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CLIENT ALERT

CFTC Staff Advisory Expands List of Entities that May Need to Register as a SEF

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AUTHORS

J. Christopher Giancarlo | Neal E. Kumar | Margo A. Bailey | Serge B. Agbre

On September 29, 2021, the Commodity Futures Trading Commission's ("CFTC") Division of Market Oversight ("DMO" or "Staff") issued a staff advisory that provides guidance on when certain entities may be required to register as a swap execution facility ("SEF").[1] The Advisory clarifies the definition of a SEF in such a way that entities that intermediate swaps between customers, but that are not currently registered as SEFs, should re-evaluate whether they meet the SEF definition. In particular, swaps-introducing brokers that do not introduce customer swaps to a SEF should carefully review the implications of the Advisory.

The Advisory explains that a swap intermediary, such as a swaps introducing broker, that receives an indicative request for quote ("RFQ") from one customer and subsequently attempts to facilitate execution of a reciprocal bid or offer from potential counterparties may need to register as a SEF. According to the CFTC Staff, under these circumstances, the introducing broker provides multiple customers with the ability to execute swaps with multiple customers, and thus meets the statutory definition of a SEF. This newly clarified framework upends the existing swaps introducing broker model. Entities that meet the recently clarified definition will need to register as SEFs or seek further guidance from the CFTC. Although the issue is not included within the Advisory's discussion, the CFTC has suggested that swaps intermediaries would not need to register as SEFs provided the intermediated and pre-arranged swaps are sent to a SEF for execution.

[1] CFTC Staff Letter No. 21-19 (the "Advisory"), available here.

Multiple-to-Multiple Platforms

The Commodity Exchange Act ("CEA") defines a SEF, in relevant part, 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 … [f]acilitates the execution of swaps between persons…."[2] DMO refers to the emphasized language above as the "multiple-to-multiple" prong of the SEF definition. Although the CFTC takes a facts-and-circumstances approach to determining whether an entity satisfies the SEF definition, the Advisory identifies specific activities, discussed below, that DMO believes could trigger SEF registration.

Platforms Offering One-to-Many or Bilateral Communications

The Advisory clarifies that the "multiple-to-multiple" prong can be satisfied if multiple participants merely have the "*ability* to execute or trade swaps" with multiple participants. DMO staff provides the following examples of when the multiple-to-multiple prong may be met:

- Where a single market participant can initiate a transaction by submitting an indicative RFQ to multiple participants. Specifically, if more than one participant can submit an RFQ to multiple participants on an entity's system or platform, that will cause the entity to satisfy the multiple-to-multiple prong of the SEF definition.

- Where an entity enables market participants to communicate bids and offers to other market participants through an online "chat."

On the same day the Advisory was issued, the CFTC settled an enforcement action with Symphony Communication Services, LLC ("Symphony") for failing to register as a SEF.[3] The CFTC found that Symphony operated a communications platform, the "SPARC Tool," that permitted multiple swap market participants to prepare and send RFQ messages to multiple other swap market participants. Recipients of the RFQ were then able to negotiate prices that could be confirmed via the SPARC Tool. The CFTC found Symphony had operated a multiple-to-multiple platform designed to facilitate the trading of swaps, and thus should have been registered as a SEF or a designated contract market.

[2] CEA Section 1a(50) (emphasis added). All entities that meet the definition of a SEF must register with the CFTC. CEA section 5h(a)(1) establishes the SEF registration requirement, providing 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 designated contract market. *See* 7 U.S.C. § 7b–3(a)(1).

[3] *In the Matter of Symphony Communication Services, LLC*, CFTC Docket No. 21-35 (Sept. 29, 2021), *available* here.

Otherwise Registered CFTC Entities

The Advisory makes clear that holding registration status with the CFTC in another capacity such as an introducing broker ("IB") or commodity trading advisor does not prevent an entity from needing to register as a SEF if it satisfies the SEF definition. DMO has informally suggested that swaps introducing brokers that receive RFQs directly from clients and then approach potential counterparties on behalf of their clients may fall within the SEF definition. However, Staff informally clarified that introducing brokers that bring intermediated swaps to a SEF for execution may not need to register as a SEF.

Platforms Providing Non-Electronic Means for the Execution of Swaps

DMO Staff reiterated that the SEF definition is not limited to electronic or online platforms that facilitate swap trading and execution, but could also apply to forms of trade execution that occur via, for instance, voice brokering. Referring to the CFTC's 2013 final rule implementing SEF registration requirements, the Advisory noted that "a variety of means of execution or communication, including, but not limited to, telephones, Internet communications, and electronic transmissions" could satisfy the definition of a SEF under the CEA.[4]

Permitted Transactions

The Advisory reminded market participants that the SEF registration requirements apply to entities facilitating the execution of swaps that meet the definition of a SEF. This would include facilitating the execution of any swap, not just swaps subject to mandatory trading and/or mandatory clearing requirements.

Routing Pre-arranged Swap Transactions to a SEF for Execution

In a November 2018 proposed rulemaking, the CFTC sought to amend various SEF core principle regulations along with the definition of a SEF. This proposed rule explained that under current practice, interdealer brokers that would otherwise fit the definition of a SEF had not been required to register with the CFTC so long as they routed all swap transactions to a SEF for execution.[5]

The CFTC's 2018 Proposed Rule sought to change this framework and would have required that interdealer brokers routing transactions to SEFs for execution would themselves need to register as SEFs.[6] However, this portion of the 2018 Proposed Rule was withdrawn in February of 2021.[7] The withdrawal of this portion of the proposal suggests that the

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4 *See* CFTC Staff Letter No. 21-19 at p. 3 (citing *Core Principles and Other Requirements for Swap Execution Facilities*, 78 FR 33476, 33501 n.328 (June 4, 2013)).

5 *SEF Execution Facilities and Trade Execution Requirement*, 83 FR 61946, 61958 (Nov. 30, 2018) ("2018 Proposed Rule").

6 *Id*. at 61959.

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

Advisory would not require a broker to register as a SEF provided all intermediated swaps were routed to a SEF for execution.

Implications

The Advisory highlights that swaps intermediaries that facilitate the execution of swaps need to carefully consider if they fall within the SEF definition. Even where the swaps IB directly intermediates the swap between the client and the counterparty, the Advisory suggests that the IB may need to register as a SEF. The impact of the Advisory may be particularly relevant to brokers that intermediate swap asset classes that are not required to be executed on SEFs (e.g., commodity swaps) because brokers in these asset classes currently may not be submitting swaps for execution on SEFs, and thus may need to register as SEFs.

The breadth of the SEF definition as interpreted by DMO Staff could result in registered intermediaries being required to register as SEFs and incurring significantly greater costs than originally contemplated when forming their businesses. For example, preparing and filing an application for SEF registration is a significant undertaking. The process requires completing the CFTC's Form SEF application that encompasses several exhibits, such as a draft rulebook, compliance manual, and methodologies to monitor, surveil, detect and prevent disruptive trading practices. Once registered, the platform is subject to ongoing reporting and compliance obligations with the CFTC that are considerably more onerous than the IB registration category. Furthermore, a SEF constitutes a self-regulatory organization that must enforce compliance with its rulebook, which would represent a paradigm shift relative to an IB's current relationship with its customers.

Willkie has a dedicated team of attorneys with extensive knowledge and experience in all aspects of the Commodity Exchange Act and the CFTC regulatory regime. We would be pleased to assist on your matters.

Athena Eastwood
202 303 1212
aeastwood@willkie.com

J. Christopher Giancarlo
212 728 3816
jcgiancarlo@willkie.com

Neal E. Kumar
202 303 1143
nkumar@willkie.com

Rita M. Molesworth
212 728 8727
rmolesworth@willkie.com

Paul J. Pantano Jr.
202 303 1211
ppantano@willkie.com

Deborah A. Tuchman
212 728 8491
dtuchman@willkie.com

Conrad G. Bahlke
212 728 8233
cbahlke@willkie.com

Margo A. Bailey
202 303 1178
mbailey@willkie.com

Lisa Eskenazi
212 728 3349
leskenazi@willkie.com

Serge B. Agbre
202 303 1173
sagbre@willkie.com

Steven C. Matos
212 728 8757
smatos@willkie.com

Michael Hartz
202 303 1161
mhartz@willkie.com