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CLIENT ALERT

CFTC Withdraws Advisory That Intermediaries May Be SEFs

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The Division of Market Oversight has withdrawn *in its entirety* DMO's own advisory position suggesting that introducing brokers and commodity trading advisors may also be swap execution facilities, even when they conduct *only* traditional IB or CTA activities.[1] Withdrawal of the 2021 Advisory, which is effective immediately, resolves the regulatory uncertainty that developed since its issuance.[2]

DMO's Advisory addressed activities that may render an entity a SEF. The Commodity Exchange Act defines a SEF as: (1) a trading system or platform (2) in which multiple participants have the ability to execute or trade swaps by accepting bids and offers (3) made by multiple participants in the facility or system (4) through any means of interstate commerce, including any trading facility, that facilitates the execution of swaps between persons, and is not a designated contract market.

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1 Commission Staff Letter 21-19, Staff Advisory on Swap Execution Facility Registration Requirement (Sept. 29, 2021) available at https://www.cftc.gov/csl/21-19/download (the 2021 Advisory).

2 Our memorandum on the 2021 Advisory can be found here: https://www.willkie.com/-/media/files/publications/2021/11/cftcstaffadvisoryexpandslist.pdf.

Key to the SEF definition is the requirement that a SEF provide *multiple participants with the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system*—sometimes referred to as the "multiple-to-multiple" prong of the SEF definition. Subject to limited exceptions generally not relevant for intermediaries,[3] an entity that meets the SEF definition must register with the CFTC as a SEF.[4]

The 2021 Advisory interpreted the multiple-to-multiple requirement in a manner that was very broad. For example, the 2021 Advisory stated that one-to-many and bilateral communications can satisfy the multiple-to-multiple prong. DMO also stated that if more than one participant can submit a request for quote to multiple participants on an entity's system or platform, the multiple-to-multiple prong of the SEF definition may be satisfied. Moreover, the 2021 Advisory stated that multiple participants do not need to be able to simultaneously make or accept bids or offers.

DMO's interpretation caused confusion because a typical one-to-many communication by an IB or CTA involving a single client and multiple potential counterparties might be recast under the 2021 Advisory into a multiple-to-multiple arrangement in circumstances where a CTA or IB has multiple clients. Thus, even if a CTA or IB engaged only in bilateral negotiations as agent for one client with multiple prospective counterparties, the fact that the IB or CTA had more than one client may, the 2021 Advisory suggested, satisfy the multiple-to-multiple prong.

A commodity pool operator that effects transactions for multiple commodity pools could be implicated as well. The strategy for various of the CPO's pools may at times call for a similar position to be established for several pools. Thus, the CPO may reach out to multiple counterparties for pricing and execute transactions for each pool, perhaps with more than one counterparty.

The 2021 Advisory correctly observed that registration in one category does not absolve a market participant from its obligation (absent an exemption) to register in another category, if its activities fall within the definition of such other category. In the case of traditional IBs, CTAs and CPOs, registration as a SEF would involve a fundamental change to the business model. All CFTC registrants are subject to regulatory requirements. SEF regulatory requirements, however, are not compatible with traditional IB, CTA and CPO structures. A SEF's obligations include, among others, the supervisory responsibilities of a self-regulatory organization, order book functionality, and audit trail requirements. Several aspects of SEF registration would be difficult for traditional intermediary registrants, including operating an order book in the case of highly customized swaps that are priced according to the creditworthiness of the relevant parties because they are uncleared.

DMO determined to withdraw the 2021 Advisory in order to address the issues raised by its language and bring legal certainty to entities that operate in the swaps markets.

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3 Intermediaries include IBs, CTAs and commodity pool operators.

4 A designated contract market may also list swaps.

If you have any questions regarding this client alert, please contact one of the authors, any member of our CFTC team listed below, or the Willkie attorney with whom you regularly work.

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.

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