 37.5(c) – Equity Interest Transfers

CME commented that the "level of immediacy" contemplated by the 24-hour timeframe for submitting agreements with the notification to the Commission of an equity interest transfer in proposed § 37.5(c) may be unrealistic.[903] CME further commented that the representation of compliance with the requirements of CEA section 5h and the Commission's regulations adopted thereunder would be more appropriate if required upon consummation of the equity interest transfer, rather than with the initial notification.[904] In this final rulemaking, the Commission has revised proposed § 37.5(c) to remove references to specific documents that must be provided with the equity transfer notification, and instead provided that the Commission may request supporting documentation. The Commission has also revised the proposed rule to increase the

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[900] CME Comment Letter at 10, 13 (Feb. 22, 2011).

[901] Id. at 10.

[902] Provisions Common to Registered Entities, 76 FR 44776, 44789 (Jul. 27, 2011). The Commission also notes that the annual burden hour estimate for DCMs that was used to calculate the annual burden hour estimate for SEFs in this part 37 rulemaking did not include the recordkeeping and reporting hours accounted for in the part 40 rulemaking's information collection estimate. Therefore, there is no double counting of hours for product and rule submissions. Furthermore, the Commission notes that, similar to the DCM rulemaking, many of the collection burdens associated with this part 37 rulemaking are covered by other existing or pending collections of information. Therefore, only those burdens that are not covered elsewhere are included in this collection of information.

[903] CME Comment Letter at 13 (Feb. 22, 2011).

[904] Id.

threshold of when a SEF must file an equity interest transfer notification with the Commission from ten percent to fifty percent and has extended the time period for a SEF to file the notification to up to ten business days from one business day under the proposed rule. In addition, the Commission has deleted the requirement for a SEF to provide a representation of compliance with section 5h of the Act and the Commission regulations thereunder with the equity interest transfer notification, as requested by CME. The Commission notes that these revisions should slightly reduce the burden of the information collection requirements for those respondents who are not requested to provide supporting documentation.

(d) § 37.202(b) – Jurisdiction

CME stated that it would be costly for a SEF to obtain every customer's consent to its regulatory jurisdiction as required by proposed § 37.202(b).[905] As noted in the preamble, the Commission believes that jurisdiction must be established by a SEF prior to granting members and market participants access to its markets in order to effectuate the statutory mandate of Core Principle 2 that a SEF shall have the capacity to detect, investigate, and enforce rules of the SEF. The Commission notes that any information collection costs associated with this rule is covered by the Commission's information collection estimate.

(e) § 37.203(f) – Investigations and Investigation Reports

CME stated that minor transgressions could be handled effectively through the issuance of a warning letter rather than a formal investigatory report.[906] As explained in the preamble, the Commission clarifies that warning letters may be issued for minor

[905] Id. at 16.

[906] Id. at 22.

transgressions; however, no more than one warning letter may be issued to the same person or entity found to have committed the same rule violation more than once within a rolling 12-month period. The Commission also clarifies that the limit on the number of warning letters is not applicable when a rule violation has not been found. The Commission believes that these clarifications will not materially affect the proposed part 37 information collection estimate.

(f) § 37.205 – Audit Trail

WMBAA commented that the proposed audit trail requirement in § 37.205(b) to retain records of customer orders should not apply to indicative quotes because it would be burdensome and costly.[907] As discussed in the preamble, the Commission believes that this requirement is necessary so that a SEF has a complete picture of all trading activity in order to carry out its statutory mandate to monitor its markets to detect abusive trading practices and trading rule violations. The Commission accounted for this recordkeeping requirement in the proposed burden hour estimate; therefore, the estimate remains unaffected.

(g) § 37.404 – Ability to Obtain Information

WMBAA commented that the requirement for SEFs to mandate that traders maintain trading and financial records is not required under the Act.[908] The Commission notes that market participants' trading records are an invaluable tool in its surveillance efforts and believes that a SEF should have direct access to such information in order to discharge its obligations under the SEF core principles. However, as noted in the preamble, the Commission states in the guidance that SEFs may limit the application of

[907] WMBAA Comment Letter at 23 (Mar. 8, 2011).

[908] Id. at 26.

this requirement to those market participants who conduct substantial trading on their facility. The Commission notes that the requirement for market participants to keep such records is sound commercial practice, and that market participants are likely already maintaining such trading records; therefore, the Commission believes that the revision above will not materially affect the proposed part 37 information collection estimate.

(h) § 37.703 – Monitoring for Financial Soundness

FXall commented that SEFs would be burdened by the "onerous financial surveillance obligations" of proposed § 37.703, which include the routine review of members' financial records.[909] The Commission agrees that burdensome financial surveillance obligations may lead to higher transaction costs; therefore, as discussed in the preamble, the Commission has revised the proposed rule to state that SEFs must monitor their market participants to ensure that they continue to qualify as ECPs. The Commission believes that this revision will not materially affect the proposed part 37 information collection estimate and is thus maintaining the estimate.

(i) § 37.1306 – Financial Resources Reporting to the Commission

MarketAxess commented that the financial resources reporting requirements are unnecessary and burdensome and recommended that the Commission allow a senior officer of the SEF to represent to the Commission that it satisfies the financial resources requirements.[910] The Commission disagrees with MarketAxess and, as discussed in the preamble, believes that much of the information required by the reports should be readily available to a SEF in the ordinary course of business. The Commission's proposed burden hour estimate includes this reporting requirement.

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[909] FXall Comment Letter at 3 (Mar. 8, 2011).

[910] MarketAxess Comment Letter at 40 (Mar. 8, 2011).

(j) § 37.1401 – System Safeguards Requirements

CME commented that the requirements to notify the Commission staff of all system security-related events and all planned changes to automated systems that may impact the reliability, security, or scalability of the systems are overly burdensome.[911] As noted in the preamble, the Commission has revised the rule to only require notification of material system malfunctions and material planned system changes. While these revisions should decrease the regulatory burden imposed by the rule, the Commission believes that, given the infrequent nature of the information collection requirement as originally proposed, the effect of the revisions should be de minimis and therefore not affect the proposed burden hour estimate.

(k) § 37.1501(e) – Preparation of Annual Compliance Report

FXall commented that the information required by the proposed regulations to be included in the annual compliance report is too detailed and will be too costly to compile.[912] The Commission is not persuaded by FXall's comment, and notes that the annual compliance report is meant to be the primary tool by which the Commission can evaluate the effectiveness of a SEF's compliance and self-regulatory programs, thus requiring a high level of detail. The Commission's proposed burden hour estimate includes the annual compliance report requirement.

3. Final Burden Estimate

The final regulations require each respondent to file information with the Commission. For instance, SEF applicants must file registration applications with the Commission pursuant to § 37.3. SEFs must record, report, and disclose information

[911] CME Comment Letter at 36-37 (Feb 22, 2011).

[912] FXall Comment Letter at 16 (Mar. 8, 2011).

related to prices, trading volume, and other trading data for swaps pursuant to Core Principles 9 and 10 ("Timely Publication of Trading Information" and "Recordkeeping and Reporting"). In general, the collections of information are required to demonstrate a SEF's operational capability and are a tool by which both the SEF and the Commission can evaluate the effectiveness of a SEF's self-regulatory programs.

The mandatory information collections are contained in several of the general provisions being adopted in subpart A, as well as in certain regulations implementing Core Principles 2, 3, 4, 5, 7, 8, 9, 10, 13, 14, and 15. Generally, the information collections covered in this final part 37 rulemaking are not covered in other existing collections or collections that are being established in connection with other Dodd-Frank rulemakings, and pertain to the following general categories of recordkeeping and reporting: registration; submissions related to material changes in the SEF's operations or business structure; compliance; financial resources reports, and an annual report by the CCO related to the SEF's performance of its self-regulatory responsibilities.

As discussed above, the methodology used to formulate the proposed estimate was an average of other registered entities. Due to the relatively low magnitude of changes made to the mandatory information collection provisions in this final part 37 rulemaking, the Commission has determined not to alter its proposed estimate of 308 hours per SEF respondent. By definition, averages are meant to serve as only a reference point; the Commission understands that due to both discretionary and mandatory requirements, some SEFs may go above the final estimate of 308 hours to complete mandatory information collection requirements, while others may stay below. The Commission is, however, adjusting the proposed estimate of annual and quarterly

responses to clarify the Commission's original intent. In this regard, the Commission is adding an estimated average hours per response number below, which is based on 5 responses per year (1 annual response and 4 quarterly responses) per respondent.

Estimated number of respondents:	*35*
Annual responses by each respondent:	*1*[913]
Total annual responses:	*35*
Quarterly responses by each respondent:	*1*[914]
Total quarterly responses:	*140*[915]
Estimated average hours per response:	*62*[916]
Aggregate annual reporting hours burden:	*10,780*

Therefore, the Commission estimates that based on 35 registered SEFs, this final part 37 rulemaking will result in 10,780 information collection hours across all respondents.[917]

4. Aggregate Information Burden

The Commission concludes that new information collection 3038-0074 will result in each SEF respondent expending, on average, $16,632 annually based on an hourly wage rate of $54 to comply with the recordkeeping and reporting requirements of this final part 37 rulemaking.[918] In aggregate, this will result in a cost to all SEF respondents of $582,120 per annum based on 35 expected respondents. This aggregate cost estimate

[913] Under § 37.1501, the SEF's CCO is required to submit to the Commission annually a compliance report.

[914] Under § 37.1306, a SEF is required to submit to the Commission each fiscal quarter a report of its financial resources available to meet the financial resources requirements of Core Principle 13.

[915] 1 quarterly response x 4 quarters per year x 35 respondents.

[916] 308 average burden hours per respondent / 5 responses total per year (1 annual response and 4 quarterly responses) = 61.6 average hours per response.

[917] 5 responses total per year x 61.6 average hours per response x 35 respondents.

[918] See supra footnote 894 for a discussion of the wage rate. The Commission has revised the wage rate to $54 per hour based on data from the 2011 SIFMA Report.

has been adjusted from the estimate in the SEF NPRM to account for updated wage rate data.[919]

C. Cost Benefit Considerations

1. Introduction

Section 15(a) of the Commodity Exchange Act ("CEA" or "Act") mandates that the Commodity Futures Trading Commission ("Commission" or "CFTC") consider the costs and benefits of the regulations that it is adopting in this rulemaking to implement the statutory requirements for the registration and operation of swap execution facilities ("SEFs"), a new type of regulated marketplace for the trading and execution of financial derivative contracts known as swaps.[920] In considering the costs and benefits of the final SEF regulations, the Commission has grouped the same into the following categories—SEF Market Structure, Registration, Recordkeeping and Reporting, Compliance, Monitoring and Surveillance, Financial Resources and Integrity, and Emergency Operations and System Safeguards.

Several preliminary matters, however, provide background for the Commission's consideration of the costs and benefits of the rules adopted in this release. Discussed in this Introduction section, these preliminary matters are: (a) the circumstances and events that form the backdrop for the statutory requirements that this rulemaking implements; (b) the Commission's statutory mandate to consider costs and benefits and its

[919] While the Commission recognizes that some estimates cited in the following cost-benefit consideration section suggest that reporting and recordkeeping requirements may result in a much higher aggregate cost to SEFs and market participants, it notes that all of the estimates provided therein account for more than pure recordkeeping and reporting costs subject to the PRA. Therefore, the Commission has not considered those estimates for purposes of reaching its final burden hour estimate and aggregate cost projection.

[920] CEA section 15(a); 7 U.S.C. 19(a). A more complete explanation of this statutory requirement is provided below. See infra section 1(b) of this Cost Benefit Considerations section. Swaps, futures, and options are collectively referred to as derivatives – contracts used by market participants to hedge against the risk of a future change in prices, such as commodity prices, interest rates, and exchange rates.

methodology for doing so; and (c) the estimated aggregate costs of forming and operating a SEF.

(a) Background

An appreciation of certain background elements is helpful to understand the costs and benefits of this rulemaking. These are: (i) the definition of the derivative financial transactions (i.e., swaps) that will be executed on SEFs; (ii) the execution and regulation of swaps prior to the Dodd-Frank Act; (iii) the 2008 financial crisis and the role of the over-the-counter ("OTC") swaps market; (iv) the new regulatory regime to reform the swaps market in Title VII of the Dodd-Frank Act; and, more specifically, (v) the role and purpose of SEFs within the Title VII regulatory regime. Each of these background elements is discussed below.

(1) The Definition of a Swap

Congress defined the term "swap" in the Dodd-Frank Act.[921] The statutory definition of the term "swap" includes, in part, any agreement, contract, or transaction "that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence."[922] The statutory definition, among other things, generally includes options (other than options on futures) as well as transactions that now or in the future are commonly known to the trade as swaps.[923] The definition also articulates a

[921] See Dodd-Frank Act section 721(a)(21), adding CEA section 1a(47). 7 U.S.C. 1a(47).

[922] CEA section 1a(47)(A)(ii); 7 U.S.C. 1a(47)(A)(ii).

[923] CEA section 1a(47)(A)(i) & (iv); 7 U.S.C. 1a(47)(A)(i) & (iv). Futures are not within the definition of swap and remain separately subject to requirements of the CEA. See CEA section 1a(47)(B)(i); 7 U.S.C. 1a(47)(B)(i).

broad range of underlying interests upon which a swap may be based: "1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind…"[924] or "the occurrence, nonoccurrence, or the extent of the occurrence of any event or contingency associated with a potential financial, economic, or commercial consequence."[925] In a joint rulemaking with the Securities and Exchange Commission ("SEC"), the Commission also adopted rules further defining the term "swap."[926]

(2) The Execution and Regulation of Swaps Prior to the Dodd-Frank Act

Unlike futures contracts which are regulated by the Commission and are listed for trading on exchanges called designated contract markets ("DCMs"), swap transactions (excluding some exchange-traded options encompassed by the post-Dodd-Frank Act definition) evolved off-exchange—largely to provide customized solutions for unique risk management needs that exchange-traded products addressed less effectively—lending themselves to the often used label of "OTC derivatives." Accordingly, many swap transactions prior to the Dodd-Frank Act were negotiated privately OTC between counterparties.[927] In these situations, only the counterparties knew that the swap transaction was taking place, and regulators and other market participants lacked access to pricing information during the negotiation phase (pre-trade) and after the agreement was consummated (post-trade). While centralized exchanges permit multiple market

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[924] CEA section 1a(47)(A)(i) & (iii); 7 U.S.C. 1a(47)(A)(i) & (iii).

[925] CEA section 1a(47)(A)(ii); 7 U.S.C. 1a(47)(A)(ii).

[926] See Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48208 (Aug. 13, 2012).

[927] The Commission notes that privately negotiated swap transactions between counterparties is only one method to execute or trade a swap transaction in the OTC market. Counterparties in the OTC market may execute or trade swap transactions through many trading methods such as order books, RFQ systems, or systems that incorporate electronic and voice components.

participants to compare, assess, accept, or reject bids (offers to buy) and asks (offers to sell), the privately negotiated OTC market provided little, if any, pre-or post-trade transparency.[928]

In a typical privately negotiated OTC swap transaction, a customer for a swap is likely to obtain a private quote from, and bilaterally negotiate contract terms with, one of a small number of market-making dealers. These dealers, often large financial institutions, may stand ready to take either a long position (if they want to buy) or a short position (if they want to sell), profiting from spreads (the difference between the bid and the offer price) and fees. Relative to their non-dealer (usually "buy-side") counterparties, these dealers enjoy asymmetric information advantages.[929] The Commodity Futures Modernization Act of 2000 ("CFMA")—which largely excluded swaps transacted between "eligible contract participants"[930] from regulation under the CEA—reinforced this outcome.[931] Swaps remained largely insulated from regulation prior to the enactment of the Dodd-Frank Act.[932]

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[928] Absent a centralized trading mechanism such as a limit order book, buyers and sellers "negotiated terms privately, often in ignorance of prices currently available from other potential counterparties and with limited knowledge of trades recently negotiated elsewhere in the market. OTC markets are thus said to be relatively opaque; investors are somewhat in the dark about the most attractive available terms and conditions and about whom to contact for attractive terms." Darrell Duffie, Dark Markets: Asset Pricing and Information Transmission in Over-the-Counter Markets 1 (Princeton University Press) (2012).

[929] Asymmetric information exists when one party to a transaction has more or better information than the other. In the context of the swaps market, as dealers are always on one side of a large fraction of trades, it is highly likely that they will have better information on prevailing market conditions and valuations compared to their non-dealer counterparties. See Michael Fleming, John Jackson, Ada Li, Asani Sarkar & Patricia Zobel, "An Analysis of OTC Interest Rate Derivatives Transactions: Implications for Public Reporting," Federal Reserve Bank of New York Staff Reports, No. 557, at 6 n. 14 (Mar. 2012), available at http://www.newyorkfed.org/research/staff_reports/sr557.pdf. Major derivatives dealer activity accounts for 89% of the total interest rate swap activity in notional terms. Id.

[930] CEA section 1a(18); 7 U.S.C. 1a(18).

[931] Under the CFMA, prior to the adoption of Title VII of the Dodd-Frank Act, swaps based on exempt commodities – including energy and metals – could be traded among eligible contract participants without CFTC regulation, but certain CEA provisions against fraud and manipulation continued to apply to these markets. No statutory exclusions were provided for swaps on agricultural commodities by the CFMA,

From these beginnings, the unregulated swaps market has expanded exponentially over the last thirty years. According to the Bank for International Settlements ("BIS"), the global OTC derivatives market measures at over $647 trillion in notional size.[933]

(3) The 2008 Financial Crisis and the Role of the OTC Swaps Market

In the fall of 2008, the United States experienced a financial crisis that led to millions of Americans losing their jobs, millions of families losing their homes, and thousands of small businesses closing their doors. The BIS characterized 2008 as a year that escalated for "what many had hoped would be merely . . . manageable market

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although they could be traded under certain regulatory exemptions provided by the CFTC prior to its enactment. Swaps based on securities were subject to certain SEC enforcement authorities, but the SEC was prohibited from prophylactic regulation of such swaps. See Commodity Futures Modernization Act of 2000, Pub. L. 106-554, 114 Stat. 2763 (2000). The Financial Crisis Inquiry Commission majority found that the CFMA "effectively shielded OTC derivatives from virtually all regulation or oversight," and "OTC derivatives markets boomed" in the law's wake, increasing "more than sevenfold" after the CFMA was enacted. See The Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (Official Government Edition), at 48, 364 (2011) (hereinafter the "FCIC Report"), available at http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

[932] Legislative history indicates that in enacting the Dodd-Frank Act, Congress recognized that OTC market opacity, combined with the availability of superior price information primarily to dealers, limited the ability of swaps customers "to shop for the best price or rate." See Mark Jickling & Kathleen Ann Ruane, "The Dodd-Frank Wall Street Reform and Consumer Protection Act: Title VII, Derivatives," Cong. Research Serv., R41398, at 7 (Aug. 30, 2010). See also S. Rep. No. 111-176, at 30 (2010) ("Information on [OTC derivative contract] prices and quantities is opaque . . . . This can lead to inefficient pricing and risk assessment for derivatives users and leave regulators ill-informed about risks building up throughout the financial system"). Ben Bernanke, Chairman of the Board of Governors of the Federal Reserve System, stated, "[a]t times [during the crisis], the complexity and diversity of derivatives instruments also posed problems. Financial firms sometimes found it quite difficult to fully assess their own net derivatives exposures or to communicate to counterparties and regulators the nature and extent of those exposures. The associated uncertainties helped fuel losses of confidence that contributed importantly to the liquidity problems I mentioned earlier. The recent legislation addresses these issues by requiring that derivatives contracts be traded on exchanges or other regulated trading facilities when possible and that they be centrally cleared." "Too Big To Fail: Expectations and Impact of Extraordinary Government Intervention and the Role of Systemic Risk in the Financial Crisis: Hearing Before the Financial Crisis Inquiry Commission," 11 (Sep. 2, 2010) (statement of Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System), available at http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0902-Bernanke.pdf.

[933] The Bank for International Settlements, Quarterly Review, at A 131 (Sep. 2012), available at http://www.bis.org/statistics/otcder/dt1920a.pdf.

turmoil [to] a full-fledged global crisis."[934] Faced with what policy makers at the time perceived as a grave threat that without immediate and unprecedented government action U.S. and global credit markets would freeze, the federal government mounted an extraordinary intervention at great cost to the American taxpayer to buttress the stability of the U.S. financial system.

While there were multiple causes of the financial crisis, unregulated swaps played an important role. Swaps contributed significantly to the interconnectedness between banks, investment banks, hedge funds, and other financial entities. As the swaps market grew, additional participation added risk to the already highly-leveraged and interconnected market. Accordingly, swaps concentrated and heightened risks in the financial system and to the public.

The crisis elevated concern among regulators that the opaque structure of the OTC swaps market and the consequent lack of information about swap prices and quantities would hinder efficient pricing, and that the lack of information about outstanding positions and exposures could "leave regulators ill-informed about the risks building up in the financial system . . . . Lack of transparency in the massive OTC market intensified systemic fears during the crisis about interrelated derivatives exposures from counterparty risk."[935] As regulators did not have a clear view into how OTC derivatives were being used, they also feared that "the complexity and limited transparency of the market reinforced the potential for excessive risk-taking . . . ."[936]

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[934] The Bank for International Settlements, 79th Annual Report, at 23 (2009), available at http://www.bis.org/publ/arpdf/ar2009e2.pdf, for a broader discussion of the development of the crisis.

[935] S. Rep. No. 111-176, at 30 (2010).

[936] See Darrell Duffie, Ada Li & Theo Lubke, "Policy Perspectives on OTC Derivatives Market Infrastructure," Federal Reserve Bank of New York Staff Reports, No. 424, at 1 (Mar. 2010), available at http://www.newyorkfed.org/research/staff_reports/sr424.pdf.

(4) The New Regulatory Regime to Reform the Swaps Market in Title VII of the Dodd-Frank Act

On July 21, 2010, President Obama signed the Dodd-Frank Act into law. Title VII of the Dodd-Frank Act established a comprehensive new regulatory framework for swaps and charged the Commission and the SEC with oversight of the more than $300 trillion domestic swaps market.[937] The legislation was enacted, among other reasons, to promote market integrity within the financial system, reduce risk, and increase transparency, including by: (i) providing for the registration and comprehensive regulation of swap dealers and major swap participants; (ii) imposing clearing and trade execution requirements on swaps; (iii) creating a rigorous recordkeeping and real-time reporting regime; and (iv) enhancing the rulemaking and enforcement authority of the Commission with respect to, among others, all registered entities, including SEFs. These various elements work in concert to provide the Commission with a comprehensive view of the entire swaps market, furthering the Commission's ability to monitor the market. Consistent with the view that the vulnerability of the OTC derivatives market during the financial crisis was not attributable to a single weakness, but a combination of several,[938] Title VII does not provide for a single-dimensional fix. Rather, it weaves together a

[937] See Section 733 of the Dodd-Frank Act, which adopted CEA section 5h regarding registration, operation, and compliance requirements for SEFs. 7 U.S.C. 7b-3. See also Section 723(a)(3) of the Dodd-Frank Act, which amended CEA section 2(h) to add CEA section 2(h)(8) setting forth a trade execution requirement . 7 U.S.C. 2(h)(8). Similarly, the Dodd-Frank Act authorized the SEC to regulate security-based swaps. See Section 763 of the Dodd-Frank Act, which amended the Securities and Exchange Act of 1934 to add section 3D of the Exchange Act, among other provisions.

[938] See FCIC Report at xxiv (listing uncontrolled leverage; lack of transparency, capital and collateral requirements; speculation; interconnection among firms; and concentrations of risk in the market as contributing factors).

multidimensional regulatory construct designed to "mitigate costs and risks to taxpayers and the financial system."[939]

(5) The Role and Purpose of SEFs Within the Title VII Regulatory Regime

One of the most important goals of the Dodd-Frank Act is to bring transparency to the opaque OTC swaps market. It is generally accepted that when markets are open and transparent, prices are more competitive and markets are more efficient.[940] The legislative history of the Dodd-Frank Act indicates that Congress viewed exchange trading as a mechanism to "provide pre- and post-trade transparency for end users, market participants, and regulators."[941] As such, exchange trading was intended as "a price transparency mechanism" that complements Title VII's separate central clearing requirement to mitigate counterparty risk.[942] Additionally, legislative history reveals a Congressional expectation that, over time, exchange trading of swaps would reduce transaction costs, enhance market efficiency, and counter the ability of dealers to extract economic rents from higher bid/ask spreads at the expense of other market participants.[943]

Consistent with this purpose, the Dodd-Frank Act amended the CEA to create SEFs, a new type of regulated marketplace, and promotes swap trading and execution on them. The statutory requirements for SEFs are similar to the requirements for the existing Commission-regulated futures market, which incorporates pre-trade and post-

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[939] S. Rep. No. 111-176, at 92 (2010).

[940] See academic research discussed below.

[941] S. Rep. No. 111-176, at 34 (2010).

[942] Id. at 33-34 (quoting former CFTC Chair Brooksley Born, the report states "'[w]hile central clearing would mitigate counterparty risk, central clearing alone is not enough . . . . [e]xchange trading is also essential in order to provide price discovery, transparency, and meaningful regulatory oversight of trading and intermediaries.'").

[943] Id. at 34 (quoting Stanford University Professor Darrel Duffie, '''[t]he relative opaqueness of the OTC market implies that bid/ask spreads are in many cases not being set as competitively as they would be on exchanges . . . . [t]his entails a loss in market efficiency.''').

trade transparency aspects not present in the OTC swaps market. SEFs will allow buyers and sellers to meet in an open, centralized marketplace, where prices are publicly available. As statutorily defined, a SEF is "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."[944]

With this rulemaking, in conjunction with the separate made available to trade rulemaking[945] and the swaps block rulemaking,[946] the Commission is implementing the Dodd-Frank Act's trade execution mandate.[947] Pursuant to this trade execution requirement, transactions involving swaps subject to the clearing requirement in CEA section 2(h)(1)[948] must be executed on a SEF or a DCM, unless no SEF or DCM "makes the swap available to trade" or the related transaction is subject to the clearing exception under CEA section 2(h)(7).[949] Further, no facility may be operated for the trading or

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[944] CEA section 1a(50), as amended by section 721 of the Dodd-Frank Act. 7 U.S.C. 1a(50). "Trading facility" is also a statutorily defined term. See CEA section 1a(51); 7 U.S.C. 1a(51).

[945] The Commission separately proposed rules to determine whether a swap is "made available to trade" for purposes of the trade execution requirement in CEA section 2(h)(8). Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available To Trade, 76 FR 77728 (proposed Dec. 14, 2011).

[946] The Commission separately proposed rules to determine minimum block trade sizes for swaps. Since the execution methods for Required Transactions excludes block trades, this rulemaking affects the scope of the trade execution mandate. See Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 77 FR 15460 (proposed Mar. 15, 2012).

[947] See Section 723(a)(3) of the Dodd-Frank Act, which amended the CEA to add section 2(h)(8). 7 U.S.C. 2(h)(8).

[948] See Section 723(a)(3) of the Dodd-Frank Act, which amended the CEA to add section 2(h)(1). 7 U.S.C. 2(h)(1).

[949] See Section 723(a)(3) of the Dodd-Frank Act, which amended the CEA to add section 2(h)(7). 7 U.S.C. 2(h)(7). The Commission separately proposed rules to determine whether a swap is "made available to trade" for purposes of the trade execution requirement in CEA section 2(h)(8). Process for a Designated

processing of swaps unless first registered as a SEF or DCM.[950] SEFs are required to comply with 15 statutorily enumerated core principles,[951] as well as any other requirements that the Commission prescribes by rule or regulation.[952]

Taken together, these statutory provisions provide the framework that transforms the swaps market from one in which prices for bilaterally-negotiated contracts are privately quoted—often by dealers with an informational advantage—to one in which bid/offer prices for swap contracts are accessible to multiple market participants to compare, assess, accept, or reject. By improving price transparency, the new provisions should reduce information asymmetry and, in turn, the informational advantage enjoyed by a small number of dealers to the detriment of other market participants.[953] These provisions benefit the financial system as a whole by creating more efficient market places, where market participants will take into account the price at which recent transactions have occurred when determining at what price to display quotes or orders.

As discussed, this rulemaking furthers Congress' goal of promoting transparency in the swaps market.[954] The goal of pre-trade transparency on SEFs is statutorily

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Contract Market or Swap Execution Facility To Make a Swap Available To Trade, 76 FR 77728 (proposed Dec. 14, 2011).

[950] CEA section 5h(a)(1); 7 U.S.C. 7b-3(a)(1).

[951] CEA section 5h(f); 7 U.S.C. 7b-3(f).

[952] CEA section 5h(f)(1)(A); 7 U.S.C. 7b-3(f)(1)(A). Further, CEA section 5h(h) mandates that the Commission prescribe rules governing SEF regulation. 7 U.S.C. 7b-3(h).

[953] While the SEF rules focus on measures to promote pre-trade price transparency and trade execution, they complement other Commission rules pertaining to real-time reporting (part 43 of the Commission's regulations) and swap data recordkeeping and reporting (part 45 of the Commission's regulations). The addition of the CEA section 5h rules for registration, operation, and compliance of SEFs to this mix results in a suite of rules covering all critical aspects of the trading process – pre-trade, trade, and post-trade.

[954] Pre-trade transparency is defined as "the dissemination of current bid and ask quotations, depths, and information about limit orders away from the best prices. Post-trade transparency refers to the public and timely transmission of information on past trades, including execution time, volume and price." See Ananth Madhavan, David Porter & Daniel Weaver, "Should securities markets be transparent?," 8 Journal of Financial Markets 265, 268 (Aug. 2005). See also Larry Harris, Trading and Exchanges – Market

mandated in the Dodd-Frank Act.[955] Notwithstanding the fact that Congress directed the Commission to construe the statute in light of this goal, some commenters have questioned the benefits of the Commission's proposals in furtherance of that goal.[956]

In response to commenters who question the Congressionally-directed goal of pre-trade price transparency and the Commission's implementation of that goal, the Commission notes that there is a body of research that tends to be generally supportive, albeit based on experience in other markets, as discussed below. Although this research was not critical to or relied upon by the Commission in its decision-making of how to best implement Congress' goal of promoting pre-trade price transparency, it does provide a useful counterpoint to many of the general comments raised by commenters and therefore merits brief mention.

While there are no studies on the effect of pre-trade transparency in the swaps market, empirical research on the likely effects of transparency on market participants exists in other markets, including the equity market, which has pre-trade transparency, and the corporate bond market, which has a similar market structure to the OTC swaps market and has post-trade transparency.[957] While academics have a range of perspectives

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Microstructure for Practitioners 102 (Oxford University Press) (2003) (hereinafter Harris, "Trading and Exchanges").

[955] See section 733 of the Dodd-Frank Act, adding CEA section 5h. 7 U.S.C. 7b-3. Under section 5h, Congress provided an explicit rule of construction, stating that "[t]he goal of this section is to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market." CEA section 5h(e); 7 U.S.C. 7b-3(e).

[956] See, e.g., ISDA Research Staff & NERA Economic Consulting, Costs and Benefits of Mandatory Electronic Execution Requirements for Interest Rate Products, ISDA Discussion Papers Series, Number Two, at 1, 4 (Nov. 2011) (added to the public comment file for the SEF rulemaking on Nov. 10, 2011) (hereinafter "ISDA Discussion Paper"); ISDA/SIFMA Comment Letter at 5-6 (Mar. 8, 2011); MetLife Comment Letter at 2-3 (Mar. 8, 2011).

[957] The corporate bond markets are generally comparable to the OTC swap markets in terms of the large number of instruments traded, with potentially a large overlap of market participants. Additionally, any single issuer will have multiple bonds outstanding, with different maturity dates and coupons. Some potential SEF registrants will likely be firms operating trading platforms for corporate bonds.

on market structure and transparency issues,[958] the empirical research discussed below and throughout this document supports the general proposition that a lack of pre- and post-trade transparency, which are characteristics of any dark, opaque market, generally increases search and transaction costs, and negatively impacts price discovery.

While some commenters contend that pre-trade price transparency requirements would increase costs for market participants, there is academic support for the general proposition that increased transparency will actually lower costs for market participants,[959] "help them predict future price changes, to predict when their orders will execute, and to evaluate their brokers' performance,"[960] and will improve the quality of execution they receive from the marketplace.[961] Greater transparency in general can increase market liquidity by reducing information asymmetry between informed and less

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[958] For example, Larry Harris notes that market participants might be "ambivalent about transparency," and explains that traders "favor transparency when it allows them to see more of what other traders are doing, but they oppose it when it requires that they reveal more of what they are doing. Generally, those who know the least about market conditions most favor transparency. Those who know the most oppose transparency because they do not want to give up their informational advantages." The Commission also recognizes that there is a continuum of markets occupying "various points between high and low transparency." See Harris, "Trading and Exchanges," at 101. See also ISDA Research Notes, "Transparency and over-the-counter derivatives: The role of transaction transparency," No. 1, at 2-3 (2009), available at http://www2.isda.org/attachment/MTY4NA==/ISDA-Research-Notes1.pdf.

[959] Discussing the trade-off between higher costs to liquidity providers and the lower costs to institutional investors from greater post-trade transparency in the corporate bond markets, Bessembinder & Maxell conclude that while "[T]raders employed by insurance companies and investment management firms bear costs associated with decreases in service provided by bond dealers . . . these higher costs are offset by lower trade execution costs that . . . benefit the investors who ultimately own the bonds transacted . . . ." See Hendrik Bessembinder & William Maxwell, "Markets: Transparency and the Corporate Bond Market," 22 Journal of Economic Perspectives 217, 232-33 (Spring 2008) (hereinafter Bessembinder & Maxwell, "Transparency").

[960] Harris, "Trading and Exchanges," at 101.

[961] It is instructive to note the view that transparency is "not an objective *per se* but rather a means for ensuring the proper functioning of the market." See Marco Avellaneda & Rama Cont, "Transparency in Credit Default Swap Markets," Finance Concepts, at 3 (Jul. 2010), available at http://www.finance-concepts.com/images/fc/CDSMarketTransparency.pdf.

informed market participants, and greater pre-trade transparency also helps improve price discovery by promoting competition among liquidity providers.[962]

Academic research supports the view that a lack of pre-trade transparency affects trading costs because it contributes to frictions in the search process, which in turn can translate into higher transaction costs and impact equilibrium prices and allocations. Given the lack of pre-trade transparency and the absence of centralized markets (i.e., exchanges) in the OTC swaps market, market participants will likely contact multiple dealers sequentially by phone or by some other electronic means of communication.[963] Bessembinder and Maxwell explain that the take-it-or-leave-it aspect of the negotiation process in the bond markets (which is also present in the OTC swaps market) "limits one's ability to obtain multiple quotations before committing to trade."[964]

More generally, this area of research, also called search and matching theory, "offers a framework for studying frictions in real-world transactions and has led to new

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[962] Pagano & Röell explain the regulatory policy support for pre-trade transparency as a means "to enable ordinary traders to check for themselves whether they have gotten a fair price." Comparing the price formation in auction and dealer markets, they find that greater transparency generates lower trading costs for uninformed traders on average, although not necessarily for every trade size. See Marco Pagano & Ailsa Röell, "Transparency and Liquidity: A Comparison of Auction and Dealer Markets with Informed Trading," 51 Journal of Finance 579 (Jun. 1996). Research referenced later in the release has found that such competition can reduce revenues and increase costs and risks for liquidity providers, thus causing them to reduce their participation in the markets.

[963] Many of the existing electronic trading platforms for bonds and for swaps display indicative quotes, but the Commission is not aware of research on the quality of these indicative quotes, and of their likely impact on price discovery and market quality in terms of transaction costs.

[964] See Bessembinder & Maxwell, "Transparency," at 223 (explaining that in addition to the cost of conducting the search, market participants are exposed to the additional cost from the fact that a dealer's quote is only good "as long as the breath is warm"). Comparing execution cost in the equity and corporate bond markets, Edwards, Harris & Piwowar theorize that despite the fact that corporate bonds are less risky than equity (in the same company), differences in pre- and post-trade transparency between the two markets contribute to higher transaction costs in the bond markets. See Amy Edwards, Lawrence Harris & Michael Piwowar, "Corporate Bond Market Transactions Costs and Transparency," 62 Journal of Finance 1421, 1438 (Jun. 2007) (hereinafter Edwards et al., "Transaction Costs and Transparency").

insights into the working of markets."[965] This research shows that "even with very minor search costs and with a large number of sellers, a search and matching environment would deliver a rather large departure from the outcome under perfect competition (which would prevail if the search costs were zero)."[966] This "Diamond paradox"[967] is of relevance to this rulemaking because given search costs, no matter how small, the presence of multiple dealers can result in trades being transacted at the single monopoly price.[968] This highlights the importance of reducing the costs that exist when a market is dominated by a small number of dealers – in other words, an oligopoly.[969]

Academic research into the impact of pre-trade transparency on market quality in the context of the equity markets is an active area of research. As buy and sell interest at the best bid and offer price is widely available to all market participants in these markets, they are not necessarily analogous to the OTC swap markets, where such information is simply not available. Nevertheless, research in this area is notable because the equity

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[965] See "Markets with Search Frictions," The Royal Swedish Academy of Sciences, at 1 (Oct. 11, 2010), available at http://www.nobelprize.org/nobel_prizes/economics/laureates/2010/advanced-economicsciences2010.pdf.

[966] Id. at 5.

[967] See Peter Diamond, "A Model of Price Adjustment," 3 Journal of Economic Theory 156 (Jun. 1971).

[968] See Darrell Duffie, Nicolae Gârleanu & Lasse Heje Pedersen, "Valuation in Over-the-Counter Markets," 20 The Review of Financial Studies 1865, 1888-89 (Nov. 2007) (hereinafter Duffie et al., "Valuation in OTC Markets") for a series of examples of markets where search costs impact price discovery, adversely resulting in prices diverging from competitive market outcomes.

[969] An oligopoly is a market form in which a market or industry is dominated by a small number of sellers (oligopolists)--dealers or market makers in the context of the OTC swaps markets. While the traditional research into oligopolistic behavior has focused on attempts by firms to collude, which could potentially result in non-competitive or monopoly pricing for the rest of the market, the search literature explains that the monopoly pricing is due to the presence of search costs. Indicative of the potential impact of such oligopolistic behavior by dealers in an environment with low pre-trade transparency, Hendershott & Madhavan reference research comparing transactions costs between equity and corporate and municipal bond markets. See Terrence Hendershott & Ananth Madhavan, "Click or Call? Auction versus Search in the Over-the-Counter Market," Working Paper, at 2 (Mar. 19, 2012) (hereinafter Hendershott & Madhavan, "Click or Call"). They explain that despite improvements in the post-trade transparency in both corporate and municipal bond markets, transaction costs are higher compared to equivalent-sized equity trades due to "the lack of pre-trade transparency that confers rents to dealers." Id.

markets have pre-trade transparency, and Congress has mandated pre-trade transparency on SEFs. Various research papers examine the impact of changes in relative levels of pre-trade transparency within a specific trading venue or exchange, and depending on the specific circumstances of each such event, market participants' behavior can be influenced, which in turn can impact liquidity and costs.[970]

While the literature from the equity markets referenced above focuses on changes in relative levels of pre-trade transparency, research from the corporate bond markets also directly addresses the benefits from bringing post-trade transparency into dark markets. Edwards, Harris, and Piwowar examine trading costs in the corporate bond market using a record of every corporate bond trade reported on the TRACE[971] system between

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[970] Empirical research evaluating the impact of transparency on market quality are typically in the context of natural experiments when there is a change in the set of trading rules in a particular market. Madhavan, Porter & Weaver examined the outcomes when the Toronto Stock Exchange increased transparency levels for stocks traded on the floor and on the screen, and found that it reduced the earnings of specialists (or liquidity providers); lower order flows from them in turn reduced market depth and caused the market to exhibit increased price volatility and higher transaction costs. See Ananth Madhavan, David Porter & Daniel Weaver, "Should securities markets be transparent?," 8 Journal of Financial Markets 265 (Aug. 2005). Eom, Ok & Park focus on the impact of changes in the display in the level of depth of the limit order book in the Korean equity market and find evidence of positive effects on market quality measured in terms of depth, volume and quoted spreads, but beyond a point, these effects taper-off, and can even become negative. See Kyong Shik Eom, Jinho Ok & Jong Ho Park, "Pre-trade transparency and market quality," 10 Journal of Financial Markets 319 (Nov. 2007). In another paper, Boehmer, Saar & Yu present evidence that when the New York Stock Exchange took specific steps to display limit-order book information to traders off the exchange floor, "an increase in pre-trade transparency affects investors' trading strategies and can improve certain dimensions of market quality." See Ekkehart Boehmer, Gideon Saar & Lei Yu, "Lifting the Veil: An Analysis of Pre-trade Transparency at the NYSE," 60 The Journal of Finance 783 (Apr. 2005). Additionally, in a paper highlighting the impact of pre-trade transparency on price discovery, and highlighting the risks of driving trading activity to competing markets, Hendershott & Jones found that when the Island electronic communications network stopped displaying its limit order book in certain exchange-traded funds ("ETFs"), ETF prices adjusted more slowly, and there was "substantial price discovery movement from ETFs to the futures market." See Terrence Hendershott & Charles M. Jones, "Island Goes Dark: Transparency, Fragmentation, and Regulation," 18 The Review of Financial Studies 743 (Fall 2005).

[971] The Trade Reporting and Compliance Engine ("TRACE") is operated by the Financial Industry Regulatory Authority ("FINRA"), and facilitates the mandatory reporting of OTC secondary market transactions in eligible fixed income securities. All broker/dealers who are FINRA member firms have an obligation to report transactions in corporate bonds to TRACE under an SEC-approved set of rules. See http://www.finra.org/Industry/Compliance/MarketTransparency/TRACE/ for further details.

January 2003 and January 2005.[972] In their paper, they find evidence that post-trade transparency through TRACE has lowered transaction costs in the corporate bond market and that higher post-transparency has helped improve liquidity in this market.[973] Summarizing findings from studies by other researchers on the impact of TRACE on market participants, Bessembinder and Maxwell confirm that it has helped provide a level playing field – in the context of information regarding current prices at which various corporate bonds are being traded.[974]

(b) The Statutory Mandate to Consider the Costs and Benefits of the Commission's Action: Section 15(a) of the CEA

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.[975] CEA section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management

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[972] See Edwards et al., "Transaction Costs and Transparency," at 1426. As with OTC swaps, given that there is no pre-trade transparency in the corporate bond markets, bid-ask spreads, a key determinant of transaction costs, have to be estimated using specialized econometric techniques. In this paper, they assume that there has been no change in the market structure (in terms of execution methods) before and after TRACE.

[973] In a related paper on the impact of higher transparency on liquidity, research examining the impact of higher post-trade transparency on the liquidity of the BBB-rated corporate bond market shows that "overall, adding transparency has either a neutral or a positive effect on liquidity." Id. at 1438.

[974] Bessembinder & Maxwell point out that prior to the introduction of TRACE, "customers found it difficult to know whether their trade price reflected market conditions . . . . With transaction reporting, customers are able to assess the competitiveness of their own trade price by comparing it to recent and subsequent transactions in the same and similar issues." Bessembinder & Maxwell, "Transparency," at 226.

[975] CEA section 15(a); 7 U.S.C. 19(a).

practices; and (5) other public interest considerations.[976] The Commission considers below the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors.

To aid the Commission in its consideration of the costs and benefits resulting from its regulations, the Commission requested in the SEF NPRM that commenters provide data and supporting information which quantify or qualify the costs and benefits of the proposed rules.[977] While a number of industry commenters expressed the general view that implementing and complying with the proposed rules would come at considerable cost and that the proposed rules would be burdensome,[978] the Commission only received one comment quantifying the costs that may result from the proposed regulations.[979] In meetings requested by potential SEF registrants during the comment period, the Commission staff invited those entities to provide specific data to support general assertions that the proposed regulations would be costly. Again, no such information was provided. In another effort to gather such data, the Commission staff initiated follow-up contacts with certain potential SEFs regarding their projected expenses in light of the Commission's proposed regulations. The product of these conversations is reflected in the cost estimates included in this release.

While certain costs are amenable to quantification, other costs are not easily monetized, such as the costs to the public of another financial crisis. The Commission's final regulations are intended to mitigate that risk, and, therefore, serve an important if

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[976] Id.

[977] See Core Principles and Other Requirements for Swap Execution Facilities, 76 FR 1214, 1237 (proposed Jan. 7, 2011).

[978] See, e.g., FXall Comment Letter at 2-4 (Mar. 8, 2011); CME Comment Letter at 2 (Mar. 8, 2011).

[979] See ISDA Discussion Paper (Nov. 2011).

unquantifiable public benefit. While the benefits of effective regulation are difficult to value in dollar terms, the Commission believes that they are no less important to consider given the Commission's mission to protect both market users and the public.

Additionally, where appropriate, in response to the cost concerns of some commenters, the Commission, as discussed below, adopted cost-mitigating alternatives presented by commenters where doing so would still achieve the goals of the Dodd-Frank Act.

The discussion of costs and benefits that follows begins with an informational discussion of the aggregate estimated costs of forming and operating a SEF. Although these costs are mostly attributable to Congress' mandate that there be SEFs, they provide useful context for the costs and benefits attributable to the Commission's action of implementing that mandate in this rulemaking. Relatedly, the Commission believes that many of the costs that arise from the application of the final rules are a consequence of the Congressional trade execution mandate of section 2(h)(8) of the CEA, as well as the Congressional goals to promote the trading of swaps on SEFs and to promote pre-trade price transparency in the swaps market in section 5h(e) of the CEA. For example, those market participants who are not eligible for the CEA section 2(h)(7) end user exception will no longer have the option to execute Required Transactions bilaterally even when they consider it more costly or less convenient to execute trades on a SEF (or a DCM). As described more fully below, the Commission has considered these costs in adopting these final rules, and has, where appropriate, attempted to mitigate the costs while observing the express direction of Congress in CEA sections 2(h)(8) and 5h(e).

After the discussion of the aggregate costs of forming and operating a SEF, the Commission's consideration of costs and benefits is organized into seven categories: (1) SEF Market Structure; (2) Registration; (3) Recordkeeping and Reporting; (4) Compliance; (5) Monitoring and Surveillance; (6) Financial Resources and Integrity; and (7) Emergency Operations and System Safeguards. For each category,[980] the Commission summarizes the final regulations; describes and responds to comments discussing the costs and benefits;[981] assesses alternatives, including those raised by commenters; and considers the costs and benefits in light of the five factors set out in CEA section 15(a), which expressly requires the Commission to consider the costs and benefits of "the action of the Commission."[982] In this regard, as with the aggregate costs of forming and operating a SEF attributable to Congress, where the Commission merely codifies a statutory requirement, the Commission believes that there is no act of discretion for consideration under CEA section 15(a). For example, for each core principle, the first section of the Commission's regulations is a codification of the statutory language of the core principle as a rule and, accordingly, there is no Commission act of discretion and thus no costs and benefits for the Commission to consider under section 15(a). In other cases, such as Core Principle 1, the rule simply codifies the text of the core principle, and thus will not be discussed as it is outside the scope of section 15(a).

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[980] The costs and benefits of Core Principle 12 are discussed in connection with a separate proposed rulemaking entitled Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 FR 63732 (proposed Oct. 18, 2010).

[981] The Commission notes that a number of these regulations also refer to requirements that are contained in other rulemakings, some that have been finalized and others that have not. The costs and benefits of these regulations have been, or will be, discussed in those other rulemakings.

[982] CEA section 15(a); 7 U.S.C. 19(a).

The Commission expects that the costs and benefits will vary based on the specific circumstances of the individual entity seeking registration as a SEF. For example, some SEF-like execution platforms that currently operate in the OTC marketplace may generally already have the infrastructure to comply with the Commission's regulations without the need for sizeable additional expenditures. For these potential SEF registrants, the regulations may occasion minimal incremental costs above their existing cost structure. In contrast, potential SEF registrants that are not currently operating in the OTC marketplace, registered as a DCM, or operating as an exempt board of trade will likely lack existing infrastructure and may incur costs, at times significant, in both physical and human capital to meet the requirements of the regulations.[983] Accordingly, where appropriate and possible to account for these differences, the Commission has attempted to express costs and benefits as a range, sometimes one that is wide.

Finally, in some instances, quantification of costs to certain market participants is not reasonably feasible because costs will depend on the size, structure, and product offering of a SEF, which are likely to have considerable variation, or because required information or data will not exist until after a SEF commences operation as a registrant. In other instances—for example with respect to protection of market participants and the public—suitable metrics to quantify costs and benefits simply do not exist. Notwithstanding the above-mentioned limitations, the Commission identifies and considers the costs and benefits of these rules in qualitative terms.

(c) Estimated Aggregate Costs of Forming and Operating a SEF

[983] The Commission notes that these registrants will also incur costs to meet the statutory requirements.

In its discussion paper, ISDA estimated the cost of establishing a new SEF to be $7.4 million,[984] and estimated ongoing operating costs to be nearly $12 million per year.[985] ISDA based its cost estimates on a survey of groups which included a "small number of (large) Buy-Side firms and the 16 largest dealers."[986] ISDA's estimate is based on a trading architecture that includes an order matching engine, and a Request for Quote system or other means of interstate commerce that will allow members to show (and see) bids and offers.[987] In addition, ISDA's estimate includes costs associated with: systems to capture and retain data necessary to create an audit trail for at least 5 years; an electronic analysis capability and the ability to collect and evaluate market data on a daily basis; a real-time electronic monitoring system to detect and deter manipulation, distortion, and market disruption; reporting transaction information to the Commission and data repositories using unique product identifiers; a Chief Compliance Officer; and disaster recovery.[988] ISDA also identified major operating costs to include the cost of compensation and benefits for staff, leasing office space, maintaining and upgrading operational infrastructure and systems, maintaining sufficient financial resources to cover

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[984] ISDA Discussion Paper at 30-31 (Nov. 2011). While the ISDA discussion paper is largely concerned with the costs and benefits resulting from the statute and regulations implemented by other rulemakings, relevant portions are discussed in this release. ISDA's estimate includes the costs of: registering with the Commission; developing an electronic system capable of providing market participants with the ability to make bids and offers to multiple participants and capable of maintaining safe storage capacity; developing and maintaining electronic analysis, reporting, and monitoring software; developing new products; drafting contractual arrangements with SEF users and vendors; drafting market rules and policies; and developing emergency backup procedures and systems.

[985] Id. at 31-32. This estimate includes the cost of compensation and benefits for staff, leasing office space, maintaining and upgrading operational infrastructure and systems, maintaining sufficient financial resources to cover operating costs for at least one year, maintaining an independent board of governors, and maintaining emergency backup facilities.

[986] Id. at 31, 34.

[987] Id. at 29.

[988] Id. at 30.

operating costs for at least one year, maintaining an independent board of governors, and maintaining emergency backup facilities.[989]

In another comment letter, MarketAxess stated that the SEC's cost estimates in its proposed rulemaking for security-based SEFs ("SB-SEFs"), were "generally realistic and accurate estimates of the costs of establishing and operating a SB-SEF" and that these estimates would be "comparable to, and thus relevant for, calculation of costs for a SEF."[990]

The SEC estimated that the cost of forming an SB-SEF is approximately $15-20 million, including the first year of operation.[991] These costs included a software and product development estimate of $6.5-10 million for the first year and ongoing technology and maintenance costs of $2-4 million.[992] The SEC also estimated that it would cost approximately $50,000-$3 million for an operator of an existing platform to modify its platform to conform to the statute and the SEC's proposed rules, depending on the enhancements that would be required by the final regulations.[993]

In the Commission staff's follow-up conversations, potential SEFs stated that the costs associated with the SEF NPRM may differ from the SEC's cost estimates in various areas. For example, one commenter estimated first-year software and product development costs of $4 million rather than the $6.5-10 million estimated by the SEC. Another commenter stated that existing entities will be able to leverage existing

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[989] Id. at 31.

[990] MarketAxess Comment Letter at 5 (Jun. 3, 2011).

[991] Registration and Regulation of Security-Based Swap Execution Facilities, 76 FR 10948, 11041 (proposed Feb. 28, 2011).

[992] Id.

[993] Id.

technology at minimal cost, and that there is no real cost associated with the rulemaking from a technology perspective if an entity is not a startup. As stated above, ISDA's estimates also differed from those of the SEC, including estimated initial software development costs of $1 million and initial product development costs of $1.25 million.[994]

In the Commission staff's follow-up conversations, potential SEFs stated that total ongoing costs would range from $3.5 million to $5 million per year. These potential SEFs also told the Commission staff that it would cost them approximately $2 million to conform to the statute and the Commission's proposed rules, including contracting with the National Futures Association ("NFA") to perform regulatory services.

While the Commission believes that the various cost estimates (including those for SB-SEFs and those reflecting costs imposed by statute) can be used as a rough guide to the costs that would be incurred to establish and operate a SEF, the Commission notes that the majority of these costs are necessary to establish and operate any platform for the trading of swaps, as a number of firms had already done prior to the enactment of the Dodd-Frank Act. The Commission believes that the additional costs of modifying a platform to comply with the Commission's regulations to implement the statute represent a relatively modest proportion of these costs.

(1) Regulatory Costs

[994] ISDA Discussion Paper at 32 (Nov. 2011). ISDA's paper also contained a discussion of the costs likely to be faced by dealers and buy-side users of interest rate swaps that must be executed on regulated exchanges. Some of these costs result from statutory requirements that were not the product of Commission discretion, while other costs are likely to derive from regulations being implemented in other rulemakings. Other costs simply reflect the cost of doing business and are not directly imposed by Commission regulations. Accordingly, these costs are beyond the scope of this rulemaking and will not be discussed in this release.

Pursuant to final § 37.204 adopted in this release, SEFs may utilize a regulatory service provider for assistance in performing certain self-regulatory functions, including, among others, trade practice surveillance, market surveillance, real-time market monitoring, investigations of possible rule violations, and disciplinary actions.[995] The costs described in this cost benefit consideration section reflect the costs that a SEF is likely to face if it does not choose to utilize the services of a regulatory service provider. To the extent that utilizing a regulatory service provider is more cost-effective for a SEF than performing the functions independently, the quantitative and qualitative cost discussions in this release may overstate the costs of complying with the rules. Based on the Commission staff's follow-up discussions with potential SEFs, it appears that most SEFs will be entering into agreements with regulatory service providers for the provision of these functions. In fact, the Commission understands that many potential SEFs have already entered into formal agreements with a regulatory service provider. The Commission notes that competition among regulatory service providers, including NFA and the Financial Industry Regulatory Authority, may result in additional cost savings for SEFs that choose to outsource compliance obligations.

2. SEF Market Structure

(a) Background

(1) Minimum Trading Functionality (Order Book)

Final § 37.3(a)(2) requires that each SEF provide its market participants with a minimum trading functionality referred to as an Order Book,[996] which the Commission

[995] Rule 37.204 permits SEFs to contract with a regulatory service provider for the provision of services to assist in compliance with the core principles, as approved by the Commission.

[996] An Order Book means: (i) an electronic trading facility, as that term is defined in section 1a(16) of the Act; (ii) a trading facility, as that term is defined in section 1a(51) of the Act; or (iii) a trading system or

believes is consistent with the SEF definition and promotes the goals provided in section 733 of the Dodd-Frank Act.[997] As noted in the preamble, the Commission is withdrawing the proposed requirement that SEFs offer indicative quote functionality because the Commission believes that, at this time, such a requirement is unnecessary.[998]

(2) Methods of Execution on a SEF

Final § 37.9 governs the execution methods that are available on a SEF and classifies transactions executed on a SEF as either Required Transactions (i.e., any transaction involving a swap that is subject to the trade execution requirement in section 2(h)(8) of the Act[999]) or Permitted Transactions (i.e., any transaction not involving a swap that is subject to the trade execution requirement in section 2(h)(8) of the Act).

Pursuant to final § 37.9(a)(2), market participants may only execute Required Transactions using either the SEF's Order Book or an RFQ System that will transmit a request for a quote to at least three market participants and that operates in conjunction with the Order Book. In contrast, while SEFs must offer an Order Book for Permitted

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platform in which all market participants in the trading system or platform have the ability to enter multiple bids and offers, observe or receive bids and offers entered by other market participants, and transact on such bids and offers. See Final § 37.3(a)(3) of the Commission's regulations.

[997] CEA section 1a(50) defines a SEF as "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…" 7 U.S.C. 1a(50). In section 5h(e) of the Act, Congress provided a "rule of construction" to guide the Commission's interpretation of certain SEF provisions (stating that the goals of section 5h of the Act are to "promote the trading of swaps on [SEFs] and to promote pre-trade price transparency in the swaps market"). 7 U.S.C. 7b-3(e).

[998] See Minimum Trading Functionality discussion above under § 37.3 – Requirements for Registration in the preamble.

[999] Transactions that are subject to the trade execution requirement of CEA section 2(h)(8) are subject to the clearing requirement of CEA section 2(h)(1) and are "available to trade" on a SEF or DCM. See Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available To Trade, 76 FR 77728 (proposed Dec. 14, 2011).

Transactions, market participants may execute Permitted Transactions on a SEF using any method of execution.[1000]

(3) Request for Quote ("RFQ") System for Required Transactions

The RFQ System definition in final § 37.9(a)(3) requires that each market participant transmit a request for a quote to at least three market participants, with each of these market participants being given the opportunity to respond. As described in greater detail in the preamble, permitting RFQ requesters to send RFQs to a single market participant would undermine the multiple participant to multiple participant requirement in the SEF definition and the goal of pre-trade price transparency.[1001] The three market participant requirement will help the RFQ requester benefit from price competition among multiple RFQ responders and thus promotes price discovery. In addition, final § 37.9(a)(3) requires that any firm bid or offer pertaining to the same instrument resting on any of the SEF's Order Books must be communicated to the RFQ requester at the same time the first responsive bid or offer is received by such requester.

(4) Time Delay Requirement

Final § 37.9(b)(1) sets forth a time delay requirement for a broker or dealer who has the ability to execute against its customer's order or to execute two of its customers' orders against each other. These orders (i.e., price, size, and other terms) are subject to a 15-second time delay between the entry of the two orders, such that one side of the potential transaction is disclosed and made available to other market participants before

[1000] The SEF NPRM provided that Permitted Transactions may be executed by an Order Book, RFQ System, Voice-Based System, or any such other system for trading as may be permitted by the Commission. Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1241.

[1001] See RFQ System Definition and Transmission to Five Market Participants discussion above under § 37.9(a)(1)(ii) – Request for Quote System in the preamble.

the second side of the potential transaction is submitted for execution. This time delay requirement is similar to certain timing delays applicable to futures transactions executed on DCMs, which are also designed to promote pre-trade transparency by allowing other market participants the opportunity to participate in the transaction and thus prevent any two market participants from crossing a bilaterally (off-exchange) negotiated trade. The Commission notes that the 15-second requirement is a default time delay; the final rule also permits SEFs to adjust this time delay requirement based upon a swap's liquidity or other product-specific characteristics.

(b) Costs

(1) Costs to SEFs

(i) Minimum Trading Functionality (Order Book) and Methods of Execution on a SEF

In the Commission staff's follow-up conversations with potential SEFs, one commenter noted that it would cost approximately $250,000 to upgrade its existing system to provide the required minimum trading functionality, while another stated that there is no real cost associated with the rulemaking from a technology perspective if an entity is already operating a trading platform, and that an existing platform could become compliant with the rule by leveraging existing technology at minimal cost. The Commission believes that these estimates are reasonable for existing platforms. Though the Commission is not requiring that systems be upgraded once they have achieved compliance with the rules, it expects that SEFs may have business incentives to incur ongoing programming costs to upgrade their systems.

ISDA/SIFMA noted that the minimum trading functionality may limit competition by increasing costs to applicants that would otherwise prefer to offer solely

RFQ functionality.[1002] As discussed in the preamble to this release,[1003] the Commission believes that the minimum trading functionality is consistent with the SEF definition and promotes the statutory goals of pre-trade price transparency and trading on SEFs provided in section 733 of Dodd-Frank.[1004] Nevertheless, the Commission has adopted cost-mitigating alternatives identified by commenters, including: (1) deleting the requirement that indicative bids and offers must be posted on a SEF's Order Book; (2) allowing work-up sessions[1005] where the original counterparties to a trade and other market participants can trade additional quantities of a swap at the previously executed price; and (3) allowing SEFs to use any means of interstate commerce in providing the execution methods for Required Transactions in § 37.9(a)(2)(i)(A) or (B) of this final rulemaking (i.e., Order Book or RFQ System that operates in conjunction with an Order Book). Not having to display indicative quotes will likely reduce the programming costs for SEFs, since they will not need to program that functionality into the platform. The Commission believes the requirement to communicate any firm bid or offer will marginally add to the programming costs for SEFs and is included in the $250,000 estimate provided above. As commenters have described, work-up sessions are part of current OTC market practice, and the Commission believes that this additional flexibility

[1002] ISDA/SIFMA Comment Letter at 5-6 (Mar. 8, 2011).

[1003] See Minimum Trading Functionality discussion above under § 37.3 – Requirements for Registration in the preamble.

[1004] In section 5h(e) of the Act (as adopted by section 733 of the Dodd-Frank Act), Congress provided a "rule of construction" to guide the Commission's interpretation of certain SEF provisions (stating that the goals of section 5h of the Act are to "promote the trading of swaps on [SEFs] and to promote pre-trade price transparency in the swaps market"). 7 U.S.C. 7b-3(e).

[1005] As described earlier, a work-up session refers to a practice wherein once a trade has been executed, one of the counterparties to the trade can express an interest in transacting additional volume at the same price.

for market participants to execute transactions in the SEF context will promote the trading of swaps on SEFs consistent with CEA section 5h(e).

(ii) Time Delay Requirement

A SEF will incur some additional programming costs as a result of the requirement that a SEF must provide for a 15-second time delay in certain circumstances. The Commission did not receive any specific estimates of these programming costs and notes that the rule permits a SEF to adjust the minimum time delay requirement based upon a swap's liquidity or other product-specific characteristics. For example, less liquid contracts may need a longer time delay than more liquid contracts.

(2) Costs to Market Participants

(i) General Costs

In its discussion paper, ISDA described what it asserted would be the likely costs and benefits of what it labeled the "electronic execution mandate," that is, mandating the execution of interest rate swaps on DCMs or on SEFs.[1006] According to ISDA, "[t]he study indicates that the EE mandate [electronic execution mandate], in all likelihood, will bring little benefit to the market while adding significantly to the costs of using derivatives."[1007] ISDA stated that the electronic execution mandate will result in higher bid/ask spreads and significant operational, technological, and compliance costs for those transacting in interest rate swaps.[1008] ISDA further stated that these costs will be borne by end users and may force some participants to withdraw from the market with

[1006] ISDA Discussion Paper at 20-21 (Nov. 2011).

[1007] Id. at 1.

[1008] Id. at 4.

"virtually no effect on small end users."[1009] ISDA stated that the electronic execution mandate is both unnecessary and counterproductive as electronic trading is already developing rapidly as users take advantage of the existing choice in execution venues.[1010]

According to ISDA, the electronic execution mandate will take away users' choice, create inefficiencies, and discourage innovation.[1011] ISDA stated that the electronic execution mandate will impose new costs because:

> SEFs themselves need to be established, licensed and operated. Buy-Side users will face significant technology and operational challenges as well as increased regulatory reporting requirements. Dealers will have to upgrade infrastructure to deal with automated trading and comply with increased regulatory reporting and record-keeping. All participants will face increased reconciliations, oversight and reporting requirements as well. Finally, regulators will need additional staff to properly oversee the new markets.[1012]

According to ISDA, the aggregate market-wide "set up costs are estimated to exceed $750 million and annual costs may run to $250 million."[1013]

In terms of benefits, ISDA concluded that:

> Transparency and market access may improve marginally for small financial entities that use IRS [interest rate swaps] but any benefit they receive will be very modest relative to the added costs of execution. Indeed, the imposition of clearing and the higher fees that will result from the EE Mandate [electronic execution mandate] and other provisions of DFA [Dodd-Frank Act] may cause these and other participants to reduce their activity or even withdraw from the IRS market.[1014]

ISDA asserted that transaction costs for OTC trades in interest rate swaps are already low with levels of transparency that market participants consider sufficient, and

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[1009] Id.

[1010] Id.

[1011] Id.

[1012] Id. at 24.

[1013] Id. at 4.

[1014] Id. at 36.

that trading in a regulated market or on an exchange does not guarantee a more efficient market because traders often get better execution off-exchange.[1015] ISDA further asserted that liquidity in OTC interest rate swaps is at least as good as liquidity in exchange-traded futures contracts, especially outside of the most liquid futures contract months, and that market participants predicted that bid-ask spreads in interest rate swaps would increase after the execution mandate takes effect.[1016]

ISDA also estimated that the market as a whole will need to absorb at least an additional $400 million in annual expenses as a result of the changes implemented in connection with the Dodd-Frank Act, and that assuming SEFs will execute 1,000 trades a day (comparable to what ISDA states is the current number of transactions in the OTC market), this will amount to execution costs of $1,280 per trade.[1017] As a result, ISDA stated that dealer costs will be passed on to end users and will cause participants to withdraw from the market, discouraging innovation.[1018]

The Commission notes that a majority of the costs identified by ISDA result from statutory requirements that were not the product of Commission discretion. For example, the requirements that certain swaps must be executed on a SEF or DCM,[1019] and that no person may operate a facility for the trading or processing of swaps unless the facility is registered as a SEF or as a DCM,[1020] are statutory requirements. Additionally, CEA section 5h(e) contains a rule of construction that states "[t]he goal of this section is to

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[1015] Id. at 20-21.

[1016] Id. at 2-4, 20-21.

[1017] Id. at 35.

[1018] Id. at 4.

[1019] CEA section 2(h)(8); 7 U.S.C. 2(h)(8).

[1020] CEA section 5h(a)(1); 7 U.S.C. 7b-3(a)(1).

promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market."[1021] The interest rate swaps discussed by ISDA are included in these statutory requirements. Moreover, notwithstanding ISDA's use of the term "electronic execution mandate," this rulemaking does not require that market participants execute swaps in Required Transactions electronically, since SEFs will be allowed to use any means of interstate commerce in providing the execution methods for such transactions as described in § 37.9(a)(2)(ii). Nevertheless, the Commission addresses below many of ISDA's comments regarding the statutory trading mandate for interest rate swaps.

Further, while commenters did not submit any data to support or refute ISDA's estimates, during follow-up calls with potential SEFs, one commenter stated that the U.S. credit default swap market experiences approximately 1,350 trades per day. If interest rate swaps and other swaps are included, the total number of trades per day is likely to be a much higher figure. In turn, this would imply that the execution costs per trade are likely to be lower than ISDA's estimate, which was based on only 1,000 trades per day.

The Commission notes that while SEFs are expected to list for trading a wide variety of swaps, ISDA's comment addresses only the costs and benefits applicable to the interest rate swap market. The interest rate swap market is one of the most liquid swap markets and is characterized by relatively tight bid-ask spreads, a high level of notional principal, and relatively high volume compared to other swap markets, including credit default swaps. Most other swap markets, especially many of the instruments like credit derivatives which contributed to the financial crisis, are less liquid than the interest rate

[1021] CEA section 5h(e); 7 U.S.C. 7b-3(e).

swap market and thus will benefit more from the enhanced pre-trade and post-trade price transparency and centralized marketplaces that will be available on SEFs.

While it may be true, as ISDA asserts, that some buy-side users contend that current levels of price transparency in the interest rate swap market are adequate, the Commission notes that an increase in pre-trade transparency benefits the public because it will allow all market participants (not just those with a strong business relationship with a particular swap dealer)[1022] to transact in the market on a level playing field, and will likely enhance price discovery in the swaps market. Moreover, as noted, section 5h(e) of the CEA states that a purpose of SEFs is to promote pre-trade transparency in the swaps market.[1023]

According to ISDA, market participants asserted that bid-ask spreads in interest rate swaps will widen after SEFs begin trading.[1024] The Commission notes that such predictions are speculative and are not based on data, which does not yet exist because SEFs have yet to begin trading. Moreover, during the Commission staff's follow-up conversations, other market participants (potential SEFs) shared information illustrating that after the financial crisis, participation by dealers or liquidity providers increased on their trading platforms. These sources stated that in some instances, new entrants now account for over a quarter of the total business transacted on such platforms. The Commission believes that, holding all else constant, increased participation and

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[1022] The ISDA comment ignores the liquidity risk inherent in the current bilateral interest rate swap market. It addresses the cost of entering into a new position, but not of unwinding it. If a buy-side firm wishes to unwind a swap in the OTC market, it will typically have to complete the unwind trade with the original counterparty or swap dealer. Given that the dealer is aware of the true trading interest of the buy-side firm, the quote might be one-sided favoring the dealer. Assuming sufficient liquidity, any anonymous trading platform will pose a lower unwind risk/cost to most non-dealer or buy-side firms.

[1023] CEA section 5h(e); 7 U.S.C. 7b-3(e).

[1024] ISDA Discussion Paper at 2-4 (Nov. 2011).

competition among liquidity providers should result in tighter spreads and greater depth, both key components of improved liquidity.[1025]

However, to promote the trading of swaps on SEFs, the Commission's final rules, as mentioned above, further increase the flexibility regarding the trading platforms that a SEF may offer for Required Transactions (which the Commission expects will include many interest rate swap contracts).[1026] In addition, as discussed above,[1027] work-up sessions will allow market participants to continue using certain existing market practices, which will help facilitate the transition of swap markets to SEFs.

To support its comments on the potentially adverse impact of moving interest rate swaps to centralized execution platforms, ISDA provided data on bid-offer spreads from both interest rate swap markets and exchange-traded futures markets.[1028] The Commission notes that interest rate swap dealers use exchange-traded interest rate futures, primarily the Eurodollar futures, to hedge the exposures that arise from their interest rate swap dealing activity. A dealer seeking to hedge an interest rate swap using Eurodollar futures will typically trade a strip of Eurodollar futures.[1029] In its comparisons of typical bid-offer spreads in exchange-traded interest rate futures and in OTC interest

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[1025] See Hendershott & Madhavan, "Click or Call," at 2; Darrell Duffie, Nicolae Gârleanu & Lasse Heje Pedersen, "Over-the-Counter Markets," 73 Econometrica 1815 (Nov. 2005) (hereinafter Duffie et al., "OTC Markets").

[1026] See, e.g., Minimum Trading Functionality discussion above under § 37.3 – Requirements for Registration in the preamble and "Through Any Means of Interstate Commerce" Language in the SEF Definition discussion above under §§ 37.9(b)(1) and (b)(4) – Execution Methods for Required Transactions in the preamble.

[1027] See "Through Any Means of Interstate Commerce" Language in the SEF Definition discussion above under §§ 37.9(b)(1) and (b)(4) – Execution Methods for Required Transactions in the preamble.

[1028] ISDA Discussion Paper at 12-20 (Nov. 2011).

[1029] A strip of Eurodollar futures contracts is a position consisting of a sequence of contract months, for example, a position consisting of the March 2013, June 2013, September 2013, and December 2013 Eurodollar futures contracts. This position is economically equivalent to a one year interest rate swap with quarterly payment dates on the futures expiration dates.

rate swaps, ISDA provided spreads in the front month Treasury bond and Treasury note futures contracts and the relatively illiquid interest rate swap futures contracts, but not the highly liquid Eurodollar futures contract.[1030] As noted, the Eurodollar futures contract is the primary vehicle used by interest rate swap dealers to hedge their residual interest rate exposure. Therefore, the Commission believes that Eurodollar futures bid-offer spreads are a more appropriate metric for comparison to interest rate swap bid-ask spreads than the interest rate swap futures contracts bid-ask spreads used by ISDA. Likewise, Eurodollar futures are more closely related to the OTC interest rate swap market and more useful for hedging interest rate swap positions than Treasury futures contracts. Thus, Eurodollar futures are also a better metric for comparison to interest rate swaps than Treasury futures.

Underlying ISDA's comment is an implicit assumption that moving swaps to electronic trading platforms will not result in any major changes to the number of transactions that occur. In computing its cost estimates, ISDA assumes that the number of trades on SEFs will be comparable to the number of trades that occur in the OTC market today. As noted above, ISDA states that, assuming SEFs will execute 1,000 trades a day, total execution costs will amount to $1,280 per trade.[1031] However, transaction volume has increased dramatically in securities markets and DCM futures

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[1030] According to the CME Group website, during the first eight months of 2012, Eurodollar futures contracts had a total volume of approximately 2300 million contracts. During that same period, the combined volume of CME Group's interest rate swap futures contracts was only about 312,000 contracts, approximately 1/10 of one percent of the volume in Eurodollar futures contracts. See http://www.cmegroup.com/wrappedpages/web_monthly_report/Web_Volume_Report_CMEG.pdf, updated monthly and viewed in September 2012.

[1031] See ISDA Discussion Paper at 35 (Nov. 2011). A recent paper by the New York Federal Reserve estimated 2,500 trades/day in the interest rate swap market. See Michael Fleming, John Jackson, Ada Li, Asani Sarkar, & Patricia Zobel, "An Analysis of OTC Interest Rate Derivatives Transactions: Implications for Public Reporting," Federal Reserve Bank of New York Staff Reports, No. 557, at 2 (Mar. 2012), available at http://www.newyorkfed.org/research/staff_reports/sr557.pdf.

markets that have migrated to electronic trading platforms (such as order books) from open outcry and other non-electronic trading environments. This volume increase is due to a tendency for typical transaction sizes to be much smaller on electronic order book markets and also because order books attract participation from new and alternate sources of liquidity, including participants using automated trading strategies.[1032] Transactions levels increased in the securities and futures markets when trading moved to electronic platforms, and the Commission believes that it is likely that the number of transactions in the swap markets will increase as swap trading migrates to SEFs and DCMs. The Commission is unaware of any comments or studies indicating that transaction sizes in the swap markets will remain unchanged when they move to electronic platforms.

(ii) RFQ-5 Market Participant Requirement

Several commenters stated that the five market participant requirement in proposed § 37.9(a)(1)(ii) is likely to increase costs, but commenters did not provide any data to support this assertion.[1033] MetLife stated that disclosure of a large expected trade by RFQ to five swap dealers would likely result in a material widening of bid/ask spreads and increased hedging costs, as swap dealers will pass on to their customers the cost of protecting themselves against potential adverse price movements due to the required pre-trade transparency.[1034] Some commenters specifically noted that these adverse price movements would be due to non-executing market participants receiving the RFQ front-

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[1032] See, e.g., George H. K. Wang & Aysegul Ates, "When Size Matters: The Case of Equity Index Futures," EFMA 2004 Basel Meetings Paper (Dec. 2003); Samarth Shah & B. Wade Brorsen, "Electronic vs. Open Outcry: Side-by-Side Trading of KCBT Wheat Futures," 36 Journal of Agricultural and Resource Economics 48 (Apr. 2011).

[1033] See RFQ System Definition and Transmission to Five Market Participants discussion above under § 37.9(a)(1)(ii) – Request for Quote System in the preamble.

[1034] MetLife Comment Letter at 2-3 (Mar. 8, 2011).

running the transaction in anticipation of the executing market participant's forthcoming and offsetting transactions.[1035] Commenters additionally stated that the risks associated with the five market participant requirement would be most pronounced in illiquid swaps or large-sized trades (i.e., transactions approaching the block trade threshold).[1036] Some commenters also stated that the five market participant requirement would negatively impact liquidity.[1037]

While the Commission believes that the five market participant requirement promotes the statutory goal of pre-trade transparency because the RFQ requester will have access to quotes from a larger group of potential responders, the Commission is sensitive to commenters' concerns about this requirement, such as the potential for increased trading costs and information leakage to the non-executing market participants in the RFQ. To address these concerns, while still complying with the statutory SEF definition and promoting the goals provided in section 733 of the Dodd-Frank, the Commission is revising final § 37.9(a)(3) so that a market participant must transmit an RFQ to no less than three market participants.

As noted in the preamble, the Commission believes that the three market participant requirement is consistent with current market practice where, in certain markets, many market participants already choose to send an RFQ to multiple market participants, while still complying with the statutory SEF definition and promoting the goal of pre-trade transparency.

[1035] See RFQ System Definition and Transmission to Five Market Participants discussion above under § 37.9(a)(1)(ii) – Request for Quote System in the preamble.

[1036] Id.

[1037] Id.; ISDA Discussion Paper at 2 (Nov. 2011).

Additionally, the Commission believes that adopting a minimum market participant requirement of fewer than three (e.g., a minimum of two market participants) will expose market participants to a higher risk of not receiving multiple responses to their RFQs. The receipt of multiple responses increases the likelihood that the requestor will execute at the best possible price. The Commission has learned that business or technology reasons may prevent any given market participant from responding to a specific RFQ. For example, DCM market maker programs typically require participants to quote two-sided markets for 75 to 85 percent of the trading day. Therefore, if the Commission established a minimum market participant requirement of two, there could be instances where one market participant does not respond to the RFQ, leaving the RFQ requester with only a single response. While there is no guarantee that even a minimum of three market participants will ensure that multiple responses are available for all RFQs at all times, it increases the probability that the goal of pre-trade price transparency is achieved and that a competitive market is created for market participants.

In response to the concerns raised by commenters about increased trading costs, the Commission also notes that research in the corporate bond market supports the view that RFQ systems in general increase search options for investors, and that the competition that ensues among market participants results in lower bid-ask spreads.[1038] One paper by Hendershott and Madhavan provides evidence that by allowing a market participant to negotiate simultaneously with multiple participants, and thus not be constrained by the limitations of the sequential search process as discussed above, RFQ

[1038] See Hendershott & Madhavan, "Click or Call," at 10-12.

systems contribute to a statistically significant reduction in transaction costs for quote requesters.[1039]

Specifically, the authors compare transaction costs across two different market structures, one with an RFQ and one with a traditional OTC structure, and find that investors are more likely to use RFQ systems when their costs are high because increased RFQ participation reduces their transaction costs.[1040] This is so because competition among dealers lowers costs.[1041] While Hendershott and Madhavan's estimates for transaction costs in the corporate bond market are consistent with those reported by others,[1042] access to RFQ market data, plus their choice of econometric model, help them obtain deeper insights into the reasons for differences in costs across different types of bonds.[1043] This research in the debt markets supports the final rules' three market participant requirement because it demonstrates that unless multiple market participants receive the RFQ, the quote requester will not be able to generate a minimal level of competition sufficient to reduce the quoted bid-ask spread.

As stated by commenters, in a market with high levels of pre-trade transparency, concerns about leakage of trading interest typically grow with trade size; a market participant posting a bid or offer in the order book, or sending a request for a quote to multiple dealers, will typically be concerned that information about their trading interest will adversely impact the market price. However, empirical research by Hendershott and Madhavan demonstrates that standard-sized (as opposed to large size) trades are more

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[1039] Id. at 10.

[1040] Id. at 14.

[1041] Id. at 17.

[1042] See, e.g., Edwards et al., "Transaction Costs and Transparency," 1421–51.

[1043] Hendershott & Madhavan, "Click or Call," at 1-4.

likely to be traded on an RFQ system.[1044] For these trade sizes, market participants believe that the benefits from lowering search costs mitigate concerns about information leakage.[1045] On the other hand, for larger trades (i.e., block trades), leakage concerns could dominate any expected savings in search costs from participating in the order book or RFQ system, and larger trades are more likely to be executed though a bilateral bargaining process. The Commission's understanding of this potential trade-off between lower search costs and higher leakage risk is generally consistent with the results from Hendershott and Madhavan described above. These findings are relevant for the final rules' exclusion of block-sized trades from the execution methods for Required Transactions.

While some commenters stated that the five market participant requirement would result in excessive and costly disclosure, other commenters argued that the requirement would result in insufficient transparency, comparing the proposed requirement to the current status quo of private OTC markets, where large swap dealers can choose to only interact with one another.[1046] According to Mallers et al., because the SEF NPRM would permit a market participant to interact with a limited number of market participants (i.e., less than the entire market), the proposal would allow "semi-private side deals" to take

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[1044] Id. at 15, 18, 28.

[1045] Id. A market participant sending an order to the market is likely to be concerned about others in the market being able to glean information through the order. In the context of a firm sending a large size trade, one substantially bigger than the typical trade size, there will always be concern that the size of the order will be interpreted as containing information, and elicit responses from other market participants. Firms will typically be interested in ensuring that the size of the order does not have an adverse impact on the order price, or the quotes from liquidity providers. Accordingly, while looking to execute such orders, firms will take steps to avoid leakage of the information of their trading interest beyond a very small group of potential counterparties.

[1046] Mallers et al. Comment Letter at 3-5 (Mar. 21, 2011).

place, and that in light of the 2008 financial crisis, the "costs and risks of permitting private RFQ markets [remained] high."[1047]

As noted above, the Commission agrees that a broader group of potential responders will encourage price competition and provide a fairer assessment of market value; however, the Commission is mindful of concerns that the five RFQ recipient model may impose additional costs, especially for illiquid and bespoke swaps. Following the practice for futures on DCMs, the Commission could have required that RFQs be disseminated to all market participants.[1048] However, the Commission recognizes that swaps tend to be less standardized than futures; therefore, the rules pertaining to the execution methods for SEFs should provide the requisite flexibility to market participants trading swaps. As such, the Commission is implementing the minimum three market participant requirement. The Commission also believes that the three market participant requirement reflects the more flexible statutory provisions for SEFs as compared to DCMs.

While commenters have not submitted any data on the potential impact of the proposed five market participant requirement from the potential information leakage and front-running risks, the Commission believes that the three market participant requirement adopted in this final release does not necessarily introduce a new source of risk for market participants as these risks to the extent that they exist are present in the

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[1047] Id. at 5.

[1048] The Commission notes that a SEF market participant may send an RFQ to the entire market. Core Principles and Other Requirements for Swap Execution Facilities, 76 FR at 1220. Based on its experience with RFQ-to-all functionality offered by DCMs, the Commission notes that there are two distinct differences between these and the requirements finalized in this release. First, RFQs submitted to DCMs are disseminated to all market participants. Second, the responses to the RFQs take the form of executable bids or offers that are entered into the DCM's order book or other centralized market, such that orders from any market participant, not just the one submitting the RFQ, can be matched against such responsive bids or offers.

current OTC market. The Commission also believes that the prices of bids and offers made in response to RFQs will reflect any subsequent hedging risks by the responders, and the potential winner's curse to the extent one exists will, if at all, be realized only if the market participant does not price this risk fully into its quote. Nonetheless, the revision from five to three market participants should help to mitigate this potential risk, while still complying with the statutory SEF definition and promoting pre-trade price transparency and price competition.

Furthermore, regarding comments concerns' about the potential winner's curse for illiquid swaps, the Commission notes that the three market participant requirement will only apply to transactions in swaps that are subject to the CEA section 2(h)(8) trade execution mandate (i.e., transactions in more liquid swaps, which are subject to the clearing mandate and made available to trade, and not to illiquid and bespoke swaps).[1049] The Commission also notes that the interest rate swaps and credit default swaps that the Commission has determined are required to be cleared under CEA section 2(h)(1) (and are likely to be subject to the trade execution mandate of CEA section 2(h)(8)) are some of the most liquid swaps.[1050] Additionally, 77 swap dealers have registered with the Commission and nearly all of them make markets in such swaps.[1051] SEFs may offer

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[1049] Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284 (Dec. 13, 2012); Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available To Trade, 76 FR 77728 (proposed Dec. 14, 2011).

[1050] Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284. The Commission notes that these swaps already went through a Commission determination process that included a five factor review, including a liquidity review. Id. ISDA, in its letter requesting interpretive relief regarding the obligation to provide a pre-trade mid-market mark, recognized that many of the swaps that the Commission has determined are required to be cleared under CEA section 2(h)(1) are "highly-liquid, exhibit narrow bid-ask spreads and are widely quoted by SD/MSPs in the marketplace…" ISDA Comment Letter at 2 (Nov. 30, 2012).

[1051] The Commission recognizes that not all swap dealers will be active in all Required Transactions. The Commission also notes that of the 77 swap dealers, 35 swap dealers are not affiliated with any of the 77 swap dealers.

RFQ systems without the three market participant requirement for Permitted Transactions (i.e., transactions not involving swaps that are subject to the trade execution mandate of CEA section 2(h)(8)). In response to commenters' concerns about the potential winner's curse for large-sized trades, the Commission notes that block-sized transactions would not be subject to the execution methods for Required Transactions, including the three market participant requirement.[1052] Therefore, excluding block-sized transactions from the execution methods for Required Transactions will address the potential risk of a winner's curse for large-sized trades.

As noted in the preamble, the three market participants may not be affiliated with or controlled by the RFQ requester and may not be affiliated with or controlled by each other, and the Commission is revising final § 37.9(a)(3) to clarify this point. The Commission believes that for an RFQ requester to send an RFQ to another entity who is affiliated with or controlled by the RFQ requester would undermine the benefits of the requirement.

The costs associated with the no-affiliate rule may include, for example, the costs that a SEF would incur to upgrade its systems to create filters that would prevent RFQs from being sent to affiliated parties, but these costs could be mitigated or eliminated by, for example, the SEF requiring market participants accepting RFQs to disclose their affiliations to potential RFQ requestors before a request is transmitted. Another possibility is for a SEF to monitor RFQs and cancel trades that it determines are made pursuant to RFQs between affiliated parties. Yet another possibility is for the SEF to

[1052] See definition of block trade in § 43.2 of the Commission's regulations.

include in its rules a requirement that market participants must not transmit RFQs to their affiliates or to market participants who are affiliated with each other.

The primary benefit of this no-affiliate rule is to ensure that RFQs are sent to three unaffiliated parties who can be expected to provide truly independent quotes. If an RFQ requester were to transmit an RFQ to one non-affiliate and two affiliates or if an RFQ requester transmits an RFQ to three requestees who are affiliates of each other, then the goal of pre-trade price transparency would be undermined (since the quotes might be coordinated or otherwise not independent) and the RFQ could effectively turn into an RFQ-to-one, which is contrary to the statutory SEF definition. The Commission also notes that such an outcome could disincentivize entities from responding to an RFQ, which would reduce price competition and liquidity.[1053]

The Commission clarifies that SEFs are not required to: (1) display RFQs to market participants not participating in the RFQ, (2) disclose RFQ responses to all market participants, or (3) disclose the identity of the RFQ requester. The Commission also clarifies that an acceptable RFQ System may allow for a transaction to be consummated if the original request to three potential counterparties receives fewer than three responses. Moreover, section 37.9(a)(2)(ii) clarifies that in providing either one of the execution methods for Required Transactions (i.e., an Order Book or an RFQ System that operates in conjunction with an Order Book), a swap execution facility may for purposes of execution and communication use any means of interstate commerce, including, but not limited to, the mail, internet, email, and telephone, provided that the chosen execution method satisfies the requirements provided in § 37.3(a)(3) for Order Books or in §

[1053] As any trades emanating from an RFQ will be subject to real time reporting, if a non-affiliated respondent to an RFQ observes trades happening away from better or equal prices quoted by it, such respondents might be discouraged from responding to future RFQ requests, thus hurting market integrity.

37.9(a)(3) for Request for Quote Systems. Finally, in order to provide market participants, SEFs, and the swaps industry generally with additional time to adapt to the new SEF regime, the Commission is phasing-in the three market participant requirement so that from the effective date of the SEF rule until one year after the compliance date for the SEF rule, RFQ requesters may transmit RFQs to no less than two market participants (rather than three). These provisions will likely significantly mitigate the likelihood and magnitude of the potential costs noted by commenters.

(iii) Time Delay Requirement

Some commenters stated that the rule requiring a 15-second time delay before crossing a trade between two customers should be eliminated because it may impact liquidity or result in increased costs.[1054] FHLB stated that this requirement would likely increase the bid-ask spread, because "by waiting for 15 seconds before entering into an offsetting transaction, brokers will be exposed to risks associated with market fluctuations and will have to pass the costs of these risks along to its customer."[1055] No commenter provided dollar estimates or data regarding these costs.

The time delay requirement (which only applies to a SEF's Order Book and not to its RFQ System) supports the Congressional goal of pre-trade transparency on SEFs by allowing other market participants the opportunity to participate in a trade where dealer internalization or a dealer crossing customers' orders would otherwise reduce such pre-trade price transparency.[1056] The Commission believes that this requirement will

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[1054] See Time Delay Requirement discussion above under § 37.9 – Permitted Execution Methods in the preamble.

[1055] FHLB Comment Letter at 13 (Jun. 13, 2011).

[1056] Dealer internalized or cross-trades are not open and competitive and may result in inferior execution for one of the parties compared to situations where the bid or offer is exposed to the market. Accordingly,

minimize the possibility of dealer internalization and incentivize competition between market participants. Absent this requirement, market participants would be free to conduct pre-execution communications away from the centralized market and then ensure that the orders from such private negotiations are matched by coordinating their submission to the SEF.

Further, the Commission notes that the costs outlined by commenters are speculative, since SEFs have not yet begun operation. Moreover, the time delay requirement is similar to certain timing delays adopted by DCMs, and the Commission is not aware of evidence that those DCM rules are imposing significant costs on participants in those markets.[1057] Nevertheless, the Commission's final rules recognize that a one-size-fits-all approach to the time delay requirement is not appropriate for all swap products and markets on a SEF. Accordingly, the Commission is revising the proposed rule to allow a SEF to adjust the duration of the time delay requirement based upon a swap's liquidity or other product-specific characteristics. SEFs therefore will have the ability to reduce the costs described by the commenters, if they arise.

(c) Benefits

As a whole, the minimum trading functionality (i.e., Order Book) and permissible execution methods established by §§ 37.3 and 37.9 advance the Congressional goals of promoting pre-trade price transparency in the swaps market and promoting trading of swaps on SEFs.[1058]

DCM rules typically require that an order be exposed to an order book or trading pit before it can be crossed with another order.

[1057] See, e.g., NYMEX rule 533, which provides for a 5-second delay for futures and a 15-second delay for options, available at http://www.cmegroup.com/rulebook/NYMEX/1/5.pdf.

[1058] CEA section 5h(e); 7 U.S.C. 7b-3(e).

(1) Promotion of Pre-Trade Price Transparency

The order book requirement is designed to ensure a base level of pre-trade transparency to all market participants by providing for live executable bids and offers in Required Transactions. This requirement gives all market participants (and potential market participants) access to the same key information that swap dealers have, including current information about the price of a particular swap, at the same time. An order book with executable bids and offers will ensure that prior to placing an order or executing a trade, a market participant will be able to view other bids and offers submitted to the SEF, including prices, quantities, and order book depth.[1059] Access to such information allows market participants to make informed trading decisions involving variables such as price, size, and timing, and to better assess the quality of execution effected by their intermediaries.

Intermediaries will know that their market participants have information to assess the quality of executions and can send their business elsewhere if they are not satisfied with their executions. Thus, intermediaries will have greater incentive to provide efficient execution to their customers at competitive prices.

In addition, an order book is an efficient method of execution of transactions for swaps that are subject to the CEA section 2(h)(8) trade execution mandate because it provides prompt and fast executions of marketable orders at market prices, while providing for a variety of functionalities such as limit orders and stop-loss orders. The order book functionality for such transactions will introduce core levels of pre-trade

[1059] See Duffie et al., "OTC Markets," at 1827 (presenting results showing that bid-ask spreads are lower if investors can find each other more easily).

transparency without hindering the ability of SEFs and market participants to deploy other market structures depending on the needs of the individual products and markets.

As discussed above, the benefits of pre-trade (and post-trade) transparency generally flow from reducing information asymmetries.[1060] In transparent markets, all market participants (and potential market participants) have timely access to the same public pricing information that insiders or professionals have, reducing potential negotiating advantages. Also, in a transparent market, market participants can better assess the quality of executions effected by their intermediaries by comparing execution prices against quotations and other transactions. A potential entrant can view current price quotations as well as prices of recent trades in an instrument, and can thereby assess whether it can offer a better price. Market transparency can thus provide incentives for new participants to enter the market, increasing competition, reducing concentration, and narrowing spreads.

The 15-second time delay requirement is intended to limit dealer internalization of trades (cross trades) and to incentivize competition between market participants. This requirement will also promote pre-trade price transparency of swaps executed on SEFs by allowing other market participants the opportunity to participate in the trade. The Commission's final rules also recognize that a one-size-fits-all approach to the time delay requirement is not appropriate for all swap products on a SEF. Therefore, the final rules provide SEFs with an appropriate level of discretion to adjust the minimum time delay requirement based upon a swap's liquidity or other product-specific characteristics.

[1060] See, e.g., Transparency of Structured Finance Products (Final Report), Technical Committee of the International Organization of Securities Commissions, at 17, 21 (Jul. 2010), available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD326.pdf.

Moreover, the Commission has clarified that the time delay requirement does not apply to the RFQ System.

The Commission recognizes commenters' concerns, as discussed in this section, that there may be certain circumstances in which pre-trade price transparency may reduce overall market liquidity. Therefore, the Commission has taken certain steps in the final regulations to mitigate such benefit-reducing effects (such as excluding block trades, tying the time-delay requirement to a swap's liquidity, clarifying the subset of swaps that are Required Transactions, and allowing SEFs to offer any method of execution for Permitted Transactions).

(2) Promotion of Trading on SEFs

While the statutory goal of pre-trade price transparency is reflected in the minimum trading functionality (i.e., Order Book) requirement, the regulations also provide a SEF with additional flexibility for offering the trading and execution of swaps by providing additional execution methods (e.g., RFQ Systems along with the discretion to offer any method of execution for Permitted Transactions). The Commission believes that these additional functionalities will provide flexibility in methods of execution that will promote the trading of swaps on SEFs, which in turn will promote price transparency.

For example, execution methods and market structures in general can vary depending on the product – simple or complex, the state of development of the market – established or new, market participants – retail or institutional, and other related factors. The Commission anticipates that the order book method will typically work well for liquid Required Transactions (i.e., transactions involving swaps that are subject to the

trade execution requirement under CEA section 2(h)(8)), but for less liquid Required Transactions, RFQ systems are expected to help facilitate trading. RFQ systems are currently used by market participants in the OTC swap market, many in conjunction with order book functionality. By providing a SEF with the flexibility to offer alternate execution methods to its market participants, the Commission is leveraging best practices from current swap trading platforms. The additional flexibility offered for the trading and execution of Permitted Transactions will allow a SEF to offer new, innovative market structures to facilitate trading in these swaps that are not subject to the trade execution requirement under CEA section 2(h)(8), and thus may help to promote the trading of these swaps on SEFs.

Additionally, the RFQ system communication requirement helps promote the trading of swaps on SEFs and enhances price competition and pre-trade price transparency by ensuring that RFQ requesters have access to competitive prices, and that competitive resting bids and offers left by market participants on the SEF will be transmitted to the RFQ requester for possible execution.

(3) Facilitating Search

The Duffie, Gârleanu, and Pedersen ("DGP") approach reflects the typical search process, which involves approaching intermediaries sequentially (similar to making phone calls to different dealers asking for quotes); strategic bargaining then ensues – prices negotiated reflect each investor's or the dealer's alternatives to trade.[1061] DGP's results show that both traded prices as well as transaction costs depend on investors'

[1061] See Duffie et al., "OTC Markets," at 1818-20.

search abilities, access to market makers, and investors' bargaining powers.[1062] DGP's results show that bid-ask spreads are lower if investors can find each other more easily, through market structures designed to allow them to negotiate simultaneously, instead of sequentially, with multiple, competing liquidity providers.[1063] Contrary to what commenters have stated, DGP reason that improvements in an investor's ability to search for alternate counterparties forces dealers to improve on their quoted prices and spreads.[1064] Further, they demonstrate that those with better access to market makers (or liquidity providers) receive tighter bid-ask spreads.[1065]

The final rules establishing a market structure for SEFs, including the provisions governing Order Books and RFQ Systems are designed to deliver improved search capabilities to investors and better access to market makers. These provisions will facilitate the shifting of trading to the centralized SEF market structure from the bilateral OTC market structure where investors may have limited ability to find one another.

The importance of facilitating investors' ability to find each other more easily is highlighted by evidence in the DGP paper of another dealer-centric market – the one prevailing at Nasdaq until the mid-1990s, where all trades had to be routed to a dealer.[1066] Notwithstanding competition among the dealers, and the fact that there was both pre- and post-trade transparency in the equity markets, spreads at Nasdaq at that time were wider

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[1062] Id. at 1815.

[1063] Id. at 1827.

[1064] Id. at 1817.

[1065] Id.

[1066] Id. at 1834-35.

than at the New York Stock Exchange.[1067] Though the latter had "a single specialist for each stock, floor brokers can find and trade among themselves, and outside brokers can find each other and trade 'around' the specialist with limit orders."[1068] Along these lines, the final rules provide for an anonymous but transparent order book that will facilitate trading among market participants directly without having to route all trades through dealers.

(d) Consideration of Alternatives

Some commenters recommended that the Commission modify the proposed five market participant requirement from no less than five market participants to either "one or more"[1069] or to all market participants.[1070] Other commenters recommended an alternative that would include some level of order interaction between the SEF's order book functionality and RFQ systems, including the order interaction model proposed by the SEC for SB-SEFs.[1071] MFA recommended that the Commission expand the definition of Permitted Transaction to include other transactions, such as exchanges of swaps for physicals, exchanges of swaps for swaps, and linked or packaged transactions.[1072] Each of these alternatives is discussed below.

[1067] Id.; see also Hendrik Bessembinder & Herbert M. Kaufman, "A Comparison of Trade Execution Costs for NYSE and NASDAQ-Listed Stocks," 32 The Journal of Financial and Quantitative Analysis 287 (Sep. 1997).

[1068] Duffie et al., "OTC Markets," at 1834-35.

[1069] See, e.g., Rosen et al. Comment Letter at 11 (Apr. 5, 2011).

[1070] Mallers et al. Comment Letter at 4 (Mar. 21, 2011); AFR Comment Letter at 4-5 (Mar. 8, 2011).

[1071] Rosen et al. Comment Letter at 12-14 (Apr. 5, 2011); JP Morgan Comment Letter at 5-6 (Mar. 8, 2011); FXall Comment Letter at 9-10 (Mar. 8, 2011); Tradeweb Comment Letter at 8 (Mar. 8, 2011); FSR Comment Letter at 5 (Mar. 8, 2011); MetLife Comment Letter at 3 (Mar. 8, 2011); SIFMA AMG Comment Letter at 9 (Mar. 8, 2011); MarketAxess Comment Letter at 32 (Mar. 8, 2011); Barclays Comment Letter at 7 (Mar. 8, 2011); ABC/CIEBA Comment Letter at 6-7 (Mar. 8, 2011); ISDA/SIFMA Comment Letter at 3-4; Evolution Comment Letter at 5-6 (Mar. 8, 2011).

[1072] MFA Comment Letter at 8 (Mar. 8, 2011).

(1) Modification to the Number of RFQ Requests

Numerous commenters recommended that the Commission adopt the SEC's proposed approach for SB-SEFs by allowing RFQs to be sent to one or more market participants (while not recommending that the Commission adopt the SEC's proposed order interaction requirement), instead of requiring that RFQs be sent to at least five market participants.[1073] The benefit of this approach, cited favorably by some commenters, would be to protect proprietary trading strategies and mitigate hedging costs.[1074]

Other commenters, however, stated that only requiring RFQs to be sent to one or more market participants would preserve the single-dealer status quo, would diminish the transparency and efficiency of the regulated swaps markets, and would be inconsistent with the goals of the Dodd-Frank Act.[1075] These commenters supported another alternative under which an RFQ must be transmitted to all participants on the SEF.[1076] In particular, one commenter stated that participants would not be disadvantaged by disclosing an RFQ to the entire market for transactions below the block trade threshold, which would not move the market.[1077] In this commenter's view, the proposed five market participant requirement would still allow a participant to conduct semi-private deals with a few favored participants to the exclusion of other market participants, which

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[1073] See RFQ System Definition and Transmission to Five Market Participants discussion above under § 37.9(a)(1)(ii) – Request for Quote System in the preamble. Under the SEC's interpretation of the SB-SEF definition, such an RFQ system would provide multiple participants with the ability, but not the obligation, to transact with multiple other participants. Registration and Regulation of Security-Based Swap Execution Facilities, 76 FR at 10953.

[1074] See, e.g., Rosen et al. Comment Letter at 11 (Apr. 5, 2011).

[1075] See, e.g., Mallers et al. Comment Letter at 3-5 (Mar. 21, 2011).

[1076] Id.

[1077] Id. at 4.

would ultimately decrease liquidity and create a substantial barrier to entry into the swaps market.[1078]

The Commission considered the costs and benefits of the above alternatives, but believes that neither alternative would satisfy the objectives of the Dodd-Frank Act. As noted by one commenter, only requiring that RFQs be sent to one market participant would preserve the status quo,[1079] while requiring that RFQs be sent to the entire market may not be feasible for certain less liquid swaps. Nevertheless, in light of the comments, the Commission is reducing the required minimum number of recipients for RFQs in the final rule from five to three. The Commission expects that this will mitigate the concerns of commenters as discussed above, while continuing to satisfy the objectives of the Dodd-Frank Act. As discussed above in connection with the RFQ to three market participant requirement, the Commission views three RFQ recipients as appropriately balancing between ensuring liquidity in the swaps market and promoting pre-trade price transparency. The Commission further notes that the three RFQ recipient model will provide a more reliable indicator of market value than a quote from a single RFQ responder.

(2) Order Interaction

Another alternative was to allow for one-to-one RFQs, but to mandate full order interaction.[1080] However, according to commenters, an order interaction requirement across trading platforms would impose significant architectural and operational costs on

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[1078] Id.

[1079] IECA Comment Letter at 3 (May 24, 2011).

[1080] Under the SEC's SB-SEF NPRM, an RFQ requester must execute against the best-priced orders of any size within and across an SB-SEF's modes of execution. See Registration and Regulation of Security-Based Swap Execution Facilities, 76 FR at 10953-54, 10971-74.

SEFs.[1081] In particular, potential SEFs were concerned that they would incur significant expenses by having to create the technological capabilities necessary to ensure that market participants execute against the best price.

The Commission did not propose this type of order interaction and has declined to impose such a requirement herein. Accordingly, the final regulations respond to concerns regarding a transacting party's ability to take into consideration factors other than price when choosing a counterparty or clearing entity, by, for example, offsetting an existing position cleared through the Derivatives Clearing Organization ("DCO") through which the position was entered into, even though a slightly better price may exist for the same instrument at a different DCO. This flexibility will allow market participants to execute swap transactions in accordance with the unique execution requirements of each transaction.

(3) Expand Definition of Permitted Transaction

Another alternative is to expand the definition of Permitted Transaction to include other transactions, such as exchanges of swaps for physicals, exchanges of swaps for swaps, and linked or packaged transactions. The Commission interprets MFA's comment suggesting this alternative to be a request that the Commission create through rulemaking an exception to the CEA section 2(h)(8) trade execution mandate similar to the centralized market trading exception established by DCM Core Principle 9 for certain exchange of futures for related positions ("EFRPs"). [1082]

[1081] See, e.g., Tradeweb Comment Letter at 6 (Mar. 8, 2011).

[1082] See CEA section 5(d)(9); 7 U.S.C. 7(d)(9). The Commission notes that DCM Core Principle 9 does not explicitly permit DCMs to offer exchange of swaps for physicals or exchange of swaps for swaps.

The Commission has determined not to adopt this alternative, because a broad exception for the off-exchange transactions described by MFA could undermine the trade execution requirement by allowing market participants to execute swaps subject to the trade execution requirement bilaterally rather than on a SEF or DCM. The Commission notes that market participants with a bona fide business purpose for executing exchange of swaps for physicals in physical commodity swaps (should such swaps become subject to the trade execution mandate) are likely to be eligible for the end-user exception. The Commission is not currently aware of any bona fide business purpose for executing such transactions in financial swaps subject to the trade execution mandate. In light of the end- user exception, the Commission expects that the costs associated with the Commission's determination will be minimal. The Commission is aware that the swaps market will evolve in ways that it does not currently anticipate and is open to revisiting this issue should a bona fide business purpose arise to execute swaps that are subject to the trade execution mandate in a manner recommended by the commenter.

(e) Section 15(a) Factors

(1) Protection of Market Participants and the Public

The final regulations, specifically the provisions requiring a minimum trading functionality (i.e., Order Book) and the communication of any firm bid or offer along with responses to the RFQ, promote the protection of market participants and the public by promoting the statutory goals of increased pre-trade transparency and trading on SEFs. Taken together, these final rules should reduce the likelihood that market participants and SEFs execute swaps at non-market prices, thus protecting traders and members of the public that rely on the prices of swaps facilitated or executed on SEFs. The rules should

benefit market participants by reducing the potential rents extracted by dealers from customers in opaque markets, "and more so from less informed customers."[1083]

The Commission mitigates the costs to market participants by minimizing the risk of information leakage to other market participants by clarifying that SEFs are not required to: (1) display RFQs to market participants not participating in the RFQ, (2) disclose RFQ responses to all market participants, or (3) disclose the identity of the RFQ requester.

As discussed above, the Commission anticipates that the requirements in § 37.9 will result in better pricing and liquidity and increased participation on SEFs because market participants will be able to trade on flexible platforms without compromising on pre- and post-trade transparency. The final regulations also provide information and pricing benefits to market participants using an RFQ System because market participants seeking liquidity will have access to additional pricing information after disseminating an RFQ. The final regulations increase the likelihood that RFQ requesters will receive competing quotes from a larger group of responders. The Commission notes that competition between multiple quote providers should result in tighter bid-offer spreads for the RFQ requesters.

The rules promoting trading on SEFs protect the public by encouraging trading on regulated SEFs rather than on unregulated OTC markets. Moreover, some market participants may be end users that provide goods and services to the public (e.g., airlines

[1083] Bessembinder & Maxwell, "Transparency," at 226. Their conclusions in the context of post-trade transparency introduced by the TRACE system can be generalized to the improvement in pre-trade transparency introduced through the minimum trading functionality (i.e., Order Book) and the ability to negotiate simultaneously with multiple market participants through the RFQ system.

or electric utilities). To the extent that these end users obtain better pricing due to these rules and are able to pass those cost savings to their customers and shareholders, the public would gain additional benefits from the pre-trade transparency and promotion of trading on SEFs.

(2) Efficiency, Competitiveness, and Financial Integrity of the Markets[1084]

The final regulations will improve the efficiency, competitiveness, and financial integrity of the swaps market by providing a SEF with the flexibility to offer several execution methods for Required Transactions to meet the needs of market participants, including RFQ Systems, as well as the flexibility to offer any execution method for Permitted Transactions. This flexibility reflects the fact that there is a continuum of markets occupying "various points between high and low transparency"[1085] and will allow participants to efficiently execute trades using various methods of execution depending on the liquidity levels in particular products. For example, participants may execute more liquid products on an Order Book, while executing less liquid products using RFQ functionality. Final § 37.9, specifically the provisions related to RFQ Systems (including the minimum RFQ to three requirement) and the 15 second time delay requirement for cross trades, should also facilitate an increase in the number of market participants that provide liquidity on SEFs by providing greater opportunities for

[1084] The Commission notes that CEA §15(a)(2)(B) requires the Commission to consider the costs and benefits of its actions in light of "considerations of the efficiency, competitiveness, and financial integrity of futures markets." The Commission is also considering the costs and benefits of these rules in light of considerations of the efficiency, competitiveness, and financial integrity of "swap markets."

[1085] See ISDA Research Notes, "Transparency and over-the-counter derivatives: The role of transaction transparency," No. 1, at 2-3 (2009), available at http://www2.isda.org/attachment/MTY4NA==/ISDA-Research-Notes1.pdf.

those market participants, which will contribute to the competitiveness of the swaps market.

Research by Hendershott and Madhavan supports the benefits of increased competition facilitated by RFQ systems.[1086] By enabling market participants to meet each other directly (without being forced to go through an intermediary as is the case in the current OTC market structure), and by providing them a facility (via the RFQ system) to simultaneously negotiate with multiple market participants, the rules reduce the search costs inherent in the current OTC market structure as described by Duffie, Gârleanu, and Pedersen,[1087] and thus promote a more efficient and competitive market structure for the swaps markets. In another paper, Zhu addresses the requirement for a minimum of five quote providers as a means to "increase direct trading among 'end-users' and reduce the fraction of trading volume that is conducted through intermediaries."[1088] Similarly, Avellaneda and Cont emphasize the importance of market transparency as "not an objective *per se* but rather a means for ensuring the proper functioning of the market."[1089]

(3) Price Discovery

The final rules provide for pre-trade transparency and promote trading on SEFs, both of which will enhance price discovery on a SEF. The minimum trading functionality will allow non-dealer firms with access to the SEF to compete with dealers

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[1086] See Hendershott & Madhavan, "Click or Call," at 3 (stating that "[T]he evolution of bilateral, sequential trading into an auction type framework" (their definition of the RFQ system), "offers a path from an over-the-counter market to centralized, continuous trading").

[1087] Duffie et al., "OTC Markets," at 1815.

[1088] Haoxiang Zhu, "Finding a Good Price in Opaque Over-the-Counter Markets," 25 The Review of Financial Studies 1255, 1264 (Apr. 2012).

[1089] Marco Avellaneda & Rama Cont, "Transparency in Credit Default Swap Markets," Finance Concepts, at 3 (Jul. 2010), available at http://www.finance-concepts.com/images/fc/CDSMarketTransparency.pdf.

by also placing bids and offers on the SEF. The 15 second time delay requirement will ensure a minimum level of pre-trade transparency by allowing other market participants the opportunity to participate in a privately negotiated trade before it is crossed. The broader participation and pre-trade transparency could increase market depth and improve price discovery. Research by Zhu shows that execution methods similar to the RFQ system can help improve the dispersion of quote information across a broader cross-section of market participants, the sensitivity of quoted prices to information, and the ability of the market to aggregate information distributed among multiple participants.[1090] These conclusions support findings from research by Duffie, Gârleanu, and Pedersen that "[s]earch frictions affect not only the average levels of asset prices but also the asset market's resilience to aggregate shocks[,]" both of which are critical elements of any efficient and effective price discovery process.[1091]

The differentiation in execution methods for Required and Permitted Transactions, and the ability to use "any means of interstate commerce" in providing the execution methods for Required Transactions as described in § 37.9(a)(2)(ii), will allow a SEF to adjust its market structures for emerging and less liquid markets by using a variety of means of communication in providing the execution methods for Required Transactions and using any execution method the SEF deems appropriate for Permitted Transactions. This approach reflects the Commission's belief that the price discovery process varies across markets and products.

(4) Sound Risk Management Practices

[1090] Haoxiang Zhu, "Finding a Good Price in Opaque Over-the-Counter Markets," 25 The Review of Financial Studies 1255, 1257-58 (Apr. 2012).

[1091] Duffie et al., "Valuation in OTC Markets," at 1881.

Centralized trading platforms have multiple checks and balances built into their systems designed to reduce operational risks (such as human error) inherent in order submission, matching, and confirmation. The Commission believes that adoption of centralized trading platforms for swaps trading on a SEF will contribute to a system-wide reduction in operational risks, and will help standardize risk management practices in the marketplace. This in turn will reduce overall transaction costs, and will, along with pre-trade transparency and the prospects for improved price discovery discussed earlier, encourage market participants to trade swaps on SEFs and thus aid in the development of the swaps market. As markets are interlinked, the growth of the swaps market will likely drive growth of the futures and other derivatives markets through the liquidity externality mechanism, which in turn will improve the ability of a broader range of market participants to measure, hedge, and transfer their risks through such contracts.[1092]

(5) Other Public Interest Considerations

The Commission has not identified any effects that these rules will have on other public interest considerations other than those enumerated above.

3. Registration

(a) Background

Section 5h(a)(1) of the Act provides that no person may operate a facility for the trading or processing of swaps unless the facility is registered as a SEF or a DCM.[1093] The SEF definition in CEA section 1a(50) defines a SEF as "a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids

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[1092] See Yakov Amihud, Haim Mendelson, & Beni Lauterbach, "Market microstructure and securities values: Evidence from the Tel Aviv Stock Exchange," 45 Journal of Financial Economics 365, 378-80 (Sep. 1997) (discussing liquidity externalities in trading).

[1093] CEA section 5h(a)(1); 7 U.S.C. 7b-3(a)(1).

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."[1094] In accordance with these provisions, the Commission has clarified that a facility would be required to register as a SEF if it offers a trading system or platform in which more than one market participant has the ability to execute or trade swaps with more than one other market participant on the system or platform.[1095] In response to comments, the Commission also provides examples of how it would interpret the registration requirement for certain entities.

Section 37.3(a)(1) codifies this statutory registration requirement and § 37.3(b) requires, among other things, that applicants requesting approval of registration as a SEF must file a complete Form SEF, which consists of general questions and a list of exhibits that will enable the Commission to determine whether the applicant complies with the core principles and the Commission's regulations. Form SEF standardizes the information that an applicant must provide to the Commission and includes comprehensive instructions that will guide applicants through the process.[1096] Section 37.3(b)(5) requires the Commission to review any application for registration as a SEF submitted two years or later after the effective date of part 37 pursuant to the 180-day timeframe and procedures specified in CEA section 6(a).

[1094] CEA section 1a(50); 7 U.S.C. 1a(50).

[1095] See Requirements for Registration discussion above under § 37.3 – Requirements for Registration in the preamble for further details.

[1096] Sections 37.3(d)-(g) provide procedures for other actions involving registration, including reinstating a dormant registration, requesting a transfer of registration, withdrawal of an application for registration, and vacation of registration. These procedures will further the ability of the Commission to efficiently monitor SEFs' compliance with the core principles, and will result in minimal administrative costs for SEFs.

Under § 37.3(c), SEF applicants may submit a notice to the Commission requesting temporary registration, allowing them to operate during the pending application process once a notice granting temporary registration from the Commission has been received. The SEF NPRM required these applicants to submit transaction data substantiating that they are trading swaps. In response to comments, the Commission is eliminating this requirement from the final rule and is also extending the termination date of the proposed temporary registration provision by one year. In addition, the Commission is shortening the proposed effective date of the regulations from 90 days to 60 days subsequent to publication in the Federal Register. In connection with this change, the Commission is also using its discretion to establish alternative dates for the commencement of its enforcement of regulatory provisions and is setting a general compliance date of 120 days subsequent to Federal Register publication.

(b) Costs

In its discussion paper, ISDA estimated the average cost of registration would be $333,000.[1097] Based on the Commission staff's follow-up discussions with commenters, the Commission estimates that the total cost of completing and filing a registration application with the Commission will be between $333,000 and $500,000. This range accounts for the time that will be expended to prepare and file Form SEF.[1098]

[1097] ISDA Discussion Paper at 32 (Nov. 2011).

[1098] The Commission notes that the SEC estimated that the one-time registration burden to prepare and file Form SB-SEF will be approximately 100 hours for each new and existing entity. See Registration and Regulation of Security-Based Swap Execution Facilities, 76 FR at 11024. The SEC based this estimate on its experience with the registration process for national securities exchanges, having last estimated the average time it should take to fill out the securities exchange registration form (Form 1) to be 47 hours. Id. The SEC adjusted this figure upwards to account for the greater resources that would be required initially in lieu of an established framework and familiarity of the industry in order to gather supporting documentation and complete Form SB-SEF.

As noted above, based on the statute as interpreted by the Commission, a facility that meets the SEF definition would be required to register as a SEF and would incur the costs of registration. These facilities would also be required to meet the minimum trading functionality and other requirements of § 37.9. The costs and benefits of those requirements are discussed above. The 180-day review period for SEF applications submitted two years or later after the effective date of part 37 is not expected to impose significant costs on applicants who submit their applications sooner since they will be eligible for two years of temporary registration and will not need to await final Commission approval before commencing SEF operation.

(c) Benefits

As discussed above, based on the statute as interpreted by the Commission, a facility that meets the SEF definition would be required to register as a SEF. These facilities will, as registered SEFs, have the benefit of being able to offer Required Transactions for execution, while alternative entities that are not required to register as SEFs, including one-to-many systems or platforms, will only be able to offer Permitted Transactions for execution. This will ensure, consistent with the statute, a level playing field, that all Required Transactions are executed on registered SEFs. This will provide market participants in Required Transactions with the benefits associated with the minimum trading functionality, core principles, and other requirements set out in this release.

Additionally, the Commission's interpretation of the registration requirement through a set of examples helps to clarify which facilities must register as a SEF. The Commission believes that providing examples of how it would interpret the CEA section

5h(a)(1) registration requirement will ensure that a consistent set of metrics is available to market participants while evaluating the applicability of the registration requirements. Providing specific examples will also mitigate the costs potential registrants may incur in seeking advice on issues pertaining to registration.

Form SEF is designed to ensure that only applicants that comply with the Act and the Commission's regulations are registered as SEFs. Form SEF is expected to minimize the amount of time the Commission staff will need to review applications and reduce the need for the Commission staff to request, and applicants to provide, supplementary information, which, in turn, benefits potential SEFs by reducing the time it takes to become fully registered. This standardized registration process will provide applicants with legal certainty regarding the type of information that is required and will ensure that no applicant is given a competitive advantage in the application process.

Further, granting temporary registration for up to two years will improve market continuity by allowing the Commission ample time to review applications without jeopardizing an applicant's ability to operate pending Commission review. By withdrawing the existing trading activity requirement in proposed § 37.3(b)(1)(ii), all SEF applicants, not only those operating existing platforms, may apply for temporary registration. The withdrawal of the trading activity requirement should promote competition between SEFs by providing opportunities for new entities to establish trading operations that compete with existing platforms. The 180-day review period for SEF applications submitted two years or later after the effective date of part 37 will provide any later SEF applicants with the same review period as is applicable under the CEA to

DCMs and will provide greater certainty for SEF applicants regarding the time period for the Commission's review of their applications.

(d) Consideration of Alternatives

Several commenters stated that the Commission should harmonize its registration procedures with the SEC in order to avoid unnecessary cost and duplication for SEFs.[1099] In particular, Tradeweb stated that SEF applicants should not have to file separate applications for each mode of execution, and that where a SEF is offering both swaps and security-based swaps, the SEF should only be required to file one application for both agencies.[1100]

The Commission recognizes that substantially similar registration forms and procedures could facilitate compliance and reduce regulatory costs for SEFs seeking dual registrations. The Commission notes, however, that it must comprehensively review and understand a SEF's proposed trading models and operations, which will facilitate trading for a more diverse universe of financial instruments and underlying commodities than SB-SEFs. Accordingly, the Commission is not permitting notice registration to SEC-registered SB-SEFs. Additionally, in response to comments raised, the Commission clarified in the preamble that a SEF applicant does not need to file separate applications for each mode of execution, but that its application must describe each mode of execution offered. This should allay concerns that multiple costly applications must be filed with the Commission.

(e) Section 15(a) Factors

[1099] See Application Procedures discussion above under § 37.3 – Requirements for Registration in the preamble.

[1100] Tradeweb Comment Letter at 3-4 (Jun. 3, 2011).

(1) Protection of Market Participants and the Public

The interpretation of the registration provision to apply to facilities that meet the SEF definition will ensure that market participants transacting any swap on these platforms, whether or not they are subject to the trade execution requirement, will benefit from the core principles and other requirements for SEFs (including the pre-trade transparency available on SEFs), especially those designed to protect market participants and the public. Furthermore, given the critical role that SEFs will play in the financial markets, it is essential that the Commission conduct a comprehensive and thorough review of all SEF applications for registration. Such a review is important for the protection of market participants and the public because it ensures that only qualified applicants who satisfy the statutory requirements and the Commission's regulations thereunder can operate as SEFs. Form SEF will enable the Commission to efficiently and accurately determine whether an applicant meets such requirements.

(2) Efficiency, Competitiveness, and Financial Integrity of the Markets

The Commission's interpretation of the registration provision to apply to facilities that meet the SEF definition, along with the minimum trading functionality requirement, will promote competition in the swaps market by providing a level playing field for entities that meet the SEF definition.

The standardized registration procedures and Form SEF will create an efficient process that will reduce the resources associated with submitting and reviewing completed applications. The final rules promote market competition by not discriminating between new and existing platforms applying to register as SEFs. For example, the elimination of the proposed existing trading activity requirement for

temporary registration will ensure that new entities wishing to qualify for temporary registration will not be placed at a competitive disadvantage to existing entities. The required information in Form SEF (Exhibits I-K--Financial Information and M and T--Compliance) will allow the Commission to evaluate each applicant's ability to operate a financially-sound SEF and to appropriately manage the risks associated with its role in the financial markets.

(3) Price Discovery

The Commission has not identified any effects that these procedures will have on price discovery.

(4) Sound Risk Management Practices

The registration procedures will require SEF applicants to examine their proposed risk management program through a series of detailed exhibits and submissions. These risks include risks associated with the SEF applicant's financial resources and operational and market risks associated with trading on the SEF platform. The submission of exhibits relating to risk management, including Exhibits I-K (Financial Information) and M, O, and T (Compliance), will provide data and information that will aid the Commission staff's analysis and evaluation of an applicant's ability to comply with the core principles.

(5) Other Public Interest Considerations

The Commission has not identified any effects that these procedures will have on other public interest considerations other than those enumerated above.

4. Recordkeeping and Reporting

(a) Background

This release finalizes a series of provisions governing the recordkeeping and reporting responsibilities of SEFs and market participants.[1101] Among other requirements, these rules require each SEF to: (1) provide the Commission with information about its business as a SEF (§§ 37.5(a), 37.503), provide a written demonstration of compliance with any core principle (§ 37.5(b)), and provide notice of any transaction involving the transfer of at least fifty percent of the equity interest in the SEF (§ 37.5(c)); (2) provide each counterparty to a swap on the SEF with a written record of all of the terms of the transaction (§ 37.6(b));[1102] and (3) maintain records of all business activities, including a complete audit trail, investigatory files, and disciplinary files, in a form and manner acceptable to the Commission for at least 5 years (§ 37.1001).

A SEF must also: (1) have the ability to obtain the information necessary to perform its self-regulatory responsibilities, including the authority to examine books and records (§§ 37.501, 37.502); (2) share information with other regulatory organizations, data repositories, and third-party data reporting services as required by the Commission (§ 37.504); (3) demonstrate that it has access to sufficient information to assess whether trading is being used to affect prices in its market (§ 37.404(a)); and (4) require market participants to keep records of their trading and make such records available to the SEF or the SEF's regulatory service provider, and the Commission, upon request (§ 37.404(b)).

[1101] For example, section 37.901 states that SEFs must report swap data as specified in parts 43 and 45 and meet the requirements of part 16. This provision references other Commission regulations, the costs and benefits of which are discussed in connection with those rulemakings.

[1102] The discretionary costs and benefits specific to the confirmation process are discussed in the part 23 rulemaking for new confirmation standards.

The final rules also govern a SEF's use of data and records obtained from market participants, and prohibit a SEF from using for business or marketing purposes proprietary or personal information that it collects from any person unless the person clearly consents to the use of its information in such a manner (§ 37.7).

(b) Costs

The costs associated with responding to requests for information or demonstrations of compliance under recordkeeping rules in § 37.5 will include the staff hours required to prepare exhibits, draft responses, and submit materials. These costs will vary among SEFs depending upon the nature and frequency of Commission inquiries.

The Commission is reducing the reporting burden associated with final § 37.5(c) (equity interest transfers) by raising the threshold of when a SEF must file a notification with the Commission from 10 percent to 50 percent, by increasing the time frame for submitting such notification to 10 days rather than the next business day, and by eliminating the proposed requirement that SEFs must provide a series of documents and a representation along with the notification of an equity transfer interest. Under the final rules, the Commission, upon receiving a notification of an equity interest transfer, may request appropriate documentation of the transfer, but all the documentation should already be in the possession of the SEF. Accordingly, a SEF that enters into agreements that could result in equity interest transfers of 50 percent of more will incur one-time costs associated with preparing and submitting the required notification for each event.

Further, final § 37.1001 (requirement to maintain business records including audit trail, investigatory, and disciplinary files) codifies the substantive requirements found in

Core Principle 10. Accordingly, most, if not all, of the costs associated with this rule are attributable to statutory mandate. Commenters did not mention any specific costs with respect to this rule. In addition, §§ 37.501 and 37.503 (establish and enforce rules and provide information to the Commission) codify requirements that appear in the statute and impose no additional costs on SEFs or market participants beyond those attributable to Congressional mandate.

Final § 37.502 requires each SEF to have rules that allow it to collect information or examine books and records of participants, but imposes no affirmative obligations on SEFs to do so. Accordingly, the only direct costs associated with § 37.502 are the de minimis costs associated with writing such rules.

Final § 37.504 (information sharing agreements) codifies and implements the Core Principle 5 requirement that a SEF have the capacity to carry out international information-sharing agreements as the Commission may require. Accordingly, SEFs will bear the cost of responding to Commission requests to share information with other regulatory organizations, data repositories, and third-party data reporting services. The cost of responding to Commission requests to share information will vary depending on the frequency and nature of the requests. To the extent that it is necessary for a SEF to enter into an information sharing agreement, the SEF may face additional costs such as negotiating such agreement. However, these costs are unlikely to be significant and will only be incurred should a SEF determine that it is necessary to enter into an information sharing agreement.

A market participant's cost to maintain records under § 37.404 (ability to obtain information) should be minimal if, as expected, it is part of its normal business practice.

As a result, a market participant's additional cost to provide records to the SEF, and the SEF's cost to request and process the records, will be nominal if, based upon the Commission's experience with DCMs, such requests are infrequent and targeted to specific and significant market situations.

Additionally, the Commission has moved to guidance the requirement from proposed § 37.404(b) that a SEF require customers engaging in intermediated trades to use a comprehensive large-trader reporting system or be able to demonstrate that they can obtain position data from other sources. This change should mitigate costs by providing SEFs with greater flexibility to identify particular methods of compliance that suit their markets and business structures.

The Commission is also amending § 37.7 (use of proprietary or personal information) to allow SEFs to use certain information for business or marketing purposes if the person consents to the use of such information. The costs imposed by this provision are limited to the cost a SEF might incur in obtaining such person's consent to use its information for the purposes described above. The Commission does not prescribe the method by which a SEF must obtain such consent, which provides flexibility to SEFs.

(c) Benefits

The Dodd-Frank Act created a robust recordkeeping regime in order to reduce risks associated with swaps trading, increase transparency, and promote market integrity. Taken as a whole, the recordkeeping and reporting regulations adopted in this release will provide a SEF and the Commission with access to information that will enhance a SEF's ability to oversee its platforms and markets and enable the Commission to determine

whether a SEF is operating in compliance with the statute and the Commission's regulations. The information-sharing requirement in § 37.504 will also provide cost-savings across market regulators by allowing the SEF to serve as the focal point for collecting certain data instead of each regulator duplicating efforts and collecting the information independently.

The confirmation requirement in § 37.6(b) will provide market participants with the certainty that transactions entered into on or pursuant to the rules of a SEF will be legally enforceable on all parties to the transaction. The requirement that a SEF provide each counterparty with a confirmation at the same time as execution will support the policy goal of straight-through processing to ensure that counterparties do not encounter gaps in their records as to their exposure level with other counterparties. This will also reduce the costs and risks involved in resolving disputes between counterparties to a trade; given dependency across trades, for example, if a participant has already unwound a position or taken a position via a trade under dispute or hedged it, any delays or uncertainties in the confirmation will result in higher costs from having to further unwind such linked trades.

The prohibition on the use by a SEF of proprietary or personal information for business purposes without consent (§ 37.7) will ensure that information provided to a SEF for regulatory purposes will not be used to advance the commercial interests of the SEF. The rule does, however, afford market participants the flexibility to consent to a SEF's use of their personal information for commercial purposes, if they so desire.

(d) Section 15(a) Factors

(1) Protection of Market Participants and the Public

The recordkeeping and reporting rules will protect market participants and the public by improving a SEF's and the Commission's ability to detect manipulative or disruptive activity. This, in turn, may deter SEFs and market participants from engaging in practices that may harm other market participants and harm the public by placing the larger economy at risk. Additionally, certification of continued compliance with the core principles will enable the Commission to ensure that performance of SEF functions is limited to only those entities that have adequately demonstrated an ability to comply with the Act and accompanying regulations. This will protect the public by promoting trading on regulated SEFs rather than OTC markets. While SEFs and the Commission may at times require access to market participants' information for regulatory purposes, the rules also protect market participants by stipulating that information they provide to SEFs for regulatory purposes is not used inappropriately to advance the commercial interests of the SEF without their consent.

(2) Efficiency, Competitiveness, and Financial Integrity of the Markets

The recordkeeping and reporting rules promote financial integrity as they ensure that the Commission and SEFs will have access to information to ensure that trading is conducted pursuant to the regulatory requirements, and that SEFs have sufficient documentation to detect, enforce, and deter potential rule violations.

(3) Price Discovery

The Commission has not identified any effects that these rules will have on price discovery considerations.

(4) Sound Risk Management Practices

Requiring that SEFs maintain audit trail, investigatory files, disciplinary, and other records will provide the Commission with access to data that will allow it to assess whether market participants are manipulating or otherwise disrupting trading in the swaps market. The Commission and SEFs can then take action to mitigate these risks.

(5) Other Public Interest Considerations

The Commission has not identified any effects that these rules will have on other public interest considerations other than those enumerated above.

5. Compliance

(a) Rule Writing and Enforcement

Under Core Principle 2, a SEF must implement a number of rule-writing and enforcement-related provisions. Among other requirements, a SEF must: (1) establish a rulebook that addresses critical areas of market protection (§ 37.201), including rules prohibiting certain abusive trading practices (§ 37.203(a)), rules ensuring impartial access to the SEF's trading system (§ 37.202), and rules governing internal disciplinary procedures (§ 37.206); and (2) have resources for effective rule enforcement, including sufficient compliance staff and resources (§ 37.203(c)), authority to collect information and examine books and records (§ 37.203(b)), and procedures for conducting investigations into possible rule violations (§ 37.203(f)). The Commission is also clarifying that a SEF must establish and enforce rules for its employees that are reasonably designed to prevent violations of the Act and the rules of the Commission.

Additionally, § 37.204 provides SEFs with the option to choose to contract with a regulatory service provider for the provision of services to assist in complying with the CEA and Commission regulations, provided that the SEF supervise the regulatory service

provider and retain exclusive authority with respect to all substantive decisions made by the regulatory service provider on the SEF's behalf.

(1) Costs

The costs associated with the rule-writing and enforcement provisions outlined above will consist mostly of one-time administrative outlays such as wages paid to attorneys and other compliance personnel for time spent drafting, reviewing, implementing, and updating rules. While new entities seeking to become SEFs would need to develop a rulebook, existing entities that already have written rules would only incur the incremental expense of updating them.

SEFs will also incur the initial and recurring costs associated with investing in the resources and staff necessary to provide effective rule enforcement. A SEF must have sufficient staff and resources, including resources to collect information and examine books and records, as well as automated systems to assist the compliance staff in carrying out the SEF's self-regulatory responsibilities. One commenter stated that these requirements are overly burdensome, but did not provide any data in support.[1103]

The Commission believes that having a minimum level of resources in place for rule enforcement purposes is a critical element of a sufficient compliance program, and is necessary pursuant to the statutory mandate of Core Principle 2, which requires SEFs to have the capacity to detect, investigate, and enforce its rules.[1104] SEFs may be able to reduce these costs by contracting with a regulatory service provider. In addition, the Commission reduced the costs of the final rules by eliminating the requirement in proposed § 37.203(c)(2) that a SEF monitor the size and workload of its compliance staff

[1103] State Street Comment Letter at 5 (Mar. 8, 2011).

[1104] CEA section 5h(f)(2)(B); 7 U.S.C. 7b-3(f)(2)(B).

on an ongoing basis and, on at least an annual basis, formally evaluate the need to increase its compliance resources and staff. The Commission believes that the final rulemaking provides greater flexibility to SEFs in determining their approach to monitoring their compliance resources.

With respect to the use of a third-party regulatory service provider as permitted under § 37.204 (Regulatory services provided by a third party), two commenters in follow-up conversations indicated to the Commission staff that they each may contract (or have already contracted) with a regulatory service provider to perform various compliance functions at a cost of between $540,000 and $720,000 per year. This estimate represents the total cost of contracting a SEF's compliance functions to a regulatory service provider. Additionally, ISDA estimates an assessment on SEFs of $45,000 per year to contract with a regulatory service provider and $635,000 per year in dues for membership to the regulatory service provider.[1105] Section 37.204 is intended to be a cost-saving provision that mitigates the burden placed on SEFs by the rule enforcement program and, as stated by one commenter, this rule may reduce a SEF's overall costs by at least thirty percent.

SEFs that choose to contract with a regulatory service provider will need to hire sufficient compliance staff to supervise the quality and effectiveness of the services provided by the regulatory service provider, including the cost of holding regular meetings with the regulatory service provider to review and assess the adequacy of the services provided. SEFs will also incur the cost of documenting any instances in which their decisions differ from those recommended by their regulatory service provider.

[1105] ISDA Discussion Paper at 28 (Nov. 2011).

(2) Benefits

Establishing a rulebook and an effective rule enforcement program will ensure that SEFs have specific and transparent procedures for addressing critical areas of market protection, and that SEFs will have the resources needed to implement those procedures. In particular, the requirements that a SEF offer impartial access, provide a fair and competitive market free of abusive trading practices, have sufficient resources to oversee and monitor the market, promptly investigate rule violations, establish disciplinary procedures that will deter abuses, and provide respondents with adequate safeguards will foster greater confidence that SEFs will provide a fair and competitive market free of trading abuses. This confidence is likely to result in increased trading of swaps on SEFs, improving liquidity and resulting in more competitive quotes.

According to conversations with commenters, SEFs that contract-out certain regulatory functions to a regulatory service provider are likely to realize significant cost savings from economies of scale -- one commenter stated that contracting with a regulatory service provider would reduce a SEF's overall costs by at least thirty percent. According to NFA's website, it appears that many potential SEFs have already contracted with, or are in the process of contracting with, a regulatory service provider. [1106] Additionally, the rule governing the use of regulatory service providers ensures that SEFs will have sufficient staff to adequately supervise their regulatory service providers. By requiring that SEFs oversee the services provided by the regulatory service provider, the rule will likely result in cost savings to the SEF, as the failure of a service provider to

[1106] See, e.g., "NFA Signs Agreement with ICAP to provide Regulatory Services to ICAP's Swap Execution Facility" (Mar. 20, 2012), available at http://www.nfa.futures.org/NFA-regulation/regulationNewsRel.asp?ArticleID=3996.

adequately fulfill its duties may result in costs to SEFs for not meeting compliance obligations.

(3) Consideration of Alternatives

As referenced above, one of a SEF's rule-writing obligations is to develop rules governing internal disciplinary procedures, including rules governing disciplinary panels. CME stated that the Commission should not provide a prescriptive approach to disciplinary panels in proposed § 37.206(b) by requiring a "hearing panel" to be separate from a "review panel."[1107] In response, the Commission removed the proposed requirement to establish separate hearing and review panels, instead allowing a SEF to establish one or more disciplinary panels, which will, among other things, issue notices of charges, conduct hearings, render written decisions, and impose disciplinary sanctions. The final rule will continue to achieve the goals of the proposed regulations by deterring violations of SEF rules, preventing recidivist behavior, and protecting respondents and customers harmed by violations of exchange rules. The procedures will achieve these goals while also providing SEFs with greater flexibility to structure their disciplinary bodies in a manner that best suits their business models and markets. The final rule is unlikely to impose additional personnel expenditures on SEFs, as the Commission anticipates that SEFs, like DCMs, will rely upon unpaid disciplinary panel members. The Commission anticipates that any actual costs associated with the disciplinary panel will be limited to de minimis administrative expenses for convening hearings over which the panel presides, such as postage, facility rentals, and printing.

[1107] CME Comment Letter at 35 (Feb. 22, 2011).

The Commission notes that it has provided additional flexibility to SEFs by delaying the effective date of proposed § 37.206(o) to 1 year from the effective date of the SEF rules.[1108] Where a rule violation is found to have occurred, this provision limits the number of warning letters to one per rolling twelve month period for the same violation. The delay in the effective date of this provision is likely to mitigate costs for persons and entities so that they may adapt to the new SEF regime.

As recommended by commenters, the Commission has also adopted cost-mitigating alternatives that will provide SEFs with additional flexibility and discretion to implement disciplinary and other enforcement programs in the manner they find most suited to their market. In particular, the Commission has: eliminated the requirement that an investigation report include the member or market participant's disciplinary history at the SEF; removed the requirement that SEFs include a copy of a warning letter in an investigation report; amended the standard for commencing an investigation from a "possible basis" to a "reasonable basis" that a violation may have occurred or will occur; and deleted several provisions.[1109]

The Commission has also moved part or all of several provisions to guidance.[1110] By moving these provisions to guidance, entities will have the flexibility to tailor

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[1108] The Commission is renumbering proposed § 37.206(o) to § 37.206(f). The Commission is also retitling this section as "Warning letters."

[1109] Deleted provisions include proposed § 37.203(c)(2) (ongoing monitoring of compliance staff and resources), the second sentence of proposed § 37.206(a) (annual review of enforcement staff), the majority of proposed § 37.206(c) (timely review of investigation reports), the last sentence of proposed § 37.206(h) (denial of charges and right to a hearing), and proposed § 37.206(j)(1)(vii) (cost of transcribing the record to be borne by the respondent).

[1110] See second part of proposed § 37.206(a) (enforcement staff), proposed § 37.206(d) (notice of charges), proposed § 37.206(e) (right to representation), proposed § 37.206(f) (answer to charges), proposed § 37.206(g) (admission or failure to deny charges), proposed § 37.206(h) (denial of charges and right to hearing), proposed § 37.206(i) (settlement of offers), the majority of proposed § 37.206(j) (hearings), proposed § 37.206(l) (right to appeal), proposed § 37.206(m) (final decisions), proposed § 37.206(o)

compliance programs to varying business models and trading platforms as well as unanticipated technological innovation or behavioral changes. While the Commission's pairing of guidance and regulations provides for a broad and flexible regulatory framework, it also promotes uniformity of safe and sound operation such that market participants and the public receive comparable levels of protection irrespective of the particular SEF on which they transact.

(4) Section 15(a) Factors (Rule Writing and Enforcement)

(i) Protection of Market Participants and the Public

Together, the rule-writing and enforcement provisions described above ensure that SEFs adopt and enforce operational rules that protect market participants and the public through orderly SEF-traded markets that are better protected from manipulative and disruptive conduct than pre-Dodd Frank OTC markets.

Rules prohibiting abusive trade practices such as wash trades and front-running are intended to deter such disruptive practices, and will protect market participants transacting on the SEF, as well as the general public, who may rely on prices derived from the market and who may be customers or shareholders of market participants.

The requirement that a SEF have the capacity to detect and investigate rule violations, including adequate compliance staff and resources to conduct automated trade surveillance and real-time monitoring (or contract with a regulatory service provider that has the capacity to perform these functions on its behalf while maintaining ultimate responsibility), will improve a SEF's ability to discover, sanction, and prevent violations and trading practices that could harm market participants and, indirectly, the public.

(summary fines for violations of rules regarding timely submission of records), and proposed § 37.206(p) (emergency disciplinary actions).

SEF-initiated investigations are a chief tool in protecting market participants and the public because they provide the first opportunity to respond to rule violations. Rules allowing the SEF to obtain information and inspect books and records will not only deter potential abusive trading practices, but will also enable the SEF to detect any manipulative or fraudulent activity quickly and efficiently. Prompt and thorough investigations are essential to detecting and remedying violations and ensuring that the violations do not harm market participants, result in price distortions, or contribute to systemic risks that can harm the economy.

In the event of demonstrated customer harm, restitution damages are generally required to make that customer whole again. Meaningful sanctions will serve as a general deterrent by discouraging others from engaging in violative conduct.

Impartial access requirements protect market participants from discriminatory treatment by prohibiting similarly situated market participants from receiving different access terms and fee structures.

The requirement that SEFs establish and enforce rules for its employees will protect market participants and the public by helping to ensure that employees operate in conformance with the Act and the rules of the Commission.

(ii) Efficiency, Competitiveness, and Financial Integrity of the Markets

The requirement that a SEF have the capacity to detect and mitigate rule and trade practice violations, including the ability to collect relevant information and examine books and records, and the requirement to establish and enforce rules for its employees will increase confidence in the financial integrity of the market by confirming to market

participants that their orders and trades are handled pursuant to the posted rules of the SEF.

In addition, impartial access requirements will eliminate a potential impediment to participation, resulting in a more competitive market. At a minimum, as required by section 2(e) of the Act, market participants must meet the definition of an ECP, which ensures that only those participants with a sufficient level of sophistication and financial resources are able to participate. Similarly, requiring a SEF to maintain minimum level of enforcement resources will promote financial integrity by ensuring that a SEF has sufficient resources to investigate wrongdoing and make aggrieved market participants whole again. Moreover, markets where wrongdoing is detected and deterred will operate more efficiently.

(iii) Price Discovery

Many of the same rule provisions previously discussed that serve to increase efficiency, liquidity, and competitiveness will, by extension, improve price discovery, because the combination of increases in liquidity and competition will help create a marketplace in which the forces of supply and demand reflect more accurate pricing.

Timely investigations will increase the likelihood that manipulation is detected early-on and quickly remedied so that price discovery is not impaired. Additionally, a system of meaningful sanctions will deter disruptive and manipulative trade practices, providing a stable and competitive trading environment more likely to foster price discovery.

(iv) Sound Risk Management Practices

The requirement that SEF participants confirm to the SEF that they meet the definition of an ECP helps assure the market that participants in SEF-traded markets have the skill, knowledge, and/or financial resources necessary to enter into financially-sound transactions and understand sound risk management practices.

(v) Other Public Interest Considerations

The Commission has not identified any effects that these rules will have on other public interest considerations other than those enumerated above.

(b) Chief Compliance Officer

Section 37.1501 implements Core Principle 15 and requires each SEF to designate an individual to serve as Chief Compliance Officer ("CCO") and to provide its CCO with the authority and resources to develop and enforce such policies and procedures as are necessary for the CCO to fulfill its statutory and regulatory duties.[1111] While the proposed rule prohibited the CCO from serving as a member of the SEF's legal department or as the SEF's general counsel, the Commission has eliminated this restriction from the final rule.

The final rule also outlines the procedures for oversight authority over the CCO and for appointing and removing the CCO. The CCO must meet with the board of directors at least annually and the Regulatory Oversight Committee ("ROC") at least quarterly. The CCO must also prepare an annual compliance report containing a detailed account of the SEF's compliance with the CEA and Commission regulations, as well as a detailed account of the SEF's self-regulatory program, and submit it to the SEF's board of directors for review and to the Commission. SEFs must maintain records pertaining

[1111] There are no costs associated with § 37.1501(a), which simply defines "board of directors."

to, among other things, code of ethics and conflict of interest policies, copies of all materials created in furtherance of the CCO's duties, and any records relevant to the SEF's annual compliance report.

(1) Costs

Several commenters stated that the proposed requirement that the CCO may not be a member of the SEF's legal department and may not serve as its general counsel is prescriptive and unnecessary.[1112] In response to these comments, the Commission has eliminated the proposed prohibition on who may serve as CCO. Accordingly, a SEF may use its general counsel or a member of its legal department to serve as CCO. This change to the final rule should significantly reduce the expense imposed by the proposed rule, which would have necessitated the hiring of an individual specifically to serve as CCO at an estimated annual cost of $181,394.[1113] The cost of assigning the role of CCO to an existing employee will be significantly less.

Several commenters requested that the Commission grant SEFs more flexibility in determining how a CCO is appointed, compensated, supervised, and removed.[1114] In response to these comments, the Commission has removed the requirement in proposed § 37.1501(c)(1) that a CCO's appointment and compensation requires a majority vote of directors, as well as the requirements in proposed § 37.1501(c)(3) that the SEF explain to the Commission the reason for the CCO's removal upon departure and that the SEF

[1112] ICE Comment Letter at 6-7 (Mar. 8, 2011); WMBAA Comment Letter at 6-7 (Mar. 8, 2011); MarketAxess Comment Letter at 27 (Mar. 8, 2011); CME Comment Letter at 12-13 (Mar. 8, 2011).

[1113] This estimate is derived from the 2010 edition of SIFMA's annual report on Management and Professional Earnings in the Securities Industry (hereinafter "SIFMA Report"). This figure reflects the median total annual compensation (including base salary and bonus) for a CCO in the securities industry. The Commission notes that this estimate only includes the cost of hiring a CCO. Although not required by statute or rule, SEFs may also choose to hire additional staff at additional cost in order to support the CCO.

[1114] Tradeweb Comment Letter at 12 (Mar. 8, 2011); WMBAA Comment Letter II at 7 (Mar. 8, 2011); MarketAxess Comment Letter at 26 (Mar. 8, 2011).

immediately appoint an interim CCO and permanent CCO as soon as reasonably practicable thereafter. The Commission notes that these revisions will provide the board of directors or senior officer of the SEF with a degree of flexibility to appoint, compensate, and remove the CCO in the manner that the SEF deems most appropriate.

Several commenters also stated that the proposed requirement that CCOs ensure "compliance with the Act and Commission regulations" is impracticable and overly burdensome, as one individual cannot ensure compliance of an entire organization.[1115] In response, the Commission is modifying § 37.1501(d)(4) to state that one of the CCO's duties shall include "taking reasonable steps to ensure compliance with the Act and Commission regulations." This modification should also reduce potential costs resulting from this rule without diminishing its benefits.

(2) Benefits

The rule ensures that each SEF has a central figure responsible for overseeing major areas of compliance with the CEA and Commission regulations. The annual compliance report will enable a SEF and the Commission to evaluate the effectiveness of the SEF's self-regulatory programs and compliance with core principles, and to take remedial actions and make recommendations to improve the SEF's self-regulatory programs in order to ensure that the SEF remains in compliance with the core principles.

(3) Consideration of Alternatives

With respect to the annual compliance report requirement in proposed § 37.1501(e), FXall stated that compiling the required information and preparing the report

[1115] Tradeweb Comment Letter at 6-7 (Jun. 3, 2011); WMBAA Comment Letter II at 5-6 (Mar. 8, 2011); MarketAxess Comment Letter at 26 (Mar. 8, 2011); Tradeweb Comment Letter at 12 (Mar. 8, 2011); CME Comment Letter at 4 (Feb. 7, 2011).

in a timely manner annually will consume considerable resources.[1116] FXall proposed an alternative report that would request fewer pieces of information.[1117] Similarly, CME stated that the Commission should specify key areas that should be discussed in the annual report, rather than requiring the report to describe in detail the registrant's compliance with respect to each of the numerous components of the CEA and Commission regulations.[1118]

After weighing the comments and alternative proposals from FXall and CME, the Commission has determined to adopt the rules as proposed, subject to certain revisions detailed in the preamble.[1119] The Commission declines to adopt commenters' proposed alternatives because without the detailed information required by statute in the annual compliance report (including a self-assessment of policies and procedures designed to ensure compliance with each core principle, a discussion of areas for improvement, and a description of the SEF's self-regulatory program's staffing, structure, and cataloguing of disciplinary actions), the Commission would not have access to the information it needs to ensure that each SEF is in compliance with the CEA and Commission regulations.

(4) Section 15(a) Factors (Chief Compliance Officer)

(i) Protection of Market Participants and the Public

The requirements that a CCO oversee the SEF's compliance with the Act and Commission regulations and supervise the SEF's self-regulatory program will ensure that the SEF monitors compliance with key provisions of the CEA designed to protect market

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[1116] FXall Comment Letter at 16 (Mar. 8, 2011).

[1117] Id. at 17.

[1118] CME Comment Letter at 7 (Feb. 7, 2011).

[1119] See discussion above under § 37.1501(e) – Annual Compliance Report Prepared by Chief Compliance Officer in the preamble.

participants and the public (including provisions governing trade practice and market surveillance, real-time market monitoring, and financial reporting). To the extent that the Commission's regulations impose more specific or supplemental requirements when compared to those requirements explicitly imposed by section 5h(f)(15) of the CEA, those incremental costs are not likely to be significant. While it is possible that those incremental costs will be passed along to market participants, the size of those costs is likely to be negligible.

The Commission believes the CCO rules will protect market participants and the public by promoting compliance with the core principles and Commission regulations through the designation and effective functioning of the CCO, and the establishment of a framework for preparation of a meaningful annual review of a SEF's compliance program. The annual compliance report will allow the SEF and the Commission to periodically assess, and evaluate where necessary, the SEF's ability to comply with the core principles. Upon review of the compliance report, the SEF and the Commission will be better able to determine whether the SEF has appropriate programs in place to protect market participants and the public from market abuses.

Maintaining records as required under § 37.1501 regarding a CCO's efforts toward ensuring that the SEF complies with core principles provides a check against what is reported in the annual compliance report. Access to these records will assist the Commission in its determination of whether a SEF's self-regulatory program complies with the core principles and the Commission's regulations. If the Commission determines the self-regulatory program is not sufficient, the Commission will be able to

use information required by the rule to take steps to remedy the shortcomings and to prevent disruptions that could harm market participants and the public.

(ii) Efficiency, Competitiveness, and Financial Integrity of the Markets

An effective CCO will implement measures that enhance the stability and efficiency of SEFs. Reliable and financially-sound SEFs are essential for the stability of the derivatives markets they serve. The CCO's oversight of self-regulatory programs and the annual compliance report will provide both the SEF and the Commission with an opportunity to assess the effectiveness of the SEF's self-regulatory programs and will help to detect and deter rule violations, increasing participation and competition in the markets.

Likewise, compliance reports will allow the Commission to review the effectiveness of and order changes to self-regulatory programs, thus enabling the market to function more efficiently while promoting confidence and attracting competition. A board that makes proactive changes to a SEF's self-regulatory programs based on the CCO's compliance report will build confidence in the market and increase competition.

(iii) Price Discovery

The Commission has not identified any effects that this rule will have on price discovery.

(iv) Sound Risk Management Policies

The CCO rules and the required annual compliance report will enhance a SEF's risk management policies by enhancing the standards for a SEF's compliance program. This in turn will emphasize risk management compliance because of its significance to the overall purpose and functioning of the SEF. Compliance with the SEF core principles

and related regulations encompasses, among other things, procedures for ensuring the financial integrity of swaps entered on or through the facilities of the SEF, including the clearance and settlement of swaps, determination of resource adequacy, and system safeguards to establish and maintain a program of risk analysis and oversight. It is the responsibility of the CCO to ensure that the SEF is compliant with the core principles and the regulations thereunder, and is otherwise engaged in appropriate risk management activities in accordance with the SEF's own rules, policies, and procedures.

(v) Other Public Interest Considerations

The Commission has not identified any effects that these rules will have on other public interest considerations other than those enumerated above.

6. Monitoring and Surveillance

Core Principle 2 requires, among other things, that each SEF establish and enforce trading, trade processing, and participation rules that will deter abuses, and have the capacity to detect, investigate, and enforce those rules, including means to provide market participants with impartial access to the market and to capture information that may be used in establishing whether rule violations have occurred. Additionally, Core Principle 4, in part, requires each SEF to monitor trading in swaps to prevent manipulation and price distortion through surveillance, including methods of conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.

(a) Monitoring of Trading

The rules that implement Core Principles 2 and 4 will require a SEF to, among other things: (1) maintain an automated trade surveillance system (§ 37.203(d)); (2) conduct real-time market monitoring of all trading activity on its platform and have the

authority to cancel trades and adjust trade prices when necessary (§ 37.203(e)); (3) maintain an acceptable audit trail program that enables the SEF to identify entities that are routinely non-compliant and to levy meaningful sanctions (§ 37.205);[1120] (4) monitor trading in real-time and accurately reconstruct trading activity in order to detect manipulation, price distortions, and other disruptions (§ 37.401); (5) and establish risk control mechanisms (including pauses and halts) to prevent and reduce the potential risk of market disruptions (§ 37.405).

(1) Costs

As discussed above, potential SEFs are likely to outsource these obligations to a regulatory service provider at significantly less cost than performing them in-house.[1121] Accordingly, the ongoing costs associated with these rules would already be included in the total annual cost of contracting with a regulatory service provider (plus the cost of overseeing the service provider's compliance).

Should a potential SEF that is a new entity choose to develop its own automated trade surveillance, real-time market monitoring, and audit trail systems, it is likely to incur the costs of developing and maintaining these systems, as well as the cost of hiring and maintaining adequate staff to administer them. The staff necessary to carry out a SEF's obligations under these rules would likely include analysts, investigators, and systems and/or IT specialists. However, existing entities may already receive the requisite data, and may also have some infrastructure in place to perform automated trade

[1120] The Commission received no comments discussing the specific costs or benefits of § 37.406, which requires SEFs to make audit trail data available to the Commission and is an explicit requirement of the statute.

[1121] The Commission notes, as described in the preamble, that a SEF that elects to use the services of a regulatory service provider must retain certain decision-making authority and cannot outsource this authority to the regulatory service provider. See, e.g., § 37.204(c) – Regulatory Decisions Required from the Swap Execution Facility in the preamble.

surveillance and real-time market monitoring. Accordingly, the incremental cost for existing entities would be limited to investing in enhancements to existing electronic systems to ensure that data is captured in compliance with the rules and that the systems themselves comply with the rules.[1122] The Commission notes that a SEF may use a unified monitoring system to jointly satisfy the requirements of § 37.401 (monitoring of trading and trade processing) and § 37.205 (audit trail).

Additionally, in response to comments that the standards set forth in the proposed requirements for real-time market monitoring are unreasonably high,[1123] the Commission is modifying the final rule to require a SEF to conduct real-time market monitoring designed to "identify" disorderly trading, instead of to "ensure" orderly trading. The Commission believes that requiring SEFs to identify disorderly trading when it occurs, rather than to ensure orderly trading at all times, will likely mitigate the overall burden of the rule. Furthermore, in response to CME's comment,[1124] the Commission is deleting the word "investigating" from proposed § 37.203(d), thus clarifying that a SEF's automated trade surveillance system will not be expected to conduct the actual investigation of potential trade practice violations. This deletion should further reduce costs for SEFs.

[1122] For example, SEFs are required to comply with a unified set of audit trail requirements for all methods of execution. The Commission notes that a SEF, for example, that utilizes the telephone as a means of interstate commerce in providing the execution methods in § 37.9(a)(2)(i)(A) or (B) may comply with certain of the audit trail requirements by recording all such communications that relate to or result in swap transactions. Such recordings must allow for reconstruction of all relevant communications between the SEF and its customers or involving SEF employees. While it is common industry practice to make and retain electronic time-stamped recordings of conversations, SEFs may incur costs to upgrade their recording systems to ensure that they comply with all of the audit trail requirements.

[1123] CME Comment Letter at 20 (Feb. 22, 2011).

[1124] Id. at 19-20.

Tradeweb and MarketAxess commented that annual audits for member and market participant compliance with the audit trail requirements pursuant to § 37.205(c)(1) are burdensome and unwarranted.[1125] In the Commission staff's follow-up conversation regarding costs, one commenter asserted that this requirement will cost SEFs at least $300,000 annually.

To mitigate the costs associated with this provision, the Commission is modifying the language in final § 37.205(c) so that it applies only to members and persons and firms subject to the SEF's recordkeeping rules, rather than to members and "market participants." With this change, the Commission limits the number of entities that a SEF must audit, which should reduce the cost noted above without any meaningful reduction in benefits because auditing those market participants subject to recordkeeping rules will ensure complete coverage of all activity pertinent to transactions on any given SEF.

Finally, SEFs may also incur the one-time cost of programming risk controls such as pauses and halts, as well as on-going costs to maintain and adjust such controls. For some SEFs, the costs of adding pause and halt functionality to swap contracts should be reduced since much of that technology is already commercially available and would not necessarily have to be developed in-house.[1126] As noted in the Pre-Trade Functionality Subcommittee of the CFTC Technology Advisory Committee report, the costs would largely be borne by the exchanges and would center around intellectual property, as many exchanges develop, own, and manage their own technology.[1127] However, the costs

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[1125] Tradeweb Comment Letter at 6 (Jun. 3, 2011); MarketAxess Comment Letter at 22 (Mar. 8, 2011).

[1126] In a separate Dodd-Frank rulemaking, DCMs are now required to have the same types of risk controls. See Core Principles and Other Requirements for Designated Contract Markets, 77 FR 36612 (Jun. 19, 2012).

[1127] See "Recommendations on Pre-Trade Practices for Trading Firms, Clearing Firms and Exchanges involved in Direct Market Access," Pre-Trade Functionality Subcommittee of the CFTC Technology

associated with implementing risk controls were not described in detail in the Pre-Trade Functionality Subcommittee report and will likely vary greatly from one SEF to another depending on the type of risk controls that will be implemented and the nature of the SEF's trading platform. The Commission received no comments stating that risk controls cannot be implemented in a cost-effective manner using commercially available technology. As further noted in the Pre-Trade Functionality Subcommittee report, "[s]ome measure of standardization of pre-trade risk controls at the exchange level is the cheapest, most effective and most robust path to addressing the Commission's concern [for preserving market integrity]."[1128]

The Commission notes that while it is requiring pauses and halts in the rule, it is also enumerating in guidance other types of automated risk controls that may be implemented by SEFs in order to give SEFs greater discretion to select among the enumerated risk controls or to create new risk controls. The Commission believes that this combination of rules and guidance will facilitate orderly markets while maintaining a flexible environment that facilitates cost-effective innovation and development.

(2) Benefits

The automated trade surveillance system, real-time monitoring, audit-trail, and trade reconstruction requirements will promote orderly trading and will ensure that SEFs have the capability to promptly identify and correct market or system anomalies that could harm market participants and the public. These tools will improve SEF compliance

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Advisory Committee ("TAC Subcommittee Recommendations"), at 4 (Mar. 1, 2011), available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/tacpresentation030111_ptfs2.pdf . The Commission notes that the subcommittee report was submitted to the Technology Advisory Committee and made available for public comment, but no final action has been taken by the full committee.

[1128] See TAC Subcommittee Recommendations at 4 (Mar. 1, 2011).

staff's ability to record, recover, sort, and query voluminous amounts of data in order to better detect potential rule violations and abusive trading practices that harm market participants and market integrity. By having the tools and data to identify these potential rule violations, a SEF can quickly respond, mitigating their effects and helping to prevent them from generating systemic risk or other severe problems. SEFs will also have the tools and information needed to prosecute rule violations supported by evidence from audit trail data and order and trade information. These tools will not only allow SEFs to more effectively respond to rule violations and trading abuses, but will also deter market participants from engaging in such conduct in the first place since market participants will be aware that rule violations are likely to be detected.

While the provisions described above will increase the likelihood that SEFs will promptly identify market or system anomalies, SEFs must also have systems in place to respond to such anomalies after they occur. Risk controls such as automated trading pauses and halts can, among other things, allow time for market participants to analyze the market impact of new information that may have caused a sudden market move, allow new orders to come into a market that has moved dramatically, and allow traders to assess and secure their capital needs in the face of potential margin calls. Pauses and halts are intended to apply in the event of extraordinary price movements that may trigger or propagate systemic disruptions. Accordingly, a SEF's ability to pause or halt trading in certain circumstances and, importantly, to re-start trading through the appropriate re-opening procedures, will allow SEFs to mitigate the propagation of shocks that are of a systemic nature.

(3) Consideration of Alternatives

While commenters requested additional flexibility to determine the risk controls that should be implemented within their market,[1129] the Commission views pauses and halts as effective risk management tools that must be implemented to facilitate orderly markets. Moreover, in recognition that such risk controls should be adapted to the unique characteristics of the markets to which they apply, and that any controls should consider the balance between avoiding a market disruption while facilitating a market's price discovery function, the Commission enumerated the other types of risk controls in guidance. Accordingly, a SEF will have discretion to select and create risk controls to meet the unique characteristics of its market and cost structure.

Finally, in response to concerns about a lack of flexibility in the proposed requirement to coordinate risk controls among other markets or exchanges,[1130] the Commission is moving the language in proposed § 37.405 to guidance.[1131] The combination of rules and guidance pertaining to risk controls will ensure that, at a minimum, SEFs implement pauses and halts, while also granting SEFs the discretion to coordinate and adopt additional risk controls in a manner they find most cost effective and appropriate for their markets.

(4) Section 15(a) Factors (Monitoring of Trading)

(i) Protection of Market Participants and the Public

[1129] See, e.g., ICE Comment Letter at 5 (Mar. 8, 2011); Tradeweb Comment Letter at 11 (Mar. 8, 2011); CME Comment Letter at 27 (Feb. 22, 2011).

[1130] CME Comment Letter at 26 (Feb. 22, 2011).

[1131] The guidance provides that a SEF with a swap that is linked to, or a substitute for, other products, either on its market or on other trading venues, must, to the extent practicable, coordinate its risk controls with any similar controls placed on those other products. If a SEF's swap is based on the level of an equity index, such risk controls must, to the extent practicable, be coordinated with any similar controls placed on national security exchanges. See guidance to Core Principle 4 in appendix B to part 37.

These rules will help ensure fair and equitable markets that are protected from abusive trading practices or manipulative conditions, and will ensure that rule violations and market disruptions that could harm market participants and the public may be prevented or detected, reconstructed, investigated, and prosecuted. The absence of these regulations would result in an increased potential for violations to go undetected and for market disruptions to create distorted prices or systemic risks that could harm the economy and the public. These requirements will strengthen SEFs' oversight of their trading platforms, increase the likelihood of early detection and prompt responses to rule violations and market disruptions, and result in stronger protection of market participants and the general public from rule violations, trading abuses, and other market disruptions that could harm market participants and, directly or indirectly, the public and the economy as a whole.

(ii) Efficiency, Competitiveness, and Financial Integrity of the Markets

These rules ensure that violations and market anomalies are detected and promptly addressed and do not generate systemic risk or other problems that could interfere with efficient and competitive markets. The requirements also help ensure that market prices are not distorted by prohibited activities. The rules strengthen market confidence and enable the market to operate more efficiently by deterring rule violations and by establishing conditions under which trading will be paused or halted, thereby promoting efficient pricing and competitive trading.

(iii) Price Discovery

Requiring SEFs to conduct effective monitoring and surveillance of their markets and to have the capacity to detect rule violations will help ensure that legitimate trades

and fundamental supply and demand information are accurately reflected in market prices. The mitigation of rule violations, which detract from the price discovery process in SEF markets, will promote confidence in the prices market participants use to hedge risk and provide confidence in the price discovery process.

(iv) Sound Risk Management Practices

The rules are designed to allow SEFs to better deter, detect, and address operational risks posed by trading practices or trading activities. To the extent they deter overly risky actions by market participants, the rules will lower potential losses and costs to SEFs and market participants and promote sound risk management practices.

(v) Other Public Interest Considerations

The Commission has not identified any effects that these rules will have on other public interest considerations other than those enumerated above.

(b) Monitoring of Contracts

The Commission is adopting rules that will require a SEF to: (1) submit new swap contracts to the Commission in advance of listing and trading and demonstrate that the contracts are not readily susceptible to manipulation (§ 37.301);[1132] (2) monitor physical delivery swaps' terms and conditions and availability of the deliverable commodity (§ 37.402); (3) monitor the reference price of cash-settled swaps used to determine cash flow or settlement, the continued appropriateness of the methodology for the reference price for SEFs that derive that price, and the continued appropriateness of the third-party index or instrument for reference prices that rely on such index or instrument (§ 37.403);

[1132] SEFs must make this demonstration by providing the information set forth in appendix C to part 38. See Core Principles and Other Requirements for Designated Contract Markets, 77 FR at 36722.

and (4) adopt position limitation or position accountability in accordance with Commission regulations (§ 37.601).[1133]

(1) Swaps Not Readily Susceptible to Manipulation

(i) Costs

Compliance with these regulations will impose costs equally on startups and entities with existing trading platforms seeking SEF registration because all SEFs must monitor their contracts in accordance with the rules on an ongoing basis. However, SEFs have incentives to review their contracts to ensure they are not susceptible to manipulation even in the absence of the core principle or these rules. For example, SEFs have a business need to develop products that provide market participants with reliable instruments that can be used for hedging and risk management. In order to do so, new and existing entities will need staff to research the underlying markets (at times using data from private sources) and to certify that the contract rules comply with Core Principle 3. SEFs likely will already have staff to ensure compliance with the applicable core principles and should plan on legal staff devoting approximately four hours per contract at a cost of approximately $400 to review a swap's compliance with Core Principle 3 as part of a sound business practice. The scale of these costs largely depends on how novel or complex a contract is, how many contracts the SEF plans to list at any given time, and whether listed swaps are similar to each other.

The Commission notes that this guidance will likely reduce the time and costs that regulated markets will incur in providing the appropriate information and will likely

[1133] Core Principle 6 requires that SEFs, for each contract and as necessary and appropriate, adopt position limitation or position accountability, and that, for any contract that is subject to a position limitation established by the Commission pursuant to CEA section 4a(a), SEFs must set the position limit at a level not higher than the position limitation established by the Commission. See Position Limits for Derivatives, 76 FR 4752 (proposed Jan. 26, 2011).

reduce the amount of time it takes the Commission staff to analyze whether a new product or rule amendment is in compliance with the CEA.

(ii) Benefits

When SEFs list contracts that are not readily susceptible to manipulation, they contribute to the integrity and stability of the marketplace by giving traders confidence that the prices associated with swaps reflect the true supply of and demand for the underlying commodities or financial instruments. Section 37.301, which implements the Core Principle 3 requirement that SEFs permit trading only in swaps that are not readily susceptible to manipulation, will promote an environment where swap prices are less likely to be subject to distortion and extreme volatility, allowing market participants to buy and sell physical and financial products at fair prices and to hedge price risk appropriately.

The guidance outlined in appendix C to part 38 provides a reference for existing and new regulated markets for information that should be provided to the Commission for new products and rule amendments based on best practices developed over the past three decades by the Commission and other regulators. This guidance will likely reduce the time and costs that regulated markets will incur in providing the appropriate information and should mitigate the need for extensive follow-up discussions with the Commission. The guidance also reduces the amount of time it takes the Commission staff to analyze whether a new product or rule amendment is in compliance with the CEA.

(2) Monitoring of Physical-Delivery Swaps

(i) Costs

While the Commission did not receive comments discussing the costs of this provision, the Commission is revising the requirement in proposed § 37.402(a)(2)[1134] so that SEFs only have to monitor the availability of the commodity supply, instead of monitoring whether the supply is adequate. This reduced monitoring obligation should lower ongoing costs for SEFs since they will not have to make determinations regarding adequacy of deliverable supply as frequently as under the proposed rule, while achieving comparable benefit for market participants and the public. Costs will be further reduced by the Commission's decision to remove from proposed § 37.402 the requirements that SEFs monitor specific details of the supply, marketing, and ownership of the commodity to be physically delivered. Instead, final appendix B to part 37 lists guidance for monitoring conditions that may cause a physical-delivery swap to become susceptible to price manipulation or distortion. Listing these details in guidance will provide SEFs with flexibility in meeting their monitoring obligations associated with physical-delivery swaps, which will likely further mitigate any burden associated with compliance. The Commission notes that a SEF may contract with a regulatory service provider to perform these duties at potentially a lower cost.

(ii) Benefits

Section 37.402 requires that SEFs monitor physical-delivery swaps' terms and conditions as they relate to the underlying commodity market and monitor the availability of the supply of the commodity specified by the delivery requirements of the swap. Such monitoring will allow SEFs to take appropriate steps to relieve the potential for market congestion or manipulation in situations where participants' ability to make good on their

[1134] Proposed § 37.402(a)(2) is now final § 37.402(b).

delivery obligations is threatened due to supply shortages, disruptions or shortages of transportation, or disruptions due to weather or labor strikes. Any interference with the physical-delivery process will likely lead to disruptions in fair and orderly trading and participants' ability to properly manage commercial risk. Moreover, close monitoring of physical-delivery contracts helps prevent the manipulation of prices, and the public benefits from prices that reflect actual market conditions.

(3) Monitoring of Cash-Settled Swaps

(i) Costs

Argus commented that monitoring of trading in underlying price indexes will be costly, and that if SEFs are required to monitor the availability and pricing of the commodity that forms the basis of a price index (particularly where an index price is published based upon transactions that are executed off the DCM or SEF), the SEF may choose not to list the contract and thus traders will lose a hedging instrument.[1135]

In response to this comment, the Commission is amending the requirement in proposed § 37.403(a)(1) that a SEF monitor the availability and pricing of the commodity making up the index to which the swap will be settled, to only require the SEF to monitor the pricing. The Commission is also moving the other requirements for monitoring and obtaining information on traders' activities in proposed § 37.403(a) and (b) to guidance. The combination of rules and guidance implementing Core Principle 4 will help ensure that the cash settlement process is not susceptible to manipulation by providing rules and guidance on how to meet the requirements of the core principle, while providing SEFs

[1135] Argus Comment Letter at 6-7 (Feb. 22, 2011).

with the flexibility to adopt the most appropriate method of compliance in light of the nature of their contracts and market structure.

As discussed above, the Commission notes that compliance with these provisions can likely be outsourced to a regulatory service provider at lower cost, and that on-going monitoring of pricing could be handled by the regulatory service provider.

(ii) Benefits

The § 37.403 requirement that a SEF monitor cash-settled swaps as they relate to the reference price, instrument, or index to which the swap is settled will reduce the potential for market disruptions or manipulations and ensure that they are discovered and promptly addressed. The interconnected nature of swap and underlying cash markets may create incentives for traders to disrupt or manipulate prices in the cash market in order to influence the prices in the swap market (potentially to benefit the trader's position in the swap). Detecting and preventing this sort of manipulation requires information on traders' activities in the cash-settled contract and in, or related to, the underlying instrument or index to which it is settled. This rule ensures that SEFs have the information and tools they need to accomplish their statutory duty to prevent manipulation and disruptions to the cash-settlement process.

(4) Section 15(a) Factors (Monitoring of Contracts)

(i) Protection of Market Participants and the Public

The demonstration required by § 37.301 and the monitoring requirements in §§ 37.402 and 37.403 allow for a timely review by the Commission staff of the SEF's supporting analysis and data to determine whether a contract is not readily susceptible to manipulation, and to ensure that SEFs are able to adequately collect information on

market activity, including special considerations for physical-delivery contracts and cash-settled contracts. As a group, these rules protect market participants by helping to prevent price manipulation and protect the public by creating an environment that fosters prices that reflect actual market conditions.

(ii) Efficiency, Competitiveness, and Financial Integrity of the Markets

By providing guidance based on best practices regarding what a SEF should consider when developing a swap or amending the terms and conditions of an existing swap, the contracts listed by SEFs, as a whole, should be more reflective of the underlying cash market, thus providing for efficient hedging of commercial risk. Sections 37.402 and 37.403 protect against disruptions and market manipulation, promote competition, and promote the efficiency and financial integrity of transactions in SEF markets because market mispricing that is due to disruptions or manipulation interferes with a market's efficiency by limiting its ability to reflect the value of the underlying product. Markets that are prone to disruption or manipulation have a severe competitive disadvantage to those without such problems. These rules are designed to address and mitigate such problems for swap transactions.

(iii) Price Discovery

Manipulation or other market disruptions interfere with the price discovery process by artificially distorting prices and preventing those prices from properly reflecting the fundamental forces of supply and demand. These rules are designed to detect and, where possible, prevent such market mispricing, and to detect disconnects between swaps and their related market prices (e.g., between cash market prices and the prices of related futures and swaps).

(iv) Sound Risk Management Practices

By following the best practices outlined in the guidance in appendix C to part 38 and the requirements of §§ 37.402 and 37.403, a SEF should minimize the susceptibility of a swap to manipulation or price distortion at the time it is developing the contract's terms and conditions. By performing this work early-on, a SEF should minimize risks to its clearing house and to market participants. Sound risk management practices rely upon execution of hedge strategies at market prices that are free of manipulation or other disruptions. These rules are designed to facilitate hedging at prices free of distortions that may be preventable by adequate controls.

(v) Other Public Interest Considerations

The Commission has not identified any effects that these rules will have on other public interest considerations other than those enumerated above.

7. Financial Resources and Integrity

(a) Background

Section 37.1301 codifies the Core Principle 13 requirement that a SEF must maintain sufficient financial resources to cover operating costs for at least one year, calculated on a rolling basis. The rules implementing Core Principle 13 also clarify the types of financial resources available to SEFs to satisfy the financial resources requirements (§ 37.1302) and require that each SEF, no less frequently than each fiscal quarter, calculate the financial resources it needs to meet the financial resource requirements, as well as the current market value of each financial resource (§§ 37.1303, 37.1304). The rules also require SEFs to maintain unencumbered liquid financial assets, such as cash or highly liquid securities, equal to at least six months' operating costs, or a

committed line of credit or similar facility (§ 37.1305), and to report certain information regarding their financial resources to the Commission quarterly or upon request (§ 37.1306).

Sections 37.701, 37.702, and 37.703 implement Core Principle 7 regarding the financial integrity of transactions. Section 37.701 requires transactions executed on or through a SEF that are mandatorily or voluntarily cleared to be cleared through a Commission-registered DCO, or a DCO that the Commission has determined is exempt from registration. Section 37.702 requires a SEF to establish minimum financial standards for its members, which at a minimum, requires that members qualify as ECPs. Section 37.703 requires a SEF to monitor its members to ensure that they continue to qualify as ECPs.

(b) Costs

ISDA estimated that it would cost each SEF $1.4 million per year to comply with the financial resource requirement.[1136] The Commission notes that the requirement that a SEF maintain sufficient financial resources to cover its operating expenses for one year appears in the statute itself, and that the Commission does not have the discretion to lower the financial resource requirement. Accordingly, § 37.1301 imposes no additional costs on SEFs or market participants beyond those imposed by statute.

With respect to the reporting requirements in § 37.1306, MarketAxess stated that the proposed requirements are unnecessary and burdensome.[1137] The Commission expects that most, if not all, SEFs would calculate and prepare financial statements

[1136] ISDA Discussion Paper at 32 (Nov. 2011). The Commission notes that the components of this cost estimate are unclear.

[1137] MarketAxess Comment Letter at 40 (Mar. 8, 2011).

regularly. Accordingly, the Commission does not believe that requiring SEFs to meet the quarterly reporting requirements imposes a significant burden on SEFs. Extrapolation from the prepared financial statements should be relatively straightforward, but will require staff and technology resources to calculate, monitor, and report financial resources. In follow-up conversations with the Commission staff, one commenter indicated that the reporting requirements would costs SEFs about $100,000 per year. Given the staffing and operational differences among SEFs, this cost will vary, perhaps significantly.

(c) Benefits

The financial resources provisions ensure the financial stability of SEFs, which promotes the integrity of the markets and confidence of market participants trading on SEFs. The requirement that SEFs maintain six months' worth of unencumbered liquid financial assets (i.e., cash and/or highly liquid securities) will also promote market integrity by ensuring that SEFs will have sufficient financial resources to continue to operate and wind-down in an orderly fashion, if necessary. In addition, the reporting requirements will ensure that the Commission can monitor the SEF's compliance with Core Principle 13.

Sections 37.702 and 37.703 promote financial integrity by requiring SEFs to establish minimum financial standards for its members and to ensure that they continue to qualify as ECPs.

(d) Consideration of Alternatives

Phoenix recommended only requiring SEFs to maintain financial resources necessary to operate for six months.[1138] As described above, the statute mandates that a SEF maintain sufficient financial resources to cover its operating expenses for one year. Accordingly, the Commission does not have the discretion to consider alternative financial resource requirements.

CME and Phoenix proposed an alternative liquidity requirement, arguing that a wind-down typically takes three months and that the proposed requirement of six months of liquid assets should be reduced accordingly.[1139] The Commission believes that three months' worth of liquid financial assets is an insufficient buffer to protect against events which may threaten a SEF's viability, and believes that six months of liquid assets will provide enough time for a SEF to liquidate its other assets so that it may have adequate resources to operate for up to one year, as required by the statute.

CME stated that it would not be feasible for SEFs to comply with the proposed 17-business-day filing deadline for submission of the financial resources report and recommended an alternative reporting deadline of 40 calendar days after the end of each fiscal quarter and 60 calendar days after the end of each fiscal year.[1140]

The Commission is adopting the alternative recommended by CME and is extending the proposed 17-business-day filing deadline to 40 calendar days for the first three quarters. The Commission's adoption of this alternative will mitigate the costs of preparing and submitting these reports as the new extended timeline will harmonize the

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[1138] Phoenix Comment Letter at 4-5 (Mar. 7, 2011).

[1139] CME Comment Letter at 37 (Feb. 22, 2011); Phoenix Comment Letter at 4-5 (Mar. 7, 2011). SDMA, however, recommended that the Commission require that SEFs have at least 12 months of unencumbered capital. SDMA Comment Letter at 12 (Mar. 8, 2011).

[1140] CME Comment Letter at 38 (Feb. 22, 2011).

Commission's regulations with the SEC's timelines for submission of Form 10-Q. Similarly, the Commission has extended the filing deadline to 60 days for the fourth quarter report to harmonize the Commission's deadline with the SEC's deadline for Form 10-K.

With respect to proposed § 37.703, FXall stated that SEFs would be burdened by the "onerous financial surveillance obligations" and recommended that a SEF, like a DCM, be able to delegate its financial surveillance functions to the NFA Joint Audit Committee.[1141] ABC/CIEBA stated that the rule would create significant barriers to entry, stifle competition, and lead to higher prices.[1142] In response to these comments, the Commission has revised § 37.703 to remove a SEF's financial surveillance obligations and to only require that a SEF monitor its members to ensure that they continue to qualify as ECPs. This amendment obviates the need to delegate any financial surveillance functions and minimizes the costs imposed by the rule. As a SEF may rely on representations from its members that they continue to qualify as ECPs, the costs of the rule should be de minimis and administrative in nature.

(e) Section 15(a) Factors

(1) Protection of Market Participants and the Public

The financial resources rules will protect market participants and the public by establishing uniform standards and a system of Commission oversight that ensures that trading occurs on a financially stable facility, which in turn, will mitigate the risk of market disruptions, financial losses, and systemic problems that could arise from a SEF's failure to maintain adequate financial resources. These requirements will enable a SEF to

[1141] FXall Comment Letter at 13 (Mar. 8, 2011).

[1142] ABC/CIEBA Comment Letter at 11 (Mar. 8, 2011).

fulfill its responsibilities of ensuring that trading occurs on a liquid, fair, and financially secure platform by maintaining appropriate minimum financial resources on hand and on an ongoing basis to sustain operations for a reasonable period of time. Additionally, in the event that a SEF does have to wind down its operations, SEFs that have sufficient amounts of liquid financial resources will be better positioned to close out trading in a manner not disruptive to market participants or to members of the public who rely on SEF prices or who are customers or shareholders of market participants.

(2) Efficiency, Competitiveness, and Financial Integrity of the Markets

The financial resources rules promote the financial integrity of the markets by requiring SEFs to have adequate operating resources (i.e., operating resources sufficient to fund both current operations and ensure operations for a sufficient length of time in the future), and preventing those SEFs that lack these resources from expanding in ways that may ultimately harm the broader financial market (i.e., confining the operations of SEFs to levels their financial resources can support).

Sections 37.702 and 37.703 will promote financial integrity by ensuring that SEFs establish minimum financial standards for their members and monitor those members to ensure that they continue to qualify as ECPs.

(3) Price Discovery

The Commission has not identified any effects that these rules will have on price discovery.

(4) Sound Risk Management Practices

By setting specific standards with respect to how SEFs should assess and monitor the adequacy of their financial resources, the financial resources rules promote sound risk management practices by SEFs and further the goal of minimizing systemic risk.

Sections 37.702 and 37.703 will promote sound risk management practices by ensuring that SEF members have the financial resources necessary for proper management of the risk associated with their swap positions. These rules will also further the goal of minimizing systemic risk.

(5) Other Public Interest Considerations

The Commission has not identified any effects that these rules will have on other public interest considerations other than those enumerated above.

8. Emergency Operations and System Safeguards

(a) Background

The Commission's guidance for Core Principle 8 addresses procedures for handling emergency situations. Specifically, the guidance referenced in § 37.801 provides that a SEF can comply with Core Principle 8 by having rules that allow it to intervene as necessary to maintain markets with fair and orderly trading and to prevent or address manipulation or disruptive trading practices by, among other things, imposing or modifying position limits, intraday market restrictions, or special margin requirements.

Section 37.1401 codifies Core Principle 14 by requiring a SEF to establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk (§ 37.1401(a)) and to maintain a business continuity-disaster recovery ("BC DR") plan and resources, emergency procedures, and backup facilities sufficient to enable timely recovery and resumption of its operations (§ 37.1401(b)). Under §§

37.1401(d)-(e), a SEF must notify the Commission promptly of certain significant systems malfunctions, including the activation of the SEF's BC-DR plan, and must provide advance notice of any material planned changes to automated systems or risk analysis and oversight programs.

(b) Costs

ISDA estimated that SEFs will spend an average of $1,116,000 initially and $866,000 annually on disaster recovery procedures covered by the regulations implementing Core Principle 14.[1143] The Commission recognizes that the costs of establishing and maintaining backup facilities could be substantial if the applicant does not already have these facilities in place to support another business area. The Commission also notes that the requirement that a SEF establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery appears in the statute and is not the product of Commission discretion.

CME commented that the requirement under proposed § 37.1401(g) that SEFs provide the Commission with timely advance notice of all planned changes to automated systems that may impact the reliability of such systems is burdensome and not cost-effective.[1144] In response to this comment, the Commission is reducing the burden and cost associated with the proposed rule by requiring a SEF to promptly advise the Commission only of all "significant" system malfunctions, and to provide timely advance notification of only "material" changes to automated systems or risk analysis and oversight programs (the proposed rule required notice of all system malfunctions and all changes to programs of risk analysis and oversight).

[1143] ISDA Discussion Paper at 32 (Nov. 2011).

[1144] CME Comment Letter at 36-37 (Feb. 22, 2011).

While no comments addressed the subject directly, the Commission is also moving several proposed provisions to guidance.[1145] The Commission believes that the combination of rules and guidance governing a SEF's emergency operations will provide SEFs with sufficient flexibility to develop optimal emergency systems and procedures, while ensuring that SEFs will also take specific measures to maintain markets with fair and orderly trading.

(c) Benefits

The guidance in appendix B to Core Principle 8 governing emergency operations ensures that SEFs have flexible authority to take prompt, decisive action to restore orderly trading and respond to market behavior that could cause significant financial losses and widespread systemic failures that could harm market participants and the public.

In addition, the rules implementing Core Principle 14 reflect generally accepted standards and best practices with respect to the development, operation, reliability, security, and capacity of automated systems, which will reduce the frequency and severity of automated system security breaches or functional failures, thereby augmenting efforts to mitigate systemic risk and ensure market continuity in the event of system failures. Ensuring the resilience of the automated systems of a SEF and the ability of a SEF to recover and resume trading promptly in the event of a disruption of its operations

[1145] The Commission is moving the following provisions to guidance: (1) proposed § 37.1401(c) suggesting that a SEF follow generally accepted standards and best practices in addressing the categories of its risk analysis and oversight program; (2) the portion of proposed § 37.1401(d) discussing the SEFs obligation to resume the trading and clearing of swaps on the next business day following a disruption; (3) the portion of proposed § 37.1401(i) suggesting that a SEF's testing of its automated systems and business continuity-disaster recovery capabilities be conducted by qualified, independent professionals; (4) proposed § 37.1401(j) discussing a SEF's coordination of its business continuity-disaster recovery plan with those of others.

will be crucial to the robust and transparent systemic risk management framework established by the Dodd-Frank Act.

Based on the Commission's experience, these requirements reflect best practices in the futures markets, where DCM compliance with generally accepted standards and best practices with respect to the development, operation, reliability, security, and capacity of automated systems can reduce the frequency and severity of automated system security breaches or functional failures, thereby augmenting efforts to mitigate systemic risk. These practices will be well-served in the swaps markets as well.

Finally, notice to the Commission concerning systems malfunctions, security incidents, or any events leading to the activation of a SEF's BC-DR plan will assist the Commission's oversight and its ability to assess systemic risk levels and intervene when needed to protect market participants and the public.

(d) Consideration of Alternatives

CME stated that the regulations pursuant to Core Principle 8 should clarify that a SEF has flexibility and independence to address market emergencies.[1146] As discussed in further detail in the preamble, the Commission did not issue rules for compliance with Core Principle 8. However, the Commission clarified its guidance to the core principle and is adopting this cost-mitigating alternative by revising the guidance to make clear that SEFs retain the authority to respond independently to emergencies in an effective and timely manner consistent with the nature of the emergency. Accordingly, a SEF will have flexibility to address market emergencies using the methods that it deems to be most

[1146] CME Comment Letter at 28 (Feb. 22, 2011).

appropriate, provided that its actions are taken in good faith and the Commission is notified of such actions in a certified rule submission.

(e) Section 15(a) Factors

(1) Protection of Market Participants and the Public

The rules and guidance outlining emergency procedures pursuant to Core Principles 8 and 14 protect market participants and the public through both discretionary actions taken by a SEF's management as well as through automated risk analysis systems that trigger specific responses. Because automated systems play a central and critical role in today's electronic financial market environment, oversight of core principle compliance by SEFs with respect to automated systems is an essential part of effective oversight of both futures and swaps markets.

Emergency rules and procedures provide SEFs with the authority and an established process by which to intervene in markets during times of crisis so that trading can continue in an orderly manner to the extent possible and so that potential harm to market participants and the public can be avoided.

Timely reporting to the Commission of significant system malfunctions, material planned changes to automated systems, and material planned changes to programs of risk analysis and oversight is necessary for the Commission to fulfill its responsibility to oversee the swaps markets. Timely reporting will also augment the Commission's efforts to monitor systemic risk (which protects the public), and ultimately further the protection of market participants and, indirectly, the public by ensuring that automated systems are available, reliable, secure, have adequate scalable capacity, and are effectively overseen.

(2) Efficiency, Competitiveness, and Financial Integrity of the Markets

A SEF that has policies and procedures in place addressing its emergency authority will be better positioned to promptly intervene in markets to respond to or eliminate conditions that may deter participation and detract from overall market confidence, which could lead to diminished market efficiency, competitiveness, and perceptions of financial integrity. Sophisticated computer systems capable of automatically predicting operational risks will enhance the efficiency and financial integrity of the markets by ensuring that in emergency situations, trading remains uninterrupted and transactional data and positions are not lost. Active and periodic testing of emergency systems and procedures promotes confidence in the markets, encouraging liquidity and stability.

Safeguarding the reliability, security, and capacity of a SEF's computer systems is also essential to the mitigation of system risk for the financial system as a whole. The global OTC market is estimated to have in excess of $600 trillion in outstanding contracts.[1147] The ability of SEFs to recover and resume trading promptly in the event of a disruption in their operations is important to the U.S. economy. Notice to the Commission concerning systems malfunctions, systems security incidents, or events leading to the activation of a SEF's BC-DR plan will assist the Commission's oversight and its ability to assess systemic risk levels. It would present unacceptable risks to the U.S. financial system if swaps markets that comprise critical components of the world financial system were to become unavailable for an extended period of time.

(3) Price Discovery

[1147] See Statistical release: OTC derivatives statistics at end-December 2011, The Bank for International Settlements (May 2012), available at http://www.bis.org/publ/otc_hy1205.htm.

Any interruption in trading in a swap on a SEF can distort the price discovery process on other related swaps.[1148] The Commission views the emergency operations rules adopted herein as likely to facilitate the price discovery process by mitigating the risk of operational market interruptions from disjoining the forces of supply and demand. The presence of emergency authority procedures signals to the market that a SEF is a financially sound place to trade, thus attracting greater liquidity which leads to more accurate price discovery.

(4) Sound Risk Management Practices

Participants who use SEF-traded swaps to manage commercial price risks should benefit from markets that behave in an orderly and controlled fashion in the face of emergency situations. If prices move in an uncontrolled fashion due to a market emergency, those who are managing risk may be forced to exit the market as a result of unwarranted margin calls or the deterioration of their capital. Those who want to enter the market to manage risk may be able to do so only at prices that do not reflect the actual supply and demand fundamentals, but have moved due to an uncontrolled emergency situation.

Reliably functioning computer systems and networks are crucial to comprehensive risk management, and prompt notice to the Commission concerning systems malfunctions, systems security incidents, or any events leading to the activation of a SEF's BC-DR plan will assist the Commission in its oversight role and bolster its ability to assess systemic risk levels. Adequate system safeguards and timely notice to the Commission regarding the status of those safeguards are crucial to mitigation of

[1148] For example, one swap may base its prices on the prices of one or more other swaps traded on other SEFs.

potential systemic risks. Should an emergency render a SEF temporarily inoperable, market participants will continue to be able to mitigate their risk through open positions transferred from the inoperable SEF to a functioning one with little to no gap in exposure. In the event of a longer period of down-time, market participants could establish functionally equivalent open positions to mimic the intended result of the swap.

(5) Other Public Interest Considerations

The Commission has not identified any effects that these rules will have on other public interest considerations other than those enumerated above.

IV. List of Commenters

1. Alice Corporation ("Alice")
2. Allston Holdings LLC, on behalf of certain trading firms ("Allston et al.")
3. Alternative Investment Management Association ("AIMA")
4. American Benefits Council/Committee on the Investment of Employee Benefit Assets ("ABC/CIEBA")
5. Americans for Financial Reform ("AFR")
6. Argus Media ("Argus")
7. Asset Management Group, Securities Industry and Financial Markets Association ("SIFMA AMG")
8. Association of Institutional Investors ("AII")
9. Better Markets
10. Barclays
11. BlackRock
12. Bloomberg
13. CanDeal.ca Inc. ("CanDeal")
14. CBOE Futures Exchange ("CBOE")
15. Chris Barnard
16. CME Group ("CME")
17. Coalition for Derivatives End-Users ("Coalition")
18. Commissioner Jill Sommers ("Commissioner Sommers")
19. David Neal
20. Depository Trust & Clearing Corporation ("DTCC")
21. Deutsche Bank ("Deutsche")
22. Eaton Vance Management ("Eaton Vance")
23. Edward Rosen, on behalf of certain dealers ("Rosen et al.")
24. Edward Rosen, on behalf of certain trade associations ("Rosen et al. II")
25. Eris Exchange ("Eris")
26. Evolution Markets ("Evolution")

27. Farm Credit Council (“FCC”)
28. Federal Home Loan Banks (“FHLB”)
29. Financial Services Roundtable (“FSR”)
30. Freddie Mac
31. FX Alliance (“FXall”)
32. Geneva Energy Markets, LLC (“Geneva”)
33. GFI Group (“GFI”)
34. Global FX Division AFME, SIFMA and ASIFMA (“Global FX”)
35. Goldman, Sachs & Co. (“Goldman”)
36. ICAP
37. Industrial Energy Consumers of America (“IECA”)
38. Intercontinental Exchange (“ICE”)
39. International Swaps and Derivatives Association (“ISDA”)
40. Joanna Mallers, on behalf of certain trading firms (“Mallers et al.”)
41. Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues
42. JP Morgan
43. LCH.Clearnet Group Limited (“LCH”)
44. Managed Funds Association (“MFA”)
45. MarketAxess Holdings (“MarketAxess”)
46. Markit
47. MarkitSERV
48. MetLife
49. Morgan Stanley
50. National Futures Association (“NFA”)
51. Natural Gas Supply Association (“NGSA”)
52. Nodal Exchange (“Nodal”)
53. NYSE Liffe U.S. (“NYSE Liffe”)
54. Parity Energy
55. Phoenix Partners Group (“Phoenix”)
56. Representative Scott Garrett
57. Representatives Scott Garrett, Gregory Meeks, Robert Hurt, and Gwen Moore (“Representative Garrett et al.”)
58. State Street Corporation (“State Street”)
59. Swap Execution Facilities Hearing Statements
60. Swaps & Derivatives Market Association (“SDMA”)
61. Thomson Reuters (“Reuters”)
62. Traccr Limited
63. Tradeweb Markets (“Tradeweb”)
64. TriOptima
65. TruMarx Data Partners (“TruMarx”)
66. UBS Securities LLC (“UBS”)
67. Wholesale Markets Brokers' Association, Americas (“WMBAA”)
68. Working Group of Commercial Energy Firms (“Energy Working Group”)

List of Subjects in 17 CFR Part 37

Swaps, Swap execution facilities, Registration application, Registered entities, Reporting and recordkeeping requirements.

For the reasons discussed in the preamble, the Commission amends 17 CFR part 37 as follows:

Revise part 37 to read as follows:

PART 37--SWAP EXECUTION FACILITIES

Subpart A – General Provisions

Sec.
37.1 Scope.
37.2 Applicable provisions.
37.3 Requirements and procedures for registration.
37.4 Procedures for listing products and implementing rules.
37.5 Information relating to swap execution facility compliance.
37.6 Enforceability.
37.7 Prohibited use of data collected for regulatory purposes.
37.8 Boards of trade operating both a designated contract market and a swap execution facility.
37.9 Methods of execution for required and permitted transactions.
37.10 [Reserved]

Subpart B – Compliance with Core Principles

Sec.
37.100 Core Principle 1 - Compliance with core principles.

Subpart C – Compliance with Rules

Sec.
37.200 Core Principle 2 – Compliance with rules.
37.201 Operation of swap execution facility and compliance with rules.
37.202 Access requirements.
37.203 Rule enforcement program.
37.204 Regulatory services provided by a third party.
37.205 Audit trail.
37.206 Disciplinary procedures and sanctions.

Subpart D – Swaps Not Readily Susceptible to Manipulation

Sec.
37.300 Core Principle 3 - Swaps not readily susceptible to manipulation.
37.301 General requirements.

Subpart E – Monitoring of Trading and Trade Processing

Sec.
37.400 Core Principle 4 - Monitoring of trading and trade processing.
37.401 General requirements.
37.402 Additional requirements for physical-delivery swaps.
37.403 Additional requirements for cash-settled swaps.
37.404 Ability to obtain information.
37.405 Risk controls for trading.
37.406 Trade reconstruction.
37.407 Regulatory service provider.
37.408 Additional sources for compliance.

Subpart F – Ability to Obtain Information

Sec.
37.500 Core Principle 5 – Ability to obtain information.
37.501 Establish and enforce rules.
37.502 Collection of information.
37.503 Provide information to the Commission.
37.504 Information-sharing agreements.

Subpart G – Position Limits or Accountability

Sec.
37.600 Core Principle 6 – Position limits or accountability.
37.601 Additional sources for compliance.

Subpart H – Financial Integrity of Transactions

Sec.
37.700 Core Principle 7 - Financial integrity of transactions.
37.701 Required clearing.
37.702 General financial integrity.
37.703 Monitoring for financial soundness.

Subpart I – Emergency Authority

Sec.
37.800 Core Principle 8 – Emergency authority.

37.801 Additional sources for compliance.

Subpart J – Timely Publication of Trading Information

Sec.
37.900 Core Principle 9 – Timely publication of trading information.
37.901 General requirements.

Subpart K – Recordkeeping and Reporting

Sec.
37.1000 Core Principle 10 – Recordkeeping and reporting.
37.1001 Recordkeeping.

Subpart L – Antitrust Considerations

Sec.
37.1100 Core Principle 11 – Antitrust considerations.
37.1101 Additional sources for compliance.

Subpart M – Conflicts of Interest

Sec.
37.1200 Core Principle 12 – Conflicts of interest.

Subpart N – Financial Resources

Sec.
37.1300 Core Principle 13 – Financial resources.
37.1301 General requirements.
37.1302 Types of financial resources.
37.1303 Computation of projected operating costs to meet financial resource requirement.
37.1304 Valuation of financial resources.
37.1305 Liquidity of financial resources.
37.1306 Reporting to the Commission.
37.1307 Delegation of authority.

Subpart O – System Safeguards

Sec.
37.1400 Core Principle 14 – System safeguards.
37.1401 Requirements.

Subpart P – Designation of Chief Compliance Officer

Sec.
37.1500 Core Principle 15 – Designation of chief compliance officer.
37.1501 Chief compliance officer.

Appendix A to Part 37 – Form SEF
Appendix B to Part 37 – Guidance on, and Acceptable Practices in, Compliance with Core Principles

Authority: 7 U.S.C. 1a, 2, 5, 6, 6c, 7, 7a-2, 7b-3 and 12a, as amended by Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

Subpart A – General Provisions

§ 37.1 Scope.

The provisions of this part shall apply to every swap execution facility that is registered or is applying to become registered as a swap execution facility under section 5h of the Act; provided, however, nothing in this provision affects the eligibility of swap execution facilities to operate under the provisions of parts 38 or 49 of this chapter.

§ 37.2 Applicable provisions.

A swap execution facility shall comply with the requirements of this part and all other applicable Commission regulations, including § 1.60 and part 9 of this chapter, and including any related definitions and cross-referenced sections.

§ 37.3 Requirements and procedures for registration.

(a) Requirements for registration. (1) Any person operating a facility that offers a trading system or platform in which more than one market participant has the ability to execute or trade swaps with more than one other market participant on the system or platform shall register the facility as a swap execution facility under this part or as a designated contract market under part 38 of this chapter.

(2) Minimum trading functionality. A swap execution facility shall, at a minimum, offer an Order Book as defined in paragraph (a)(3) of this section.

(3) Order book means:

(i) An electronic trading facility, as that term is defined in section 1a(16) of the Act;

(ii) A trading facility, as that term is defined in section 1a(51) of the Act; or

(iii) A trading system or platform in which all market participants in the trading system or platform have the ability to enter multiple bids and offers, observe or receive bids and offers entered by other market participants, and transact on such bids and offers.

(b) Procedures for full registration. (1) An applicant requesting registration as a swap execution facility shall:

(i) File electronically a complete Form SEF as set forth in appendix A to this part, or any successor forms, and all information and documentation described in such forms with the Secretary of the Commission in the form and manner specified by the Commission;

(ii) Provide to the Commission, upon the Commission's request, any additional information and documentation necessary to review an application; and

(iii) Request from the Commission a unique, extensible, alphanumeric code for the purpose of identifying the swap execution facility pursuant to part 45 of this chapter.

(2) Request for confidential treatment. (i) An applicant requesting registration as a swap execution facility shall identify with particularity any information in the application that will be subject to a request for confidential treatment pursuant to § 145.9 of this chapter.

(ii) Section 40.8 of this chapter sets forth those sections of the application that will be made publicly available, notwithstanding a request for confidential treatment pursuant to § 145.9 of this chapter.

(3) Amendment of application prior or subsequent to full registration. An applicant amending a pending application for registration as a swap execution facility or requesting an amendment to an order of registration shall file an amended application electronically with the Secretary of the Commission in the manner specified by the Commission. A swap execution facility shall file any amendment to an application subsequent to registration as a submission under part 40 of this chapter or as specified by the Commission.

(4) Effect of incomplete application. If an application is incomplete pursuant to paragraph (b)(1) of this section, the Commission shall notify the applicant that its application will not be deemed to have been submitted for purposes of the Commission's review.

(5) Commission review period. For an applicant who submits its application for registration as a swap execution facility on or after two years from the effective date of this part, the Commission shall review such application pursuant to the 180-day timeframe and procedures specified in section 6(a) of the Act.

(6) Commission determination. (i) The Commission shall issue an order granting registration upon a Commission determination, in its own discretion, that the applicant has demonstrated compliance with the Act and the Commission's regulations applicable to swap execution facilities. If deemed appropriate, the Commission may issue an order granting registration subject to conditions.

(ii) The Commission may issue an order denying registration upon a Commission determination, in its own discretion, that the applicant has not demonstrated compliance with the Act and the Commission's regulations applicable to swap execution facilities.

(c) Temporary registration. An applicant seeking registration as a swap execution facility may request that the Commission grant the applicant temporary registration by complying with the requirements in paragraph (c)(1) of this section.

(1) Requirements for temporary registration. The Commission shall grant a request for temporary registration upon a Commission determination that the applicant has:

(i) Completed all of the requirements under paragraph (b)(1)(i) of this section; and

(ii) Submitted a notice to the Commission, concurrent with the filing of the application under paragraph (b)(1)(i) of this section, requesting that the Commission grant the applicant temporary registration. An applicant that is currently operating a swaps-trading platform in reliance upon either an exemption granted by the Commission or some form of no-action relief granted by the Commission staff shall include in such notice a certification that the applicant is operating pursuant to such exemption or no-action relief.

(iii) The Commission may deny a request for temporary registration upon a Commission determination that the applicant has not met the requirements under paragraphs (c)(1)(i) and (c)(1)(ii) of this section.

(2) Operation pursuant to a grant of temporary registration. An applicant may operate as a swap execution facility under temporary registration upon receipt of a notice from the Commission granting such temporary registration, but in no case may begin

operating as a temporarily registered swap execution facility before the effective date of this regulation.

(3) Expiration of temporary registration. The temporary registration for a swap execution facility shall expire on the earlier of the date that:

(i) The Commission grants or denies registration of the swap execution facility as provided under paragraph (b) of this section;

(ii) The swap execution facility withdraws its application for registration pursuant to paragraph (f) of this section; or

(iii) Temporary registration terminates pursuant to paragraph (c)(5) of this section.

(4) Effect of temporary registration. A grant of temporary registration by the Commission does not affect the right of the Commission to grant or deny registration as provided under paragraph (b) of this section.

(5) Termination of temporary registration. Paragraph (c) of this section shall terminate two years from the effective date of this regulation except as provided for under paragraph (c)(6) of this section and except for an applicant who requested that the Commission grant the applicant temporary registration by complying with the requirements in paragraph (c)(1) of this section before the termination of paragraph (c) of this section and has not been granted or denied registration under paragraph (b)(6) of this section by the time of the termination of paragraph (c) of this section. Such an applicant may operate as a swap execution facility under temporary registration upon receipt of a notice from the Commission granting such temporary registration until the Commission grants or denies registration pursuant to paragraph (b)(6) of this section. On the

termination date of paragraph (c) of this section, the Commission shall review such applicant's application pursuant to the time period and procedures in paragraph (b)(5) of this section.

(6) Temporary registration for applicants that are operational designated contract markets. An applicant that is an operational designated contract market and is also seeking to register as a swap execution facility in order to transfer one or more of its contracts may request that the Commission grant the applicant temporary registration by complying with the requirements in paragraph (c)(1) of this section. The termination of temporary registration provision in paragraph (c)(5) of this section shall not apply to an applicant that is a non-dormant designated contract market as described in this paragraph.

(d) Reinstatement of dormant registration. A dormant swap execution facility as defined in section 40.1 of this chapter may reinstate its registration under the procedures of paragraph (b) of this section. The applicant may rely upon previously submitted materials if such materials accurately describe the dormant swap execution facility's conditions at the time that it applies for reinstatement of its registration.

(e) Request for transfer of registration. (1) A swap execution facility seeking to transfer its registration from its current legal entity to a new legal entity as a result of a corporate change shall file a request for approval to transfer such registration with the Secretary of the Commission in the form and manner specified by the Commission.

(2) Timeline for filing a request for transfer of registration. A request for transfer of registration shall be filed no later than three months prior to the anticipated corporate change; or in the event that the swap execution facility could not have known of the

anticipated change three months prior to the anticipated change, as soon as it knows of such change.

(3) Required information. The request for transfer of registration shall include the following:

(i) The underlying agreement that governs the corporate change;

(ii) A description of the corporate change, including the reason for the change and its impact on the swap execution facility, including its governance and operations, and its impact on the rights and obligations of market participants;

(iii) A discussion of the transferee's ability to comply with the Act, including the core principles applicable to swap execution facilities, and the Commission's regulations thereunder;

(iv) The governing documents of the transferee, including, but not limited to, articles of incorporation and bylaws;

(v) The transferee's rules marked to show changes from the current rules of the swap execution facility;

(vi) A representation by the transferee that it:

(A) Will be the surviving entity and successor-in-interest to the transferor swap execution facility and will retain and assume, without limitation, all of the assets and liabilities of the transferor;

(B) Will assume responsibility for complying with all applicable provisions of the Act and the Commission's regulations promulgated thereunder, including this part and appendices thereto;

(C) Will assume, maintain, and enforce all rules implementing and complying with the core principles applicable to swap execution facilities, including the adoption of the transferor's rulebook, as amended in the request, and that any such amendments will be submitted to the Commission pursuant to section 5c(c) of the Act and part 40 of this chapter;

(D) Will comply with all self-regulatory responsibilities except if otherwise indicated in the request, and will maintain and enforce all self-regulatory programs; and

(E) Will notify market participants of all changes to the transferor's rulebook prior to the transfer and will further notify market participants of the concurrent transfer of the registration to the transferee upon Commission approval and issuance of an order permitting this transfer.

(vii) A representation by the transferee that upon the transfer:

(A) It will assume responsibility for and maintain compliance with core principles for all swaps previously made available for trading through the transferor, whether by certification or approval; and

(B) None of the proposed rule changes will affect the rights and obligations of any market participant.

(4) Commission determination. Upon review of a request for transfer of registration, the Commission, as soon as practicable, shall issue an order either approving or denying the request.

(f) Request for withdrawal of application for registration. An applicant for registration as a swap execution facility may withdraw its application submitted pursuant to paragraph (b) of this section by filing a withdrawal request electronically with the

Secretary of the Commission. Withdrawal of an application for registration shall not affect any action taken or to be taken by the Commission based upon actions, activities, or events occurring during the time that the application was pending with the Commission.

(g) Request for vacation of registration. A swap execution facility may request that its registration be vacated under section 7 of the Act by filing a vacation request electronically with the Secretary of the Commission. Vacation of registration shall not affect any action taken or to be taken by the Commission based upon actions, activities, or events occurring during the time that the swap execution facility was registered by the Commission.

(h) Delegation of authority. The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, upon consultation with the General Counsel or the General Counsel's delegate, authority to notify an applicant seeking registration that its application is incomplete and that it will not be deemed to have been submitted for purposes of the Commission's review, to notify an applicant seeking registration under section 6(a) of the Act that its application is materially incomplete and the running of the 180-day period is stayed, and to notify an applicant seeking temporary registration that its request is granted or denied. The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

§ 37.4 Procedures for listing products and implementing rules.

(a) An applicant for registration as a swap execution facility may submit a swap's terms and conditions prior to listing the product as part of its application for registration.

(b) Any swap terms and conditions or rules submitted as part of a swap execution facility's application for registration shall be considered for approval by the Commission at the time the Commission issues the swap execution facility's order of registration.

(c) After the Commission issues the order of registration, a swap execution facility shall submit a swap's terms and conditions, including amendments to such terms and conditions, new rules, or rule amendments pursuant to the procedures under part 40 of this chapter.

(d) Any swap terms and conditions or rules submitted as part of an application to reinstate the registration of a dormant swap execution facility, as defined in § 40.1 of this chapter, shall be considered for approval by the Commission at the time the Commission approves the dormant swap execution facility's reinstatement of registration.

§ 37.5 Information relating to swap execution facility compliance.

(a) Request for information. Upon the Commission's request, a swap execution facility shall file with the Commission information related to its business as a swap execution facility in the form and manner and within the time period as the Commission specifies in its request.

(b) Demonstration of compliance. Upon the Commission's request, a swap execution facility shall file with the Commission a written demonstration, containing supporting data, information, and documents that it is in compliance with one or more core principles or with its other obligations under the Act or the Commission's

regulations as the Commission specifies in its request. The swap execution facility shall file such written demonstration in the form and manner and within the time period as the Commission specifies in its request.

(c) Equity interest transfer. (1) Equity interest transfer notification. A swap execution facility shall file with the Commission a notification of each transaction that the swap execution facility enters into involving the transfer of fifty percent or more of the equity interest in the swap execution facility. The Commission may, upon receiving such notification, request supporting documentation of the transaction.

(2) Timing of notification. The equity interest transfer notice described in paragraph (c)(1) of this section shall be filed electronically with the Secretary of the Commission at its Washington, D.C. headquarters at submissions@cftc.gov and the Division of Market Oversight at DMOSubmissions@cftc.gov, at the earliest possible time but in no event later than the open of business ten business days following the date upon which the swap execution facility enters into a firm obligation to transfer the equity interest.

(3) Rule filing. Notwithstanding the foregoing, if any aspect of an equity interest transfer described in paragraph (c)(1) of this section requires a swap execution facility to file a rule as defined in part 40 of this chapter, then the swap execution facility shall comply with the requirements of section 5c(c) of the Act and part 40 of this chapter, and all other applicable Commission regulations.

(4) Certification. Upon a transfer of an equity interest of fifty percent or more in a swap execution facility, the swap execution facility shall file electronically with the Secretary of the Commission at its Washington, D.C. headquarters at

submissions@cftc.gov and the Division of Market Oversight at DMOSubmissions@cftc.gov, a certification that the swap execution facility meets all of the requirements of section 5h of the Act and the Commission regulations adopted thereunder, no later than two business days following the date on which the equity interest of fifty percent or more was acquired.

(d) Delegation of authority. The Commission hereby delegates, until it orders otherwise, the authority set forth in this section to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time. The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

§ 37.6 Enforceability.

(a) A transaction entered into on or pursuant to the rules of a swap execution facility shall not be void, voidable, subject to rescission, otherwise invalidated, or rendered unenforceable as a result of:

(1) A violation by the swap execution facility of the provisions of section 5h of the Act or this part;

(2) Any Commission proceeding to alter or supplement a rule, term, or condition under section 8a(7) of the Act or to declare an emergency under section 8a(9) of the Act; or

(3) Any other proceeding the effect of which is to: (i) alter or supplement a specific term or condition or trading rule or procedure; or (ii) require a swap execution

facility to adopt a specific term or condition, trading rule or procedure, or to take or refrain from taking a specific action.

(b) A swap execution facility shall provide each counterparty to a transaction that is entered into on or pursuant to the rules of the swap execution facility with a written record of all of the terms of the transaction which shall legally supersede any previous agreement and serve as a confirmation of the transaction. The confirmation of all terms of the transaction shall take place at the same time as execution; provided that specific customer identifiers for accounts included in bunched orders involving swaps need not be included in confirmations provided by a swap execution facility if the applicable requirements of § 1.35(b)(5) of this chapter are met.

§ 37.7 Prohibited use of data collected for regulatory purposes.

A swap execution facility shall not use for business or marketing purposes any proprietary data or personal information it collects or receives, from or on behalf of any person, for the purpose of fulfilling its regulatory obligations; provided, however, that a swap execution facility may use such data or information for business or marketing purposes if the person from whom it collects or receives such data or information clearly consents to the swap execution facility's use of such data or information in such manner. A swap execution facility shall not condition access to its market(s) or market services on a person's consent to the swap execution facility's use of proprietary data or personal information for business or marketing purposes. A swap execution facility, where necessary for regulatory purposes, may share such data or information with one or more swap execution facilities or designated contract markets registered with the Commission.

§ 37.8 Boards of trade operating both a designated contract market and a swap execution facility.

(a) An entity that intends to operate both a designated contract market and a swap execution facility shall separately register the two entities pursuant to the designated contract market designation procedures set forth in part 38 of this chapter and the swap execution facility registration procedures set forth in this part. On an ongoing basis, the entity shall comply with the core principles for designated contract markets under section 5(d) of the Act and the regulations under part 38 of this chapter and the core principles for swap execution facilities under section 5h of the Act and the regulations under this part.

(b) A board of trade, as defined in section 1a(6) of the Act, that operates both a designated contract market and a swap execution facility and that uses the same electronic trade execution system for executing and trading swaps on the designated contract market and on the swap execution facility shall clearly identify to market participants for each swap whether the execution or trading of such swaps is taking place on the designated contract market or on the swap execution facility.

§ 37.9 Methods of execution for required and permitted transactions.

(a) Execution methods for required transactions.

(1) Required transaction means any transaction involving a swap that is subject to the trade execution requirement in section 2(h)(8) of the Act.

(2) Execution methods. (i) Each Required Transaction that is not a block trade as defined in § 43.2 of this chapter shall be executed on a swap execution facility in accordance with one of the following methods of execution:

(A) An Order Book as defined in section 37.3(a)(3); or

(B) A Request for Quote System, as defined in paragraph (a)(3) of this section, that operates in conjunction with an Order Book as defined in section 37.3(a)(3).

(ii) In providing either one of the execution methods set forth in paragraph (a)(2)(i)(A) or (B) of this section, a swap execution facility may for purposes of execution and communication use any means of interstate commerce, including, but not limited to, the mail, internet, email, and telephone, provided that the chosen execution method satisfies the requirements provided in section 37.3(a)(3) for Order Books or in paragraph (a)(3) of this section for Request for Quote Systems.

(3) Request for quote system means a trading system or platform in which a market participant transmits a request for a quote to buy or sell a specific instrument to no less than three market participants in the trading system or platform, to which all such market participants may respond. The three market participants shall not be affiliates of or controlled by the requester and shall not be affiliates of or controlled by each other. A swap execution facility that offers a request for quote system in connection with Required Transactions shall provide the following functionality:

(i) At the same time that the requester receives the first responsive bid or offer, the swap execution facility shall communicate to the requester any firm bid or offer pertaining to the same instrument resting on any of the swap execution facility's Order Books, as defined in section 37.3(a)(3);

(ii) The swap execution facility shall provide the requester with the ability to execute against such firm resting bids or offers along with any responsive orders; and

(iii) The swap execution facility shall ensure that its trading protocols provide each of its market participants with equal priority in receiving requests for quotes and in transmitting and displaying for execution responsive orders.

(b) Time delay requirement for required transactions on an order book.

(1) Time delay requirement. A swap execution facility shall require that a broker or dealer who seeks to either execute against its customer's order or execute two of its customers' orders against each other through the swap execution facility's Order Book, following some form of pre-arrangement or pre-negotiation of such orders, be subject to at least a 15 second time delay between the entry of those two orders into the Order Book, such that one side of the potential transaction is disclosed and made available to other market participants before the second side of the potential transaction, whether for the broker's or dealer's own account or for a second customer, is submitted for execution.

(2) Adjustment of time delay requirement. A swap execution facility may adjust the time period of the 15 second time delay requirement described in paragraph (b)(1) of this section, based upon a swap's liquidity or other product-specific considerations; however, the time delay shall be set for a sufficient period of time so that an order is exposed to the market and other market participants have a meaningful opportunity to execute against such order.

(c) Execution methods for permitted transactions.

(1) Permitted transaction means any transaction not involving a swap that is subject to the trade execution requirement in section 2(h)(8) of the Act.

(2) Execution methods. A swap execution facility may offer any method of execution for each Permitted Transaction.

§ 37.10 [Reserved.]

Subpart B – Compliance with Core Principles

§ 37.100 Core Principle 1 - Compliance with core principles.

(a) In general. To be registered, and maintain registration, as a swap execution facility, the swap execution facility shall comply with –

(1) The core principles described in section 5h of the Act; and

(2) Any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5) of the Act.

(b) Reasonable discretion of a swap execution facility. Unless otherwise determined by the Commission by rule or regulation, a swap execution facility described in paragraph (a) of this section shall have reasonable discretion in establishing the manner in which the swap execution facility complies with the core principles described in section 5h of the Act.

Subpart C – Compliance with Rules

§ 37.200 Core Principle 2 – Compliance with rules.

A swap execution facility shall:

(a) Establish and enforce compliance with any rule of the swap execution facility, including the terms and conditions of the swaps traded or processed on or through the swap execution facility and any limitation on access to the swap execution facility;

(b) Establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means to provide market participants with impartial access to the market and to

capture information that may be used in establishing whether rule violations have occurred;

(c) Establish rules governing the operation of the facility, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the facility, including block trades; and

(d) Provide by its rules that when a swap dealer or major swap participant enters into or facilitates a swap that is subject to the mandatory clearing requirement of section 2(h) of the Act, the swap dealer or major swap participant shall be responsible for compliance with the mandatory trading requirement under section 2(h)(8) of the Act.

§ 37.201 Operation of swap execution facility and compliance with rules.

(a) A swap execution facility shall establish rules governing the operation of the swap execution facility, including, but not limited to, rules specifying trading procedures to be followed by members and market participants when entering and executing orders traded or posted on the swap execution facility, including block trades, as defined in part 43 of this chapter, if offered.

(b) A swap execution facility shall establish and impartially enforce compliance with the rules of the swap execution facility, including, but not limited to –

(1) The terms and conditions of any swaps traded or processed on or through the swap execution facility;

(2) Access to the swap execution facility;

(3) Trade practice rules;

(4) Audit trail requirements;

(5) Disciplinary rules; and

(6) Mandatory trading requirements.

§ 37.202 Access requirements.

(a) Impartial access to markets and market services. A swap execution facility shall provide any eligible contract participant and any independent software vendor with impartial access to its market(s) and market services, including any indicative quote screens or any similar pricing data displays, provided that the facility has:

(1) Criteria governing such access that are impartial, transparent, and applied in a fair and nondiscriminatory manner;

(2) Procedures whereby eligible contract participants provide the swap execution facility with written or electronic confirmation of their status as eligible contract participants, as defined by the Act and Commission regulations, prior to obtaining access; and

(3) Comparable fee structures for eligible contract participants and independent software vendors receiving comparable access to, or services from, the swap execution facility.

(b) Jurisdiction. Prior to granting any eligible contract participant access to its facilities, a swap execution facility shall require that the eligible contract participant consent to its jurisdiction.

(c) Limitations on access. A swap execution facility shall establish and impartially enforce rules governing any decision to allow, deny, suspend, or permanently bar eligible contract participants' access to the swap execution facility, including when such decisions are made as part of a disciplinary or emergency action taken by the swap execution facility.

§ 37.203 Rule enforcement program.

A swap execution facility shall establish and enforce trading, trade processing, and participation rules that will deter abuses and it shall have the capacity to detect, investigate, and enforce those rules.

(a) Abusive trading practices prohibited. A swap execution facility shall prohibit abusive trading practices on its markets by members and market participants. Swap execution facilities that permit intermediation shall prohibit customer-related abuses including, but not limited to, trading ahead of customer orders, trading against customer orders, accommodation trading, and improper cross trading. Specific trading practices that shall be prohibited include front-running, wash trading, pre-arranged trading (except for block trades permitted by part 43 of this chapter or other types of transactions certified to or approved by the Commission pursuant to the procedures under part 40 of this chapter), fraudulent trading, money passes, and any other trading practices that a swap execution facility deems to be abusive. A swap execution facility shall also prohibit any other manipulative or disruptive trading practices prohibited by the Act or by the Commission pursuant to Commission regulation.

(b) Capacity to detect and investigate rule violations. A swap execution facility shall have arrangements and resources for effective enforcement of its rules. Such arrangements shall include the authority to collect information and documents on both a routine and non-routine basis, including the authority to examine books and records kept by the swap execution facility's members and by persons under investigation. A swap execution facility's arrangements and resources shall also facilitate the direct supervision

of the market and the analysis of data collected to determine whether a rule violation has occurred.

(c) Compliance staff and resources. A swap execution facility shall establish and maintain sufficient compliance staff and resources to ensure that it can conduct effective audit trail reviews, trade practice surveillance, market surveillance, and real-time market monitoring. The swap execution facility's compliance staff shall also be sufficient to address unusual market or trading events as they arise, and to conduct and complete investigations in a timely manner, as set forth in § 37.203(f).

(d) Automated trade surveillance system. A swap execution facility shall maintain an automated trade surveillance system capable of detecting potential trade practice violations. The automated trade surveillance system shall load and process daily orders and trades no later than 24 hours after the completion of the trading day. The automated trade surveillance system shall have the capability to detect and flag specific trade execution patterns and trade anomalies; compute, retain, and compare trading statistics; compute trade gains, losses, and swap-equivalent positions; reconstruct the sequence of market activity; perform market analyses; and support system users to perform in-depth analyses and ad hoc queries of trade-related data.

(e) Real-time market monitoring. A swap execution facility shall conduct real-time market monitoring of all trading activity on its system(s) or platform(s) to identify disorderly trading and any market or system anomalies. A swap execution facility shall have the authority to adjust trade prices or cancel trades when necessary to mitigate market disrupting events caused by malfunctions in its system(s) or platform(s) or errors in orders submitted by members and market participants. Any trade price adjustments or

trade cancellations shall be transparent to the market and subject to standards that are clear, fair, and publicly available.

(f) Investigations and investigation reports. (1) Procedures. A swap execution facility shall establish and maintain procedures that require its compliance staff to conduct investigations of possible rule violations. An investigation shall be commenced upon the receipt of a request from Commission staff or upon the discovery or receipt of information by the swap execution facility that indicates a reasonable basis for finding that a violation may have occurred or will occur.

(2) Timeliness. Each compliance staff investigation shall be completed in a timely manner. Absent mitigating factors, a timely manner is no later than 12 months after the date that an investigation is opened. Mitigating factors that may reasonably justify an investigation taking longer than 12 months to complete include the complexity of the investigation, the number of firms or individuals involved as potential wrongdoers, the number of potential violations to be investigated, and the volume of documents and data to be examined and analyzed by compliance staff.

(3) Investigation reports when a reasonable basis exists for finding a violation. Compliance staff shall submit a written investigation report for disciplinary action in every instance in which compliance staff determines from surveillance or from an investigation that a reasonable basis exists for finding a rule violation. The investigation report shall include the reason the investigation was initiated; a summary of the complaint, if any; the relevant facts; compliance staff's analysis and conclusions; and a recommendation as to whether disciplinary action should be pursued.

(4) Investigation reports when no reasonable basis exists for finding a violation. If after conducting an investigation, compliance staff determines that no reasonable basis exists for finding a rule violation, it shall prepare a written report including the reason the investigation was initiated; a summary of the complaint, if any; the relevant facts; and compliance staff's analysis and conclusions.

(5) Warning letters. No more than one warning letter may be issued to the same person or entity found to have committed the same rule violation within a rolling twelve month period.

(g) Additional sources for compliance. A swap execution facility may refer to the guidance and/or acceptable practices in Appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.203.

§ 37.204 Regulatory services provided by a third party.

(a) Use of regulatory service provider permitted. A swap execution facility may choose to contract with a registered futures association or another registered entity, as such terms are defined under the Act, or the Financial Industry Regulatory Authority (collectively, "regulatory service providers"), for the provision of services to assist in complying with the Act and Commission regulations thereunder, as approved by the Commission. Any swap execution facility that chooses to contract with a regulatory service provider shall ensure that such provider has the capacity and resources necessary to provide timely and effective regulatory services, including adequate staff and automated surveillance systems. A swap execution facility shall at all times remain responsible for the performance of any regulatory services received, for compliance with

the swap execution facility's obligations under the Act and Commission regulations, and for the regulatory service provider's performance on its behalf.

(b) Duty to supervise regulatory service provider. A swap execution facility that elects to use the service of a regulatory service provider shall retain sufficient compliance staff to supervise the quality and effectiveness of the regulatory services provided on its behalf. Compliance staff of the swap execution facility shall hold regular meetings with the regulatory service provider to discuss ongoing investigations, trading patterns, market participants, and any other matters of regulatory concern. A swap execution facility shall also conduct periodic reviews of the adequacy and effectiveness of services provided on its behalf. Such reviews shall be documented carefully and made available to the Commission upon request.

(c) Regulatory decisions required from the swap execution facility. A swap execution facility that elects to use the service of a regulatory service provider shall retain exclusive authority in all substantive decisions made by its regulatory service provider, including, but not limited to, decisions involving the cancellation of trades, the issuance of disciplinary charges against members or market participants, and denials of access to the trading platform for disciplinary reasons. A swap execution facility shall document any instances where its actions differ from those recommended by its regulatory service provider, including the reasons for the course of action recommended by the regulatory service provider and the reasons why the swap execution facility chose a different course of action.

§ 37.205 Audit trail.

A swap execution facility shall establish procedures to capture and retain information that may be used in establishing whether rule violations have occurred.

(a) Audit trail required. A swap execution facility shall capture and retain all audit trail data necessary to detect, investigate, and prevent customer and market abuses. Such data shall be sufficient to reconstruct all indications of interest, requests for quotes, orders, and trades within a reasonable period of time and to provide evidence of any violations of the rules of the swap execution facility. An acceptable audit trail shall also permit the swap execution facility to track a customer order from the time of receipt through fill, allocation, or other disposition, and shall include both order and trade data.

(b) Elements of an acceptable audit trail program. (1) Original source documents. A swap execution facility's audit trail shall include original source documents. Original source documents include unalterable, sequentially-identified records on which trade execution information is originally recorded, whether recorded manually or electronically. Records for customer orders (whether filled, unfilled, or cancelled, each of which shall be retained or electronically captured) shall reflect the terms of the order, an account identifier that relates back to the account(s) owner(s), the time of order entry, and the time of trade execution. Swap execution facilities shall require that all orders, indications of interest, and requests for quotes be immediately captured in the audit trail.

(2) Transaction history database. A swap execution facility's audit trail program shall include an electronic transaction history database. An adequate transaction history database includes a history of all indications of interest, requests for quotes, orders, and trades entered into a swap execution facility's trading system or platform, including all

order modifications and cancellations. An adequate transaction history database also includes:

(i) All data that are input into the trade entry or matching system for the transaction to match and clear;

(ii) The customer type indicator code;

(iii) Timing and sequencing data adequate to reconstruct trading; and

(iv) Identification of each account to which fills are allocated.

(3) Electronic analysis capability. A swap execution facility's audit trail program shall include electronic analysis capability with respect to all audit trail data in the transaction history database. Such electronic analysis capability shall ensure that the swap execution facility has the ability to reconstruct indications of interest, requests for quotes, orders, and trades, and identify possible trading violations with respect to both customer and market abuse.

(4) Safe storage capability. A swap execution facility's audit trail program shall include the capability to safely store all audit trail data retained in its transaction history database. Such safe storage capability shall include the capability to store all data in the database in a manner that protects it from unauthorized alteration, as well as from accidental erasure or other loss. Data shall be retained in accordance with the recordkeeping requirements of Core Principle 10 for swap execution facilities and the associated regulations in subpart K of this part.

(c) Enforcement of audit trail requirements. (1) Annual audit trail and recordkeeping reviews. A swap execution facility shall enforce its audit trail and recordkeeping requirements through at least annual reviews of all members and persons

and firms subject to the swap execution facility's recordkeeping rules to verify their compliance with the swap execution facility's audit trail and recordkeeping requirements. Such reviews shall include, but are not limited to, reviews of randomly selected samples of front-end audit trail data for order routing systems; a review of the process by which user identifications are assigned and user identification records are maintained; a review of usage patterns associated with user identifications to monitor for violations of user identification rules; and reviews of account numbers and customer type indicator codes in trade records to test for accuracy and improper use.

(2) Enforcement program required. A swap execution facility shall establish a program for effective enforcement of its audit trail and recordkeeping requirements. An effective program shall identify members and persons and firms subject to the swap execution facility's recordkeeping rules that have failed to maintain high levels of compliance with such requirements, and impose meaningful sanctions when deficiencies are found. Sanctions shall be sufficient to deter recidivist behavior. No more than one warning letter shall be issued to the same person or entity found to have committed the same violation of audit trail or recordkeeping requirements within a rolling twelve month period.

§ 37.206 Disciplinary procedures and sanctions.

A swap execution facility shall establish trading, trade processing, and participation rules that will deter abuses and have the capacity to enforce such rules through prompt and effective disciplinary action, including suspension or expulsion of members or market participants that violate the rules of the swap execution facility.

(a) Enforcement staff. A swap execution facility shall establish and maintain sufficient enforcement staff and resources to effectively and promptly prosecute possible rule violations within the disciplinary jurisdiction of the swap execution facility.

(b) Disciplinary panels. A swap execution facility shall establish one or more disciplinary panels that are authorized to fulfill their obligations under the rules of this subpart. Disciplinary panels shall meet the composition requirements of part 40 of this chapter, and shall not include any members of the swap execution facility's compliance staff or any person involved in adjudicating any other stage of the same proceeding.

(c) Hearings. A swap execution facility shall adopt rules that provide for the following minimum requirements for any hearing:

(1) The hearing shall be fair, shall be conducted before members of the disciplinary panel, and shall be promptly convened after reasonable notice to the respondent; and

(2) If the respondent has requested a hearing, a copy of the hearing shall be made and shall become a part of the record of the proceeding. The record shall not be required to be transcribed unless:

(i) The transcript is requested by Commission staff or the respondent;

(ii) The decision is appealed pursuant to the rules of the swap execution facility; or

(iii) The decision is reviewed by the Commission pursuant to section 8c of the Act or part 9 of this chapter. In all other instances, a summary record of a hearing is permitted.

(d) Decisions. Promptly following a hearing conducted in accordance with the rules of the swap execution facility, the disciplinary panel shall render a written decision based upon the weight of the evidence contained in the record of the proceeding and shall provide a copy to the respondent. The decision shall include:

(1) The notice of charges or a summary of the charges;

(2) The answer, if any, or a summary of the answer;

(3) A summary of the evidence produced at the hearing or, where appropriate, incorporation by reference of the investigation report;

(4) A statement of findings and conclusions with respect to each charge, and a complete explanation of the evidentiary and other basis for such findings and conclusions with respect to each charge;

(5) An indication of each specific rule that the respondent was found to have violated; and

(6) A declaration of all sanctions imposed against the respondent, including the basis for such sanctions and the effective date of such sanctions.

(e) Disciplinary sanctions. All disciplinary sanctions imposed by a swap execution facility or its disciplinary panels shall be commensurate with the violations committed and shall be clearly sufficient to deter recidivism or similar violations by other market participants. All disciplinary sanctions, including sanctions imposed pursuant to an accepted settlement offer, shall take into account the respondent's disciplinary history. In the event of demonstrated customer harm, any disciplinary sanction shall also include full customer restitution, except where the amount of restitution or to whom it should be provided cannot be reasonably determined.

(f) Warning letters. Where a rule violation is found to have occurred, no more than one warning letter may be issued per rolling twelve month period for the same violation.

(g) Additional sources for compliance. A swap execution facility may refer to the guidance and/or acceptable practices in Appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.206.

Subpart D – Swaps Not Readily Susceptible to Manipulation

§ 37.300 Core Principle 3 - Swaps not readily susceptible to manipulation.

The swap execution facility shall permit trading only in swaps that are not readily susceptible to manipulation.

§ 37.301 General requirements.

To demonstrate to the Commission compliance with the requirements of § 37.300, a swap execution facility shall, at the time it submits a new swap contract in advance to the Commission pursuant to part 40 of this chapter, provide the applicable information as set forth in Appendix C to part 38 of this chapter—Demonstration of Compliance That a Contract is not Readily Susceptible to Manipulation. A swap execution facility may also refer to the guidance and/or acceptable practices in Appendix B of this part.

Subpart E – Monitoring of Trading and Trade Processing

§ 37.400 Core Principle 4 - Monitoring of trading and trade processing.

The swap execution facility shall:

(a) Establish and enforce rules or terms and conditions defining, or specifications detailing:

(1) Trading procedures to be used in entering and executing orders traded on or through the facilities of the swap execution facility; and

(2) Procedures for trade processing of swaps on or through the facilities of the swap execution facility; and

(b) Monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.

§ 37.401 General requirements.

A swap execution facility shall:

(a) Collect and evaluate data on its market participants' market activity on an ongoing basis in order to detect and prevent manipulation, price distortions, and, where possible, disruptions of the physical-delivery or cash-settlement process;

(b) Monitor and evaluate general market data in order to detect and prevent manipulative activity that would result in the failure of the market price to reflect the normal forces of supply and demand;

(c) Demonstrate an effective program for conducting real-time monitoring of trading for the purpose of detecting and resolving abnormalities; and

(d) Demonstrate the ability to comprehensively and accurately reconstruct daily trading activity for the purpose of detecting instances or threats of manipulation, price distortion, and disruptions.

§ 37.402 Additional requirements for physical-delivery swaps.

For physical-delivery swaps, the swap execution facility shall demonstrate that it:

(a) Monitors a swap's terms and conditions as they relate to the underlying commodity market; and

(b) Monitors the availability of the supply of the commodity specified by the delivery requirements of the swap.

§ 37.403 Additional requirements for cash-settled swaps.

(a) For cash-settled swaps, the swap execution facility shall demonstrate that it monitors the pricing of the reference price used to determine cash flows or settlement;

(b) For cash-settled swaps listed on the swap execution facility where the reference price is formulated and computed by the swap execution facility, the swap execution facility shall demonstrate that it monitors the continued appropriateness of its methodology for deriving that price; and

(c) For cash-settled swaps listed on the swap execution facility where the reference price relies on a third-party index or instrument, including an index or instrument traded on another venue, the swap execution facility shall demonstrate that it monitors the continued appropriateness of the index or instrument.

§ 37.404 Ability to obtain information.

(a) A swap execution facility shall demonstrate that it has access to sufficient information to assess whether trading in swaps listed on its market, in the index or instrument used as a reference price, or in the underlying commodity for its listed swaps is being used to affect prices on its market.

(b) A swap execution facility shall have rules that require its market participants to keep records of their trading, including records of their activity in the index or instrument used as a reference price, the underlying commodity, and related derivatives

markets, and make such records available, upon request, to the swap execution facility or, if applicable, to its regulatory service provider, and the Commission.

§ 37.405 Risk controls for trading.

The swap execution facility shall establish and maintain risk control mechanisms to prevent and reduce the potential risk of market disruptions, including, but not limited to, market restrictions that pause or halt trading under market conditions prescribed by the swap execution facility.

§ 37.406 Trade reconstruction.

The swap execution facility shall have the ability to comprehensively and accurately reconstruct all trading on its facility. All audit-trail data and reconstructions shall be made available to the Commission in a form, manner, and time that is acceptable to the Commission.

§ 37.407 Regulatory service provider.

A swap execution facility shall comply with the regulations in this subpart through a dedicated regulatory department or by contracting with a regulatory service provider pursuant to § 37.204.

§ 37.408 Additional sources for compliance.

A swap execution facility may refer to the guidance and/or acceptable practices in Appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.400.

Subpart F – Ability to Obtain Information

§ 37.500 Core Principle 5 – Ability to obtain information.

The swap execution facility shall:

(a) Establish and enforce rules that will allow the facility to obtain any necessary information to perform any of the functions described in section 5h of the Act;

(b) Provide the information to the Commission on request; and

(c) Have the capacity to carry out such international information-sharing agreements as the Commission may require.

§ 37.501 Establish and enforce rules.

A swap execution facility shall establish and enforce rules that will allow the swap execution facility to have the ability and authority to obtain sufficient information to allow it to fully perform its operational, risk management, governance, and regulatory functions and any requirements under this part, including the capacity to carry out international information-sharing agreements as the Commission may require.

§ 37.502 Collection of information.

A swap execution facility shall have rules that allow it to collect information on a routine basis, allow for the collection of non-routine data from its market participants, and allow for its examination of books and records kept by the market participants on its facility.

§ 37.503 Provide information to the Commission.

A swap execution facility shall provide information in its possession to the Commission upon request, in a form and manner that the Commission approves.

§ 37.504 Information-sharing agreements.

A swap execution facility shall share information with other regulatory organizations, data repositories, and third-party data reporting services as required by the Commission or as otherwise necessary and appropriate to fulfill its self-regulatory and

reporting responsibilities. Appropriate information-sharing agreements can be established with such entities or the Commission can act in conjunction with the swap execution facility to carry out such information sharing.

Subpart G – Position Limits or Accountability

§ 37.600 Core Principle 6 – Position limits or accountability.

(a) In general. To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, a swap execution facility that is a trading facility shall adopt for each of the contracts of the facility, as is necessary and appropriate, position limitations or position accountability for speculators.

(b) Position limits. For any contract that is subject to a position limitation established by the Commission pursuant to section 4a(a) of the Act, the swap execution facility shall:

(1) Set its position limitation at a level no higher than the Commission limitation; and

(2) Monitor positions established on or through the swap execution facility for compliance with the limit set by the Commission and the limit, if any, set by the swap execution facility.

§ 37.601 Additional sources for compliance.

Until such time that compliance is required under part 151 of this chapter, a swap execution facility may refer to the guidance and/or acceptable practices in Appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.600.

Subpart H – Financial Integrity of Transactions

§ 37.700 Core Principle 7 - Financial integrity of transactions.

The swap execution facility shall establish and enforce rules and procedures for ensuring the financial integrity of swaps entered on or through the facilities of the swap execution facility, including the clearance and settlement of the swaps pursuant to section 2(h)(1) of the Act.

§ 37.701 Required clearing.

Transactions executed on or through the swap execution facility that are required to be cleared under section 2(h)(1)(A) of the Act or are voluntarily cleared by the counterparties shall be cleared through a Commission-registered derivatives clearing organization, or a derivatives clearing organization that the Commission has determined is exempt from registration.

§ 37.702 General financial integrity.

A swap execution facility shall provide for the financial integrity of its transactions:

(a) By establishing minimum financial standards for its members, which shall, at a minimum, require that members qualify as an eligible contract participant as defined in section 1a(18) of the Act;

(b) [Reserved]

§ 37.703 Monitoring for financial soundness.

A swap execution facility shall monitor its members to ensure that they continue to qualify as eligible contract participants as defined in section 1a(18) of the Act.

Subpart I – Emergency Authority

§ 37.800 Core Principle 8 – Emergency authority.

The swap execution facility shall adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, as is necessary and appropriate, including the authority to liquidate or transfer open positions in any swap or to suspend or curtail trading in a swap.

§ 37.801 Additional sources for compliance.

A swap execution facility may refer to the guidance and/or acceptable practices in Appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.800.

Subpart J – Timely Publication of Trading Information

§ 37.900 Core Principle 9 – Timely publication of trading information.

(a) In general. The swap execution facility shall make public timely information on price, trading volume, and other trading data on swaps to the extent prescribed by the Commission.

(b) Capacity of swap execution facility. The swap execution facility shall be required to have the capacity to electronically capture and transmit trade information with respect to transactions executed on the facility.

§ 37.901 General requirements.

With respect to swaps traded on or through a swap execution facility, each swap execution facility shall:

(a) Report specified swap data as provided under part 43 and part 45 of this chapter; and

(b) Meet the requirements of part 16 of this chapter.

Subpart K – Recordkeeping and Reporting

§ 37.1000 Core Principle 10 – Recordkeeping and reporting.

(a) In general. A swap execution facility shall:

(1) Maintain records of all activities relating to the business of the facility, including a complete audit trail, in a form and manner acceptable to the Commission for a period of five years;

(2) Report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines to be necessary or appropriate for the Commission to perform the duties of the Commission under the Act; and

(3) Keep any such records relating to swaps defined in section 1a(47)(A)(v) of the Act open to inspection and examination by the Securities and Exchange Commission.

(b) Requirements. The Commission shall adopt data collection and reporting requirements for swap execution facilities that are comparable to corresponding requirements for derivatives clearing organizations and swap data repositories.

§ 37.1001 Recordkeeping.

A swap execution facility shall maintain records of all activities relating to the business of the facility, in a form and manner acceptable to the Commission, for a period of at least five years. A swap execution facility shall maintain such records, including a complete audit trail for all swaps executed on or subject to the rules of the swap execution facility, investigatory files, and disciplinary files, in accordance with the requirements of § 1.31 and part 45 of this chapter.

Subpart L – Antitrust Considerations

§ 37.1100 Core Principle 11 – Antitrust considerations.

Unless necessary or appropriate to achieve the purposes of the Act, the swap execution facility shall not:

(a) Adopt any rules or take any actions that result in any unreasonable restraint of trade; or

(b) Impose any material anticompetitive burden on trading or clearing.

§ 37.1101 Additional sources for compliance.

A swap execution facility may refer to the guidance and/or acceptable practices in Appendix B of this part to demonstrate to the Commission compliance with the requirements of § 37.1100.

Subpart M – Conflicts of Interest

§ 37.1200 Core Principle 12 – Conflicts of interest.

The swap execution facility shall:

(a) Establish and enforce rules to minimize conflicts of interest in its decision-making process; and

(b) Establish a process for resolving the conflicts of interest.

Subpart N – Financial Resources

§ 37.1300 Core Principle 13 – Financial resources.

(a) In general. The swap execution facility shall have adequate financial, operational, and managerial resources to discharge each responsibility of the swap execution facility.

(b) Determination of resource adequacy. The financial resources of a swap execution facility shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the swap execution facility to cover the operating costs of the swap execution facility for a one-year period, as calculated on a rolling basis.

§ 37.1301 General requirements.

(a) A swap execution facility shall maintain financial resources sufficient to enable it to perform its functions in compliance with the core principles set forth in section 5h of the Act.

(b) An entity that operates as both a swap execution facility and a derivatives clearing organization shall also comply with the financial resource requirements of § 39.11 of this chapter.

(c) Financial resources shall be considered sufficient if their value is at least equal to a total amount that would enable the swap execution facility to cover its operating costs for a period of at least one year, calculated on a rolling basis.

§ 37.1302 Types of financial resources.

Financial resources available to satisfy the requirements of § 37.1301 may include:

(a) The swap execution facility's own capital, meaning its assets minus its liabilities calculated in accordance with U.S. generally accepted accounting principles; and

(b) Any other financial resource deemed acceptable by the Commission.

§ 37.1303 Computation of projected operating costs to meet financial resource requirement.

A swap execution facility shall, each fiscal quarter, make a reasonable calculation of its projected operating costs over a twelve-month period in order to determine the amount needed to meet the requirements of § 37.1301. The swap execution facility shall have reasonable discretion in determining the methodology used to compute such projected operating costs. The Commission may review the methodology and require changes as appropriate.

§ 37.1304 Valuation of financial resources.

No less than each fiscal quarter, a swap execution facility shall compute the current market value of each financial resource used to meet its obligations under § 37.1301. Reductions in value to reflect market and credit risk ("haircuts") shall be applied as appropriate.

§ 37.1305 Liquidity of financial resources.

The financial resources allocated by the swap execution facility to meet the requirements of § 37.1301 shall include unencumbered, liquid financial assets (*i.e.*, cash and/or highly liquid securities) equal to at least six months' operating costs. If any portion of such financial resources is not sufficiently liquid, the swap execution facility may take into account a committed line of credit or similar facility for the purpose of meeting this requirement.

§ 37.1306 Reporting to the Commission.

(a) Each fiscal quarter, or at any time upon Commission request, a swap execution facility shall:

(1) Report to the Commission:

(i) The amount of financial resources necessary to meet the requirements of § 37.1301; and

(ii) The value of each financial resource available, computed in accordance with the requirements of § 37.1304;

(2) Provide the Commission with a financial statement, including the balance sheet, income statement, and statement of cash flows of the swap execution facility or of its parent company;

(b) The calculations required by paragraph (a) of this section shall be made as of the last business day of the swap execution facility's fiscal quarter.

(c) The swap execution facility shall provide the Commission with:

(1) Sufficient documentation explaining the methodology used to compute its financial requirements under § 37.1301;

(2) Sufficient documentation explaining the basis for its determinations regarding the valuation and liquidity requirements set forth in §§ 37.1304 and 37.1305; and

(3) Copies of any agreements establishing or amending a credit facility, insurance coverage, or other arrangement evidencing or otherwise supporting the swap execution facility's conclusions.

(d) The reports required by this section shall be filed not later than 40 calendar days after the end of the swap execution facility's first three fiscal quarters, and not later than 60 calendar days after the end of the swap execution facility's fourth fiscal quarter, or at such later time as the Commission may permit, in its discretion, upon request by the swap execution facility.

§ 37.1307 Delegation of authority.

(a) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, authority to:

(1) Determine whether a particular financial resource under § 37.1302 may be used to satisfy the requirements of § 37.1301;

(2) Review and make changes to the methodology used to compute projected operating costs under § 37.1303;

(3) Request reports, in addition to fiscal quarter reports, under § 37.1306(a); and

(4) Grant an extension of time to file fiscal quarter reports under § 37.1306(d).

(b) The Director may submit to the Commission for its consideration any matter that has been delegated in this section. Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

Subpart O – System Safeguards

§ 37.1400 Core Principle 14 – System safeguards.

The swap execution facility shall:

(a) Establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk, through the development of appropriate controls and procedures, and automated systems, that:

(1) Are reliable and secure; and

(2) Have adequate scalable capacity;

(b) Establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for:

(1) The timely recovery and resumption of operations; and

(2) The fulfillment of the responsibilities and obligations of the swap execution facility; and

(c) Periodically conduct tests to verify that the backup resources of the swap execution facility are sufficient to ensure continued:

(1) Order processing and trade matching;

(2) Price reporting;

(3) Market surveillance; and

(4) Maintenance of a comprehensive and accurate audit trail.

§ 37.1401 Requirements.

(a) A swap execution facility's program of risk analysis and oversight with respect to its operations and automated systems shall address each of the following categories of risk analysis and oversight:

(1) Information security;

(2) Business continuity-disaster recovery planning and resources;

(3) Capacity and performance planning;

(4) Systems operations;

(5) Systems development and quality assurance; and

(6) Physical security and environmental controls.

(b) A swap execution facility shall maintain a business continuity-disaster recovery plan and resources, emergency procedures, and backup facilities sufficient to enable timely recovery and resumption of its operations and resumption of its ongoing fulfillment of its responsibilities and obligations as a swap execution facility following

any disruption of its operations. Such responsibilities and obligations include, without limitation, order processing and trade matching; transmission of matched orders to a designated clearing organization for clearing, where appropriate; price reporting; market surveillance; and maintenance of a comprehensive audit trail. The swap execution facility's business continuity-disaster recovery plan and resources generally should enable resumption of trading and clearing of swaps executed on the swap execution facility during the next business day following the disruption. Swap execution facilities determined by the Commission to be critical financial markets pursuant to Appendix E to part 40 of this chapter are subject to more stringent requirements in this regard, set forth in § 40.9 of this chapter.

(c) A swap execution facility that is not determined by the Commission to be a critical financial market satisfies the requirement to be able to resume its operations and resume its ongoing fulfillment of its responsibilities and obligations during the next business day following any disruption of its operations by maintaining either:

(1) Infrastructure and personnel resources of its own that are sufficient to ensure timely recovery and resumption of its operations and resumption of its ongoing fulfillment of its responsibilities and obligations as a swap execution facility following any disruption of its operations; or

(2) Contractual arrangements with other swap execution facilities or disaster recovery service providers, as appropriate, that are sufficient to ensure continued trading and clearing of swaps executed on the swap execution facility, and ongoing fulfillment of all of the swap execution facility's responsibilities and obligations with respect to such

swaps, in the event that a disruption renders the swap execution facility temporarily or permanently unable to satisfy this requirement on its own behalf.

(d) A swap execution facility shall notify Commission staff promptly of all:

(1) Electronic trading halts and material system malfunctions;

(2) Cyber security incidents or targeted threats that actually or potentially jeopardize automated system operation, reliability, security, or capacity; and

(3) Activations of the swap execution facility's business continuity-disaster recovery plan.

(e) A swap execution facility shall provide Commission staff timely advance notice of all material:

(1) Planned changes to automated systems that may impact the reliability, security, or adequate scalable capacity of such systems; and

(2) Planned changes to the swap execution facility's program of risk analysis and oversight.

(f) A swap execution facility shall provide to the Commission, upon request, current copies of its business continuity-disaster recovery plan and other emergency procedures, its assessments of its operational risks, and other documents requested by Commission staff for the purpose of maintaining a current profile of the swap execution facility's automated systems.

(g) A swap execution facility shall conduct regular, periodic, objective testing and review of its automated systems to ensure that they are reliable, secure, and have adequate scalable capacity. A swap execution facility shall also conduct regular, periodic testing and review of its business continuity-disaster recovery capabilities. Pursuant to

Core Principle 10 under section 5h of the Act (Recordkeeping and Reporting) and §§ 37.1000 through 37.1001, the swap execution facility shall keep records of all such tests, and make all test results available to the Commission upon request.

(h) Part 40 of this chapter governs the obligations of those registered entities that the Commission has determined to be critical financial markets, with respect to maintenance and geographic dispersal of disaster recovery resources sufficient to meet a same-day recovery time objective in the event of a wide-scale disruption. Section 40.9 establishes the requirements for core principle compliance in that respect.

Subpart P – Designation of Chief Compliance Officer

§ 37.1500 Core Principle 15 – Designation of chief compliance officer.

(a) In general. Each swap execution facility shall designate an individual to serve as a chief compliance officer.

(b) Duties. The chief compliance officer shall:

(1) Report directly to the board or to the senior officer of the facility;

(2) Review compliance with the core principles in this subsection;

(3) In consultation with the board of the facility, a body performing a function similar to that of a board, or the senior officer of the facility, resolve any conflicts of interest that may arise;

(4) Be responsible for establishing and administering the policies and procedures required to be established pursuant to this section;

(5) Ensure compliance with the Act and the rules and regulations issued under the Act, including rules prescribed by the Commission pursuant to section 5h of the Act; and

(6) Establish procedures for the remediation of noncompliance issues found during compliance office reviews, look backs, internal or external audit findings, self-reported errors, or through validated complaints.

(c) Requirements for procedures. In establishing procedures under paragraph (b)(6) of this section, the chief compliance officer shall design the procedures to establish the handling, management response, remediation, retesting, and closing of noncompliance issues.

(d) Annual reports. (1) In general. In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of:

(i) The compliance of the swap execution facility with the Act; and

(ii) The policies and procedures, including the code of ethics and conflict of interest policies, of the swap execution facility.

(2) Requirements. The chief compliance officer shall:

(i) Submit each report described in paragraph (d)(1) of this section with the appropriate financial report of the swap execution facility that is required to be submitted to the Commission pursuant to section 5h of the Act; and

(ii) Include in the report a certification that, under penalty of law, the report is accurate and complete.

§ 37.1501 Chief compliance officer.

(a) Definition of board of directors. For purposes of this part, the term "board of directors" means the board of directors of a swap execution facility, or for those swap

execution facilities whose organizational structure does not include a board of directors, a body performing a function similar to a board of directors.

(b) Designation and qualifications of chief compliance officer.

(1) Chief compliance officer required. Each swap execution facility shall establish the position of chief compliance officer and designate an individual to serve in that capacity.

(i) The position of chief compliance officer shall carry with it the authority and resources to develop and enforce policies and procedures necessary to fulfill the duties set forth for chief compliance officers in the Act and Commission regulations.

(ii) The chief compliance officer shall have supervisory authority over all staff acting at the direction of the chief compliance officer.

(2) Qualifications of chief compliance officer. The individual designated to serve as chief compliance officer shall have the background and skills appropriate for fulfilling the responsibilities of the position. No individual disqualified from registration pursuant to sections 8a(2) or 8a(3) of the Act may serve as a chief compliance officer.

(c) Appointment, supervision, and removal of chief compliance officer. (1) Appointment and compensation of chief compliance officer.

(i) A swap execution facility's chief compliance officer shall be appointed by its board of directors or senior officer. A swap execution facility shall notify the Commission within two business days of appointing any new chief compliance officer, whether interim or permanent.

(ii) The board of directors or the senior officer shall approve the compensation of the chief compliance officer.

(iii) The chief compliance officer shall meet with the board of directors at least annually and the regulatory oversight committee at least quarterly.

(iv) The chief compliance officer shall provide any information regarding the swap execution facility's self-regulatory program that is requested by the board of directors or the regulatory oversight committee.

(2) Supervision of chief compliance officer. A swap execution facility's chief compliance officer shall report directly to the board of directors or to the senior officer of the swap execution facility, at the swap execution facility's discretion.

(3) Removal of chief compliance officer. (i) Removal of a swap execution facility's chief compliance officer shall require the approval of a majority of the swap execution facility's board of directors. If the swap execution facility does not have a board of directors, then the chief compliance officer may be removed by the senior officer of the swap execution facility.

(ii) The swap execution facility shall notify the Commission of such removal within two business days.

(d) Duties of chief compliance officer. The chief compliance officer's duties shall include, but are not limited to, the following:

(1) Overseeing and reviewing the swap execution facility's compliance with section 5h of the Act and any related rules adopted by the Commission;

(2) In consultation with the board of directors, a body performing a function similar to the board of directors, or the senior officer of the swap execution facility, resolving any conflicts of interest that may arise, including:

(i) Conflicts between business considerations and compliance requirements;

(ii) Conflicts between business considerations and the requirement that the swap execution facility provide fair, open, and impartial access as set forth in § 37.202; and;

(iii) Conflicts between a swap execution facility's management and members of the board of directors;

(3) Establishing and administering written policies and procedures reasonably designed to prevent violations of the Act and the rules of the Commission;

(4) Taking reasonable steps to ensure compliance with the Act and the rules of the Commission;

(5) Establishing procedures for the remediation of noncompliance issues identified by the chief compliance officer through a compliance office review, look-back, internal or external audit finding, self-reported error, or validated complaint;

(6) Establishing and following appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues;

(7) Establishing and administering a compliance manual designed to promote compliance with the applicable laws, rules, and regulations and a written code of ethics designed to prevent ethical violations and to promote honesty and ethical conduct;

(8) Supervising the swap execution facility's self-regulatory program with respect to trade practice surveillance; market surveillance; real-time market monitoring; compliance with audit trail requirements; enforcement and disciplinary proceedings; audits, examinations, and other regulatory responsibilities with respect to members and market participants (including ensuring compliance with, if applicable, financial integrity, financial reporting, sales practice, recordkeeping, and other requirements); and

(9) Supervising the effectiveness and sufficiency of any regulatory services provided to the swap execution facility by a regulatory service provider in accordance with § 37.204.

(e) Preparation of annual compliance report. The chief compliance officer shall, not less than annually, prepare and sign an annual compliance report that, at a minimum, contains the following information covering the time period since the date on which the swap execution facility became registered with the Commission or since the end of the period covered by a previously filed annual compliance report, as applicable:

(1) A description of the swap execution facility's written policies and procedures, including the code of ethics and conflict of interest policies;

(2) A review of applicable Commission regulations and each subsection and core principle of section 5h of the Act, that, with respect to each:

(i) Identifies the policies and procedures that are designed to ensure compliance with each subsection and core principle, including each duty specified in section 5h(f)(15)(B) of the Act;

(ii) Provides a self-assessment as to the effectiveness of these policies and procedures; and

(iii) Discusses areas for improvement and recommends potential or prospective changes or improvements to its compliance program and resources;

(3) A list of any material changes to compliance policies and procedures since the last annual compliance report;

(4) A description of the financial, managerial, and operational resources set aside for compliance with respect to the Act and Commission regulations, including a

description of the swap execution facility's self-regulatory program's staffing and structure, a catalogue of investigations and disciplinary actions taken since the last annual compliance report, and a review of the performance of disciplinary committees and panels;

(5) A description of any material compliance matters, including noncompliance issues identified through a compliance office review, look-back, internal or external audit finding, self-reported error, or validated complaint, and an explanation of how they were resolved; and

(6) A certification by the chief compliance officer that, to the best of his or her knowledge and reasonable belief, and under penalty of law, the annual compliance report is accurate and complete.

(f) Submission of annual compliance report.

(1) Prior to submission to the Commission, the chief compliance officer shall provide the annual compliance report to the board of directors of the swap execution facility for its review. If the swap execution facility does not have a board of directors, then the annual compliance report shall be provided to the senior officer for his or her review. Members of the board of directors and the senior officer shall not require the chief compliance officer to make any changes to the report. Submission of the report to the board of directors or the senior officer, and any subsequent discussion of the report, shall be recorded in board minutes or a similar written record, as evidence of compliance with this requirement.

(2) The annual compliance report shall be submitted electronically to the Commission not later than 60 calendar days after the end of the swap execution facility's

fiscal year, concurrently with the filing of the fourth fiscal quarter financial report pursuant to § 37.1306.

(3) Promptly upon discovery of any material error or omission made in a previously filed annual compliance report, the chief compliance officer shall file an amendment with the Commission to correct the material error or omission. An amendment shall contain the certification required under paragraph (e)(6) of this section.

(4) A swap execution facility may request from the Commission an extension of time to file its annual compliance report based on substantial, undue hardship. Extensions of the filing deadline may be granted at the discretion of the Commission.

(g) Recordkeeping. (1) The swap execution facility shall maintain:

(i) A copy of the written policies and procedures, including the code of ethics and conflicts of interest policies adopted in furtherance of compliance with the Act and Commission regulations;

(ii) Copies of all materials created in furtherance of the chief compliance officer's duties listed in paragraphs (d)(8) and (d)(9) of this section, including records of any investigations or disciplinary actions taken by the swap execution facility;

(iii) Copies of all materials, including written reports provided to the board of directors or senior officer in connection with the review of the annual compliance report under paragraph (f)(1) of this section and the board minutes or a similar written record that documents the review of the annual compliance report by the board of directors or senior officer; and

(iv) Any records relevant to the swap execution facility's annual compliance report, including, but not limited to, work papers and other documents that form the basis of the report, and memoranda, correspondence, other documents, and records that are

(A) created, sent, or received in connection with the annual compliance report and

(B) contain conclusions, opinions, analyses, or financial data related to the annual compliance report.

(2) The swap execution facility shall maintain records in accordance with § 1.31 and part 45 of this chapter.

(h) Delegation of authority. The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, authority to grant or deny a swap execution facility's request for an extension of time to file its annual compliance report under paragraph (f)(4) of this section.

Appendix A to Part 37 – Form SEF

COMMODITY FUTURES TRADING COMMISSION

FORM SEF

SWAP EXECUTION FACILITY
APPLICATION OR AMENDMENT TO APPLICATION FOR REGISTRATION

REGISTRATION INSTRUCTIONS

Intentional misstatements or omissions of material fact may constitute federal criminal violations (7 U.S.C. § 13 and 18 U.S.C. § 1001) or grounds for disqualification from registration.

DEFINITIONS

Unless the context requires otherwise, all terms used in this Form SEF have the same meaning as in the Commodity Exchange Act, as amended ("Act"), and in the General Rules and Regulations of the Commodity Futures Trading Commission ("Commission") thereunder.

For the purposes of this Form SEF, the term "Applicant" shall include any applicant for registration as a swap execution facility, any applicant amending a pending application, or any registered swap execution facility that is applying for an amendment to its order of registration.

GENERAL INSTRUCTIONS

1. This Form SEF, which includes instructions, a Cover Sheet, and required Exhibits (together, "Form SEF"), is to be filed with the Commission by all Applicants, pursuant to section 5h of the Act and the Commission's regulations thereunder. Applicants may prepare their own Form SEF but must follow the format prescribed herein. Upon the filing of an application for registration or a registration amendment in accordance with the instructions provided herein, the Commission will publish notice of the filing and afford interested persons an opportunity to submit written data, views, and arguments concerning such application. No application for registration or registration amendment shall be effective unless the Commission, by order, grants such registration or amended registration.

2. Individuals' names, except the executing signature, shall be given in full (Last Name, First Name, Middle Name).

3. Signatures on all copies of the Form SEF filed with the Commission can be executed electronically. If this Form SEF is filed by a corporation, it shall be signed in the name of the corporation by a principal officer duly authorized; if filed by a limited liability company, it shall be signed in the name of the limited liability company by a manager or member duly authorized to sign on the limited liability company's behalf; if filed by a partnership, it shall be signed in the name of the partnership by a general partner duly authorized; if filed by an unincorporated organization or association which is not a partnership, it shall be signed in the name of such organization or association by the managing agent, i.e., a duly authorized person who directs or manages or who participates in the directing or managing of its affairs.

4. If this Form SEF is being filed as an application for registration, all applicable items must be answered in full. If any item is inapplicable, indicate by "none," "not applicable," or "N/A," as appropriate.

5. Under section 5h of the Act and the Commission's regulations thereunder, the Commission is authorized to solicit the information required to be supplied by this Form SEF from any Applicant seeking registration as a swap execution facility and from any registered swap execution facility. Disclosure by the Applicant of the information specified on this Form SEF is mandatory prior to the start of the processing of an application for, or an amendment to, registration as a swap execution facility. The information provided in this Form

SEF will be used for the principal purpose of determining whether the Commission should grant or deny registration to an Applicant. The Commission may determine that additional information is required from the Applicant in order to process its application. **A Form SEF which is not prepared and executed in compliance with applicable requirements and instructions may be returned as not acceptable for filing. Acceptance of this Form SEF, however, shall not constitute a finding that the Form SEF has been filed as required or that the information submitted is true, current, or complete**.

6. Except in cases where confidential treatment is requested by the Applicant and granted by the Commission pursuant to the Freedom of Information Act and the rules of the Commission thereunder, information supplied on this Form SEF will be included routinely in the public files of the Commission and will be available for inspection by any interested person.

APPLICATION AMENDMENTS

1. An Applicant amending a pending application for registration as a swap execution facility or requesting an amendment to an order of registration shall file an amended Form SEF electronically with the Secretary of the Commission in the manner specified by the Commission. Otherwise, a swap execution facility shall file any amendment to this Form SEF as a submission under part 40 of the Commission's regulations or as specified by the Commission.

2. When filing this Form SEF for purposes of amending a pending application or requesting an amendment to an order of registration, Applicants must re-file the Cover Sheet, amended if necessary and including an executing signature, and attach thereto revised Exhibits or other materials marked to show changes, as applicable. The submission of an amendment represents that the remaining items and Exhibits that are not amended remain true, current, and complete as previously filed.

WHERE TO FILE

This Form SEF must be filed electronically with the Secretary of the Commission in the manner specified by the Commission.

COMMODITY FUTURES TRADING COMMISSION

FORM SEF

SWAP EXECUTION FACILITY
APPLICATION OR AMENDMENT TO APPLICATION FOR REGISTRATION

COVER SHEET

_____

Exact name of Applicant as specified in charter

_____

Address of principal executive offices

☐ If this is an **APPLICATION** for registration, complete in full and check here.

☐ If this is an **AMENDMENT** to an application, or to an existing order of registration, list all items that are amended and check here.

_____

_____

_____

_____

GENERAL INFORMATION

1. Name under which the business of the swap execution facility is or will be conducted, if different than name specified above (include acronyms, if any):

   _____

2. If name of swap execution facility is being amended, state previous swap execution facility name:

   _____

3. Contact information, including mailing address if different than address specified above:

   _____
   Number and Street

   _____
   City State Country Zip Code

   _____ _____
   Main Phone Number Fax

   _____ _____
   Website URL E-mail Address

4. List of principal office(s) and address(es) where swap execution facility activities are/will be conducted:

Office	**Address**
_____	_____
_____	_____
_____	_____

5. If the Applicant is a successor to a previously registered swap execution facility, please complete the following:

   a. Date of succession

      _____

   b. Full name and address of predecessor registrant

      _____
      Name

      _____
      Number and Street

      _____
      City State Country Zip Code

      _____
      Main Phone Number Website URL

BUSINESS ORGANIZATION

6. Applicant is a:

☐ Corporation
☐ Partnership
☐ Limited Liability Company
☐ Other form of organization (specify) _____

7. Date of incorporation or formation: _____

8. State of incorporation or jurisdiction of organization: _____

9. The Applicant agrees and consents that the notice of any proceeding before the Commission in connection with this application may be given by sending such notice by certified mail to the person named below at the address given.

_____
Print Name and Title

_____
Name of Applicant

_____
Number and Street

_____
City State Zip Code

SIGNATURES

10. The Applicant has duly caused this application or amendment to be signed on its behalf by the undersigned, hereunto duly authorized, this _____ day of _____, 20_____. The Applicant and the undersigned represent hereby that all information contained herein is true, current, and complete. It is understood that all required items and Exhibits are considered integral parts of this Form SEF and that the submission of any amendment represents that all unamended items and Exhibits remain true, current, and complete as previously filed.

_____
Name of Applicant

_____
Signature of Duly Authorized Person

_____
Print Name and Title of Signatory

COMMODITY FUTURES TRADING COMMISSION

FORM SEF

SWAP EXECUTION FACILITY
APPLICATION OR AMENDMENT TO APPLICATION FOR REGISTRATION

EXHIBITS INSTRUCTIONS

The following Exhibits must be filed with the Commission by each Applicant applying for registration as a swap execution facility, or by a registered swap execution facility amending its registration, pursuant to section 5h of the Act and the Commission's regulations thereunder. The Exhibits must be labeled according to the items specified in this Form SEF.

The application must include a Table of Contents listing each Exhibit required by this Form SEF and indicating which, if any, Exhibits are inapplicable. For any Exhibit that is inapplicable, next to the Exhibit letter specify "none," "not applicable," or "N/A," as appropriate.

If the Applicant is a newly formed enterprise and does not have the financial statements required pursuant to Items 9 and 10 (Exhibits I and J) of this Form SEF, the Applicant should provide *pro forma* financial statements for the most recent six months or since inception, whichever is less.

LIST OF EXHIBITS

EXHIBITS – BUSINESS ORGANIZATION

1. Attach as **Exhibit A,** the name of any person who owns ten percent (10%) or more of the Applicant's stock or who, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the management or policies of the Applicant.

   Provide as part of Exhibit A the full name and address of each such person and attach a copy of the agreement or, if there is none written, describe the agreement or basis upon which such person exercises or may exercise such control or direction.

2. Attach as **Exhibit B,** a list of the present officers, directors, governors (and, in the case of an Applicant that is not a corporation, the members of all standing committees, grouped by committee), or persons performing functions similar to any of the foregoing, of the swap execution facility or of any entity that performs the regulatory activities of the Applicant, indicating for each:
   a. Name
   b. Title
   c. Dates of commencement and termination of present term of office or position
   d. Length of time each present officer, director, or governor has held the same office or position
   e. Brief account of the business experience of each officer and director over the last five (5) years
   f. Any other business affiliations in the derivatives and securities industry
   g. For directors, list any committees on which they serve and any compensation received by virtue of their directorship
   h. A description of:
      (1) Any order of the Commission with respect to such person pursuant to section 5e of the Act;
      (2) Any conviction or injunction against such person within the past ten (10) years;
      (3) Any disciplinary action with respect to such person within the last five (5) years;
      (4) Any disqualification under sections 8b and 8d of the Act;
      (5) Any disciplinary action under section 8c of the Act; and
      (6) Any violation pursuant to section 9 of the Act.

3. Attach as **Exhibit C,** a narrative that sets forth the fitness standards for the Board of Directors and its composition including the number and percentage of public directors.

4. Attach as **Exhibit D,** a narrative or graphic description of the organizational structure of the Applicant. Include a list of all affiliates of the Applicant and indicate the general nature of the affiliation. Note: If the swap execution facility activities of the Applicant are or will be conducted primarily by a division, subdivision, or other separate entity within the Applicant, corporation, or organization, describe the relationship of such entity within the overall organizational structure and attach as Exhibit D a description only as it applies to the division, subdivision, or separate entity, as applicable. Additionally, provide any relevant jurisdictional information, including any and all jurisdictions in which the Applicant or any affiliated entity are doing business, and registration status, including pending applications (e.g., country, regulator, registration category, date of registration). Provide the address for legal service of process for each jurisdiction, which cannot be a post office box.

5. Attach as **Exhibit E,** a description of the personnel qualifications for each category of professional employees employed by the Applicant or the division, subdivision, or other separate entity within the Applicant as described in Item 4.

6. Attach as **Exhibit F,** an analysis of staffing requirements necessary to carry out the operations of the Applicant as a swap execution facility and the name and qualifications of each key staff person.

7. Attach as **Exhibit G,** a copy of the constitution, articles of incorporation, formation, or association with all amendments thereto, partnership or limited liability agreements, and existing by-laws, operating agreement, rules or instruments corresponding thereto, of the Applicant. Include any additional governance fitness information not included in Exhibit C. Provide a certificate of good standing dated within one week of the date of this Form SEF.

8. Attach as **Exhibit H,** a brief description of any material pending legal proceeding(s), other than ordinary and routine litigation incidental to the business, to which the Applicant or any of its affiliates is a party or to which any of its or their property is the subject. Include the name of the court or agency where the proceeding(s) are pending, the date(s) instituted, the principal parties involved, a description of the factual basis alleged to underlie the proceeding(s), and the relief sought. Include similar information as to any proceeding(s) known to be contemplated by the governmental agencies.

EXHIBITS — FINANCIAL INFORMATION

9. Attach as **Exhibit I:**
    a. (i) Balance sheet, (ii) Statement of income and expenses, (iii) Statement of cash flows, and (iv) Statement of sources and application of revenues and all notes or schedules thereto, as of the most recent fiscal year of the Applicant, or of its parent company, if applicable. If a balance sheet and any statement(s) certified by an independent public accountant are available, that balance sheet and statement(s) should be submitted as Exhibit I.

    b. Provide a narrative of how the value of the financial resources of the Applicant is at least equal to a total amount that would enable the Applicant to cover its operating costs for a period of at least one year, calculated on a rolling basis, and whether such financial resources include unencumbered, liquid financial assets (i.e., cash and/or highly liquid securities) equal to at least six months' operating costs.

    c. Attach copies of any agreements establishing or amending a credit facility, insurance coverage, or other arrangement evidencing or otherwise supporting the Applicant's conclusions regarding the liquidity of its financial assets.

    d. Representations regarding sources and estimates for future ongoing operational resources.

10. Attach as **Exhibit J,** a balance sheet and an income and expense statement for each affiliate of the swap execution facility that also engages in swap execution facility activities or that engages in designated contract market activities as of the end of the most recent fiscal year of each such affiliate.

11. Attach as **Exhibit K,** the following:
    a. A complete list of all dues, fees, and other charges imposed, or to be imposed, by or on behalf of the Applicant for its swap execution facility services that are provided on an exclusive basis and identify the service or services provided for each such due, fee, or other charge.

    b. A description of the basis and methods used in determining the level and structure of the dues, fees, and other charges listed in paragraph (a) of this item.

    c. If the Applicant differentiates, or proposes to differentiate, among its customers or classes of customers in the amount of any dues, fees, or other charges imposed for the same or similar exclusive services, describe and indicate the amount of each differential. In addition, identify and describe any differences in the cost of providing such services and any other factors that account for such differentiations.

EXHIBITS — COMPLIANCE

12. Attach as **Exhibit L,** a narrative and any other form of documentation that may be provided under other Exhibits herein, that describes the manner in which the Applicant is able to comply with each core principle. Such documentation must include a regulatory compliance chart setting forth each core principle and providing citations to the Applicant's relevant rules, policies, and procedures that address each core principle. To the extent that the application raises issues that are novel or for which compliance with a core principle is not self-evident, include an explanation of how that item and the application satisfy the core principles.

13. Attach as **Exhibit M,** a copy of the Applicant's rules (as defined in § 40.1 of the Commission's regulations) and any technical manuals, other guides, or instructions for users of, or participants in, the market, including minimum financial standards for members or market participants. Include rules citing applicable federal position limits and aggregation standards in part 151 of the Commission's regulations and any facility set position limit rules. Include rules on publication of daily trading information with regards to the requirements of part 16 of the Commission's regulations. The Applicant should include an explanation and any other form of documentation that the Applicant thinks will be helpful to its explanation, demonstrating how its rules, technical manuals, other guides, or instructions for users of, or participants in, the market, or minimum financial standards for members or market participants as provided in this Exhibit M help support the swap execution facility's compliance with the core principles.

14. Attach as **Exhibit N,** executed or executable copies of any agreements or contracts entered into or to be entered into by the Applicant, including third party regulatory service provider or member or user agreements that enable or empower the Applicant to comply with applicable core principles. Identify: (1) the services that will be provided; and (2) the core principles addressed by such agreement.

15. Attach as **Exhibit O,** a copy of any compliance manual and any other documents that describe with specificity the manner in which the Applicant will conduct trade practice, market, and financial surveillance.

16. Attach as **Exhibit P,** a description of the Applicant's disciplinary and enforcement protocols, tools, and procedures and, if applicable, the arrangements for alternative dispute resolution.

17. Attach as **Exhibit Q,** an explanation regarding the operation of the Applicant's trading system(s) or platform(s) and the manner in which the system(s) or platform(s) satisfy any Commission rules, interpretations, or guidelines regarding a swap execution facility's execution methods, including the minimum trading functionality requirement in § 37.3(a)(2) of the Commission's regulations. This explanation should include, as applicable, the following:
    a. For trading systems or platforms that enable market participants to engage in transactions through an order book:
        (1) How the trading system or platform displays all orders and trades in an electronic or other form, and the timeliness in which the trading system or platform does so;

        (2) How all market participants have the ability to see and have the ability to transact on all bids and offers; and

(3) An explanation of the trade matching algorithm, if applicable, and examples of how that algorithm works in various trading scenarios involving various types of orders.

b. For trading systems or platforms that enable market participants to engage in transactions through a request for quote system:

(1) How a market participant transmits a request for a quote to buy or sell a specific instrument to no less than three market participants in the trading system or platform, to which all such market participants may respond;

(2) How resting bids or offers from the Applicant's Order Book are communicated to the requester; and

(3) How a requester may transact on resting bids or offers along with the responsive orders.

c. How the timing delay described under § 37.9 of the Commission's regulations is incorporated into the trading system or platform.

18. Attach as **Exhibit R,** a list of rules prohibiting specific trade practice violations.

19. Attach as **Exhibit S,** a discussion of how trading data will be maintained by the swap execution facility.

20. Attach as **Exhibit T,** a list of the name of the clearing organization(s) that will be clearing the Applicant's trades, and a representation that clearing members of that organization will be guaranteeing such trades.

21. Attach as **Exhibit U,** any information (described with particularity) included in the application that will be subject to a request for confidential treatment pursuant to § 145.9 of the Commission's regulations.

EXHIBITS — OPERATIONAL CAPABILITY

22. Attach as **Exhibit V,** information responsive to the Technology Questionnaire. This questionnaire focuses on information pertaining to the Applicant's program of risk analysis and oversight. Main topic areas include: information security; business continuity-disaster recovery planning and resources; capacity and performance planning; systems operations; systems development and quality assurance; and physical security and environmental controls. The questionnaire will be provided to Applicants on the Commission's website.

Appendix B to Part 37 – Guidance on, and Acceptable Practices in, Compliance with Core Principles

1. This appendix provides guidance on complying with core principles, both initially and on an ongoing basis, to maintain registration under section 5h of the Act and this part 37. Where provided, guidance is set forth in paragraph (a) following the relevant heading and can be used to demonstrate to the Commission compliance with the selected requirements of a core principle of this part 37. The guidance for the core principle is illustrative only of the types of matters a swap execution facility may address, as applicable, and is not intended to be used as a mandatory checklist. Addressing the issues set forth in this appendix would help the Commission in its consideration of whether the swap execution facility is in compliance with the selected requirements of a core principle; provided however, that the guidance is not intended to diminish or replace, in any event, the obligations and requirements of applicants and swap execution facilities to comply with the regulations provided under this part 37.

2. Where provided, acceptable practices meeting selected requirements of core principles are set forth in paragraph (b) following the guidance. Swap execution facilities that follow specific practices outlined in the acceptable practices for a core principle in this appendix will meet the selected requirements of the applicable core principle; provided however, that the acceptable practice is not intended to diminish or replace, in any event, the obligations and requirements of applicants and swap execution facilities to comply with the regulations provided under this part 37. The acceptable practices are for illustrative purposes only and do not state the exclusive means for satisfying a core principle.

Core Principle 1 of section 5h of the Act – Compliance with Core Principles

(A) In general. To be registered, and maintain registration, as a swap execution facility, the swap execution facility shall comply with – (i) the core principles described in section 5h of the Act; and (ii) any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5) of the Act.

(B) Reasonable discretion of swap execution facility. Unless otherwise determined by the Commission by rule or regulation, a swap execution facility described in paragraph (A) shall have reasonable discretion in establishing the manner in which the swap execution facility complies with the core principles described in section 5h of the Act.

(a) Guidance. [Reserved]

(b) Acceptable Practices. [Reserved]

Core Principle 2 of section 5h of the Act – Compliance with Rules

A swap execution facility shall:

(A) Establish and enforce compliance with any rule of the swap execution facility, including the terms and conditions of the swaps traded or processed on or through the swap execution facility and any limitation on access to the swap execution facility;

(B) Establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means to provide market participants with impartial access to the market and to capture information that may be used in establishing whether rule violations have occurred;

(C) Establish rules governing the operation of the facility, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the facility, including block trades; and

(D) Provide by its rules that when a swap dealer or major swap participant enters into or facilitates a swap that is subject to the mandatory clearing requirement of section 2(h) of the Act, the swap dealer or major swap participant shall be responsible for compliance with the mandatory trading requirement under section 2(h)(8) of the Act.

(a) Guidance.

(1) Investigations and investigation reports – Warning letters. The rules of a swap execution facility may authorize its compliance staff to issue a warning letter to a person or entity under investigation or to recommend that a disciplinary panel take such an action.

(2) Additional rules required. A swap execution facility should adopt and enforce any additional rules that it believes are necessary to comply with the requirements of section 37.203.

(3) Enforcement staff. A swap execution facility's enforcement staff should not include either members of the swap execution facility or persons whose interests conflict with their enforcement duties. A member of the enforcement staff should not operate under the direction or control of any person or persons with trading privileges at the swap execution facility. A swap execution facility's enforcement staff may operate as part of the swap execution facility's compliance department.

(4) Notice of charges. If compliance staff authorized by a swap execution facility or a swap execution facility disciplinary panel determines, based upon reviewing an

investigation report pursuant to section 37.203(f)(3), that a reasonable basis exists for finding a violation and adjudication is warranted, it should direct that the person or entity alleged to have committed the violation be served with a notice of charges and should proceed in accordance with this guidance. A notice of charges should adequately state the acts, conduct, or practices in which the respondent is alleged to have engaged; state the rule, or rules, alleged to have been violated (or about to be violated); advise the respondent that it is entitled, upon request, to a hearing on the charges; and prescribe the period within which a hearing on the charges may be requested. If the rules of the swap execution facility so provide, a notice may also advise:

(i) That failure to request a hearing within the period prescribed in the notice, except for good cause, may be deemed a waiver of the right to a hearing; and

(ii) That failure to answer or to deny expressly a charge may be deemed to be an admission of such charge.

(5) Right to representation. Upon being served with a notice of charges, a respondent should have the right to be represented by legal counsel or any other representative of its choosing in all succeeding stages of the disciplinary process, except by any member of the swap execution facility's board of directors or disciplinary panel, any employee of the swap execution facility, or any person substantially related to the underlying investigations, such as a material witness or respondent.

(6) Answer to charges. A respondent should be given a reasonable period of time to file an answer to a notice of charges. The rules of a swap execution facility governing the requirements and timeliness of a respondent's answer to a notice of charges should be fair, equitable, and publicly available.

(7) Admission or failure to deny charges. The rules of a swap execution facility may provide that if a respondent admits or fails to deny any of the charges, a disciplinary panel may find that the violations alleged in the notice of charges for which the respondent admitted or failed to deny any of the charges have been committed. If the swap execution facility's rules so provide, then:

(i) The disciplinary panel should impose a sanction for each violation found to have been committed;

(ii) The disciplinary panel should promptly notify the respondent in writing of any sanction to be imposed pursuant to paragraph (7)(i) of this guidance and shall advise the respondent that it may request a hearing on such sanction within the period of time, which shall be stated in the notice;

(iii) The rules of a swap execution facility may provide that if a respondent fails to request a hearing within the period of time stated in the notice, the respondent will be deemed to have accepted the sanction.

(8) Denial of charges and right to hearing. In every instance where a respondent has requested a hearing on a charge that is denied, or on a sanction set by the disciplinary panel, the respondent should be given an opportunity for a hearing in accordance with the rules of the swap execution facility.

(9) Settlement offers. (i) The rules of a swap execution facility may permit a respondent to submit a written offer of settlement at any time after an investigation report is completed. The disciplinary panel presiding over the matter may accept the offer of settlement, but may not alter the terms of a settlement offer unless the respondent agrees.

(ii) The rules of a swap execution facility may provide that, in its discretion, a disciplinary panel may permit the respondent to accept a sanction without either admitting or denying the rule violations upon which the sanction is based.

(iii) If an offer of settlement is accepted, the panel accepting the offer should issue a written decision specifying the rule violations it has reason to believe were committed, including the basis or reasons for the panel's conclusions, and any sanction to be imposed, which should include full customer restitution where customer harm is demonstrated, except where the amount of restitution or to whom it should be provided cannot be reasonably determined. If an offer of settlement is accepted without the agreement of the enforcement staff, the decision should adequately support the disciplinary panel's acceptance of the settlement. Where applicable, the decision should also include a statement that the respondent has accepted the sanctions imposed without either admitting or denying the rule violations.

(iv) The respondent may withdraw his or her offer of settlement at any time before final acceptance by a disciplinary panel. If an offer is withdrawn after submission, or is rejected by a disciplinary panel, the respondent should not be deemed to have made any admissions by reason of the offer of settlement and should not be otherwise prejudiced by having submitted the offer of settlement.

(10) Hearings. (i) The swap execution facility need not apply the formal rules of evidence for a hearing; nevertheless, the procedures for the hearing may not be so informal as to deny a fair hearing. No member of the disciplinary panel for the matter may have a financial, personal, or other direct interest in the matter under consideration.

(ii) In advance of the hearing, the respondent should be entitled to examine all books, documents, or other evidence in the possession or under the control of the swap execution facility. The swap execution facility may withhold documents that: (i) Are privileged or constitute attorney work product; (ii) Were prepared by an employee of the swap execution facility but will not be offered in evidence in the disciplinary proceedings; (iii) May disclose a technique or guideline used in examinations, investigations, or enforcement proceedings; or (iv) Disclose the identity of a confidential source.

(iii) The swap execution facility's enforcement and compliance staffs should be parties to the hearing, and the enforcement staff should present their case on those charges and sanctions that are the subject of the hearing.

(iv) The respondent should be entitled to appear personally at the hearing, should be entitled to cross-examine any persons appearing as witnesses at the hearing, and should be entitled to call witnesses and to present such evidence as may be relevant to the charges.

(v) The swap execution facility should require persons within its jurisdiction who are called as witnesses to participate in the hearing and produce evidence. The swap execution facility should make reasonable efforts to secure the presence of all other persons called as witnesses whose testimony would be relevant.

(vi) The rules of a swap execution facility may provide that a sanction may be summarily imposed upon any person within its jurisdiction whose actions impede the progress of a hearing.

(11) Right to appeal. The rules of a swap execution facility may permit the parties to a proceeding to appeal promptly an adverse decision of a disciplinary panel in all or in

certain classes of cases. Such rules may require a party's notice of appeal to be in writing and to specify the findings, conclusions, or sanctions to which objection are taken. If the rules of a swap execution facility permit appeals, then both the respondent and the enforcement staff should have the opportunity to appeal and the swap execution facility should provide for the following:

(i) The swap execution facility should establish an appellate panel that should be authorized to hear appeals of respondents. In addition, the rules of a swap execution facility may provide that the appellate panel may, on its own initiative, order review of a decision by a disciplinary panel within a reasonable period of time after the decision has been rendered.

(ii) The composition of the appellate panel should be consistent with part 40 of this chapter, and should not include any members of the swap execution facility's compliance staff or any person involved in adjudicating any other stage of the same proceeding. The rules of a swap execution facility should provide for the appeal proceeding to be conducted before all of the members of the appellate panel or a panel thereof.

(iii) Except for good cause shown, the appeal or review should be conducted solely on the record before the disciplinary panel, the written exceptions filed by the parties, and the oral or written arguments of the parties.

(iv) Promptly following the appeal or review proceeding, the appellate panel should issue a written decision and should provide a copy to the respondent. The decision issued by the appellate panel should adhere to all the requirements of section 37.206(d) to the extent that a different conclusion is reached from that issued by the disciplinary panel.

(12) Final decisions. Each swap execution facility should establish rules setting forth when a decision rendered pursuant to its rules will become the final decision of such swap execution facility.

(13) Summary fines for violations of rules regarding timely submission of records. A swap execution facility may adopt a summary fine schedule for violations of rules relating to the failure to timely submit accurate records required for clearing or verifying each day's transactions. A swap execution facility may permit its compliance staff, or a designated panel of swap execution facility officials, to summarily impose minor sanctions against persons within the swap execution facility's jurisdiction for violating such rules. A swap execution facility's summary fine schedule may allow for warning letters to be issued for first-time violations or violators. If adopted, a summary fine schedule should provide for progressively larger fines for recurring violations.

(14) Emergency disciplinary actions. (i) A swap execution facility may impose a sanction, including suspension, or take other summary action against a person or entity subject to its jurisdiction upon a reasonable belief that such immediate action is necessary to protect the best interest of the marketplace.

(ii) Any emergency disciplinary action should be taken in accordance with a swap execution facility's procedures that provide for the following:

(A) If practicable, a respondent should be served with a notice before the action is taken, or otherwise at the earliest possible opportunity. The notice should state the action, briefly state the reasons for the action, and state the effective time and date, and the duration of the action.

(B) The respondent should have the right to be represented by legal counsel or any other representative of its choosing in all proceedings subsequent to the emergency action taken. The respondent should be given the opportunity for a hearing as soon as reasonably practicable and the hearing should be conducted before the disciplinary panel pursuant to the rules of the swap execution facility.

(C) Promptly following the hearing provided for in paragraph (14)(ii)(B) of this guidance, the swap execution facility should render a written decision based upon the weight of the evidence contained in the record of the proceeding and should provide a copy to the respondent. The decision should include a description of the summary action taken; the reasons for the summary action; a summary of the evidence produced at the hearing; a statement of findings and conclusions; a determination that the summary action should be affirmed, modified, or reversed; and a declaration of any action to be taken pursuant to the determination, and the effective date and duration of such action.

(b) Acceptable Practices. [Reserved]

Core Principle 3 of section 5h of the Act – Swaps Not Readily Susceptible to Manipulation

The swap execution facility shall permit trading only in swaps that are not readily susceptible to manipulation.

(a) Guidance.

(1) In general, a swap contract is an agreement to exchange a series of cash flows over a period of time based on some reference price, which could be a single price, such as an absolute level or a differential, or a price index calculated based on multiple observations. Moreover, such a reference price may be reported by the swap execution facility itself or

by an independent third party. When listing a swap for trading, a swap execution facility shall ensure a swap's compliance with Core Principle 3, paying special attention to the reference price used to determine the cash flow exchanges. Specifically, Core Principle 3 requires that the reference price used by a swap not be readily susceptible to manipulation. As a result, when identifying a reference price, a swap execution facility should either: (i) calculate its own reference price using suitable and well-established acceptable methods or (ii) carefully select a reliable third-party index.

(2) The importance of the reference price's suitability for a given swap is similar to that of the final settlement price for a cash-settled futures contract. If the final settlement price is manipulated, then the futures contract does not serve its intended price discovery and risk management functions. Similarly, inappropriate reference prices cause the cash flows between the buyer and seller to differ from the proper amounts, thus benefitting one party and disadvantaging the other. Thus, careful consideration should be given to the potential for manipulation or distortion of the reference price.

(3) For swaps that are settled by physical delivery or by cash settlement refer to the guidance in appendix C to part 38 of this chapter—Demonstration of Compliance That a Contract is not Readily Susceptible to Manipulation, section b(2) and section c(5), respectively.

(b) Acceptable Practices. [Reserved]

Core Principle 4 of section 5h of the Act – Monitoring of Trading and Trade Processing

The swap execution facility shall:

(A) Establish and enforce rules or terms and conditions defining, or specifications detailing:

(1) Trading procedures to be used in entering and executing orders traded on or through the facilities of the swap execution facility; and

(2) Procedures for trade processing of swaps on or through the facilities of the swap execution facility; and

(B) Monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.

(a) Guidance. The monitoring of trading activity in listed swaps should be designed to prevent manipulation, price distortion, and disruptions of the physical-delivery and cash settlement processes. The swap execution facility should have rules in place that allow it to intervene to prevent or reduce such market disruptions. Once a threatened or actual disruption is detected, the swap execution facility should take steps to prevent the market disruption or reduce its severity.

(1) General requirements. Real-time monitoring for market anomalies is the most effective, but the swap execution facility may also demonstrate that it has an acceptable program if some of the monitoring is accomplished on a T+1 basis. The monitoring of trading should use automated alerts to detect abnormal price movements and unusual trading volumes in real-time and instances or threats of manipulation, price distortion, and disruptions on at least a T+1 basis. The T+1 detection and analysis should incorporate any additional data that becomes available on a T+1 basis, including the trade

reconstruction data. In some cases, a swap execution facility may demonstrate that its manual processes are effective.

The swap execution facility should continually monitor the appropriateness of its swaps' terms and conditions, including the physical-delivery requirements or reference prices used to determine cash flows or settlement. The swap execution facility should act promptly to address the conditions that are causing price distortions or market disruptions, including, when appropriate, changes to contract terms. The swap execution facility should be mindful that changes to contract terms may affect whether a product is subject to the trade execution and clearing requirements of the Act.

(2) Physical-delivery swaps. For physical-delivery swaps, the swap execution facility should monitor for conditions that may cause the swap to become susceptible to price manipulation or distortion, including: a) the general availability of the commodity specified by the swap, the commodity's characteristics, and the delivery locations; and b) if available, information related to the size and ownership of deliverable supplies.

(3) Cash-settled swaps. For cash-settled swaps, the swap execution facility should monitor for pricing abnormalities in the index or instrument used to calculate the reference price. If the swap execution facility computes its own reference price used for cash flows or settlement, it should promptly amend any methodologies that result, or are likely to result, in manipulation, price distortions, or market disruptions, or impose new methodologies to resolve the threat of disruptions or distortions. If the swap execution facility relies upon a third-party index or instrument, including an index or instrument traded on another venue for the swap reference price, it should conduct due diligence to

ensure that the reference price is not susceptible to manipulation and that the terms and conditions of the swap continue to comply with section 37.300.

(4) Ability to obtain information. The swap execution facility shall demonstrate that it has access to sufficient information to assess whether trading in swaps listed on its market, in the index or instrument used as a reference price, or the underlying commodity for its listed swaps is being used to affect prices on its market. The swap execution facility should demonstrate that it can obtain position and trading information directly from the market participants that conduct substantial trading on its facility or through an information sharing agreement with other venues or a third-party regulatory service provider. If the position and trading information is not available directly from the market participants in its markets, but is available through information sharing agreements with other trading venues or a third-party regulatory service provider, the swap execution facility should cooperate in such information sharing agreements.

The swap execution facility may limit the application of the requirement for market participants to keep and provide records of their activity in the index or instrument used as a reference price, the underlying commodity, and related derivatives markets, to only those market participants that conduct substantial trading on its facility.

(5) Risk controls for trading. An acceptable program for preventing market disruptions shall demonstrate appropriate trading risk controls, in addition to pauses and halts. Risk controls should be adapted to the unique characteristics of the trading platform and of the markets to which they apply and should be designed to avoid market disruptions without unduly interfering with that market's price discovery function. The swap execution facility may choose from among controls that include: pre-trade limits on order size, price

collars or bands around the current price, message throttles, daily price limits, and intraday position limits related to financial risk to the clearing member, or design other types of controls, as well as clear error-trade and order-cancellation policies. Within the specific array of controls that are selected, the swap execution facility should set the parameters for those controls, so that the specific parameters are reasonably likely to serve the purpose of preventing market disruptions and price distortions. If a swap is fungible with, linked to, or a substitute for other swaps on the swap execution facility or on other trading venues, such risk controls should, to the extent practicable, be coordinated with any similar controls placed on those other swaps. If a swap is based on the level of an equity index, such risk controls should, to the extent practicable, be coordinated with any similar controls placed on national security exchanges.

(b) Acceptable practices. [Reserved]

Core Principle 5 of section 5h of the Act – Ability to Obtain Information

The swap execution facility shall:

(A) Establish and enforce rules that will allow the facility to obtain any necessary information to perform any of the functions described in section 5h of the Act;

(B) Provide the information to the Commission on request; and

(C) Have the capacity to carry out such international information-sharing agreements as the Commission may require.

(a) Guidance. [Reserved]

(b) Acceptable Practices. [Reserved]

Core Principle 6 of section 5h of the Act – Position Limits or Accountability

(A) In general. To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, a swap execution facility that is a trading facility shall adopt for each of the contracts of the facility, as is necessary and appropriate, position limitations or position accountability for speculators.

(B) Position limits. For any contract that is subject to a position limitation established by the Commission pursuant to section 4a(a) of the Act, the swap execution facility shall:

(1) Set its position limitation at a level no higher than the Commission limitation; and

(2) Monitor positions established on or through the swap execution facility for compliance with the limit set by the Commission and the limit, if any, set by the swap execution facility.

(a) Guidance. Until such time that compliance is required under part 151 of this chapter, a swap execution facility should have reasonable discretion to comply with section 37.600, including considering part 150 of this chapter. For Required Transactions as defined in section 37.9, a swap execution facility may demonstrate compliance with section 37.600 by setting and enforcing position limitations or position accountability levels only with respect to trading on the swap execution facility's own market. For Permitted Transactions as defined in section 37.9, a swap execution facility may demonstrate compliance with section 37.600 by setting and enforcing position accountability levels or sending the Commission a list of Permitted Transactions traded on the swap execution facility.

(b) Acceptable Practices. [Reserved]

Core Principle 7 of section 5h of the Act – Financial Integrity of Transactions

The swap execution facility shall establish and enforce rules and procedures for ensuring the financial integrity of swaps entered on or through the facilities of the swap execution facility, including the clearance and settlement of the swaps pursuant to section 2(h)(1) of the Act.

(a) Guidance. [Reserved]

(b) Acceptable Practices. [Reserved]

Core Principle 8 of section 5h of the Act – Emergency Authority

The swap execution facility shall adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, as is necessary and appropriate, including the authority to liquidate or transfer open positions in any swap or to suspend or curtail trading in a swap.

(a) Guidance.

(1) A swap execution facility should have rules that authorize it to take certain actions in the event of an emergency, as defined in section 40.1(h) of this chapter. A swap execution facility should have the authority to intervene as necessary to maintain markets with fair and orderly trading and to prevent or address manipulation or disruptive trading practices, whether the need for intervention arises exclusively from the swap execution facility's market or as part of a coordinated, cross-market intervention. A swap execution facility should have the flexibility and independence to address market emergencies in an effective and timely manner consistent with the nature of the emergency, as long as all such actions taken by the swap execution facility are made in good faith to protect the integrity of the markets. However, the swap execution facility should also have rules that

allow it to take market actions as may be directed by the Commission. Additionally, in situations where a swap is traded on more than one platform, emergency action to liquidate or transfer open interest shall be as directed, or agreed to, by the Commission or the Commission's staff. Swap execution facility rules should include procedures and guidelines for decision-making and implementation of emergency intervention that avoid conflicts of interest in accordance with the provisions of section 40.9 of this chapter, and include alternate lines of communication and approval procedures to address emergencies associated with real time events. To address perceived market threats, the swap execution facility should have rules that allow it to take emergency actions, including imposing or modifying position limits, imposing or modifying price limits, imposing or modifying intraday market restrictions, imposing special margin requirements, ordering the liquidation or transfer of open positions in any contract, ordering the fixing of a settlement price, extending or shortening the expiration date or the trading hours, suspending or curtailing trading in any contract, transferring customer contracts and the margin, or altering any contract's settlement terms or conditions, or, if applicable, providing for the carrying out of such actions through its agreements with its third-party provider of clearing or regulatory services.

(2) A swap execution facility should promptly notify the Commission of its exercise of emergency action, explaining its decision-making process, the reasons for using its emergency authority, and how conflicts of interest were minimized, including the extent to which the swap execution facility considered the effect of its emergency action on the underlying markets and on markets that are linked or referenced to the contracts traded on its facility, including similar markets on other trading venues. Information on all

regulatory actions carried out pursuant to a swap execution facility's emergency authority should be included in a timely submission of a certified rule pursuant to part 40 of this chapter.

(b) Acceptable Practices. [Reserved]

Core Principle 9 of section 5h of the Act – Timely Publication of Trading Information

(A) In general. The swap execution facility shall make public timely information on price, trading volume, and other trading data on swaps to the extent prescribed by the Commission.

(B) Capacity of swap execution facility. The swap execution facility shall be required to have the capacity to electronically capture and transmit trade information with respect to transactions executed on the facility.

(a) Guidance. [Reserved]

(b) Acceptable Practices. [Reserved]

Core Principle 10 of section 5h of the Act – Recordkeeping and Reporting

(A) In general. A swap execution facility shall:

(1) Maintain records of all activities relating to the business of the facility, including a complete audit trail, in a form and manner acceptable to the Commission for a period of five years;

(2) Report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines to be necessary or appropriate for the Commission to perform the duties of the Commission under the Act; and

(3) Keep any such records relating to swaps defined in section 1a(47)(A)(v) of the Act open to inspection and examination by the Securities and Exchange Commission.

(B) Requirements. The Commission shall adopt data collection and reporting requirements for swap execution facilities that are comparable to corresponding requirements for derivatives clearing organizations and swap data repositories.

(a) Guidance. [Reserved]

(b) Acceptable Practices. [Reserved]

Core Principle 11 of section 5h of the Act – Antitrust Considerations

Unless necessary or appropriate to achieve the purposes of the Act, the swap execution facility shall not:

(A) Adopt any rules or take any actions that result in any unreasonable restraint of trade; or

(B) Impose any material anticompetitive burden on trading or clearing.

(a) Guidance. An entity seeking registration as a swap execution facility may request that the Commission consider under the provisions of section 15(b) of the Act, any of the entity's rules, including trading protocols or policies, and including both operational rules and the terms or conditions of products listed for trading, at the time of registration or thereafter. The Commission intends to apply section 15(b) of the Act to its consideration of issues under this core principle in a manner consistent with that previously applied to contract markets.

(b) Acceptable Practices. [Reserved]

Core Principle 12 of section 5h of the Act – Conflicts of Interest:

The swap execution facility shall:

(A) Establish and enforce rules to minimize conflicts of interest in its decision-making process; and

(B) Establish a process for resolving the conflicts of interest.

(a) Guidance. [Reserved]

(b) Acceptable Practices. [Reserved]

Core Principle 13 of section 5h of the Act – Financial Resources

(A) In general. The swap execution facility shall have adequate financial, operational, and managerial resources to discharge each responsibility of the swap execution facility.

(B) Determination of resource adequacy. The financial resources of a swap execution facility shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the swap execution facility to cover the operating costs of the swap execution facility for a one-year period, as calculated on a rolling basis.

(a) Guidance. [Reserved]

(b) Acceptable Practices. [Reserved]

Core Principle 14 of section 5h of the Act – System Safeguards

The swap execution facility shall:

(A) Establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk, through the development of appropriate controls and procedures, and automated systems, that:

(1) Are reliable and secure; and

(2) Have adequate scalable capacity;

(B) Establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for:

(1) The timely recovery and resumption of operations; and

(2) The fulfillment of the responsibilities and obligations of the swap execution facility; and

(C) Periodically conduct tests to verify that the backup resources of the swap execution facility are sufficient to ensure continued:

(1) Order processing and trade matching;

(2) Price reporting;

(3) Market surveillance; and

(4) Maintenance of a comprehensive and accurate audit trail.

(a) Guidance.

(1) Risk analysis and oversight program. In addressing the categories of its risk analysis and oversight program, a swap execution facility should follow generally accepted standards and best practices with respect to the development, operation, reliability, security, and capacity of automated systems.

(2) Testing. A swap execution facility's testing of its automated systems and business continuity-disaster recovery capabilities should be conducted by qualified, independent professionals. Such qualified independent professionals may be independent contractors or employees of the swap execution facility, but should not be persons responsible for development or operation of the systems or capabilities being tested.

(3) Coordination. To the extent practicable, a swap execution facility should:

(i) Coordinate its business continuity-disaster recovery plan with those of the market participants it depends upon to provide liquidity, in a manner adequate to enable effective

resumption of activity in its markets following a disruption causing activation of the swap execution facility's business continuity-disaster recovery plan;

(ii) Initiate and coordinate periodic, synchronized testing of its business continuity-disaster recovery plan with those of the market participants it depends upon to provide liquidity; and

(iii) Ensure that its business continuity-disaster recovery plan takes into account such plans of its telecommunications, power, water, and other essential service providers.

(b) Acceptable Practices. [Reserved]

Core Principle 15 of section 5h of the Act – Designation of Chief Compliance Officer

(A) In general. Each swap execution facility shall designate an individual to serve as a chief compliance officer.

(B) Duties. The chief compliance officer shall:

(1) Report directly to the board or to the senior officer of the facility;

(2) Review compliance with the core principles in this subsection;

(3) In consultation with the board of the facility, a body performing a function similar to that of a board, or the senior officer of the facility, resolve any conflicts of interest that may arise;

(4) Be responsible for establishing and administering the policies and procedures required to be established pursuant to this section;

(5) Ensure compliance with the Act and the rules and regulations issued under the Act, including rules prescribed by the Commission pursuant to section 5h of the Act; and

(6) Establish procedures for the remediation of noncompliance issues found during compliance office reviews, look backs, internal or external audit findings, self-reported errors, or through validated complaints.

(C) Requirements for procedures. In establishing procedures under paragraph (B)(6) of this section, the chief compliance officer shall design the procedures to establish the handling, management response, remediation, retesting, and closing of noncompliance issues.

(D) Annual reports.

(1) In general. In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of:

(i) The compliance of the swap execution facility with the Act; and

(ii) The policies and procedures, including the code of ethics and conflict of interest policies, of the swap execution facility.

(2) Requirements. The chief compliance officer shall:

(i) Submit each report described in clause (1) with the appropriate financial report of the swap execution facility that is required to be submitted to the Commission pursuant to section 5h of the Act; and

(ii) Include in the report a certification that, under penalty of law, the report is accurate and complete.

(a) Guidance. [Reserved]

(b) Acceptable Practices. [Reserved]

Issued in Washington, DC, on May 17, 2013, by the Commission.

Melissa D. Jurgens,

Secretary of the Commission.

Appendices to Core Principles and Other Requirements for Swap Execution Facilities

NOTE: The following appendices will not appear in the Code of Federal Regulations.

Appendix 1 – Commission Voting Summary

On this matter, Chairman Gensler and Commissioners Chilton, O'Malia and Wetjen voted in the affirmative; Commissioner Sommers voted in the negative.

Appendix 2 – Statement of Chairman Gary Gensler

I support the final rulemaking on swap execution facilities (SEFs). This rule is key to fulfilling transparency reforms that Congress mandated in the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Congress included a trade execution requirement in the law. This means that swaps subject to mandatory clearing and made available to trade would move to transparent trading platforms. Market participants would benefit from the price competition that comes from trading platforms where multiple participants have the ability to trade swaps by accepting bids and offers made by multiple participants. Congress also said that the market participants must have impartial access to these platforms.

Farmers, ranchers, producers and commercial companies that want to hedge a risk by locking in a future price or rate would get the benefit of the competition and

transparency that trading platforms, both SEFs and designated contract markets (DCMs), will provide.

These transparent platforms will give everyone looking to compete in the marketplace the ability to see the prices of available bids and offers prior to making a decision on a transaction. By the end of this year, a significant portion of interest rate and credit derivative index swaps would be in full view to the marketplace before transactions occur. This is a significant shift toward market transparency from the status quo.

Such common-sense transparency has existed in the securities and futures markets since the historic reforms of the 1930s. Transparency lowers costs for investors, businesses and consumers, as it shifts information from dealers to the broader public. It promotes competition and increases liquidity.

As Congress made clear in the law, trading on SEFs and DCMs would be required only when financial institutions transact with financial institutions. End-users would benefit from access to the information on these platforms, but would not be required to use them.

Further, companies would be able to continue relying on customized transactions – those not required to be cleared – to meet their particular needs, as well as to enter into large block trades.

Consistent with Congress' directive that multiple parties have the ability to trade with multiple parties on these transparent platforms, these reforms require that market participants trade through an order book, and provide the flexibility as well to seek requests for quotes.

To be a registered SEF, the trading platform will be required to provide an order book to all its market participants. This is significant, as for the first time, the broad public will be able to gain access and compete in this market with the assurance that their bids or offers will be communicated to the rest of the market. This provision alone will significantly enhance transparency and competition in the market.

SEFs also will have the flexibility to offer trading through requests for quotes. The rule provides that such requests would have to go out to a minimum of three unaffiliated market participants before a swap that is cleared, made available to trade and less than a block could be executed. There will be an initial phase-in period with a minimum of two participants to smooth the transition.

As long as the minimum functionality is met, as detailed in the rule, and the SEF complies with these rules and the core principles, the SEF can conduct business through any means of interstate commerce, such as the Internet, telephone or even the mail. Thus, today's rule is technology neutral.

Under these transparency reforms coupled with the Commission's rule on making swaps available for trading, the trade execution requirement will be phased in for market participants, giving them time to comply.

These reforms benefited from extensive public comments. Moving forward, the CFTC will work with SEF applicants on implementation.

Appendix 3 – Concurring Statement of Commissioner Scott D. O'Malia

Today, the Commission votes to establish a new trading venue, a Swap Execution Facility (SEF) that will allow market participants to access a more transparent market and offer innovative trading opportunities. Unlike the futures exchanges which are tied to a

single clearinghouse, trades executed on SEFs can be cleared at different clearinghouses, which will provide a new competitive execution space. For these reasons, I have always had high hopes for SEFs.

I am pleased that the final rule has been revised to soften many of the proposed rough edges and should allow for a smooth transition to this new trading environment.

The final rule allows for a streamlined temporary registration process to ensure that SEF platforms are not disadvantaged by regulatory delays that could stifle competition or provide a first-mover advantage. However, instead of "rubberstamping" SEFs' applications, a better approach would have been to conduct a more substantive, but limited review of applications by coming up with a Checklist that contains specific requirements and that takes into account work already done by the National Futures Association in reviewing the SEFs' systems and rulebooks.

I am also cautiously optimistic about the Commission's commitment to revisit the SEF rule and other Commission's rules to address regulatory conflicts with foreign jurisdictions. Such regulatory disparities will discourage U.S. and foreign traders from doing business in the United States and prompt them to move their businesses to foreign jurisdictions with a less restrictive trading environment. I am pleased to have the commitment of Chairman Gensler who stated his intention to revisit the SEF rule if it proves to conflict with international regulatory requirements making U.S. platforms uncompetitive or disadvantaged as a result of this rulemaking.

For SEFs to be successful, the Commission must be faithful to the express directives of Dodd-Frank and implement rules that are clear and promote efficient and fair trading.

As I explain below, the Commission's rules have fallen short of these objectives.

The Rule's Requirement to Send a Request for Quote to Three Market Participants is Not Supported by Law.

Dodd-Frank seeks to "promote the trading on SEFs and to promote pre-trade price transparency in the swaps market."[1] To advance these objectives, the rule must permit SEFs to offer flexible execution platforms that ensure pre-trade price transparency, but at the same time, allow participants (buy-side, sell-side, commercial firms) to execute various products with different levels of trading liquidity at the price acceptable to them.

Thus, the success of a SEF is determined by whether it will be able to meet the liquidity needs of various market participants. Although the rules allow a Request for Quote (RFQ) to accommodate transactions in less liquid products to the extent that such products are determined to be made available to trade as provided in the Made Available to Trade rule,[2] I am concerned that the requirement to broadcast a quote to at least three market participants is not supported by the statute and is not based on data analysis.[3]

One way for the Commission to assess trading liquidity on a SEF and make necessary adjustments to the RFQ requirement is to analyze transaction data that the Commission now receives from Swap Data Repositories (SDRs). Over time, as liquidity increases and the market feels more confident about SEFs, there will be a natural progression for market participants to migrate to more centralized execution platforms

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[1] CEA § 5h(e).

[2] Commissioner Scott D. O'Malia Dissenting Statement, Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade under Section 2(h)(8) of the Commodity Exchange Act; Swap Transaction Compliance and Implementation Schedule; Trade Execution Requirement Under Section 2(h) of the Commodity Exchange Act (May 16, 2013).

[3] A SEF is defined as a "trading system . . . in which multiple participants have the ability to . . . trade swaps by accepting bids and offers made by multiple participants in the . . . system, through any means of interstate commerce." CEA § 1(a)(50).

and the role of the RFQ may be significantly reduced. But again, the Commission should not come up with an unsubstantiated number and declare it to be the law. Instead, the Commission must make such determination based on an evaluation of the SDR transaction data.

The Rule Should Have Provided Further Clarity Regarding Voice Execution.

SEFs, by definition, may execute swaps "through any means of interstate commerce."[4] As I mentioned before, I strongly support the use of various methods of execution, including voice, to foster a competitive trading environment on a SEF. I am pleased that the final rule acknowledges the "any means of interstate commerce" clause and provides for a role of voice and other means of execution. However, I remain concerned that although the preamble to the rule provides an example of a voice-based method of execution, the rule text does not expressly allow for voice and other execution methods.[5] A better approach would have been to add voice to the rule text as the third method of execution on a SEF.

The Rule Should Have Provided Clarity Regarding Exchange of Swaps for Related Position Transactions

For some unknown reason, the draft rule prohibited trades involving an Exchange of Swaps for Related Positions (ESRPs). Yet again, such ban would have caused the **pendulum** of the Commission's **regulations** to continue its **swing** toward futures trading as the Commodity Exchange Act (CEA) expressly allows for *bone fide* Exchange of Futures for Related Positions transactions.

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[4] CEA § 1(a) (50).

[5] Commission Regulation § 37.9.

The Commission sought to ban ESRPs transactions because they were not expressly allowed by the CEA. Just because these transactions are not mentioned in the statute, they don't have to be banned by the Commission's rules.

I am glad that in the final rule, the Commission took a more reasonable approach and now has committed to entertaining requests from market participants to permit off-exchange trades where swaps are components of exchanges of swaps for physicals transactions.

Conclusion

For the reasons stated above, I reluctantly concur with the decision of the Commission to approve this final rule.