

# RECOMMENDATIONS REGARDING THE SWAP DEALER LANDSCAPE

Report of the Market Structure Subcommittee,  
Market Risk Advisory Committee of the  
U.S. Commodity Futures Trading Commission

Acting Chairman Rostin Behnam, Sponsor

Stephen Berger & Lisa A. Shemie, Co-Chairmen

*This report was approved on February 10, 2021 by the Market Structure Subcommittee of the Market Risk Advisory Committee (MRAC). The views, analyses, and conclusions expressed herein reflect the work of the Market Structure Subcommittee of the MRAC, and do not necessarily reflect the views of the MRAC, the Commodity Futures Trading Commission or its staff, or the U.S. government. Reference to any products, services, websites, organizations, or enterprises, or the use of any, organization, trade, firm, or corporation name is for informational purposes only and does not constitute endorsement, recommendation, or favoring by the U.S. Government.*

## Objective

The Market Structure Subcommittee of the Market Risk Advisory Committee has focused on considering ways to seek to encourage liquidity and diversity among liquidity providers trading on swap execution facilities (SEFs) and designated contract markets (DCMs) without undermining the goals of swap dealer regulation.

## Recommendations

The Market Structure Subcommittee of the Market Risk Advisory Committee recommends that the Commission (a) exempt swaps that are exchange-traded<sup>1</sup> and centrally cleared from the swap dealer registration threshold calculation, and (b) further explore additional modifications to the swap dealer regime to encourage additional liquidity without undermining its objectives or increasing systemic risk, as further set forth below.

### **I. Background; History; Key elements of swap market reform**

- The primary objective of swap market reform was to address the risks the previously unregulated swaps market posed to the financial system. In response to the role the swap markets played in the financial crisis the various financial regulatory agencies proposed, and Congress chose to adopt, two complimentary regulatory regimes:
  - Central clearing/trading: Recognizing that the futures markets functioned well during the financial crisis and that certain parts of the swaps markets had become sufficiently standardized to be supported by a centrally traded and cleared market infrastructure, Congress called for those swaps that were sufficiently standardized to be centrally cleared, and those suitable for central trading to be traded on a DCM or SEF.
  - Bespoke/other swaps not suitable for central clearing/trading: Separately, to regulate what remained, bespoke and certain other swaps products not suitable for centralization were to remain in the OTC market under a specific regime designed to address the risks to the marketplace by regulating the large dealers/intermediaries in that space, namely “swap dealers”<sup>2</sup>.
- Swap dealers are required to comply with capital and margin requirements, reporting and recordkeeping, daily trading records, business conduct standards, Chief Compliance Officer requirements and annual reports, as well as segregation requirements related to collateral held against uncleared swaps.

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<sup>1</sup> As used herein, references to “exchange-traded” swaps denote swaps that are traded on a SEF or a DCM.

<sup>2</sup> The Commission does not, nor has it ever, regulated futures market “dealing” activity through registration at the entity level. No such regulatory regime exists for liquidity provision in futures.

- The policy considerations/key elements of each of the central clearing/trading and the swap dealer regime are the same (the “**key elements**”):
  - a. Capital
  - b. Margin
  - c. Reporting
  - d. Business conduct standards

Alongside implementation of the central clearing and trading mandates, Congress included registration and regulation of large dealers as part of its swaps markets reforms.

## **II. Previous Commission actions**

The Commission has recognized the regulatory benefits of central clearing/trading and the lack of new entrants as liquidity providers, and has put forth proposed solutions:

### **Floor Trader Exemption**

- The floor trader exception to the swap dealer definition was intended to allow firms that registered as floor traders, but not as swap dealers, to access the swaps markets on DCMs and SEFs.
  - See Regulation 1.3(ggg)(6)(iv), 17 C.F.R. 1.3(ggg)(6)(iv); Entity Definition Rules, 77 Fed. Reg. at 30,746
- Following the receipt of input from market participants, the Commission has sought to clarify through no-action relief what has been considered to be an ineffective provision.
  - See Division of Swap Dealer and Intermediary Oversight (DSIO) No-Action Letter 13-37 (June 27, 2013) (<https://www.cftc.gov/sites/default/files/idc/groups/public/@lrllettergeneral/documents/letter/13-37.pdf>)
  - See DSIO No-Action Letter 13-61 (September 30, 2013) (<https://www.cftc.gov/sites/default/files/idc/groups/public/@lrllettergeneral/documents/letter/13-61.pdf>)
  - See DSIO No-Action Letter 19-14 (June 27, 2019) (<https://www.cftc.gov/system/files/csl/final/pdfs/19/1561667900/19-14.pdf>)
- In seeking to address the issue through the above-cited No-Action Letters, Commissioner Berkovitz noted that the current Floor Trader rule has not worked as intended and that “***a rulemaking to amend the swap dealer definition is the best way to fix the issues with the current rule***”
  - See Statement of Commissioner Dan Berkovitz in Support of the Staff No Action Letter Regarding Floor Traders (June 27, 2019) (<https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement062719>)

- Notwithstanding the issuance of this no-action relief, firms have not availed themselves of this avenue in any meaningful way. As stated by Commissioner Quintenz in his objection to the issuance of the no-action relief, “the floor trader exception from swap dealer registration targeted by today’s no-action relief only applies to proprietary trading firms that have historically never been required to register with the Commission. These firms, which risk their own capital and do not have customers or investors, can participate freely in the futures markets without registering with the CFTC.” He went on to say that ***“[A]ny proprietary trading firm that takes advantage of this revised floor trader exception should remember that no-action relief can be withdrawn at any time and with little notice.”***

### **De Minimis Exception**

- The de minimis exception to the swap dealer definition sought to define the level of swaps activity beyond which registration is required. The Commission has continued to consider whether that level is appropriate, and as recently as last year determined that lowering the threshold was not needed to achieve the goal of regulating systemically important firms.
  - See Swap Dealer De Minimis Exception Final Staff Report (August 15, 2016) ([https://www.cftc.gov/sites/default/files/idc/groups/public/@swaps/documents/file/dfreport\\_sddeminis081516.pdf](https://www.cftc.gov/sites/default/files/idc/groups/public/@swaps/documents/file/dfreport_sddeminis081516.pdf))
  - See De Minimis Exception to the Swap Dealer Definition – Final Rule (<https://www.federalregister.gov/documents/2018/11/13/2018-24579/de-minimis-exception-to-the-swap-dealer-definition>)
- As part of the work culminating in the Final Rule on the de minimis exception, the Commission sought comment on the idea of exempting exchange-traded and/or cleared swaps from the de minimis threshold, as well as exempting non-deliverable foreign exchange forwards (NDFs).
  - See De Minimis Exception to the Swap Dealer Definition – Notice of Proposed Rulemaking (<https://www.govinfo.gov/content/pkg/FR-2018-06-12/pdf/2018-12362.pdf>), Sections III(B) and (C)
  - Most commenters supported including an exception for exchange-traded and/or cleared swaps; only two commenters were opposed.
  - Further, most commenters generally supported including an exception for NDFs; one commenter was opposed.
- In the Final Rule, the Commission stated that it might consider exempting exchange-traded and/or cleared swaps in response to the comments.
  - Page 55681, in section IV, states: “At this time, the Commission is not adopting final rules regarding any of these three potential changes [i.e., exempting cleared swaps]. The Commission may take subsequent action or conduct further study with respect to any of these issues.”

- Also at page 56682, in “B. Exception for Exchange-Traded and/or Cleared Swaps,” there is acknowledgement that most commenters supported including an exception for exchange-traded and/or cleared swaps.
- Chairman Giancarlo’s statement in support of the Final Rule indicated that he would direct Commission staff to conduct a study on calculating de minimis trigger and the feasibility of exempting cleared swaps.
- In response to Chairman Giancarlo’s statement, the Commission’s Division of Swap Dealer and Intermediary Oversight (DSIO) issued a report in July 2019 setting forth the results of that study, which sought to explore the impact to the swap dealer landscape that could result from the exemption of certain swaps from the de minimis determination. The report demonstrated that 95 of the 108 then-currently-registered swap dealers would have been required to register as swap dealers even if swaps that were exchange-traded and cleared were not counted towards their de minimis threshold. The report did not, however, consider whether exempting such swaps would have the effect of inducing additional firms to trade them on DCMs/SEFs as a result of such trading not triggering a requirement to register as a swap dealer.
  - See Report Regarding the Swap Dealer De Minimum Exception and On-Venue and Cleared Swaps (July 8, 2019) (<https://www.cftc.gov/PressRoom/PressReleases/7958-19>) (the “DSIO Report”)

### **III. Effect on Swap Dealer Regulation’s “Key Elements” of Excluding Certain Swaps from the Swap Dealer De Minimis Determination**

#### **Swaps that are exchange-traded and centrally cleared**

Each of the key elements is met in a swap that is exchange-traded and cleared without the need to require market participants to register as a swap dealer or to place additional regulatory requirements on them. Taking each of the key elements individually, in a swap that is exchange-traded and cleared:

- Clearing members of the CCP facilitate swap clearing and are already subject to regulatory capital requirements
- Approved margin requirements are met by both counterparties clearing through the CCP
- Reporting requirements are met by the SEF or DCM
- Business conduct standard regulations are met by the policies of the SEF or DCM governing trading behavior

Given that each of the key elements of swap dealer regulation is met under this scenario, coupled with the recognition that parallel futures trading activity does not carry an analogous entity-level registration regime, the Subcommittee urges the Commission to follow through with the longstanding suggestion of exempting swaps that are exchange-traded and centrally cleared from the swap dealer registration threshold calculation.

### **Swaps that are exchange-traded and not centrally cleared**

In addition to exempting swaps that are both exchange-traded and cleared from the registration threshold, the Commission should also consider the exemption of certain swaps that are exchange-traded but not centrally cleared. Certain swaps that are currently not listed for clearing – primarily foreign exchange options and NDFs – are executed through SEFs, and many market participants access SEFs through a prime broker (PB) relationship, and most (if not all) PBs are registered swap dealers. As a result, all such swaps executed on a SEF through a PB, as well as the mirror swap executed off-exchange, would have at least one swap dealer counterparty, thus satisfying each of the key elements notwithstanding the absence of central clearing.

#### **IV. Conclusions and recommendations**

The Subcommittee urges the Commission to exempt swaps that are exchange-traded and cleared from the swap dealer registration threshold calculation.

Further, the Subcommittee recommends that the Commission consider other solutions to seek to increase liquidity, such as:

- exempting swaps that are exchange-traded but not centrally cleared from the swap dealer registration threshold calculation to the extent they are traded through a PB that is a registered swap dealer (such as FX options and NDFs that are traded through this common model);
- pursuing additional fact finding to better understand the reasons why certain firms are reluctant to pursue registration as floor traders notwithstanding the no-action relief from certain of the regime's conditions, and to seek to quantify the potential effect of exempting certain swaps from the swap dealer registration threshold in terms of increased liquidity.

The Market Structure Subcommittee of the Market Risk Advisory Committee believes that the Commission's goal of increasing liquidity and diversity among liquidity providers trading on SEFs and DCMs would be aided by the recommendations supported above and would reduce unnecessary barriers to entry to SEFs and DCMs without sacrificing the policy objectives of swap dealer regulation, and appreciates the opportunity to provide the views of its diverse membership in furtherance of the accomplishment of those goals.

### Members of the MRAC Market Structure Subcommittee

	<u>Name</u>	<u>Entity Representing</u>	<u>Title</u>
1.	Stephen Berger (Co-Chair)	Citadel	Managing Director and Global Head of Government & Regulatory Policy
2.	Lisa Shemie (Co-Chair)	Cboe Global Markets	Associate General Counsel, Chief Legal Officer – Cboe FX Markets and Cboe SEF
3.	B. Salman Banaei	IHS Markit	Executive Director, Global Head of Clearance and Settlement
4.	Lee Betsill	CME Group	Managing Director and Chief Risk Officer
5.	Peter Borish	Quad Group	Chief Strategist
6.	Biswarup Chatterjee	Citigroup	Managing Director, Global Head of Innovation, Markets & Securities Services
7.	Shelly Goodwin	BP IST Global Americas	Compliance Director, Refining & Products Trading Americas and Global Crude
8.	Graham Harper	Futures Industry Association – Principal Traders Group	Head of Public Policy and Market Structure at DRW
9.	Frank Hayden	Calpine Corporation	Vice President, Trading Compliance
10.	Annette Hunter	Federal Home Loan Bank of Atlanta	Senior Vice President and Director of Accounting Operations
11.	Eileen Kiely	BlackRock	Managing Director, Deputy Head of Counterparty Risk
12.	Derek Kleinbauer	Bloomberg SEF LLC	Global Head of Fixed Income & Equities Electronic Trading, Bloomberg LP and Vice President, Bloomberg SEF LLC
13.	Laura Klimpel	The Depository Trust & Clearing Corporation	Managing Director
14.	Craig Messinger	Virtu Financial	Vice Chairman
15.	Robert Mangrelli	Chatham Financial	Director
16.	Dr. Sam Priyadarshi	Vanguard	Principal, Global Head of Portfolio Risk Management and Derivatives

**Members of the MRAC Market Structure Subcommittee**

	<b><u>Name</u></b>	<b><u>Entity Representing</u></b>	<b><u>Title</u></b>
17.	Jonathan Raiff	Nomura Global Financial Products, Inc.	Senior Managing Director, Head of Global Markets Americas
18.	Tyson Slocum	Public Citizen	Director, Energy Program
19.	Sujatha Srinivasan	Goldman Sachs	Co-Head of Market Risk Specialists, Securities Division
20.	Janine Tramontana <sup>1</sup>	Federal Reserve Bank of New York	Vice President and Senior Counsel
21.	Nadia Zakir <sup>2</sup>	Pacific Investment Management Company LLC (PIMCO)	Executive Vice President and Deputy General Counsel
22.	Scott Zucker	Tradeweb	Chief Administrative Officer

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<sup>1</sup> Ms. Tramontana, in representing the Federal Reserve Bank of New York, is a non-voting member. In this capacity, she did not provide advice and recommendations on this report.

<sup>2</sup> Ms. Zakir, as the Chair of the MRAC, is a non-voting member.

**Concurring Statement**



Citi Concurring Statement on MRAC Market Structure Subcommittee  
Recommendation on Swap Dealer Landscape

Citi supports efforts to increase market liquidity that promote Dodd-Frank reforms of the swaps market to address systemic risk. We commend Acting Chairman Behnam on his leadership in exploring these important issues and support the effort of the subcommittee. We believe that the CFTC's comprehensive regulation of swap dealers and market participants has improved market integrity and oversight while mitigating risk. Therefore, policymakers should be cautious in approaching any change to the swap dealer registration regime that may undermine the benefits of these market reforms.

Accordingly, it is important to ensure that all considerations related to capital adequacy and business conduct are addressed carefully while considering the recommendation to exempt exchange-traded and centrally cleared swaps from the swap dealer registration threshold calculation. Unlike some listed markets, the same swap contract can be traded on multiple venues, and in some cases no single SEF or DCM may be able to oversee the trading activity and monitor conduct risk of a participant across the entire market. Further, no single DCO may be able to ensure that overall individual counterparty risk has been adequately addressed via margin posting for that market participant. A participant could build up a large cumulative cleared position across the market while clearing smaller pieces through multiple clearinghouses.

We also agree with the subcommittee's recommendation that any potential future rulemaking should be data-driven and based on evidence. We support a study on these recommendations to identify what pools of new market participants and liquidity would come into the market if these exemptions were given, so that a careful analysis of the costs and benefits can be performed.

## Dissenting Statement

## Dissenting Statement

Sujatha Srinivasan, Goldman Sachs &amp; Co. LLC.

Market Risk Advisory Committee, Subcommittee on Market Structure

*Recommendation Regarding the Swap Dealer Landscape*

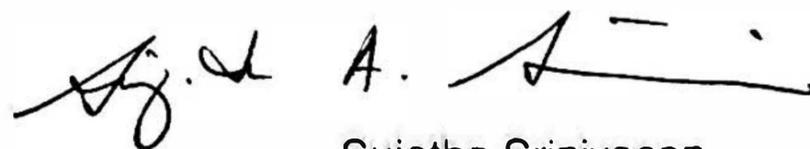
February 16, 2021

Goldman Sachs supports the objective of the Subcommittee, which is to encourage liquidity and diversity among liquidity providers on SEFs, and looks forward to working with the industry and the CFTC to that end. However, we cannot support the recommendation that the CFTC exempt cleared swaps traded on swap execution facilities (SEFs) from the swap dealer registration threshold calculation.

The Subcommittee's report would remove key aspects of the CFTC's regulatory regime critical to market integrity and market resilience, including risk management, compliance oversight, recordkeeping and capital. These requirements are relevant to all swaps, regardless of whether a swap is cleared or executed on a venue.

Further, the report does not adequately address the policy and legal issues raised by bifurcating swap dealers into regulated and unregulated categories for the same activity on a SEF. For example, while the report provides as justification that there is no "dealer" regime in futures markets, Congress did not take the same approach for swaps in the Dodd-Frank Act, even as it applied other requirements intended to make swaps markets more similar to futures markets, including central clearing and SEF-trading.

In light of these considerations, a comprehensive review of the factors affecting swap market liquidity is warranted, and would support more targeted solutions to address barriers to liquidity provision, rather than exempting a class of market participants from all of the CFTC's Swap Dealer rules and oversight.

Sujatha Srinivasan  
Goldman Sachs & Co. LLC.