



July 29, 2010

Mr. Gary Gensler,  
Chairman  
U.S. Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20281

Ms. Mary Schapiro,  
Chairman  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Dear Mr. Gensler and Ms. Shapiro;

On behalf of the Wholesale Markets Brokers Association - America (WMBA), I am conveying to you a Discussion Draft of Model Core Principles for Swap Execution Facilities (SEFs). This was prepared by the WMBA's Legal and Compliance Committee over the last couple of months.

When it was becoming clear that the Dodd Frank bill would include a very robust definition of swap execution facilities, the Board of the WMBA asked the Committee to begin developing model core principles for SEFs.

As the Association representing the interdealer broker community that already provides SEF-like services in the cash and derivatives markets, we wanted to provide regulators our best thoughts on core principles that are substantive, meaningful and consistent with the intended competitive environment for SEFs.

Although the WMBAA Legal and Compliance Committee and the Board of the WMBA fully support the concepts in this document, we send it to you and release it as Discussion Draft because it is our hope that it will facilitate discussions among a broad array of market participants and regulators about this important topic.

We hope you find this Model SEF Core Principles useful in the coming weeks and months as you start to craft the extensive regulations implementing the Dodd Frank Act.

We look forward to working with you in this process.

Thank you

J. Christopher Giancarlo,  
Chairman



## **PROPOSED CORE PRINCIPLES FOR SWAP EXECUTION FACILITIES**

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act establishes a new framework for regulation of the over-the-counter swaps markets. A central component of this framework is the establishment of a new form of regulated market for the trading and processing of swaps through swap execution facilities.

The Wholesale Markets Brokers' Association, Americas, an independent industry body representing the largest inter-dealer brokers (IDBs) operating in the North American wholesale markets, proposes the following guidance for compliance with the core principles for swap execution facilities established in section 733(f) of the Dodd-Frank Act. This guidance is based on the CFTC's existing guidance for compliance with the core principles for designated contract markets (17 CFR 38, Appendix B), modified to reflect the specific legislative requirements for swap execution facilities and the unique structure of the IDBs which operate at the core of the existing swap market. It is our goal to use this discussion draft as a starting point for a dialogue with the various regulatory and industry participants that will be affected by the new legislation.

**Core Principle 1: *IN GENERAL***

- No substantive changes from DCM CP
- References to Board of Trade replaced w/Swap Execution Facility

Core Principle 1 of section \_\_\_\_ of the Act: *IN GENERAL*—*To maintain the designation of a swap execution facility, the facility shall comply with the core principles specified in this subsection. The swap execution facility shall have reasonable discretion in establishing the manner in which it complies with the core principles.*

An entity applying for designation as a swap execution facility must satisfactorily demonstrate its capacity to operate in compliance with the core principles under section \_\_\_\_ of the Act and §\_\_\_\_\_. The Commission may require that a swap execution facility demonstrate to the Commission that it is in compliance with one or more core principles.

## **Core Principle 2: COMPLIANCE WITH RULES**

- WMBA proposed revision reflects statutory requirements for trading and operational rules and proposal for a new SRO for swap execution facilities

Core Principle 2 of section \_\_\_\_ of the Act: **COMPLIANCE WITH RULES**—*The swap execution facility shall (A) establish and enforce compliance with any rule of the swap execution facility and any limitations on access to the swap execution facility; (B) establish and, in coordination with the self-regulatory organization, enforce trading, trade processing, and participation rules including means to provide market participants with impartial access and to capture information that may be used in establishing whether rule violations have occurred; (C) establish rules governing the operation of the facility specifying procedures to enter and execute orders, including block trades; and (D) provide that when a swap dealer or major swap participant enters into a clearable swap transaction, the swap dealer or major swap participant is responsible for compliance with the mandatory trading requirements.*

(a) *Application guidance.* (1) A swap execution facility should have rules governing the operation of the facility and arrangements or resources for effective compliance programs with respect to transactions executed through the facility. The arrangements and resources should facilitate the direct supervision of the facility and the analysis of data collected. Trade practice surveillance programs may be carried out by the swap execution facility itself or through delegation or contracting-out to a third party. If the swap execution facility delegates or contracts-out the trade practice surveillance responsibility to a third party, such third party should have the capacity and authority to carry out such program, and the swap execution facility should retain appropriate oversight over the third party.

(2) The Commission shall establish a self-regulatory organization (“SRO”) that is not owned or controlled by, or affiliated with, any single SEF or DCM that has the authority to enforce the rules of swap execution facilities and all market participants shall become members of and consent to the jurisdiction of the SRO. The Commission believes the authority of the SRO should include the ability to limit, or suspend the activities of a market participant; the authority and ability to terminate the activities of a market participant pursuant to clear and fair standards; and the ability to impose monetary sanctions on a market participant for violations of swap execution facility rules.

(b) *Acceptable practices.* An acceptable trade practice surveillance program generally would include:

- (1) Maintenance of data reflecting the material details of each transaction executed on the swap execution facility;
- (2) Routine analysis of this data in order to reasonably detect potential violations of the SEF’s rules;

- (3) Appropriate investigative analysis of these and other potential trading violations brought to the swap execution facility's attention; and
- (4) Procedures for the referral of potential violations to the SRO.

**Core Principle 3: SWAPS NOT READILY SUBJECT TO MANIPULATION**

- WMBA proposed revision reflects deference to CFTC determination on swaps subject to manipulation

Core Principle 3 of section \_\_\_\_ of the Act: *SWAPS NOT READILY SUBJECT TO MANIPULATION—The swap execution facility shall only permit trading in swaps that are not readily susceptible to manipulation.*

(a) *Application guidance.* Swap execution facilities may

- (1) make available for trading any swap; and
- (2) facilitate trade processing of any swap,

unless the Commission has determined that the swap is readily susceptible to manipulation.

#### **Core Principle 4: MONITORING OF TRADING AND TRADE PROCESSING**

- WMBA proposed revision reflects changes for swap markets
- Key Issues:
  - We must develop (with CFTC) application guidance on what SEFs can and should monitor

Core Principle 4 of section \_\_\_\_ of the Act: **MONITORING OF TRADING AND TRADE PROCESSING** —*The swap execution facility shall monitor trading to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process.*

- (a) *Application guidance.* A swap execution facility could monitor for market manipulation through a dedicated regulatory department, or by delegation of that function to an appropriate third party.
- (b) *Acceptable practices.* (1) An acceptable program for monitoring markets will generally involve the collection of various market data, including information on participant's market activity. Those data should be evaluated on an ongoing basis in order to make an appropriate regulatory response to potential market disruptions or abusive practices.  
(2) The swap execution facility should collect data in order to assess whether trading is taking place in an orderly fashion, by looking at trading volumes, price volatility, number of market participants, and processing of trade settlement with the DCO.

### **Core Principle 5: ABILITY TO OBTAIN INFORMATION**

- The WMBA proposed core principle reflects the legislative requirements
- Key Issues:
  - We must develop (with CFTC) application guidance on what information SEFs can and should obtain in general **and** what SEFs are expected to do under international information-sharing agreements

Core Principle 5 of section \_\_\_\_ of the Act: **ABILITY TO OBTAIN INFORMATION**—*The swap execution facility shall establish and enforce rules that will allow the facility to obtain any necessary information to perform any of the functions described in this section and to provide that information to the Commission on request and carry out such international information-sharing agreements as the Commission may require.*

(a) *Application guidance.* In general a swap execution facility shall develop systems to obtain and retain data on price, time and material facts of all transactions executed on the facility as well as any information specifically required by the Commission. The swap execution facility shall provide such information to the Commission upon request, or to an SRO responsible for the swap execution facility, as may be directed by the Commission.

**Core Principle 6: POSITION LIMITATIONS OR ACCOUNTABILITY**

- WMBA proposed revisions reflect deference to CFTC established limits and SEF obligations based only on readily available information – i.e., trade data (as SEFs will not otherwise know a customer's positions)

Core Principle 6 of section \_\_\_\_ of the Act: **POSITION LIMITATIONS OR ACCOUNTABILITY**—*To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, the swap execution facility shall enforce position limitations where necessary and appropriate.*

(a) *Application guidance.* [Reserved]

(b) *Acceptable practices.* (1) For any contract that is subject to a position limitation established by the Commission pursuant to section 4a(a), the swap execution facility shall set its position limitation at a level no higher than the Commission limitation.

(2) For any swap that is subject to a position limitation established by the Commission pursuant to section 4a(a), a swap execution facility shall reject any proposed swap transaction if, based on information readily available to a swap execution facility, any proposed swap transaction would cause a swap execution facility participant that would be a party to such swap transaction to exceed such position limitation.

(3) Swap execution facilities should establish a program for effective enforcement of these limits. A swap execution facility should use the Commission's LTRS to monitor and enforce compliance with position limit rules where necessary and appropriate.

(4) Finally, an acceptable speculative limit program should have specific policies for taking regulatory action once a violation of a position limit or exemption is detected. Acceptable policies would include procedures to report to the Commission, or to an SRO responsible for the swap execution facility, as may be directed by the Commission, any proposed swap transaction that was rejected by the swap execution facility because it would have violated a position limit.

**Core Principle 7: FINANCIAL INTEGRITY OF TRANSACTIONS**

- WMBA proposed changes reflect new requirements that participants must be ECPs and where applicable, members of a DCO

Core Principle 7 of section \_\_\_\_ of the Act: **FINANCIAL INTEGRITY OF TRANSACTIONS—  
The swap execution facility shall establish and enforce rules providing for the financial integrity of swaps transactions 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)).**

(a) *Application guidance.* Clearing of transactions executed on a swap execution facility must be provided through a Commission-registered derivatives clearing organization except as provided in applicable laws and regulations. In addition, a swap execution facility should maintain the financial integrity of transactions entered on or through its facilities by seeking confirmation that all participants are eligible contract participants and, where applicable, members of the Commission-registered derivatives clearing organization that they indicate will clear the transaction.

### **Core Principle 8: EMERGENCY AUTHORITY**

- WMBA proposal reflects several substantive revisions to limit SEFs obligations to the suspension or curtailing of trading
- Key Issue:
  - The bill requires a SEF to liquidate or transfer open positions in any contract, which is beyond a SEF's ability

Core Principle 8 of section \_\_\_\_ 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, where necessary and appropriate, including the authority to—(A) liquidate or transfer open positions in any swap; and (B) suspend or curtail trading in any contract.*

(a) *Application guidance.* A swap execution facility should have clear procedures and guidelines for decision-making regarding emergency intervention in the operation of the facility, including procedures and guidelines to avoid conflicts of interest while carrying out such decision-making. A contract market should also have the authority to intervene as necessary to maintain fair and orderly trading as well as procedures for carrying out the intervention. Procedures and guidelines should include notifying the Commission of the exercise of a swap execution facility's regulatory emergency authority, explaining how conflicts of interest are minimized, and documenting the contract market's decision-making process and the reasons for using its emergency action authority. To address perceived market threats, the swap execution facility, among other things, should be able to implement price limits established by the Commission, extend or shorten the trading hours, suspend or curtail trading on the facility, and to the extent applicable, request the liquidation or transfer open positions in any swap, as may be directed by the Commission.

**Core Principle 9: TIMELY PUBLICATION OF TRADING INFORMATION**

- WMBA proposed revision reflects intent to report available transaction data to a swap data repository

Core Principle 9 of section \_\_\_\_ of the Act: **TIMELY PUBLICATION OF TRADING INFORMATION**—*The swap execution facility shall make public timely information on settlement prices, transaction price range and volume and other transaction data on swaps for actively traded swaps on the swap execution facility.*

(a) *Application guidance.* A swap execution facility should provide to the public information regarding settlement prices, transaction price range and volume, and other transaction data on swaps, as prescribed by the Commission, on a fair, equitable and timely basis. Provision of information for any applicable swap could be through such means as provision of the information to a financial information service or by timely placement of the information on a swap execution facility's web site.

(b) *Acceptable Practices.* The mandatory compliance with Section \_\_\_\_\_, “Trading volume, open contracts, prices and critical dates,” required under the regulations, would constitute an acceptable practice under Core Principle 9.

**Core Principle 10: RECORDKEEPING AND REPORTING**

- WMBA proposed revision reflects conforming changes to comparable principle for DCMs and need for CFTC to issue further requirements

Core Principle 10 of section \_\_\_\_ of the Act: *RECORDKEEPING AND REPORTING—The swap execution facility shall maintain records of all activities related to the business of the facility in a form and manner acceptable to the Commission for a period of 5 years and 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 this Act.*

(a) *Acceptable practices.*

(1) Section 1.31 of this chapter governs recordkeeping obligations under the Act and the Commission's regulations thereunder. In order to provide broad flexible performance standards for recordkeeping, §1.31 was updated and amended by the Commission in 1999. Accordingly, §1.31 itself establishes the guidance regarding the form and manner for keeping records.

(2) The mandatory compliance with Part 15.0, “Reports – General Provisions” required under the regulations, would constitute an acceptable practice under Core Principle 10.

**Core Principle 11: ANTITRUST CONSIDERATIONS**

- WMBA proposed revision reflects conforming changes to comparable principle for DCMs

Core Principle 11 of section \_\_\_\_ of the Act: **ANTITRUST CONSIDERATIONS—Unless necessary or appropriate to achieve the purposes of this Act, the swap execution facility shall not—(A) adopt any rules or taking any actions that result in any unreasonable restraints of trade; or (B) impose any material anticompetitive burden on trading on the swap execution facility.**

(a) *Application guidance.* An entity seeking designation 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 to be traded on the facility, at the time of designation 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.

### **Core Principle 12: CONFLICTS OF INTEREST**

- The WMBA revisions reflect the new legislative requirements for SEFs

Core Principle 12 of section \_\_\_\_ of the Act: *CONFLICTS OF INTEREST—swap execution facility shall establish and enforce rules to minimize or disclose conflicts of interest in the decision making process of the swap execution facility and establish a process for resolving such conflicts of interest.*

(a) *Application guidance.* The means to address conflicts of interest in decision-making of a swap execution facility should include methods to ascertain the presence of conflicts of interest and to make decisions in the event of such a conflict.

(b) *Acceptable Practices.* All swap execution facilities are required to minimize or disclose conflicts of interest in their decision-making processes. To comply with this Core Principle, swap execution facilities should be particularly vigilant for such conflicts between and among any of their responsibilities, their commercial interests, and the several interests of their management, owners, customers and market participants, other industry participants, and other constituencies.

***Core Principle 13: FINANCIAL RESOURCES***

- The WMBA revisions reflect the new legislative requirements for SEFs

Core Principle 13 of section \_\_\_\_ of the Act: *FINANCIAL RESOURCES — swap execution facilities shall have adequate financial, operational, and managerial resources to discharge each responsibility of the swap execution facility.*

(a) *Application guidance.* The financial resources of a swap execution facility shall be considered to be adequate if the value of the financial resources available to the facility exceeds the total amount that would enable the swap execution facility to cover the operating costs of the swap execution facility for a 1-year period, as calculated on a rolling basis.

**Core Principle 14: SYSTEM SAFEGUARDS**

- The WMBA revisions reflect the new legislative requirements for SEFs

Core Principle 14 of section \_\_\_\_ of the Act: **SYSTEM SAFEGUARDS** — *swap execution facilities shall 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 have adequate capacity, backup facilities, and a plan for disaster recovery.*

(a) *Application guidance.* The procedures adopted by the swap execution facility should provide for:

- (1) *the timely recovery and resumption of operations;*
- (2) *the fulfillment of the swap execution facility's obligations;*
- (3) *periodic testing to verify that the backup resources are sufficient to ensure continued order processing, trade matching, price reporting, market surveillance and maintenance of an audit trail.*

### **Core Principle 15: DESIGNATION OF CHIEF COMPLIANCE OFFICER**

- The WMBA revisions reflect the new legislative requirements for SEFs
- Open issue:
  - To whom is the annual report submitted?

Core Principle 15 of section \_\_\_\_ of the Act: **DESIGNATION OF CHIEF COMPLIANCE OFFICER** — *Each swap execution facility shall designate an individual to serve as a chief compliance officer who shall report directly to the board or to the senior officer of the facility and review compliance with the core principles in this subsection.*

(a) *Application guidance.* The chief compliance officer shall--

- (i) be responsible for establishing and administering the policies and procedures reasonably designed to achieve compliance with the Act and the rules and regulations issued under the Act;
- (ii) 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; and,
- (iii) annually prepare sign and submit, as required, a report that contains a description of:
  - (I) the compliance of the swap execution facility with this Act; and
  - (II) the policies and procedures, including the code of ethics and conflict of interest policies, of the swap execution facility.