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## Part II

### Commodity Futures Trading Commission

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17 CFR Parts 37

Core Principles and Other Requirements for Swap Execution Facilities;  
Proposed Rule

## 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:** Notice of Proposed Rulemaking.

**SUMMARY:** The Commodity Futures Trading Commission (“Commission” or “CFTC”) is proposing new rules, and guidance and acceptable practices to implement the new statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposed rules, guidance, and acceptable practices, which apply to the registration and operation of a new type of regulated entity named a swap execution facility, implement the new statutory framework that, among other things, adds a new Section 5h to the Commodity Exchange Act (“CEA”) concerning the registration and operation of swap execution facilities, and new Section 2(h)(8) to the CEA concerning the listing, trading and execution of swaps on swap execution facilities. The Commission requests comment on all aspects of the proposed rules, guidance and acceptable practices.

**DATES:** Comments must be received on or before March 8, 2011.

**ADDRESSES:** You may submit comments, identified by RIN number 3038-AD18, by any of the following methods:

- *Agency Web site, via its Comments Online process:* <http://comments.cftc.gov>. Follow the instructions for submitting comments through the Web site.
- *Mail:* David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.
- *Hand Delivery/Courier:* Same as mail above.

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments. Please submit your comments using only one method.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <http://www.cftc.gov>. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information

that may be exempt from disclosure under the Freedom of Information Act (“FOIA”),<sup>1</sup> a petition for confidential treatment of the exempt information may be submitted according to the established procedures in § 145.9.<sup>2</sup>

The Commission reserves the right, but shall have no obligation, to review, prescreen filter, redact, refuse, or remove any or all of your submission from <http://www.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under FOIA.

**FOR FURTHER INFORMATION CONTACT:** Riva Spear Adriance, Associate Director, 202-418-5494, [radriance@cftc.gov](mailto:radriance@cftc.gov), or Mauricio Melara, Attorney-Advisor, 202-418-5719, [mmelara@cftc.gov](mailto:mmelara@cftc.gov), Division of Market Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

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#### I. Background

##### A. Overview

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).<sup>3</sup> Title VII of the

Dodd-Frank Act<sup>4</sup> amended the CEA<sup>5</sup> to establish a comprehensive new regulatory framework for swaps and security-based swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivatives products; (3) creating robust recordkeeping and real-time reporting regimes; and (4) enhancing the Commission’s rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission’s oversight.

The Dodd-Frank Act creates a new type of regulated marketplace: “Swap execution facilities” (“SEFs”),<sup>6</sup> for which the Dodd-Frank Act establishes a comprehensive regulatory framework, including by: Section 733 (adding new Section 5h to the CEA to provide a regulatory framework of Commission oversight), Section 723(a)(3) (adding new Section 2(h)(8) to the CEA, to require, among other things, that swaps subject to the clearing requirement of Section 2(h)(1) of the CEA be executed either on a designated contract market (“DCM”) or on a SEF, unless no DCM or SEF made the swap “available for trading”),<sup>7</sup> and Section 733 of the Dodd-Frank Act (adding Section 5h(a)(1), requiring 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).

In enacting the Dodd-Frank Act, Congress directed that rules and regulations required by the provisions of Title VII be promulgated by the later of either 360 days of its enactment or, to the extent that a rulemaking is required by Dodd-Frank, not less than 60 days after the publication of that final rule.<sup>8</sup> Consistent with Congress’ directive, this release proposes amendments to Part 37 of the Commission’s regulations to

<sup>4</sup> Pursuant to Section 701 of the Dodd-Frank Act, Title VII may be cited as the “Wall Street Transparency and Accountability Act of 2010.”

<sup>5</sup> 7 U.S.C. 1 *et seq.*

<sup>6</sup> This new 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. The definition of swap execution facility is added in Section 721 of the Dodd-Frank Act, amending Section 1a of the CEA. 7 U.S.C. 1a(50).

<sup>7</sup> See Section 723 of the Dodd-Frank Act.

<sup>8</sup> See Section 754 of the Dodd-Frank Act.

<sup>1</sup> 5 U.S.C. 552.

<sup>2</sup> 17 CFR 145.9.

<sup>3</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at <http://www.cftc.gov/LawRegulation/OTCDERIVATIVES/index.htm>.

implement Sections 723(a)(3) and 733 of the Dodd-Frank Act.<sup>9</sup>

### B. The Dodd-Frank Act

Section 723(a)(3) of the Dodd-Frank Act amends Section 2(h) of the CEA, providing that, with respect to transactions involving a swap subject to the clearing requirement of paragraph 2(h)(1), counterparties must execute the transaction on a DCM or a SEF.<sup>10</sup> This “exchange trading” requirement does not apply if no DCM or SEF “makes the swap available to trade” or if the exceptions to the clearing requirement apply.<sup>11</sup>

Section 733 of the Dodd-Frank Act adopts new Section 5h of the CEA, providing that: (i) 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; (ii) 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; and (iii) the Commission has the authority to prescribe rules governing the regulation of SEFs.

The proposed regulations, guidance and acceptable practices will implement the regulatory obligations that each SEF must meet in order to comply with Section 5h of the CEA both initially upon registration and on an ongoing basis. The Commission requests comments on all aspects of its proposal.

<sup>9</sup> See Section 754 of the Dodd-Frank Act. Please also note that Section 734 of the Dodd-Frank Act deletes the provision of the CEA that provided for Derivatives Transaction Execution Facilities (“DTEFs”), which previously were regulated under Part 37, replacing those provisions with regulations establishing the regulatory requirements for SEFs.

<sup>10</sup> See Section 2(h)(8) of the CEA, as enacted by Section 723(a)(3) of the Dodd-Frank Act. The Dodd-Frank Act also eliminates the swaps exemption under former Section 2(g) of the CEA, supporting the requirement that trading and processing of cleared swaps must occur on a DCM or a SEF as well as expanding the types of products that can be listed and traded on a DCM to include swaps. The Commission is proposing provisions for the trading of swaps on a DCM in a separate rulemaking. See also Notice of Proposed Rulemaking Relating to Core Principles and Other Requirements for Designated Contract Markets approved for publication by the Commission at an open meeting on Dec. 1, 2010 and expected to be published shortly in the *Federal Register* (to be codified at 17 CFR part 38) (the “DCM NPRM”). This Notice is available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister120110b.pdf> (last visited on Dec. 8, 2010).

<sup>11</sup> See Section 2(h)(8)(B) of the CEA, as enacted by Section 723(a)(3) of the Dodd-Frank Act. Newly amended Section 2(h)(7) of the CEA provides for exceptions to the clearing requirement when one of the counterparties to a swap (i) is not a financial entity, (ii) is using the swap to hedge or mitigate commercial risk, and (iii) notifies the Commission how it meets its financial obligations associated with entering into a non-cleared swap.

## II. The Proposed Regulations, Guidance and Acceptable Practices

### A. Adoption of New Regulations, Guidance and Acceptable Practices

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 DCMs and SEFs comply with the core principles. In consideration of the novel nature of SEFs and also based on 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, the Commission is proposing a combination of regulations, guidance and acceptable practices for the oversight and regulation of SEFs.

### B. Proposed General Regulations Under Part 37

The Commission is proposing to organize Part 37 to include new subparts A through P. Proposed Subpart A would include general § 37.1 through 37.11.<sup>12</sup> While in this rulemaking, the Commission is proposing §§ 37.1 through 37.11, it notes that § 37.19, addressing conflicts of interest, was proposed in a separate rulemaking.<sup>13</sup> Subparts B through P would establish relevant regulations applicable to each of the 15 core principles.<sup>14</sup>

#### 1. Subpart A—General Provisions

##### a. Scope—Proposed § 37.1

Proposed § 37.1 provides that Part 37 will apply to entities that are registered

<sup>12</sup> These sections apply both to applicants for registration and registered SEFs, clarify which provisions are applicable to trading on SEFs, provide for SEF registration processes (including processes for the vacation, reinstatement, and transfer of a SEF registration), and provide general requirements regarding: (i) The listing and trading of swaps; (ii) the responsibility, upon request of the Commission, to respond to requests for information and demonstrations of compliance with core principles, and to provide information and certifications upon transfers of equity interest; (iii) the enforceability of a SEF’s swap transactions under certain conditions, (iv) limitations on the use of data collected for regulatory purposes, (v) the need for a board of trade that operates a trading facility that has been designated as a DCM by the Commission and also intends to operate a SEF to separately register the entity that will operate as a SEF, (vi) the appropriate execution of swaps based on the type of transaction and order interaction, and (vii) the periodic assessment of the method by which swaps are made available for trading.

<sup>13</sup> 75 FR 63732 (October 18, 2010).

<sup>14</sup> Each subpart begins with a regulation containing the language of the core principle.

SEFs or that are submitting an application for SEF registration under Section 5h of the CEA, and clarifies that Part 37 does not restrict the eligibility of SEFs to operate under the provisions of Parts 38 or 49 of this Chapter.

##### b. Applicable Provisions—Proposed § 37.2

Proposed § 37.2 lists those Commission regulations that are applicable to SEFs, and provides that SEFs must comply with, in addition to the requirements in Part 37, the proposed Part 43 requirements regarding the real time reporting of swaps and the determination of appropriate block size for swaps, the proposed Part 45 requirements for data elements, recordkeeping and reporting of swap information to swap data repositories (“SDRs”), the proposed Part 46 requirements for business continuity and disaster recovery, the proposed Part 49 requirements regarding SDRs, and the proposed Part 151 position limits requirements.<sup>15</sup>

##### c. Requirements for Registration—Proposed § 37.3

##### i. Application Procedures—Proposed § 37.3(a)

Proposed § 37.3 sets forth the application and approval procedures for registration of new SEFs. The provision would require that all SEF applications, reinstatements of registrations, requests for transfer of registrations, requests for withdrawal of application for registration, and vacation of registrations must be filed electronically with the Secretary of the Commission, in the form and manner as provided by the Commission.<sup>16</sup>

To assist prospective applicants, the Commission proposes to include an application form under Appendix A to Part 37 (“Form SEF”); the proposed form would also be used for any updates or amendments for registration that are not required to be submitted under Part 40 of this Chapter.<sup>17</sup> Each applicant will be required to provide the Commission with documents and descriptions pertaining to its: (i) Business

<sup>15</sup> The Commission notes that because some of the proposed rulemakings are either ongoing or forthcoming, this proposed list of applicable sections under proposed § 37.2 may be subject to further revisions pending the final rules for each respective rulemaking.

<sup>16</sup> This amendment also would ensure consistency with the process used for filing rule and product submissions under Parts 38, 39 and 40 of the Commission’s regulations. See 17 CFR Parts 38, 39 and 40.

<sup>17</sup> The Commission also is requiring tailored application forms for the designation of DCMs and the registration of Designated Clearing Organizations and Swap Data Repositories.

organization, (ii) financial resources, (iii) compliance program and (iv) technological capabilities.

Other than the specific requirements necessitated by the core principles, the majority of information required under the Form SEF consists of information that Commission staff has historically found necessary considering DCM applications. The Commission expects that similar information will be necessary to assess applications for SEF registration. Proposed § 37.3(a)(1) requires that, at a minimum, all applicants must complete the application form and provide the necessary information and documentation in order to initiate the SEF registration review process. The determination when a submission is complete will be at the sole discretion of the Commission. The Commission will review Form SEF and, at the conclusion of its review, by order either: (i) Grant registration; (ii) deny the application for registration; or (iii) grant registration subject to Commission-established conditions.

SEF applicants will be required to provide various documents describing the applicant's legal and financial status. SEF applicants must also submit copies of any applicable rules and regulations (as defined in § 40.1),<sup>18</sup> disclose any affiliates and a brief description of the nature of the affiliation, and submit copies of any agreements between the SEF and third parties that would assist the applicant in complying with its duties under the CEA.

Applicants will be required to demonstrate operational capability through documentation, including technical manuals and third party service provider agreements. Proposed § 37.3 also requires that each applicant request and obtain from the Commission a unique, extensible, alphanumeric code for the purpose of identifying the SEF pursuant to the swap recordkeeping and reporting requirements under proposed Part 45.<sup>19</sup>

## ii. Procedures for Temporary Grandfather Relief—Proposed § 37.3(b)

Section 754 of the Dodd-Frank Act provides that: “[u]nless otherwise provided in this title, the provisions of this subtitle [Subtitle A—Regulation of Over-the-Counter Swaps Markets] shall take effect on the later of 360 days after the date of enactment of this subtitle [i.e., July 15, 2011], or, to the extent a provision of this subtitle requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of this subtitle.”

The Commission anticipates that, upon the effective date of this Part 37, it may receive a large number<sup>20</sup> of applications for SEF registration from entities that currently provide a marketplace for the listing and trading of swaps. The Commission notes that it would be difficult to carry out and complete an appropriate and comprehensive review of all such applications during the period between publication of the final rulemaking and the effective date of this Part 37. Any consequent delay in the processing of these SEF applications could adversely impact SEF applicants, undermine the efficient implementation of the Dodd-Frank Act, create legal uncertainty for market participants and adversely affect the swaps market.

Therefore, proposed § 37.3(b) permits the Commission, upon the request of an applicant, to grant temporary grandfather relief to qualifying entities that, due to their operations, will be required to register as a SEF in order to continue operating as of the effective date of the regulations. The proposed temporary grandfather relief would be optional and would enable a qualifying entity to operate without SEF registration on a short-term basis during the pendency of the application review process on the condition that it otherwise operate in conformance with all SEF requirements under the Dodd-Frank Act. This approach is intended to avoid undue market disruption as well as to ensure continuity of the business operations of an existing entity that, at the time that Part 37 becomes effective,<sup>21</sup> is providing a marketplace for the trading of swaps. The temporary relief would also allow the Commission to implement registration requirements of the Dodd-Frank Act for SEFs while providing the Commission sufficient

time to fully review the application of a SEF. Each SEF that qualifies for temporary relief would be subject to Section 5h of the CEA and related regulations during the period in which the Commission is reviewing the SEF's application of registration.

The Commission notes that it previously issued orders providing grandfather relief to exempt commercial markets (“ECMs”) and exempt boards of trade (“EBOTs”), allowing them to continue to operate as EBOTs and ECMs after the effective date of the Dodd-Frank Act (July 15, 2011) (“ECM and EBOT grandfather relief orders”).<sup>22</sup> The relief under proposed § 37.3(b) would be consistent with the ECM and EBOT grandfather relief orders. In addition, the Commission notes that the grandfather relief under proposed § 37.3(b) would also be available for entities that are currently operating pursuant to another exemption or exclusion provided under the CEA (prior to its amendment by the Dodd-Frank Act) as of the effective date of this Part 37.<sup>23</sup>

As a condition for receiving temporary grandfather relief, the applicant must: (1) File a complete application, as required under proposed § 37.3(a),<sup>24</sup> on the proposed application form, Form SEF, under Appendix A to Part 37; (2) notify the Commission, at the time of its submission of the application, of its interest in operating under the temporary relief; (3) 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 the request; and (4) provide a certification that the applicant believes that its operation on a temporary basis will meet the requirements of Part 37 of the CEA, as adopted by the Commission. Since the purpose of the temporary relief is to provide an appropriate process to ensure continuity of the business operations during the pendency of the review of an application, the temporary grandfather relief would expire on the earlier of: (i) The date that the Commission grants or denies registration of the SEF, or (ii) the

<sup>18</sup> See 75 FR. 67282, 67292 (November 2, 2010).

<sup>19</sup> This requirement stems from the Commission's authority, under Section 728 of the Dodd-Frank Act, to establish standards and requirements related to reporting and recordkeeping for swaps. In particular, the Commission is required to adopt consistent data element standards for “registered entities,” which include SEFs. Proposed Part 45 will set forth the recordkeeping and reporting requirements of each SEF with respect to swap transactions on or through its facility. Proposed § 37.3 codifies the obligation of SEFs to comply with the provisions of proposed Part 45. See 75 FR 76574 (December 8, 2010).

<sup>20</sup> The Commission notes that although the public estimate regarding the expected number of applications ranges from 30 to 40, certain market participants have noted that the number of SEFs could exceed 100.

<sup>21</sup> See Section 754 of the Dodd-Frank Act.

<sup>22</sup> See Orders Regarding the Treatment of Petitions Seeking Grandfather Relief for Exempt Commercial Markets and Exempt Boards of Trade (“ECM and EBOT grandfather relief”). 75 FR 56513 (September 10, 2010). The Commission's Orders set forth various conditions for such grandfather relief, including the filing of a relief petition and a SEF or DCM application with the Commission.

<sup>23</sup> See CEA Sections 2(d), 2(e), 2(g) and 2(h)(1)–(2).

<sup>24</sup> As noted above, the determination of when a submission on Form SEF is complete is at the sole discretion of the Commission.

date that the Commission rescinds the temporary relief. Additionally, the temporary relief would not be a permanent provision of Part 37. Proposed § 37.3(b) provides for a “sunset” provision so that temporary grandfather relief would terminate 365 days from the effective date of proposed § 37.3(b).

### iii. Procedures for Transfer of Registration—Proposed § 37.3(d)

The Commission is proposing § 37.3(d) to formalize the procedures that a SEF must follow when requesting the transfer of its registration, in anticipation of a corporate event (e.g., a merger, corporate reorganization, or change in corporate domicile) which results in the transfer of all or substantially all of the SEF’s assets to another legal entity. Under proposed § 37.3(d), the SEF would submit to the Commission a request for transfer no later than three months prior to the anticipated corporate change, with a limited exception.<sup>25</sup>

Proposed § 37.3(d) also would require, as a condition of approval, that the SEF submit a representation that it is in compliance with the CEA, including the SEF core principles, and the Commission’s regulations. In addition, the SEF would have to submit various representations by the transferee regarding its duties and obligations.

Proposed § 37.3(d) also provides that the Commission will review any requests for transfer of registration as soon as practicable, and such request will be approved or denied pursuant to a Commission order.

### d. Procedures for Listing Products and Implementing Rules—Proposed § 37.4

Proposed § 37.4 conforms to the proposed changes to existing §§ 40.3 (Voluntary submission of new products for Commission review and approval) and 40.5(b) (Voluntary submission of rules for Commission review and approval),<sup>26</sup> in the Commission’s separate rule proposal pertaining to “Provisions Common to Registered Entities.”<sup>27</sup>

<sup>25</sup> The proposed rule would require that where a SEF does not know or could not have reasonably known three months prior to the anticipated change, it shall be required to file the request as soon as it knows of the change.

<sup>26</sup> Proposed § 40.3 is amended to require additional information to be provided by registered entities that submit new products for the Commission’s review and approval. Proposed § 40.5(b) codifies a new standard for the review of new rules or rule amendments as established under the Dodd-Frank Act.

<sup>27</sup> 75 FR 67282 (November 2, 2010).

### e. Information Relating to Swap Execution Facility Compliance—Proposed § 37.5

Under proposed § 37.5(a), upon request by the Commission, a SEF must file with the Commission certain information related to its business as a SEF, in the form and manner as specified by the Commission. Under proposed § 37.5(b), the Commission may demand that a SEF file a written demonstration regarding its compliance with any specified core principles. The information requested under proposed § 37.5(a) and (b) provides for information requests to entities regarding compliance with the conditions for registration made for any oversight purpose.<sup>28</sup>

The Commission believes that on occasion, SEFs will enter into equity interest transfers that result in a change in ownership. In those situations, Commission staff must determine whether the change in ownership will impact adversely the operations of the SEF or the SEF’s ability to comply with the core principles and the Commission’s regulations. The Commission is proposing § 37.5 to ensure that SEFs remain mindful of their self-regulatory responsibilities when negotiating the terms of significant equity interest transfers, and to improve the Commission staff’s ability to undertake a timely and effective due diligence review of the impact, if any, of such transfers.

Proposed § 37.5(c) would require SEFs to file with the Commission a notice of the equity interest transfer of ten percent or more, with certain documents providing information on the transfer, no later than the business day<sup>29</sup> following the date on which the SEF enters into a firm obligation to transfer the equity interest.<sup>30</sup> The

<sup>28</sup> In this regard, for example, the Commission may request SEFs to provide information relating to their operations or their practices in connection with its general oversight responsibilities under the CEA, in connection with the Commission’s formulation of statements of acceptable practice, or in connection with a particular SEF’s compliance with particular core principles or other conditions of its registration.

<sup>29</sup> “Business day” is defined in Commission § 40.1.

<sup>30</sup> The Commission is proposing a 10 percent threshold because it believes that a change in ownership of such magnitude may have an impact on the operations of the swap execution facility. The Commission believes that such impact may be present even if the change in ownership does not constitute a change in control. For example, if one entity holds a minority 10 percent equity share in the SEF, it may have a more significant voice in the operation of the SEF than five entities each with a minority 2 percent equity share. Given the potential impact that a change in ownership might have on the operations of a SEF, the Commission believes that it is appropriate to require such SEF to certify

proposed regulation requires that the SEF keep the Commission apprised of the projected date that the transaction resulting in the equity interest transfer will be consummated, and must provide to the Commission any new agreements or modifications to the original agreement(s) filed pursuant to proposed § 37.5(c). The SEF must notify the Commission of the consummation of the transaction on the day on which it occurs. The proposed regulation will enable staff to consider whether any conditions contained in an equity transfer agreement(s) are inconsistent with the self-regulatory responsibilities of a SEF or with any of the core principles.

The Commission believes when there is a 10% or greater change in ownership, the SEF itself is the more appropriate entity to provide a certification of its continued compliance with all regulatory obligations. Accordingly, proposed § 37.5(c)(3) would require that if there is a change in ownership,<sup>31</sup> the SEF must certify, no later than two business days following the date on which the change in ownership occurs, that the SEF meets all of the requirements of Section 5h of the CEA and the provisions of Part 37 of the Commission’s regulations.

### Request for Comment:

The Commission notes that there are differences in the proposed notification requirements for changes in the ownership of SEFs, derivative clearing organizations (“DCOs”), DCMs, and SDRs.<sup>32</sup> The Commission requests comment on the proposed notification requirements under 37.5(c) and, more specifically, the extent to which there should be uniformity or differentiation in procedures applied to different types of registrants.

after such change that it continues to comply with all obligations under the CEA and Commission regulations.

<sup>31</sup> The Commission’s regulations consistently identify a financial or ownership interest of ten percent or more as material and indicative of the ability to influence the activities of an entity or trading in an account. See, e.g., Core Principle 5, Acceptable Practices, and Core Principle 14, Application Guidance, in Appendix B to Part 38 of the Commission’s regulations. 17 CFR part 38, Appendix B.

<sup>32</sup> See, *supra* note 10, DCM NPRM; also the Notice of Proposed Rulemaking Relating to Swap Data Repositories, approved for publication by the Commission at an open meeting on November 19, 2010 and expected to be published shortly in the *Federal Register* (to be codified at 17 CFR part 49). This Notice is available at <http://www.cftc.gov/stellent/groups/public/@otherif/documents/ifdocs/federalregister112210d.pdf> (last visited on Dec. 8, 2010); and other appropriate future rulemakings.

#### f. Enforceability of Executed Swaps—Proposed § 37.6

Proposed § 37.6 is intended to provide legal certainty to market participants transacting in swaps. Under § 37.6(a), a transaction entered into on or pursuant to the rules of a registered SEF will not be void, voidable, subject to rescission or otherwise invalidated or rendered unenforceable as a result of: (1) A violation by the registered SEF of the provisions of Section 5h of the CEA or Part 37; or (2) any Commission proceeding to alter or supplement a rule, term or condition under Section 8a(7) of the CEA, to declare an emergency under Section 8a(9) of the CEA, or any other proceeding the effect of which is to alter, supplement, 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.

In other rules proposed by the Commission, 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.<sup>33</sup> Proposed § 37.6(b) provides that a confirmation must be in writing (whether electronic or otherwise) and must legally supersede any previous agreement (electronically or otherwise). For swaps executed on a SEF, the SEF will provide the counterparties with a definitive written record of the terms of their agreement, which will serve as a confirmation of the swap. The proposed regulation on swap confirmations would require that parties have full written agreement on all terms of a swap at the same time as execution.

#### g. Prohibited Use of Data Collected for Regulatory Purposes—Proposed § 37.7

In fulfilling their regulatory and compliance obligations, the Commission expects that SEFs will often require market participants to provide proprietary data or personal information. Proposed § 37.7 prohibits a SEF from using information generated by market participants for purposes of meeting regulatory and compliance obligations for marketing products or for other commercial purposes.<sup>34</sup> The

Commission notes that nothing in this regulation prohibits a SEF from sharing such information with another SEF or DCM offering swaps for trading for regulatory purposes.

#### h. Boards of Trade Operating Both a Designated Contract Market and a Swap Execution Facility—Proposed § 37.8

Proposed § 37.8 implements CEA Section 5h(c) by requiring that a board of trade that operates a trading facility that has been designated as a DCM by the Commission and also intends to operate an entity for the execution or trading of swaps: (1) Must separately register such entity as a SEF under Part 37; and (2) may use the same electronic trade execution system for executing swaps that it uses for its DCM operations, provided that, the entity clearly identifies to market participants whether the execution or trading of a swaps is taking place on the DCM or the SEF.<sup>35</sup>

#### i. Permitted Execution Methods—§ 37.9

This rule proposal will provide market participants with the choice of a number of means to access the market and execute trades therein. This flexibility would allow market participants to use requests for quotes, indications of interest, or executable quotes to consummate a trade. It would allow SEFs to use a variety of different trading systems or platforms as long as market participants have the ability to access the market and execute trades as discussed below.

#### i. SEF Definition

The term ‘swap execution facility’ means 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

rules were proposed requiring FCMs to develop a written disposal program to the extent that such FCMs possess consumer information. The underlying policy for these rules is to protect the privacy of customer information. Similarly, Proposed § 37.7 is intended to protect market participants’ information provided to a SEF for regulatory purposes from its use to advance the commercial interests of the SEF.

<sup>35</sup> Section 5h(c) of the CEA provides:

IDENTIFICATION OF FACILITY USED TO TRADE SWAPS BY CONTRACT MARKETS.—A board of trade that operates a contract market shall, to the extent that the board of trade also operates a swap execution facility and uses the same electronic trade execution system for listing and executing trades of swaps on or through the contract market and the swap execution facility, identify whether the electronic trading of such swaps is taking place on or through the contract market or the swap execution facility.

execution of swaps between persons; and (B) is not a designated contract market.<sup>36</sup>

Market participants currently use a number of different methods for transacting swaps, including: brokers who facilitate trades over the telephone (commonly referred to as “voice brokers”); hybrid voice and electronic trading systems; fully electronic inter-dealer brokerage systems; single-dealer trading platforms; various versions of “request for quote” platforms (including platforms that allow more than one customer to submit requests for quotes to, and receive responses from, multiple dealers); and order books. The Commission does not believe that all of these methods comply with the statutory definition of a SEF, especially the “multiple participant to multiple participant” requirement thereunder. Specifically, as discussed below, the Commission notes that entities offering the following services do not comply with the statutory definition of a SEF: one-to-one voice services for the execution or trading of swaps (other than for the execution of block trades),<sup>37</sup> single-dealer platforms, and services that solely provide for the processing of swaps.

The SEF definition requires at a minimum the existence of a “trading system or platform.” The Commission notes that the terms “trading system” and “platform” are not defined under the Dodd-Frank Act or anywhere in the CEA. Based on the SEF definition under the Dodd-Frank Act, the Commission interprets trading system and platform to include, but not be limited to, the term “trading facility” as defined in CEA Section 1a(51).<sup>38</sup> In addition, as discussed in detail below, the Commission believes that any other method that allows multiple market participants to have the ability to execute or trade swaps by accepting

<sup>36</sup> CEA Section 1a(50).

<sup>37</sup> As proposed, a block trade is a swap of a large notional or principal amount that is transacted off-exchange, pursuant to the rules of a SEF or DCM, and that is greater than the minimum block trade size set by the SEF or DCM. As proposed, a SEF or DCM must set the minimum block size for a particular swap contract at an amount greater than the appropriate minimum block size for the appropriate category of swap instrument in which such swap contract is categorized. See 75 FR 76140 (December 7, 2010).

<sup>38</sup> See CEA Section 1a(51). In this context, a trading facility requires “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.”

<sup>33</sup> See 75 FR 76140 (December 7, 2010); and 75 FR 76574 (December 8, 2010).

<sup>34</sup> The Commission notes that, in the recent notice of proposed rulemaking for Business Affiliate Marketing and Disposal of Consumer Information Rules, it proposed rules prohibiting futures commission merchants (“FCMs”) (and other intermediaries) from using certain consumer information received from an affiliate to make a solicitation for marketing purposes. In addition,

bids and offers made by other multiple participants in the facility or system, through any means of interstate commerce, may qualify as an acceptable trade execution method for an entity that wishes to register as a SEF.

In order for an entity to meet the definition of a SEF 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” and such participants must be provided impartial access to the market. The Commission believes that an acceptable SEF platform or system must provide at least a basic functionality to allow market participants the ability to make executable bids or offers and indicative quotes, and to display them to multiple parties, including all other parties participating in the SEF, if the market participants wish to do so. As set forth in proposed § 37.9(b) and discussed below, the Commission proposes that a SEF also must provide market participants with the ability to make a bid, make an offer, hit a bid, or lift an offer, and may provide the ability to request a bid and request an offer. Accordingly, market participants would not have to receive a “request for quote”<sup>39</sup> from another market participant in order to make a bid or offer or to execute a trade with other market participants. In addition to this basic functionality whereby market participants would have the ability to access all other market participants, a SEF could also provide a multiple-to-multiple request for quote trading system for those market participants that do not wish to display their bids, offers, or requests to all other market participants. A SEF’s chosen approach(es) would be described in its registration application, to be evaluated by the Commission during the application process. Once operational, the Commission would be able to empirically evaluate the SEF’s treatment of executable bids and offers as compared to responses to requests for quotes to ensure ongoing compliance with the definition of a SEF, the SEF registration requirements, and the core principles.

#### ii. One-to-One Voice and Single-Dealer Platforms

The Commission notes that one-to-one voice services and single-dealer platforms do not satisfy the statutory requirement under CEA Section 1a(50) that “multiple participants have the ability to execute or trade swaps by

accepting bids and offers made by multiple participants in the facility or system”. The nature of these types of trading systems or platforms, where transactions are negotiated or consummated via a one-to-one or one-to-many basis, do not provide the ability for participants to conduct multiple-to-multiple execution or trading. The Commission also notes that CEA Sections 5h(f)(2)(A)(ii) and (2)(B)(i) require that SEFs provide market participants with impartial access to their markets, and that SEFs must adopt rules with respect to any limitations they place on access. Entities operating either one-to-one voice services or single-dealer platforms, by definition, limit the provision of liquidity to single dealers or liquidity providers, thus excluding other participants from filling those roles, in non-compliance with the impartial market access requirements applicable to SEFs under the CEA.

#### iii. Processing of Swaps

In regard to entities that offer, with respect to swaps transactions, processing services exclusively, the Commission notes that Section 5h(a)(1) of the CEA states “[n]o person may operate a facility for the trading or processing of swaps, unless the facility is registered as a [SEF] or as a [DCM] under this section.” In addition, Section 5h(b) states that a registered SEF may “(A) make available for trading any swap, and (B) facilitate trade processing of any swap.” Although these provisions could be read to require the registration of entities that engage in trade processing (but not trade execution) as SEFs, the Commission believes that entities that operate exclusively as swap processors do not meet the SEF definition (and should not be required to register as SEFs) because: (1) They do not provide (as required by the definition) the ability to “execute or trade” a swap; and (2) the definition does not include the term “process.”

#### iv. Trading Systems or Platforms

When determining what types of trading systems qualify to register as a SEF, the Commission takes into account, in addition to consideration of the SEF definition as discussed above, the core principles applicable to SEFs<sup>40</sup> as well as the goals provided in Section 733 of the Dodd-Frank Act: (1) Bringing greater pre-trade price transparency to swap transactions; and (2) bringing more swaps trading onto regulated

trading systems or platforms.<sup>41</sup> Therefore, the Commission interprets the SEF registration requirements to necessitate that the trading system or platform: (a) Provide multiple participants with the ability to make bids and offers to other multiple participants or to accept bids or offers made by other multiple participants; (b) promote pre-trade price transparency; (c) ensure that the trading of swaps on the trading system or platform is in accordance with the SEF core principles, the registration requirements and the Commission’s regulations; and (d) provide all market participants with impartial access to the SEF’s market.

The Commission believes that, to register as a SEF or to maintain registration, an applicant or SEF must provide market participants with the ability to make executable quotes on either side of a swap transaction and to take the opposite side of a trade from participants who seek to enter into transactions on such contract. The “multiple participant to multiple participant” requirement, when read in conjunction with the impartial access requirement (*i.e.*, the Core Principle 2 requirement that the SEF must “provide market participants with impartial access to the market”) requires that each SEF provide any market participant with the ability to make any bid or offer transparent to all other market participants of the SEF. In addition, the “ability to execute or trade” statutory provision means that the SEF must provide market participants with the ability to post both firm and indicative quotes on a centralized screen such that they can be executed or traded against by other multiple market participants. Under the proposal, it is a market participant’s prerogative to make a bid or offer available to all other market participants in the trading system or platform without an invitation to join an auction process. Willing counterparties should have the ability to execute swap trades by accepting such bids or offers. The Commission believes there could be a number of ways for a SEF to provide this functionality, including but not limited to having an order book.

Additionally, SEFs must make indicative quote functionalities available, such that market participants could provide non-executable quotes or indicative quotes through the SEF that are visible and accessible to all other market participants. Such functionalities could include electronic,

<sup>40</sup> See *e.g.*, Sections 5h(f)(2)(A)(ii) and (2)(B)(i) (Core Principle 2, requiring the provision of impartial access). See also *infra*, Section II.C.2.a. (discussing the provision of impartial access under to Core Principle 2).

<sup>41</sup> See CEA Section 5h(e) (Stating twin goals regarding the promotion of “the trading of swaps on swap execution facilities” and “pre-trade price transparency in the swaps market”).

<sup>39</sup> See *infra*, Section II.C.2.i.v for further discussion of “request for quote” systems.

streaming indicative quotes, or other methods for providing market participants with indicative quotes. Indicative quotes provide additional information about pricing and help inform market participants as they consider hedging and investment strategies, as well as when considering whether and how to execute a trade (either through a request for quote or through an existing executable quote). The Commission believes that indicative quotes are consistent with the statute's goal of achieving pre-trade price transparency.

The Commission believes that SEFs can utilize various trading systems and platforms that provide market participants with the ability to post executable bids or offers for display to multiple potential counterparties. A trading system or platform that provides this minimum multiple-to-multiple functionality, as described above, also may include other functionalities that provide multiple participants with the ability to access multiple market participants, but not necessarily the entire market if the participant so chooses. These may include certain request for quote systems, as described below, or other systems that meet the SEF definition and comply with the core principles.<sup>42</sup> Hence, although at times a market participant 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, market participants that desire to access the entire market must be provided with the ability to do so as well.

#### v. Execution Methods

Proposed § 37.9 will allow market participants to have the choice of a number of means to access and execute within a SEF's marketplace. There would not be any requirements for pre-trade transparency for: (1) Blocks; (2) trades subject to the end user exceptions; or (3) contracts which are not "made available for trading." Thus the requirements for pre-trade transparency (*e.g.*, posting both firm and indicative quotes on a centralized electronic screen accessible to all market participants)<sup>43</sup> for trades executed on a SEF would only relate in the context of transactions in swaps which are: (1) Subject to the mandatory clearing requirement; (2) "made available for trading" on a SEF; and (3) too small to be a block trade under part

45. For these three types of transactions, SEFs could permit their market participants to trade via requests for quotes, indications of interest, or executable quotes.

As stated in the preceding section, Section 5h(e) of the CEA sets forth Congress' goals with respect to SEFs: The promotion of "the trading of swaps on swap execution facilities" and "pre-trade price transparency in the swaps market."<sup>44</sup> The Commission believes that these goals can be achieved for swap transactions that are subject to the CEA execution requirements, are made available for trading, and are not block trades by providing for the execution of such swap transactions on trading systems or platforms that give market participants the option to post both firm and indicative quotes or accept bids and offers that are transparent to the entire market.<sup>45</sup>

Under proposed § 37.9, applicants and registered SEFs must offer trading services to facilitate the ability of market participants to make executable bids or offers and to display them to multiple parties. Transactions may be executed by providing market participants with a number of execution methods from which to choose, including: (1) "Request for quote" systems that provide market participants the ability to interact with multiple participants but less than the entire market, as described below; (2) systems that allow market participants to display executable bids and offers on a centralized, electronic screen to the entire market; or (3) other systems that comply with the core principles.

Additionally, under the proposal, SEFs must provide a general timing requirement applicable to traders such as brokers who have the ability to execute against a customer's trade or are entering a trade for two customers on opposite sides of the transaction. Under the proposal, a broker would have to provide a minimum pause before entering the second side (whether for its own account or for a second customer), thus "showing" other market participants the terms of a request for quote from its customer, and providing other market participants the opportunity to join in the trade. The Commission proposes to require a minimum pause of 15 seconds between entry of two potentially matching customer-broker swap orders or two potentially matching customer-customer swap orders on SEFs.

<sup>44</sup> See CEA Section 5h(e).

<sup>45</sup> While currently such systems are often used by traders in order to account for counterparty risk, it is important to note that there is no counterparty risk for swaps that are cleared.

#### (A) Request for Quote Systems

As proposed by the Commission, the steps taken by market participants in order to complete a transaction using an acceptable request for quote system are similar to the steps taken in the marketplace today (*i.e.*, a market participant transmits a request to counterparties for bids or offers and chooses to transact with one of the respondents to the request). However, to ensure that multiple participants have the ability to reach multiple counterparties, the Commission proposes to require SEFs to provide that market participants transmit a request for quote to at least five potential counterparties in the trading system or platform. The Commission notes that, under the proposal, acceptable request for quote systems offered by SEFs could be designed such that requests for quotes are visible to all market participants with access to the trading system or platform, but should permit requesters the option of making a request for quote visible to the entire market. Additionally, the proposal provides that an acceptable request for quote system may allow for a transaction to be consummated if the original request to five potential counterparties receives fewer than five responses.<sup>46</sup>

Under the proposal, SEFs that utilize request for quote systems must also furnish liquidity providers with the ability to post both executable bids or offers and indicative quotes. The terms of any such "resting" executable bids or offers would be displayed to the requester along with any other specific bids or offers included in the responses to its request for quote. Upon receipt of the responses and the appropriate resting bids or offers, the original requester would have the option to execute the transaction. The Commission believes that SEFs that utilize request for quote systems must ensure that any competitive resting bids or offers be taken into account and communicated to the requester along with any bids or offers included with responses to requests for quotes. While the Commission does not believe it appropriate to prescribe a method of integration as part of this rulemaking,

<sup>46</sup> The proposal also provides that request for quote systems include trading systems or platforms in which multiple market participants view real-time electronic streaming quotes, both firm and indicative, from multiple potential counterparties on a centralized electronic screen, and have the ability to accept a firm streaming quote and complete the transaction or based on an indicative streaming quote, issue a request for quote to no less than five market participants and upon receipt of a responsive quote, have the option to complete the transaction. See proposed § 37.9(a)(1)(v).

<sup>42</sup> As previously noted, one-to-one voice systems and single-dealer platforms do not satisfy the listed factors.

<sup>43</sup> See also, proposed § 37.205(b)(1).



the Commission would expect each SEF to describe its chosen integration mechanism as part of its application.

The Commission believes its proposed approach to the use of request for quote systems by SEFs is consistent with the statute and promotes: (a) The ability of multiple participants to make bids and offers to other multiple participants or to accept bids or offers made by other multiple participants; (b) pre-trade price transparency; (c) the trading of swaps on a regulated trading system or platform in accordance with the registration requirements and the Commission's regulations; and (d) the ability for all market participants to receive impartial access to all other market participants. The Commission further believes that this feature would help encourage price competition within the market.

(B) "By Any Means of Interstate Commerce"

For block trades, swaps not subject to clearing, and bespoke or illiquid swaps, the Commission interprets the statute's language "by any means of interstate commerce" to allow execution methods that may include voice. This method of execution is consistent with the use of voice in the futures markets for executing block trades, where in light of the size of the trades, pre-trade transparency is not required. It is also possible that a SEF might choose to offer to facilitate bilateral trading for those transactions not bound by the CEA's execution requirements and, therefore, the use of voice may be acceptable. The Commission notes that with respect to these types of transactions, market participants may have an interest in choosing their counterparty in light of the credit risk involved. Voice transactions must be entered into some form of electronic affirmation system immediately upon execution.

With regard to swaps available for trading that are not blocks, trading systems or platforms facilitating the execution of such swaps via voice exclusively are not multiple participant to multiple participant and do not provide for pre-trade transparency. While not acceptable as the sole method of execution of swaps required to be traded on a SEF or DCM, the Commission believes voice would be appropriate for a market participant to communicate a message to an employee of the SEF, whether requests for quotes, indications of interest, or firm quotes. For instance, voice-based communications in the proposed SEF context may occur in certain circumstances, such as when an agent: (1) Assists in executing a trade for a

client, immediately entering the terms of the trade into the SEF's electronic system; or (2) enters a bid, offer or request for quote immediately into a SEF's electronic multiple-to-multiple trading system or platform. In all cases, the employee of the SEF must promptly provide transparency and comply with audit trail requirements, including by the immediately entering into the trading system or platform any orders or requests for quote that are immediately executable, or, if not, immediately creating an electronic record with the order or request for quote entered into the trading system or platform as soon as practicable. The core principles and these rules would fully apply to such communications including but not limited to the transparency, audit trail, impartial access and standards for requests for quotes.

*Request for Comment:*

The Commission seeks public comment regarding the trading systems or platforms described in this section. In addition, the Commission asks the public to respond to the specific questions below.

- Does the proposal appropriately implement the statutory directive 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? If not, how should the Commission best carry out the intent of Congress in the registration and oversight of SEFs?
- The Commission interprets the "multiple participant to multiple participant" requirement (in conjunction with the impartial access requirement) as requiring that the facility provide the ability for any market participant to make any bid or offer transparent to the entire market, if the market participant chooses to do so. Should the Commission be explicit as to the means or methods which can be used to fulfill this functionality? If so, in addition to an order book, what other means or models should be included in the final regulations?
- In 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.

- Should the Commission determine that other models of execution satisfy the statutory "multiple participant to multiple participant" requirement as well as the pre-trade price transparency and open access policy objectives under the Dodd-Frank Act?
- Does the proposal properly implement the provision in the SEF definition regarding having the ability to execute or trade swaps "through any means of interstate commerce"?
- In general, does the proposal properly implement the CEA's goal to promote both the trading of swaps on SEFs and pre-trade price transparency? Should there be other characteristics the Commission should consider? If so, what are they?
- What level of pre-trade transparency should be required to promote price discovery, competition and the trading of swaps on SEFs? Should the Commission consider requiring a request for quote method that provides for transparency in the request for quote process in addition to the posting of any resting bids/offers on its trading system or platform? Should all orders and quotes be displayed to all participants or should alternative engagement rules apply on a pre-trade basis?
- Should SEFs be required to communicate executable bids/offers to issuers of requests for quotes? Also, should any such executable bids/offers be provided any priority during the request for quote process? Should market participants have an obligation to consider and/or execute against an executable bid/offer if it is competitive?
- Should SEFs be required to make responses to requests for quotes transparent to all market participants? If so, when should this information be provided to the market? Prior to execution? At the time of execution? Subsequent to execution?
- Would the SEF provisions in the Dodd-Frank Act support a requirement that swaps that meet a certain level of trading activity be limited to trading through order books? If so, what level of trading activity would be the appropriate level at which to mandate trading exclusively on an order book? Should any such analysis be done on a product or asset-class basis?
- Should swap processors be subject to the registration requirements for SEFs?

j. Swaps Made Available for Trading—Proposed § 37.10

The Dodd-Frank Act requires that transactions involving swaps subject to

the clearing requirement be executed on a SEF or DCM.<sup>47</sup> This trade execution requirement will not apply if (i) the Commission has not made a determination regarding the clearing requirement with respect to the swap,<sup>48</sup> (ii) an eligible counterparty availed itself of an exception to the clearing requirement and does not wish to transact the swap on a SEF or DCM, or (iii) no DCM or SEF “makes the swap available to trade.”<sup>49</sup>

The Commission proposes to require SEFs to make periodic assessments to determine whether a swap has been made available for trading. To that end, proposed § 37.10 requires each SEF to annually conduct an assessment and provide a report to the Commission regarding the determination that the swaps it offers are made available for trading thereunder. With respect to the determination that swaps are made available to trade, the SEF may consider frequency of transactions and open interest, and any additional factors requested by the Commission.

#### *Request for Comment:*

The Commission seeks general public comment regarding the meaning of “made available for trading.” In addition, the Commission asks the public to respond to the specific questions below.

- In addition to the frequency of transactions and open interest, should the Commission request that SEFs consider the number of market participants trading a particular swap? If so, should a minimum number of participants be required, for example, should the swap be traded by more than two participants? More than three?
- Should the Commission request that SEFs consider any other factors or processes to make the determination that swaps are made available for trading?

#### **k. Identification of Non-Cleared Swaps or Swaps Not Made Available To Trade—Proposed § 37.11**

The Commission acknowledges that certain market participants may desire to avail themselves of the benefits of trading on SEFs (e.g., automated confirmation of trades, straight-through processing) with respect to trades that are not otherwise required to be executed on a SEF or DCM. In particular, market participants might want to effect swap transactions on SEFs or DCMs regarding swaps that have not been determined to come

under the clearing mandate of Section 2(h) of the CEA, transactions that are excepted from the clearing requirements as provided under Section 2(h)(7) of the CEA, and transactions regarding swaps determined to not be available for trading pursuant to Commission § 37.10. Proposed § 37.11 requires that if a SEF determines to provide for trading of swaps that are excepted from the clearing requirements, the SEF must clearly identify to market participants that the particular swap is to be transacted pursuant to one of the applicable exemptions from execution and clearing.

#### *C. Proposed Regulations, Guidance and Acceptable Practices for Compliance With the Core Principles*

As noted above, this rulemaking establishes the relevant regulations, guidance and acceptable practices applicable to the 15 core principles. As proposed, the regulations applicable to the 15 core principles are set out in separate subparts to Part 37, Subparts B through P, 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.

##### **1. Subpart B—Core Principle 1 (Compliance With Core Principles)**

Under Core Principle 1, compliance with the core principles, and any other rule or regulation that the Commission may impose under Section 8a(5) of the CEA, is a condition of obtaining and maintaining registration as a SEF.<sup>50</sup> The Commission proposes to codify the statutory text of Core Principle 1 in proposed § 37.100. SEFs will have reasonable discretion in establishing the manner in which they comply with the core principles.

##### **2. Subpart C—Core Principle 2 (Compliance With Rules)**

###### **a. Background**

Core Principle 2 requires a SEF to establish and enforce compliance with its rules,<sup>51</sup> including by: (1) Establishing various rules to deter abuses; and (2) having the capacity to detect, investigate, and enforce such rules.<sup>52</sup> Similarly, under Core Principle 2, a SEF must establish and enforce rules to provide any eligible contract participant (“ECP”) and any independent software

vendor (“ISV”)<sup>53</sup> with impartial access to the market and to capture information that the SEF may use in establishing whether rule violations have occurred.<sup>54</sup> Additionally, SEF Core Principle 2 requires a SEF to establish rules governing the operations of the trading platform and provide rules relating to the mandatory clearing requirement under Section 2(h)(8).<sup>55</sup> The Commission proposes to implement these requirements through §§ 37.200–37.207.

Although SEFs are a new type of regulated exchange, the Commission notes that the statutory text for SEF Core Principle 2 is largely a compilation of established regulatory principles applicable to DCMs. As a result, proposed §§ 37.200–37.207, implementing SEF Core Principle 2, set forth requirements for establishing and enforcing rules, providing access, conducting trade practice surveillance, and implementing audit trail requirements and disciplinary rules, that are analogous to those found in the proposed regulations for DCM Core Principles 2, 10, and 13. In addition, proposed §§ 37.200–37.207 also address elements of Core Principle 2 that are not implicated by these DCM core principles.

###### **b. Operation of a Swap Execution Facility and Compliance With Rules—Proposed § 37.201**

Proposed § 37.201 addresses the requirement to establish and enforce rules. More specifically, the core principle requires that a SEF establish and enforce compliance with its rules.<sup>56</sup> A SEF is also required to

<sup>53</sup> The Commission notes that examples of independent software vendors include: Smart order routers, trading software companies that develop front-end trading applications, and aggregators of transaction data. 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. Aggregators of transaction data provide access to news, analytics and execution services. 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.

<sup>54</sup> CEA Section 5h(f)(2)(B).

<sup>55</sup> CEA Section 2(h)(8) requires counterparties transacting in swaps that are subject to the clearing requirement of Section 2(h) to execute the transaction on a DCM or a SEF, unless no DCM or SEF “makes the swap available to trade” or the swap transaction is subject to the clearing exception under Section 2(h)(7). The sentence annotated by this footnote captures both 2(C) and 2(D).

<sup>56</sup> CEA Section 5h(f)(2)(A)(i).

<sup>47</sup> CEA Section 2(h)(8).

<sup>48</sup> CEA Section 2(h)(1).

<sup>49</sup> CEA Section 2(h)(8).

<sup>50</sup> CEA Section 5h(f)(1)(A).

<sup>51</sup> CEA Section 5h(f)(2)(A).

<sup>52</sup> CEA Section 5h(f)(2)(C) requires SEFs to establish rules specifying trading procedures to be used in entering and executing orders traded or posted on the trading platform, including block trades. The sentence annotated by this footnote also captures 2(B).

establish rules governing the operation of the trading platform.<sup>57</sup>

Proposed § 37.201 addresses these elements by requiring SEFs to establish rules governing the members' and market participants' use of their markets, including rules specifying trading procedures for entering and executing orders traded or posted on the trading platform, including block trades. Proposed § 37.201(b) further requires SEFs to establish and impartially enforce compliance with the rules of the SEF, including, but not limited to: (1) The terms and conditions of any swaps traded or processed on or through the SEF; (2) access rules for the SEF; (3) trade practice rules; (4) audit trail requirements; (5) disciplinary rules; and (6) mandatory trading requirements.

#### c. Access Requirements—Proposed § 37.202

Proposed § 37.202 addresses Core Principle 2's requirement that SEFs provide any ECP and any ISV with impartial access to the market, and that they adopt rules with respect to any limitations they place on access.<sup>58</sup> In that regard, proposed § 37.202(a) requires a SEF to provide any ECP and any ISV with impartial access to its market(s) and market services (including any indicative quote screens or any similar pricing data displays), which includes establishing criteria that are impartial, transparent, and applied in a fair and nondiscriminatory manner and levying equal fees for participants receiving comparable access to, or services from, the SEF. The purpose of the proposed impartial access requirements is to prevent a SEF's owners or operators from using discriminatory access requirements as a competitive tool against certain participants. Access to a SEF should be determined, for example, on the SEF's impartial evaluation of an applicant's disciplinary history and financial and operational soundness against objective, pre-established criteria. Any participant should be able to demonstrate financial soundness either by showing that it is a clearing member of a DCO that clears products traded on that SEF or by showing that it has clearing arrangements in place with such a clearing member.

Proposed § 37.202(b) requires that, prior to granting a participant access to its markets, a SEF must require each member or market participant to

consent to its jurisdiction.<sup>59</sup> Finally, proposed § 37.202(c) requires a SEF to establish and impartially enforce its rules governing any decision to deny, suspend, or permanently bar participants' access to the SEF, including when such decisions are part of a disciplinary or emergency action taken by the SEF.

#### *Request for Comment:*

The Commission solicits specific public comments regarding the sufficiency of proposed § 37.202.

- In particular, the Commission is interested to know whether additional regulations are necessary to ensure that a SEF can assert jurisdiction over any person or entity executing swaps on the SEF, either for their own account or on behalf of another's account.
- The Commission also requests public comments on proposed §§ 37.202(a) and 37.202(c), which are intended to ensure that similarly situated persons and entities receive equal access to a SEF's trading platform and services, and that similar access and services be charged a similar fee.
- In addition, the Commission wants to know whether the proposed regulations seeking to prohibit a SEF from abusing its authority to deny or suspend access via disciplinary or emergency procedures are sufficient to prohibit discrimination by a SEF against competitors or for inappropriate business reasons.

#### d. Rule Enforcement Program—Proposed § 37.203

Proposed § 37.203 addresses SEF Core Principle 2's requirement that SEFs establish and enforce trading and trade processing rules that will deter abuses and have the capacity to investigate and enforce those rules.<sup>60</sup>

Proposed regulation 37.203(a) addresses abusive trading practices by requiring SEFs to prohibit specific practices in connection with intermediated and non-intermediated trading activities,<sup>61</sup> as well as any other

manipulative or disruptive trading practices prohibited by the CEA or by the Commission pursuant to Commission regulation.

Subsection (b) of the proposed regulation requires that a SEF have arrangements and resources for effective rule enforcement, including the authority to collect information and examine books and records of members and market participants. The Commission believes that SEFs must have appropriate resources to enforce all of its rules, including the ability to perform effective trade practice surveillance. Furthermore, a SEF must have the authority to examine books and records for all market participants. 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.

Next, subsection (c) of proposed § 37.203 requires that a SEF maintain sufficient compliance resources to conduct effective and timely audit trail reviews, trade practice surveillance, market surveillance, and real-time monitoring. A SEF must also monitor its staff size annually to ensure that it is appropriate to effectively perform those functions. A SEF's staff size also must be sufficient to address unusual or unanticipated market or trading events while continuing to effectively conduct routine self-regulatory duties. Proposed § 37.203 reflects the Commission's belief that sufficient compliance staff are essential to the effectiveness of a SEF's self-regulatory program.

While requiring sufficient staff, proposed § 37.203(c) does not require that staff size be determined based on a specific formula. Rather, it permits the individual SEF to determine what size staff it needs to effectively perform its self-regulatory responsibilities.<sup>62</sup>

Proposed § 37.203(d) requires SEFs to maintain an automated trade surveillance system capable of detecting

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 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).

<sup>62</sup> In making this determination, the proposed regulation requires that a SEF take into account specific facts and circumstances (e.g., volume of trading, the number of swaps listed, number of traders, etc.), as well as any other factors suggesting the need for increased resources. A factor that may suggest the need for increased compliance resources is a prolonged surge in trading volume or a prolonged period of price volatility.

<sup>57</sup> CEA Section 5h(f)(2)(C).

<sup>58</sup> CEA Section 5h(f)(2)(A)(ii) and (2)(B)(i).

<sup>59</sup> Consent may be obtained in the form of a written agreement at the time that a member or market participant is granted access to the SEF.

<sup>60</sup> CEA Section 5h(f)(2)(B).

<sup>61</sup> The prohibited practices include: trading ahead of customer orders, trading against customer orders, accommodation trading, and improper cross-trading. Specific trading practice violations that must be prohibited by all SEFs include: Front-running, wash trading, pre-arranged trading, fraudulent trading, money passes, and any other trading practices that the SEF deems to be abusive. These practices are a compilation of abusive trading practices that DCMs already prohibit, and include trading practices that Congress expressly prohibited in Section 747 of the Dodd-Frank Act. Section 747 of the Dodd-Frank Act amends section 4c(a) of the CEA by adding three disruptive practices, which make it:

and investigating potential trade practice violations. At a minimum, a SEF's systems must be capable of generating alerts on at least a trade date plus one day (T+1) basis to help staff focus on potential violations and anomalies found in trade data.<sup>63</sup> They must also provide compliance staff the ability to sort, query and analyze voluminous amounts of data. In order to detect and prosecute the abusive trading practices enumerated in proposed § 37.203(a), a SEF's automated surveillance system must maintain all trade and order data, including order modifications and cancellations. In addition, a SEF's automated trade surveillance system must provide users with the ability to compute retain, and compare trading statistics; compute profit and loss; and reconstruct the sequence of trading activity. The proposed regulation reflects the Commission's belief that a SEF must have automated surveillance systems that are equivalent to those of a DCM in order to fulfill its trade practice surveillance requirements.

Subsection (e) of proposed § 37.203 requires SEFs to conduct real-time market monitoring of all trading activity on its trading platform, in order to ensure orderly trading and to identify and correct any market or system anomalies. The Commission's proposed regulation requires that any price adjustments or trade cancellations be transparent to the market and subject to clear and fair publicly available standards.

Next, proposed § 37.203(f) requires SEFs to establish procedures for conducting investigations and the requirements for an investigation report. Subsection (f)(1) requires that a SEF have procedures to conduct investigations of possible rule violations and subsection (f)(2) requires that an investigation be completed within a timely manner (generally defined as 12 months after an investigation is opened, absent mitigating circumstances).<sup>64</sup>

Subsections (f)(3) and (f)(4) of proposed § 37.203 set forth what must be included in an investigation report. Subsection (f)(3) requires that when compliance staff believes there is a reasonable basis for finding a violation, the investigation report must include

the potential wrongdoer's disciplinary history. Similarly, subsection (f)(4) requires that an investigation report include the potential wrongdoer's disciplinary history when compliance staff recommends that a warning letter be issued. The Commission believes that prior disciplinary history is critical information that a disciplinary committee should consider when either issuing a warning letter or assessing an appropriate penalty as part of any settlement decision or hearing.<sup>65</sup>

Subsection (f)(5) of proposed § 37.203 provides that a SEF may authorize its compliance staff to issue a warning letter or to recommend that a disciplinary committee issue a warning letter. However, the proposed regulation prohibits SEFs from issuing more than one warning letter, in lieu of stronger disciplinary action, for the same violation during a rolling 12-month period.<sup>66</sup>

Finally, proposed § 37.203(g) requires a SEF to adopt and enforce any additional rules that it believes are necessary to comply with the requirements of proposed § 37.203.

#### *Request for Comment:*

The Commission requests public comment on proposed § 37.203.

- In particular, the Commission requests public comment on the abusive trading practices enumerated in subsection 37.203(a). These practices are identical to the abusive trading practices prohibited in DCM trading.

- The Commission also solicits comments regarding the types of abusive trading practices that should be prohibited on a SEF's trading platform, particularly whether SEFs and DCMs are likely to face similar types of trading abuses by market participants, whether additional or different trading practices should be prohibited on a SEF, and whether SEFs should be required to have the same types of trade practice surveillance and real-time market monitoring programs as DCMs.

<sup>63</sup> As noted below in the discussion of proposed § 37.206(n), a SEF's disciplinary committee should review a member's complete disciplinary history when determining appropriate sanctions and impose meaningful sanctions on members who repeatedly violate the same or similar rules to discourage recidivist activity.

<sup>66</sup> For purposes of this regulation, the Commission does not consider a "reminder letter" or such other similar letter to be any different than a warning letter. 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, whether for the same or similar violations is ever appropriate. A policy of issuing repeated warning letters to members and market participants who violate the same or similar rules, rather than issuing meaningful sanctions, reduces the effectiveness of a SEF's rule enforcement program.

- Finally, the Commission requests comments on whether the investigatory reports prepared by DCM compliance staff as a prelude to formal disciplinary proceedings, and included in these proposed regulations, are needed within SEFs.

#### *e. Regulatory Services Provided by a Third Party—Proposed § 37.204*

Proposed § 37.204 permits a SEF to utilize the services of a registered futures association or another registered entity for assistance in performing certain self-regulatory functions.<sup>67</sup> However, SEFs remain responsible for the execution of these functions and for compliance with their associated core principles. In this regard, the Commission notes that the Dodd-Frank Act does not confer on SEFs the same right to delegate certain core principle compliance functions as that conferred to DCMs, pursuant to Section 5c(b) of the CEA.

The proposed regulation requires that any SEF that contracts with a third-party regulatory service provider ensure that the provider has sufficient capacity and resources to render timely and effective regulatory services. The SEF must also oversee the quality of regulatory services provided on its behalf, and must retain exclusive authority with respect to all substantive decisions made by its regulatory service provider.<sup>68</sup> The proposed regulation also specifies that any instances where a SEF's actions differ from those recommended by its regulatory provider must be documented and explained in writing.

#### *Request for Comment:*

The Commission requests public comment on proposed § 37.204.

- In particular, the Commission requests comments on the supervisory and decision-making relationship that should exist between a SEF and a third-party regulatory service provider.

- The Commission also seeks public comment on the types of information that SEFs and their regulatory service providers should be required to share with other SEFs and regulatory service providers, in order to conduct effective surveillance of fungible swap products trading on multiple SEFs.

<sup>67</sup> Self-regulatory functions include, for example, trade practice surveillance; market surveillance; real-time market monitoring; investigations of possible rule violations; and disciplinary actions.

<sup>68</sup> Such decisions include, but are not limited to, those involving the cancellation of trades, the issuance of disciplinary charges against members or market participants, denials of access to the trading platform, and any decision to open an investigation into a possible rule violation.

<sup>63</sup> These systems typically differ from those systems used for real-time market monitoring. The requirements for real-time market monitoring can be found in proposed Commission § 37.203(e).

<sup>64</sup> Mitigating circumstances may 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.

• Finally, because SEFs are not permitted to delegate core principle compliance functions, as are DCMs, are there any additional conditions that the Commission should impose on SEFs' use of third-party regulatory service providers?

**f. Audit Trail Requirements—Proposed § 37.205**

Proposed § 37.205 addresses SEF Core Principle 2's requirements that a SEF be able to capture information that may be used to determine whether rule violations have occurred.<sup>69</sup> Proposed § 37.205 requirements are akin to the DCM regulations addressing audit trail requirements.<sup>70</sup>

Proposed § 37.205 requires that a SEF establish an audit trail, and sets forth the elements of an effective audit trail and the requirements for effective audit trail enforcement.<sup>71</sup> The Commission believes that these requirements will help to ensure that SEFs can appropriately monitor and investigate any potential customer and market abuse. Additionally, the audit trail data captured by SEFs must be sufficient to reconstruct all transactions promptly, and to provide evidence of any rule violations that may have occurred.

Subsection (b)(1) of the proposed regulation requires that a SEF's audit trail include original source documents, defined to include unalterable, sequentially-identified records on which trade execution information is originally recorded, whether manually or electronically. It also requires that customer order records demonstrate the terms of the order, the unique account identifier that relates to the account owner, and the time of the order entry. Subsection (b)(2) of the proposed regulation requires that a SEF's audit trail program include a transaction history database to facilitate rapid access and analysis of all original source documents. Subsection (b)(2) also specifies the trade information that must be included in a transaction history database.<sup>72</sup> Subsection (b)(3) of the

proposed regulation requires that a SEF's audit trail program have electronic analysis capability for all data in its transaction history database and enable the SEF to reconstruct trades in order to identify possible rule violations. Subsection (b)(4) requires that a SEF's audit trail program 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. Safe storage capability also requires a SEF to protect its audit trail data from unauthorized alteration, accidental erasure or other loss.

Subsection (c) of proposed § 37.205 is organized in two parts. First, subsection (c)(1) requires that a SEF develop an effective audit trail enforcement program, which must, at a minimum, review all members and market participants annually to verify their compliance with all applicable audit trail requirements. Subsection (c)(1) also sets forth minimum review criteria for an electronic trading audit trail that must be carried out by each SEF. Finally, subsection (c)(2) requires that SEFs develop programs to ensure effective enforcement of their audit trail and recordkeeping requirements, including a requirement that SEFs levy meaningful sanctions when deficiencies are found. Sanctions may not include more than one warning letter or other non-financial penalty, in lieu of stronger disciplinary action, for the same violation within a rolling twelve-month period.

**Request for Comment:**

The Commission seeks public comment on the proposed audit trail and audit trail enforcement requirements for SEFs.

- The Commission seeks specific public comment on whether such requirements should be similar for both SEFs and DCMs.
- Should SEFs be subject to additional requirements beyond the proposed regulations? Are there elements of the proposed regulations that are inappropriate for SEFs?
- For example, is the CTI code system used by DCMs to denote different types of futures participants also necessary for swap transactions on SEFs?
- What specific data points should a SEF's audit trail enforcement program seek to verify?

**g. Disciplinary Procedures and Sanctions—Proposed § 37.206**

Proposed § 37.206 addresses SEF Core Principle 2's requirement that SEFs establish and enforce participation rules to deter abuse, and have the capacity to

investigate and enforce such abuses.<sup>73</sup> Subsection (a) of the proposed regulation requires that a SEF establish and maintain sufficient enforcement staff and resources to effectively and promptly prosecute possible rule violations within the jurisdiction of the SEF. Subsection (a) also provides that a SEF's enforcement staff may not include members of the SEF or persons whose interests conflict with their enforcement duties. Moreover, a member of the enforcement staff may not operate under the direction or control of any person or persons with trading privileges at the SEF. These provisions seek to ensure the independence of enforcement staff, and help promote disciplinary procedures that are free of potential conflicts of interest.

Subsection (b) requires SEFs to establish one or more Review Panels and one or more Hearing Panels (together, "disciplinary panels"). Neither panel may include members of the SEF's compliance staff or any person involved in adjudicating any other stage of the same proceeding.<sup>74</sup> The proposed regulation provides 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, while a separate Hearing Panel must be responsible for adjudicating the matter and issuing sanctions.<sup>75</sup>

<sup>73</sup> See CEA Section 5h(f)(2)(B). In general, the proposed regulations addressing disciplinary procedures for SEFs parallel the disciplinary procedure regulations for DCMs. The proposed regulations pursuant to DCM Core Principle 13 are also similar to the text of the disciplinary procedures in part 8, which the Commission found to be the model for many DCMs' disciplinary programs. 17 CFR 8.01 *et seq.* DCMs were exempt from Part 8 pursuant to § 38.2; however, the predecessor DCM Core Principle 13 offered the disciplinary procedures in Part 8 as an example of appropriate disciplinary procedures.

<sup>74</sup> Disciplinary panels must also adhere to the composition requirement of § 40.9(c)(3)(ii), as proposed, which provides 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 "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." See 75 FR 63752 (October 18, 2010).

<sup>75</sup> The Commission notes that, while proposed § 37.206(b) requires SEFs to empanel distinct bodies to issue charges and to adjudicate charges in a particular matter, SEFs may determine for themselves whether their Review and Hearing Panels are separate standing panels or ad hoc bodies whose members are chosen from a larger "disciplinary committee" to serve in one capacity or

Continued

<sup>69</sup> CEA Section 5h(f)(2)(B)(ii).

<sup>70</sup> For further explanation of the elements of an effective audit trail, see *supra* note 10, DCM NPRM.

<sup>71</sup> Subsection (a) of the proposed regulation establishes the overarching requirements for SEFs' audit trail programs, while Subsection (b) prescribes the four elements of an acceptable audit trail program and Subsection (c) prescribes the elements of an effective audit trail enforcement program.

<sup>72</sup> For example, mandatory information includes a history of all orders and trades; all data input in the trade matching system for purposes of clearing; the categories of participant for which each trade is executed (*i.e.*, the customer type indicator or "CTI" codes); timing and sequencing data sufficient to reconstruct trading; and identification of each account to which fills are allocated.

Subsection (c) of the proposed regulation requires a Review Panel to promptly review an investigation report received pursuant to proposed § 37.203(f)(3), and to take action within 30 days of receipt. The Commission believes that prompt disciplinary action provides the best opportunity for witnesses to recall conversations, facts, and other information relevant to the matter, and transmits a clear signal to the market and to market participants that violations of exchange rules will not be tolerated. Subsection (c) also specifies the range of actions which a Review Panel may take upon receiving a completed investigation report. Subsection (d) describes the minimally acceptable contents of any notice of charges ("notice") issued by a Review Panel. The notice 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; and prescribe the period within which a hearing may be requested. Further, the notice must advise the respondent charged that he or she is entitled, upon request, to a hearing on the charges.<sup>76</sup> Subsection (e), in turn, specifies a respondent's right to be represented by any counsel or representative of his choosing upon receiving a notice of charges and in all succeeding stages of the disciplinary process. Subsection (f) requires that a respondent must be given a reasonable period of time to file an answer to a charges.<sup>77</sup> Subsection (g) provides that, if a respondent admits or fails to deny any of the alleged violations a Hearing Panel may find that the violations admitted or not denied have been committed.<sup>78</sup> Subsection (h) requires

the other for a particular disciplinary matter. The purposes of separate Review and Hearing Panels is to help ensure adjudication of disciplinary matters by separating a decision to issue charges from a hearing on the merits of a matter.

<sup>76</sup> The proposed regulations permit a SEF to adopt rules providing that the failure to request a hearing within the time prescribed in the notice, except for good cause, must be deemed a waiver of the right to a hearing and that the failure to answer or deny expressly a charge must be deemed to be an admission of such charge.

<sup>77</sup> Subsection (f) also permits a SEF, through its rules, to require 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.

<sup>78</sup> In addition, if a SEF adopts a rule concerning the admission or failure to deny charges pursuant to Proposed § 37.206(f), then Subsections (g)(1) through (g)(3) of the proposed regulation provide that: (1) The Hearing Panel must impose a sanction for each violation found to have been committed; (2) the SEF must promptly notify the respondent in

that in every instance where a respondent has requested a hearing on a charge that he or she denies, 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).

Subsection (i) provides the procedures a SEF must follow when it settles a disciplinary case. The provision states that the rules of a SEF may permit a respondent to submit a written offer of settlement 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 the offer unless the respondent agrees. Subsection (i) requires a disciplinary panel that accepts a settlement offer to 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. Significantly, proposed § 37.206(i)(3) also provides that if an offer of settlement is accepted without the agreement of a SEF's enforcement staff, the decision must carefully explain the panel's acceptance of the settlement.<sup>79</sup>

Subsection (j) requires a SEF to adopt rules that provide certain minimum requirements for any hearing conducted pursuant to a notice of charges. In general, Subsections (j)(1)(i) through (j)(1)(vi) require that the SEF: (1) Provide a fair hearing; (2) permit respondents to examine evidence relied on by enforcement staff in presenting the notice of charges; (3) require enforcement and compliance staffs to be parties to the hearing and enforcement staff to present their case on those charges and sanctions that are the subject of the hearing; (4) permit respondents to appear personally at the hearing, to cross-examine and call witnesses and to present evidence; (5) require that persons within its jurisdiction who are called as witnesses

writing of any sanction to be imposed and advise the respondent that they may request a hearing on such sanction within the period of time stated in the notice; and (3) the rules of the SEF may provide that if the respondent fails to request a hearing within the period of time stated in the notice, then the respondent will be deemed to have accepted the sanction.

<sup>79</sup> Subsection (i) allows 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.

participate in the hearing and produce evidence; and (6) transcribe and retain a copy of the hearing. Additionally, subsection (j)(2) specifies 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.

Subsection (k) details the procedures that a Hearing Panel must follow in rendering disciplinary decisions. The provision requires that all decisions include: (1) A notice of charges or a summary of the charges; (2) an 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 in the investigation report; (4) a statement of findings and conclusions with respect to each charge, and a careful explanation of the evidentiary and other bases for such findings and conclusions with respect to each charge; (5) an indication of each specific rule which the respondent was found to have violated; and (6) a declaration of any penalty imposed against the respondent, including the basis for such sanctions and the effective date of such sanctions.

Subsection Proposed § 37.206(l) provides the procedures that a SEF must follow in the event that the SEF's rules authorize an appeal of adverse decisions in all or in certain classes of cases.<sup>80</sup> Notably, the proposed § requires a SEF that permits appeals by disciplinary respondents to also permit appeals by its enforcement staff. This provision reflects the Commission's belief that SEF enforcement staff must have the discretion to appeal disciplinary panel decisions that, for example, do not adequately sanction a respondent's violative conduct. Subsection (m) requires that each SEF establish rules setting forth when a decision rendered under this subsection C will become the final decision of the SEF.

Subsection (n) requires that every disciplinary sanction imposed by a SEF must be commensurate with the

<sup>80</sup> For SEFs that permit appeals, the language in subsections (l)(1) through (l)(4) of proposed § 37.206 generally require the SEF to: (1) Establish an appellate panel that is authorized to hear appeals; (2) ensure that the appellate panel composition is consistent with § 40.9(c)(3)(iii) 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) except for good cause shown, the appeal or review must be conducted solely on the record before the Hearing Panel, the written exceptions filed by the parties, and the oral or written arguments of the parties; and (4) promptly following the appeal or review proceeding, the board of appeals must issue a written decision and provide a copy to the respondent. The Commission notes that a respondent has certain rights of appeal to the Commission under Part 9 of the Commission's regulations.

violations committed and must be clearly sufficient to deter recidivism or similar violations by other market participants. Additionally, the proposed regulation requires that, in the event of demonstrated customer harm, any disciplinary sanction must include full customer restitution. In evaluating appropriate sanctions, the proposed regulation requires the SEF to take into account a respondent's disciplinary history.<sup>81</sup>

Subsection (o) permits a SEF to adopt a summary fine schedule for violations of rules relating to timely submission of accurate records required for clearing or verifying each day's transactions. The proposed regulation makes clear that a SEF should issue no more than one warning letter in a rolling 12-month period for the same violation before sanctions are imposed. Additionally, the proposed regulation specifies that a summary fine schedule must provide for progressively larger fines for recurring violations. The Commission believes that these provisions will serve to discourage recidivist behavior.

Finally, subsection (p) provides that a SEF may impose an immediate sanction upon a reasonable belief that such action is necessary to protect the best interest of the marketplace. The proposed regulation also provides that any emergency action taken by the SEF must be performed in accordance with certain procedural safeguards.

#### *Request for Comment:*

The Commission seeks public comment on proposed § 37.206.

- In particular, comments should address whether SEFs should be subject to the detailed disciplinary procedures proposed herein. The proposed disciplinary procedures emphasize procedural safeguards for respondents, including a clear separation between SEF personnel recommending the issuance of charges, review panels determining whether charges should be issued, and hearing panels adjudicating cases on the merits. Are these disciplinary procedures sufficient for SEFs? Or, should SEFs instead utilize a more streamlined disciplinary process that features, for example, a robust staff summary fine program rather than formal disciplinary hearings.

- Finally, given the significant financial resources of the ECPs conducting swap transactions on SEFs, should Commission regulations provide more detailed guidelines on the

appropriate size of any financial penalties levied by SEFs for violative conduct? Should any such guidelines take cognizance of the financial resources of potential respondents?

#### *h. Swaps Subject to Mandatory Clearing—Proposed § 37.207*

Proposed § 37.207 mandates that SEFs provide rules that require swap dealers or major swap participants, who trade a swap subject to the mandatory clearing requirement under Section 2(h)(1), to execute the transaction on either a DCM or a SEF. However, swap dealers or major swap participants are not required to execute such transactions if no DCM or SEF makes the swap available to trade.

#### *3. Subpart D—Core Principle 3 (Swaps Not Readily Susceptible to Manipulation)*

Under Core Principle 3, Congress required that SEFs offer for trading swaps that are not readily susceptible to manipulation. The Commission notes that the statutory language of Core Principle 3 is substantively identical to the counterpart core principle under Section 5(d)(3) of the CEA as applicable to DCMs. Historically, DCMs complied with the requirements of Section 5(d)(3) by using as guidance the provisions of Guideline No. 1, contained in Appendix A to Part 40. In a separate release, the Commission proposes certain revisions to the former Guideline No. 1, including: (i) Amending the provisions to include swap transactions, (ii) re-titling the guidance as “Demonstration of compliance that a contract is not readily susceptible to manipulation,” and (iii) re-designating the guidance to be included under Appendix C to Part 38.<sup>82</sup>

Accordingly, proposed § 37.301 requires that, applicants and SEFs must provide to the Commission the information required under Appendix C to Part 38 for purposes of demonstrating to the Commission that their swap contracts are not readily susceptible to manipulation.

Under Appendix B to Part 37, the guidance for compliance with Core Principle 3 focuses on the selection and construction of the price index on which the swaps' cash flows are based. If obtained from a private third-party, the company should be independent and reputable. Moreover, the third party should use a sound, well-documented methodology that protects the index from manipulation. If the SEF itself determines the price index, then it should take precautions to safeguard

against attempts to artificially influence the index. In this regard, if the price index is based on a survey of cash market sources, then the SEF should maintain a list of such entities which all should be reputable sources with knowledge of the cash market. In addition, the sample of sources polled should be representative of the cash market, and the poll should be conducted at a time when trading in the cash market is active. The cash-settlement survey should include a minimum of four independent entities if such sources do not take positions in the commodity (e.g., if the survey list is comprised exclusively of brokers) or at least eight independent entities if such sources trade for their own accounts (e.g., if the survey list is comprised of dealers or commercial users).

#### *4. Subpart E—Core Principle 4 (Monitoring of Trading and Trade Processing)*

Under Core Principle 4, Congress required that SEFs must take an active role in preventing manipulation, price distortion and disruptions of the delivery or cash settlement process. Accordingly, the proposed regulations under Subpart E of Part 37 clarify the related responsibilities for applicants and SEFs to monitor trading activities and prevent market disruptions.

#### *a. General Requirements—Proposed § 37.401*

Proposed § 37.401 requires that applicants and SEFs must collect, monitor and evaluate data to detect and prevent manipulative activity. Proposed § 37.401 also requires that applicants and SEFs have the ability to conduct real-time monitoring of trading and comprehensive and accurate trade reconstructions.

As noted above in its discussion of the need for automated tools in connection with Core Principle 2 requirements, the Commission believes that it would be difficult, if not impossible, to monitor for market disruptions in markets with high transaction volume and a large number of trades unless the SEF has installed automated trading alerts to detect many types of potential violations of exchange or Commission rules. Accordingly, the Commission proposes in § 37.401 to require that, where the SEF cannot reasonably demonstrate that its manual processes are effective in detecting and preventing abuses, the SEF must implement automated trading alerts to detect potential problems.

<sup>81</sup> Proposed § 37.203(f)(3) also requires that a copy of a member or market participant's disciplinary history be included in the compliance staff's investigation report.

<sup>82</sup> See, *supra* note 10, DCM NPRM.



*Request for Comment:*

The Commission seeks public comment on whether in any rule the Commission may adopt in this matter, SEFs should be required to monitor the extent of high frequency trading, and whether automated trading systems should include the ability to detect and flag high frequency trading anomalies.

b. Additional Requirements for Physical-Delivery Swaps—Proposed § 37.402

For physical delivery swaps, proposed § 37.402 requires that SEFs monitor each swap's terms and conditions as well as take meaningful corrective action to allow market participants to continue to use the market to make sound hedging decisions and for price discovery.

c. Additional Requirements for Cash-Settled Swaps—Proposed § 37.403

Over the past several years, there has been a growth in markets that are linked, for example, where the settlement price of one market is linked to the prices established in another market. As a result, traders may have incentives to disrupt or manipulate prices in the reference market in order to influence the prices in the linked market. The Commission believes that in such situations SEFs must monitor trading in the market to which its swap is linked. Accordingly, proposed § 37.403 requires that, where a swap is settled by reference to the price of an instrument traded in another venue the SEF must 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.

d. Ability To Obtain Information—Proposed § 37.404

To ensure that SEFs have the ability to properly assess the potential for price manipulation, price distortions, and the disruption of the delivery or cash-settlement process, proposed § 37.404 provides that SEFs require that traders in their market keep and make available records of their activity in underlying commodities and related derivatives markets and swaps.

e. Risk Controls for Trading—Proposed § 37.405

Proposed § 37.405 requires that a SEF have effective risk controls to reduce the potential risk of market disruptions and ensure orderly market conditions. In the current futures markets, DCMs have implemented a variety of risk controls to avoid market disruptions through

restrictions on order entry, including daily price limits, price/quantity bands, and trading pauses. In order to prevent market disruptions due to sudden volatile price movements, proposed § 37.405 requires SEFs to have in place effective risk controls, including but not limited to pauses and/or halts to trading in the event of extraordinary price movements that may result in distorted prices or trigger market disruptions. Such risk controls can, among other things, allow time for 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. Moreover, where a swap is linked to, or a substitute for, other swaps on the SEF or other trading venues, including where a swap is based on the level of an equity index, risk controls should be coordinated with those on the similar markets or trading venues, to the extent possible.

The desirability of coordination of various risk controls, for example, “circuit breakers” in equities and their various derivatives including futures and options, recently has been the subject of discussions by regulators and the industry. The Commission believes that pauses and halts are effective risk management tools and must be implemented by SEFs to facilitate orderly markets. These basic risk controls also have proven to be effective and necessary in preventing market disruptions. The Commission recognizes that pauses and halts are only one category of risk controls and that additional controls may be necessary to further reduce the potential for market disruptions. Such controls may include price collars or bands,<sup>83</sup> maximum order size limits,<sup>84</sup> stop loss order protections,<sup>85</sup> kill buttons,<sup>86</sup> and others.

<sup>83</sup> Price bands would prevent clearly erroneous orders from entering the trading system, including “fat finger” errors, by automatically rejecting orders priced outside of a range of reasonability.

<sup>84</sup> Maximum order size limitations would prevent entry into the trading system of an order that exceeds a maximum quantity established by the SEF.

<sup>85</sup> Stop loss orders would be triggered if the market declines to a level pre-selected by the person entering the order. This mechanism would provide that when the market declines to the trader's pre-selected stop level for such an order, the order would become a limit order executable only down to a price within the range of reasonability permitted by the system, instead of becoming a market order.

<sup>86</sup> Kill buttons would give clearinghouses associated with a SEF the ability to delete open orders and quotes and reject entry of new orders or

*Request for Comment:*

The Commission is considering mandating in this rulemaking risk controls that are appropriate and/or necessary. Accordingly, the Commission invites comments on the appropriateness of these and other controls that could supplement trading halts or pauses. The Commission also invites comments on the following additional questions:

- Which risk controls should be mandated and how?
- What types of pauses and halts are necessary and appropriate for particular market conditions?
- What other risk controls are appropriate or necessary to reduce the risk of market disruptions?

f. Trade Reconstruction—Proposed § 37.406

Under Core Principle 4, Congress required that SEFs have the ability to comprehensively and accurately reconstruct all trading on its facility. Proposed § 37.406 sets forth this requirement, including the requirement that audit-trail data and reconstructions be made available to the Commission upon request.

g. Additional Rules Required—Proposed § 37.407

Proposed § 37.407 requires SEFs to adopt and enforce any additional rules that it believes are necessary to comply with the requirements of Subpart E.

5. Subpart F—Core Principle 5 (Ability To Obtain Information)

The proposed regulations under Subpart F require an applicant and a SEF to have the ability and authority, necessary Core Principle 5, to obtain necessary information to perform its obligations.

6. Subpart G—Core Principle 6 (Position Limits or Accountability)

Under Core Principle 6, Congress required that SEFs adopt for each swap, as is necessary and appropriate, position limits or position accountability. In addition, Congress required that, for any contract that is subject to a Federal position limit under CEA Section 4a(a), the SEF shall set its position limits at a level no higher than the position limitation established by the Commission in its Part 151 regulations. Proposed § 37.601 requires that each SEF must comply with the requirements of Part 151 in order to be in compliance with Core Principle 6.

quotes in instances where a trader breaches its obligations with the clearinghouse. See FIA Market Access Risk Management Recommendations, p. 10 (April 2010).



## 7. Subpart H—Core Principle 7 (Financial Integrity of Transactions)

Proposed § 37.700 sets out the financial integrity requirements for transactions on a SEF, as required under Core Principle 7. Under such core principle, a SEF must establish and enforce rules to ensure the financial integrity of swaps entered on or through the facilities of the SEF, including the clearing and settlement of the swaps. The requirements of proposed § 37.700 depend, in part, on whether the swap is cleared.<sup>87</sup>

Under proposed § 37.702(a), a SEF must ensure that all its members meet the definition of “eligible contract participant” under CEA Section 1(a)(18). Under proposed § 37.702(b), for swaps cleared by a DCO, a SEF must ensure that it has the capacity to route transactions to the DCO. With respect to swaps that are not required to be cleared, a SEF must impose additional requirements to ensure the financial integrity of the transaction,<sup>88</sup> including requiring the transacting member to have entered into a credit arrangement for the transaction, demonstrate an ability to exchange collateral, and have appropriate credit filters in place. The Commission believes that these additional requirements are necessary in light of the fact that uncleared swaps will not have the risk management protections of a DCO.

The Commission requests comment on whether these standards are appropriate financial integrity safeguards for SEFs. Specifically, the Commission solicits comment regarding how SEF members would demonstrate sufficient credit documentation and ability to exchange collateral.

### *Request for Comment:*

The Commission seeks public comment on the proposed rule, and specifically on the following questions:

- Whether SEFs should provide additional controls to permit FCMs to manage their risks? If so, what specific direct access controls and procedures should SEFs implement?
- Should such controls be mandatory?

<sup>87</sup> The Commission interprets the mandatory clearing requirement in Section 723(a)(3) of the Dodd-Frank Act to mean that a DCO must clear a swap for any DCM or SEF that requests such clearing services, so long as the DCO offers the swap. In addition, a DCO that is clearing particular swaps must also clear the same swaps when listed on DCMs or SEFs, whether affiliated or unaffiliated, on a nondiscriminatory basis.

<sup>88</sup> Separately, if the SEF determines to allow swap transactions that are not cleared, the SEF must have provisions to determine that the swap meets the exemption to the clearing requirement provided under section 2(h)(7) of the CEA, as amended by the Dodd-Frank Act.

## 8. Subpart I—Core Principle 8 (Emergency Authority)

Under Core Principle 8, a SEF must provide for emergency situations. Based upon its experience with DCMs, and in recognition of the fact that individual SEFs may have different approaches to handling emergency action, proposed § 37.801 refers to the guidance in Appendix B to Part 37 to demonstrate compliance with Core Principle 8.

The guidance reflects the Commission’s belief that there should be an increased emphasis on cross-market coordination of emergency actions and SEFs should have alternate lines of communication and approval procedures in order to address emergencies in real time.

The Commission’s experience has demonstrated that there are some specific requirements that at a minimum should be followed and these requirements are incorporated under the proposed guidance. Specifically, the SEF should have procedures and guidelines for decision-making and implementation of emergency intervention in the market. The SEF should have the authority to perform various actions, including without limitation: Liquidating or transferring open positions in the market,<sup>89</sup> suspending or curtailing trading in any swap, and taking such market actions as the Commission may direct. In addition, the guidance notes that SEFs must 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.

## 9. Subpart J—Core Principle 9 (Timely Publication of Trading Information)

Under Core Principle 9, Congress required that SEFs make available to the public timely information on price, trading volume, and other trading data on swaps to the extent prescribed by the Commission. Congress also required a SEF to have the capability of electronically capturing trade information for those transactions that occur on the trading system or platform. These matters are addressed in separate releases.<sup>90</sup> Proposed § 37.901 requires that SEFs comply with the real-time swap reporting and swap reporting and

<sup>89</sup> In situations where a swap is traded on more than one platform, emergency action to liquidate or transfer open interest must be directed, or agreed to, by the Commission or Commission staff.

<sup>90</sup> See, *supra* note 10, DCM NPRM; 75 FR 76140 (December 7, 2010); and 75 FR 76574 (December 8, 2010).

recordkeeping requirements being separately proposed by the Commission.

### *Request for Comment:*

In order to address all relevant considerations with respect to the reporting requirements of Core Principle 9, the Commission seeks general comments and asks the public to respond to the specific questions below.

- For interest rate swaps, because the term life on an interest rate swap can be one of a large number of possible periods along a yield curve, what would be an appropriate manner to display prices?

- Would prices for interest rate swaps be meaningful or misleading and why?

- If the prices are misleading, what useful information should be displayed at the end of the trading day?

- Please identify any other swap products that have similar price reporting issues and address how the prices for that product should be reported to provide a summary of the trading for that day.

## 10. Subpart K—Core Principle 10 (Recordkeeping and Reporting)

Core Principle 10 establishes a three-part recordkeeping and reporting requirement applicable to all SEFs, which the Commission proposes to implement through proposed §§ 37.1001–37.1003.<sup>91</sup>

Proposed § 37.1001 largely codifies the statutory language of Core Principle 10. In addition, it clarifies that investigatory and disciplinary files are included in the records that a SEF must maintain, and requires that a SEF comply with the recordkeeping requirements of § 1.31.<sup>92</sup>

By incorporating § 1.31, proposed § 37.1001 effectively requires that SEF books and records be readily accessible for the first 2 years of the minimum 5-

<sup>91</sup> CEA Section 5h(f)(10)(A) requires all SEFs to: Maintain records of all activities relating to the business of each SEF, including a complete audit trail, for a period of at least five years; report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines to be necessary or appropriate; and keep records relating to swaps defined in CEA Section 1a(47)(A)(v) open to inspection and examination by the Securities and Exchange Commission. CEA Section 5h(f)(10)(B) requires the Commission to “adopt data collection and reporting requirements for swap execution facilities that are comparable to corresponding requirements for derivatives clearing organizations and swap data repositories.” The Commission’s data standards are included in proposed rules in Part 45 of the Commission’s regulations.

<sup>92</sup> The Commission notes that it has always considered audit trails and investigatory and disciplinary files as a part of the records which a DCM is required to maintain and which the Commission is permitted to request and to examine. In this respect, the proposed regulation merely codifies existing Commission practice.

year statutory period and be open to inspection by any representatives of the Commission or the United States Department of Justice.<sup>93</sup> The SEF, at its own expense, must promptly provide either a copy or the original books or records upon request.

The statutory regime for SEFs established by the Dodd-Frank Act envisions ongoing Commission oversight of SEFs and their trading activity. Such oversight will resemble, in concept, the oversight already conducted by the Commission with respect to DCMs. Accordingly, proposed § 37.1002 requires that SEFs report to the Commission any information necessary or appropriate for the Commission to perform its oversight duties. The proposed regulation does not articulate specific information that must be provided to the Commission; instead, it establishes the general requirement that SEFs must provide any relevant data requested by the Commission in a form and manner acceptable to the Commission.<sup>94</sup>

Proposed § 37.1003 codifies Core Principle 10's statutory requirement that a SEF keep any records relating to

security-based swap agreements defined in Section 1a(47)(A)(v) of the CEA open to inspection and examination by the Securities and Exchange Commission ("SEC").<sup>95</sup>

#### 11. Subpart L—Core Principle 11 (Antitrust Considerations)

Core Principle 11 governs the antitrust obligations of SEFs.<sup>96</sup> This SEF core principle is substantially similar to DCM Core Principle 19.<sup>97</sup> The Commission believes that the existing guidance applicable to DCM Core Principle 19 remains appropriate. Accordingly, the Commission proposes to codify the statutory text of Core Principle 11 into proposed § 37.1100. Additionally, proposed § 37.1101 refers applicants and SEFs to the guidance in Appendix B to Part 37 for purposes of demonstrating compliance with proposed § 37.1100.

#### 12. Subpart M—Core Principle 12 (Conflicts of Interest)

Core Principle 12 governs conflicts of interest. Like Core Principle 11, Core Principle 12 is substantially similar to both the DCM and the DCO conflicts of interest core principles, as amended by the Dodd-Frank Act.<sup>98</sup> As a result, the Commission proposes to handle Core Principle 12 consistent with its handling of those DCM and DCO core principles. This release proposes to codify the statutory text of the core principle in proposed § 37.1200. The applicable regulations implementing this core principle 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."<sup>99</sup>

#### 13. Subpart N—Core Principle 13 (Financial Resources)

Core Principle 13 requires that a SEF have adequate financial resources to discharge its responsibilities. In particular, SEFs must maintain financial resources sufficient to cover operating costs for a period of at least one year, calculated on a rolling basis.

##### a. General Rule

Under proposed § 37.1301(b), SEFs that also operate as DCOs are also subject to the financial resource

requirements for DCOs in proposed § 39.11. Proposed § 37.1301(c) would require that SEFs maintain sufficient financial resources to cover operating costs for at least one year, calculated on a rolling basis—i.e., at all times. The one year period is required under the CEA. The Commission believes that a one-year timeframe would allow a SEF's business to wind down in an orderly fashion and should generally enhance the financial integrity of the markets.<sup>100</sup>

The one-year period also is consistent with established accounting standards, under which an entity's ability to continue as a going concern comes into question if there is evidence that the entity may be unable to continue to meet its obligations in the next 12 months without substantial disposition of assets outside the ordinary course of business, restructuring of debt, externally forced revisions of its operations, or similar actions.<sup>101</sup>

##### b. Types of Financial Resources

Under proposed § 37.1302, financial resources available to SEFs to satisfy the applicable financial requirements would include the SEF's own capital (assets in excess of liabilities) and any other financial resource deemed acceptable by the Commission. A SEF would be able to request an informal interpretation from CFTC staff on whether or not a particular financial resource would be acceptable.

##### *Request for Comment:*

The Commission invites commenters to recommend particular financial resources for inclusion in the final regulation.

##### c. Computation of Financial Resource Requirement

Proposed § 37.1303 would require that a SEF, at the end of each fiscal quarter, make a reasonable calculation of the financial resources it needs to meet the requirements of proposed

<sup>93</sup> Proposed § 37.1001 also effectively incorporates § 1.31(b)'s description of the permissible methods of storing books and records. Consequently, a SEF may store its books and records as prescribed by § 1.31(b)(1)(ii). Among other criteria, § 1.31(b)(1)(ii) defines electronic storage media as "any digital storage medium or system that preserves the records exclusively in a non-rewritable, non-erasable format [and] verifies automatically the quality and accuracy of the storage media recording process \* \* \*." SEFs must, at all times, have the facilities to immediately produce and be prepared to present legible hard-copy images of such records. Additionally, SEFs must keep only Commission-required records on the media, store a duplicate of the record at a separate location, and organize and maintain an accurate index of all information maintained on both the original and duplicate storage media. SEFs that use electronic storage media are also required to develop and maintain an audit system to track the initial entry of original or duplicate records and any subsequent changes made thereafter. Proposed § 37.1001 also incorporates §§ 1.31(c) and 1.31(d), which expand upon the requirements established by proposed § 37.1001. Section 1.31(c) requires that record-keepers who employ an electronic storage system certify with Commission that the system meets the requirements of an electronic storage media as defined in § 1.31(b)(1)(ii). Section 1.31(d) states that trading cards, documents on which trade information is originally recorded in writing, certain written orders, and paper copies of certain electronically filed forms and reports with original signatures must be retained in hard-copy for the requisite time period. Finally, proposed § 37.1001 also requires that SEFs comply with the recordkeeping requirements applicable to swaps in proposed Part 45.

<sup>94</sup> The Commission anticipates that the records it will routinely request will include, for example, daily trading records, board of directors' meeting minutes, investigatory and disciplinary files, information regarding resources allocated to compliance functions, and other records used in the Commission's trade practice surveillance program and rule enforcement review program.

<sup>95</sup> CEA Section 5h(f)(10)(A)(iii).

<sup>96</sup> Part 38 contains guidance governing compliance with former Core Principle 18. 17 CFR part 38, App. B.

<sup>97</sup> Prior to the Dodd-Frank Act, the DCM core principle on antitrust considerations was numbered as DCM Core Principle 18.

<sup>98</sup> DCM Core Principle 16 and DCO Core Principle P, both as amended by the Dodd-Frank Act.

<sup>99</sup> 75 FR 63732 (October 18, 2010).

<sup>100</sup> Some foreign regulatory authorities already have similar requirements for the equivalent entities they regulate. For example, the UK Financial Services Authority's ("FSA") recognition requirements for UK recognized investment exchanges and UK recognized clearing houses (collectively, "UK recognized bodies") include the maintenance of financial resources sufficient to ensure that the UK recognized body would be able to complete an orderly closure or transfer of its business without being prevented from doing so by insolvency or lack of available funds. Section 2.3.7 of the FSA Recognition Requirements calls for a UK recognized body to have at all times liquid financial assets amounting to at least six months' operating costs and net capital of at least that amount.

<sup>101</sup> See American Institute of Certified Public Accountants Auditing Standards Board Statement of Auditing Standards No. 59, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern, as amended.

§ 37.1301. In the first instance, the SEF would have reasonable discretion in determining how to make this calculation, the Commission may require changes as appropriate.

#### d. Valuation of Financial Resources

Proposed § 37.1304 would require that SEFs, no less frequently than quarterly, calculate the current market value of each financial resource used to meet their obligations under these proposed regulations. Additionally, SEFs would have to perform the valuation at other times as appropriate. This provision 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. When valuing a financial resource, a SEF would be required to reduce the value, as appropriate, to reflect any market or credit risk specific to that particular resource, *i.e.*, apply a haircut.<sup>102</sup>

#### e. Liquidity of Financial Resources

Proposed § 37.1305 would require that SEFs maintain unencumbered liquid financial assets, such as cash or highly liquid securities, equal to at least six months' operating costs. The Commission believes that having six months' worth of unencumbered liquid financial assets would give a SEF time to liquidate the remaining financial assets it would need to continue operating for the last six months of the required one-year period. If a SEF does not have six months' worth of unencumbered liquid financial assets, it would be allowed to use a committed line of credit or similar facility to satisfy this requirement.

The Commission notes that a committed line of credit or similar facility is not listed in proposed § 37.1302 as a financial resource available to a SEF to satisfy the requirements of proposed § 37.1301. A SEF may only use such resources to meet the liquidity requirements of proposed § 37.1305.

#### f. Reporting Requirements

Under proposed § 37.1306, at the end of each fiscal quarter, or at any time upon Commission request, SEFs would be required to report to the Commission: (i) The amount of financial resources necessary to meet the requirements set forth in the regulation; and (ii) the value

of each financial resource available to meet those requirements. A SEF would also have to provide the Commission with a financial statement, including the balance sheet, income statement, and statement of cash flows, of the SEF or of its parent company, as appropriate.

#### 14. Subpart O—Core Principle 14 (System Safeguards)

Core Principle 14 requires that SEFs: (1) Establish and maintain a program of risk 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 (3) periodically conduct tests to verify that backup resources are sufficient to ensure continued order processing and trade matching, price reporting, market surveillance, and maintenance of a comprehensive and accurate audit trail. Proposed § 37.1401 would establish system safeguards requirements for all SEFs, pursuant to Core Principle 14.

The proposed rule would require 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.

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 the trading of swaps. Sophisticated computer systems will be crucial to a SEF's ability to meet its obligations and responsibilities. SEF 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.

#### 15. Subpart P—Core Principle 15 (Designation of Chief Compliance Officer)

Section 5h(f)(15) of the CEA, as added by Section 733 of the Dodd-Frank Act,

creates an internal regulatory framework for all SEFs, with the position of chief compliance officer ("CCO") serving as a focal point for compliance with the CEA and applicable Commission regulations. The four-part structure of Section 5h(f)(15) requires, first, that every SEF designate an individual to serve as CCO. Second, it enumerates specific duties for CCOs and establishes their responsibilities within a SEF. Third, it requires CCOs to design the procedures establishing the handling, management response, remediation, retesting, and closing of noncompliance issues. Fourth, it outlines the requirements of a mandatory annual report from SEFs to the Commission, which must be prepared and signed by a SEF's CCO. The Commission proposes to implement Section 5h(f)(15) of the CEA through proposed § 37.1501, which further develops the already robust CCO requirements enacted by the Dodd-Frank Act. Section 5h(f)(15) of the CEA and proposed § 37.1501 are summarized below.

The first provision of Section 5h(f)(15)—5h(f)(15)(A)—provides only for the self-explanatory requirement that each SEF designate an individual to serve as its CCO. The second provision of Section 5h(f)(15) offers a detailed description of a CCO's role within a SEF. Specifically, Section 5h(f)(15)(B) includes six enumerated duties incumbent upon all CCOs, and thereby outlines the internal regulatory structure of a SEF as contemplated by the Dodd-Frank Act. The enumerated duties of CCOs include: (1) Reporting directly to the SEF's board of directors or to its senior officer; (2) reviewing an SEF's compliance with the requirements and core principles described in Section 5h; (3) resolving any conflicts of interest that may arise, in consultation with the board of directors or the senior officer of the SEF; (4) establishing and administering any policy or procedure that is required to be established by a SEF pursuant to Section 5h; (5) ensuring compliance with the CEA, including rules prescribed by the Commission pursuant to Section 5h; and (6) establishing procedures for the remediation of noncompliance issues identified by the CCO. The third provision of Section 5h(f)(15) provides that the CCO in establishing and following appropriate procedures shall design such procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

Finally, the fourth provision of Section 5h(f)(15)—5h(f)(15)(D)—requires CCOs to prepare and sign annual compliance reports on behalf of their

<sup>102</sup> The Commission would permit each SEF to exercise its discretion in determining the applicable haircuts. However, such haircuts are subject to Commission review and must be acceptable to the Commission.

SEFs. The annual compliance reports must describe a SEF's compliance with the CEA and Commission regulations. They must also describe the policies and procedures of the SEF, including the code of ethics and conflict of interest policies. In addition, the annual compliance reports must include "a certification that, under penalty of law, the report is accurate and complete." The annual compliance report must be furnished to the Commission as it may prescribe.

Proposed subpart P develops each of these statutory provisions in greater detail and grants CCOs the regulatory authority necessary to fulfill responsibilities in each regard.

**a. Definition of Board of Directors—Proposed § 37.1501(a)**

Proposed § 37.1501(a) defines "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." The proposed definition reflects the various forms of business associations which a SEF could conceivably take, including forms which do not include a corporate board of directors. It also reflects the flexibility in Section 733 of the Dodd-Frank Act, which refers, for example, to "a body performing a function similar to a board" in discussing the duties of a CCO pursuant to Section 5h(f)(15)(B)(iii) of the CEA.

**Request for Comment:**

The Commission requests comment on the following:

- Should the Commission develop additional rules around the types of bodies which may perform board-like functions at a SEF, depending on their business form?
- Should the proposed definition of board of directors appropriately address issues related to parent companies, subsidiaries, affiliates, and SEFs located in foreign jurisdictions? Does the proposed rule allow for sufficient flexibility with regard to a SEF's business structure?

**b. Designation and Qualifications of Chief Compliance Officer—Proposed § 37.1501(b)**

Proposed § 37.1501(b)(1) requires a SEF to establish the position of CCO, designate an individual to serve in that capacity and provide that individual with the authority and resources to develop and enforce policies and procedures necessary to fulfill the duties set forth for CCOs in the Dodd-

Frank Act and Commission regulations. In addition, proposed § 37.1501(b)(1) provides that CCOs must have supervisory authority over all staff acting in furtherance of the CCO's statutory and regulatory obligations. In short, proposed § 37.1501(b)(1) establishes CCOs as the focal point of a SEF's regulatory compliance functions.

Proposed § 37.1501(b)(2) details minimum competency standards for CCOs. It requires that CCOs have the background and skills necessary to fulfill the responsibilities of the position, and prohibits anyone who would be disqualified from registration under Sections 8a(2) or 8a(3) of the CEA from serving as a CCO. Although the CCO would not be required to register with the Commission, as the primary individual with responsibility for ensuring a SEF's legal compliance, the Commission believes that CCOs should meet the same standard as those individuals who are required to register, as set forth in the list of statutory disqualifications under Sections 8a(2) and (3) of the CEA. These standards largely consist of a high degree of responsibility and requirements relating to integrity and honesty in financial and business dealings. Section 37.1501(b)(2) also requires that a CCO not serve as general counsel of a SEF. This prohibition reflects the Commission's belief that granting these dual roles to a single individual is incompatible with effective regulation and self-regulation.<sup>103</sup>

**Request for Comment:**

The Commission is seeking comment on whether additional limitations should be placed on persons who may be designated as a CCO.

- The Commission requests comment on whether the provisions of proposed § 37.1501(b) are sufficient to ensure that

<sup>103</sup> As conceived by the Commission, SEF CCOs have overall responsibility for SEFs' compliance programs. CCOs must be neutral fact-finders, and must be able to act in the interest of effective compliance regardless of the persons, entities, or conduct that may be the subject of investigation. In contrast, an entity's general counsel serves as the legal counsel and defender of a company and seeks to avoid or negate related legal risks. A second basis for the separation of the general counsel and CCO roles is the Commission's determination that an individual acting as CCO should not be in a position to assert attorney-client privilege against the Commission. If a SEF's CCO were also its general counsel, much of the information about its compliance program could potentially be protected from third-party review, including the Commission's, under the shroud of attorney-client privilege. While there may be circumstances where the attorney-client privilege could be asserted by a SEF, the Commission believes that such circumstances do not include the areas of responsibility assigned to CCOs by the CEA or Commission regulations.

a CCO has the authority and resources necessary to fulfill his or her statutory and regulatory obligations.

- The Commission also requests comment regarding the qualifications that should be required of a CCO, and whether the requirements expressed in proposed § 37.1501(b) are sufficient.

- Should there be additional restrictions placed on who is qualified to be designated as a CCO? The Commission requests comment on whether restricting a CCO from serving as the General Counsel or other attorney within the legal department of a SEF would sufficiently address conflict of interest concerns?

**c. Appointment, Supervision, and Removal of Chief Compliance Officer—Proposed § 37.1501(c)**

Taken together, proposed §§ 37.1501(c)(1), 37.1501(c)(2), and 37.1501(c)(3) provide the supervisory regime applicable to CCOs. Proposed § 37.1501(c) requires that a CCO be appointed by a majority of the SEF's board of directors or senior officer, and that a majority of the board or senior officer be responsible for approving the CCO's compensation. A SEF must notify the Commission within two business days of appointing a new CCO. The proposed regulation also requires the CCO to meet at least annually with the board of directors to discuss the effectiveness of the CCO's administration of the compliance policies adopted by the registrant. The meeting or meetings would create an opportunity for a CCO and the directors to speak freely about any sensitive issues of concern to any of them, including any reservations about the cooperativeness or compliance practices of the registrant's management. The Commission's governance proposals require that each SEF's board of directors include a board-level regulatory oversight committee ("ROC") consisting exclusively of public directors.<sup>104</sup> The Commission believes

<sup>104</sup> Proposed § 37.1501(a) defines board of directors for purposes of subpart P as follows: "the board of directors or board of governors of a swap execution facility, or equivalent governing body of a swap execution facility or of an entity operating a swap execution facility." The proposed definition reflects the various forms of business associations which a SEF could take, including forms which do not include a corporate board of directors. With respect to boards of directors and ROCs, the Commission notes that in a separately proposed series of regulations governing conflicts of interest within SEFs, DCMs, and DCOs, the Commission proposes a number of governance measures that impact the proposed regulations for CCOs. First, proposed § 40.9(b)(1)(i) requires a SEF's board of directors to be composed of at least 35%, but no less than two, public directors. Second, proposed § 40.9(b)(2) prohibits a SEF from "permit[ing] itself

that ROCs will help to mitigate potential conflicts of interest within a SEF by introducing an independent perspective to board deliberations.<sup>105</sup> The Commission also believes that both CCOs and ROCs will be strengthened in their regulatory work and independence through close cooperation and coordination. Although a CCO is not required to report to his or her ROC, proposed § 37.1501(c)(1) provides that a CCO must meet with the ROC quarterly to discuss matters of mutual concern and share information. These meetings will create an opportunity for a CCO and the ROC to speak freely about potentially sensitive issues, including any reservations by the CCO regarding the SEF's management. They will also facilitate the ROC's oversight responsibilities, and allow the CCO to seek assistance and institutional support from the ROC as necessary.

Finally, proposed § 37.1501(c)(1) also provides that the senior officer of a SEF may assume responsibility for appointing the CCO and approving his or her compensation.

Proposed § 37.1501(c)(2) addresses routine oversight of a SEF's CCO. It allows a SEF with a board of directors to grant oversight authority to either its board or to its senior officer. The proposed regulation is modeled on the terms of Section 5h(f)(15)(B)(i) of the CEA, which requires a CCO to "report directly to the board or to the senior officer of the facility."

#### *Request for Comment:*

The Commission requests comment regarding the appropriate reporting relationship for the CCO of a SEF that has both a senior officer and a board of directors.

- In such cases, should a CCO report to the SEF's board rather than to its senior officer?
- What potential conflicts of interest might arise if a CCO reports to the senior officer rather than to the board, and how might those conflicts be mitigated?
- In addition, the Commission requests comment regarding whether "senior officer" of a SEF should be a defined term, and if so, how the term should be defined.

to be operated by any entity" that does not adhere to the board composition requirements of 40.9(b)(1)(i). Third, proposed § 37.19(b)(3) requires a SEF to have a board-level ROC consisting exclusively of public directors.

<sup>105</sup> See proposed § 37.19(b)(1) for a description of a ROC's role in overseeing the performance of a CCO and effectiveness, efficiency, and independence of a SEF's regulatory and self-regulatory programs.

#### *d. Removal of CCO—Proposed § 37.1501(c)(3)*

Proposed § 37.1501(c)(3) requires approval of a majority of an SDR's board of directors to remove a CCO. The Commission believes that these removal provisions will help insulate CCOs and their decision-making from day-to-day commercial pressures that they may otherwise experience. If a SEF does not have a board, the proposed regulation provides that the CCO may be removed by its senior officer. Proposed § 37.1501(c)(3) also requires an SDR to notify the Commission in writing within two business days of the removal or voluntary departure of its CCO by providing a statement describing the circumstances surrounding his or her departure.<sup>106</sup> The Commission believes that this provision will help protect CCOs from undue influence or retaliatory termination by the board or the senior officer of the SEF.

Proposed §§ 37.1501(c)(1) and 37.1501(c)(3) seek to provide a SEF's CCO with a measure of independence from management in the performance of his or her duties, and to ensure that such duties are executed in the most effective and impartial manner possible.

#### *Request for Comment:*

The Commission requests comment on any additional measures that should be required to adequately protect CCOs from undue influence in the performance of their duties. The Commission is particularly interested in how it might offer such protection to a CCO who reports to his or her senior officer, either at the SEF's choosing or because the SEF does not have a board of directors. In addition, the Commission also requests comment on whether the provision that would require a majority of a board of directors to remove the CCO is sufficiently specific.

#### *e. Duties of the Chief Compliance Officer—Proposed § 37.1501(d)*

Proposed § 37.1501(d) details the duties of a CCO, as well as his or her authority within a SEF. The proposed regulation codifies and expands upon the CCO duties already set forth in Section 5h(f)(15)(B) of the CEA. These duties include overseeing and reviewing compliance with the CEA and Commission regulations, as well as resolving, in consultation with the board of directors or the senior officer, any conflicts of interest that may arise.

<sup>106</sup> Upon the departure of a CCO, proposed § 37.1501(c)(3) requires a SEF to appoint an interim CCO immediately and a permanent replacement as soon as practicable.

The proposed regulation also lists a number of potential conflicts that may confront a CCO. The list of conflicts of interest indicates the types of conflicts that the Commission believes a SEF's CCOs should be aware of, but it is not exhaustive.

Proposed § 37.1501(d) also requires that the CCO establish and administer a written code of ethics and policies and procedures designed to prevent violations of the CEA and Commission regulations. Section 37.1501(d) also requires that a CCO establish and administer written policies and procedures, including a "compliance manual," designed to prevent violations of the CEA and Commission regulations.<sup>107</sup>

The Commission believes that such written documentation will serve as a useful guide for the SEF's management and staff, as well as for swap participants who will be trading on the SEF. It will also help the Commission to evaluate the SEF's compliance and adherence to its own internal standards. Finally, proposed § 37.1501(d) requires that a CCO establish and follow procedures for the remediation and closing of any noncompliance issues that are identified. To assist the CCO in meeting this responsibility, proposed § 37.1501(b)(1), summarized above, grants a CCO oversight authority over all compliance functions and staff acting in furtherance of those compliance functions. The CCO's authority would also extend to any activities performed by the SEF to verify that other entities are in compliance with applicable laws and regulations, such as the verification of the timeliness of reporting certain swap data, pursuant to proposed § 37.901. The Commission recognizes that the staff that assists a CCO may not be dedicated to the CCO full-time; however, the proposed regulation would ensure that a CCO has authority over any staff and resources while they are acting in furtherance of compliance functions.

Section 37.1501(d), for example, reflects the statutory text of the Dodd-Frank Act by requiring that a CCO review and ensure a SEF's compliance

<sup>107</sup> By "compliance manual," the Commission means a detailed internal handbook explaining to SEF staff the resources and procedures that they are to use in monitoring trading, conducting investigations, documenting their work, and making findings and recommendations to supervisory staff regarding trading in any swap or other conduct by SEF members and market participants that is subject to SEF rules. The Commission believes that such written documentation will serve as a useful guide for the SEF's management and staff. It will also help the Commission evaluate the SEF's compliance and adherence to its own internal standards.

with the CEA and Commission regulations. It also reflects a CCO's responsibilities with respect to the regulation of members and market participants utilizing a SEF's trading platform. In this regard, Section 37.1501(d)(8) requires that a CCO supervise a SEF'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; and audits, examinations, and other regulatory responsibilities with respect to members and market participants. Similarly, Section 37.1501(d)(9) requires that a CCO supervise the effectiveness and sufficiency of any regulatory services provided to the SEF by a registered futures association or other registered entity in accordance with § 37.204.<sup>108</sup>

*Request for Comment:*

The Commission requests comment regarding proposed § 37.1501(d). Comments should address any additional CCO duties which the Commission should include in the proposed regulation. In addition, they should specifically address a CCO's role in managing conflicts of interest within a SEF, the types of conflicts which commenters believe might arise within a SEF, and how and by whom those conflicts should be resolved.

**f. Preparation and Submission of Annual Compliance Report—Proposed §§ 37.1501(e) and 37.1501(f)**

Section 5h(f)(15)(D) of the CEA requires a CCO to prepare an annual compliance report. As discussed above, the Commission believes that this annual compliance report should give the Commission a complete and accurate picture of a SEF's compliance program. Proposed § 37.1501(e) details the information that must be included in the annual compliance report. The report must include: (i) A description of the SEF's written policies and procedures, code of ethics and conflicts of interest policies; (ii) a detailed review of the SEF compliance with Section 5h of the CEA, including an assessment by the CCO of the effectiveness of the SEF's policies and procedures in ensuring compliance with Section 5h of the CEA and a discussion of areas for improvement; (iii) a description of any material changes to the policies and procedures that were made to these

since the last annual compliance report; (iv) a description of the financial, managerial, operational, and staffing resources set aside for the SEF's compliance program, including a description of the SEF's compliance program, describing resources set aside for the SEF's self-regulatory responsibilities. An annual compliance report must also provide: a detailed description and review of the SEF's self-regulatory program, which includes a description of staff associated with self-regulation, a catalogue of investigations and disciplinary actions taken, and a review of the performance of disciplinary committees and panels; (v) a description of any material compliance matters, including instances of noncompliance, that were identified in the year prior to the filing of the report; and (vi) any objections to the annual compliance report by the board or senior officer of the SEF. In addition to the above information, proposed § 37.1501(e) also requires the annual report to include a certification by the CCO that, under penalty of law, the compliance report is accurate and complete.

Proposed § 37.1501(f)(1) sets forth the procedures for the review of the annual compliance report by the board of directors of the SEF or senior officer, prior to submission to the Commission. While the board or senior officer has a chance to review the annual compliance report before submission, the report is not subject to their approval. Proposed § 37.1501(f)(1) explicitly prohibits the board or senior officer from forcing the CCO to make any material changes to the report. The purpose of this review is to permit the members of the board or the senior officer to provide the Commission with any objections they might have to the report. The Commission believes that the prohibition against the board and senior officer making changes to the annual compliance report will allow the CCO to make a complete and accurate assessment of the SEF's compliance program.

Proposed § 37.1501(f)(2) describes the process for submission of the report to the Commission. The proposed regulation requires that the annual compliance report be electronically provided to the Commission not more than 60 days after the end of the calendar year. If a CCO determines that an annual compliance report filed with the Commission has a material error or if material non-compliance is identified after filing, proposed § 37.1501(f)(3) would require a SEF to promptly file an amended report. This amended report must also include the certification by

the CCO as to the accuracy and completeness made in the initial submission of the report. If a CCO is unable to file an annual compliance report within 60 days of the end of the calendar year, proposed § 37.1501(f)(4) would permit a CCO to request the Commission to grant an extension of time to file its compliance report based on substantial undue hardship. Extensions for the filing deadline would be granted at the discretion of the Commission. Additionally, to protect the trade secrets of the SEF and the security of the data held by the SEF, the proposed regulation requires that annual compliance reports filed pursuant to § 37.1501 be treated as exempt from mandatory public disclosure for purposes of FOIA and the Sunshine Act and parts 145 and 147 of Commission regulations.

*Request for Comment:*

The Commission requests comment on its proposed regulations regarding the preparation and submission of a SEF's annual compliance report.

- Should the annual compliance report contain additional content beyond what is proposed in § 37.1501(e)? Are additional provisions necessary to ensure that a SEF's board of directors cannot adversely influence the content of an annual compliance report as drafted by the CCO?

- In the alternative, are additional provisions necessary to ensure that individual directors or other SEF employees have an adequate opportunity to register any concerns or objections they might have to the contents of an annual compliance report?

The Commission also requests comment relating to insulating a SEF's CCO from undue influence or coercion.

- Should the Commission adopt a regulation that prohibits an officer, director or employee of the SEF or related person to coerce, manipulate, mislead, or fraudulently influence the CCO in performing his or her duties?

- Is it necessary to adopt regulations to address potential conflicts between and among a SEF's compliance, commercial, and ownership interests?

- If so, what should such regulations entail, and what specific conflicts of interest should they address?

**g. Recordkeeping—Proposed § 37.1501(g)**

Proposed § 37.1501(g) details SEFs' recordkeeping requirements for records relating to a CCO's areas of responsibility. This proposed regulation requires a SEF to maintain: (i) A copy of its written policies and procedures,

<sup>108</sup> See proposed § 37.204 (governing a SEF's use of third-party regulatory service providers and its duty to supervise such providers and any services received).

including its code of ethics and conflicts of interest policies; (ii) copies of all materials created in furtherance of the chief compliance officer's self-regulatory duties, including records of any investigations or disciplinary actions taken by the SEF; (iii) copies of all materials, including written reports provided to the board of directors in connection with review of the annual report, as well as the board minutes or other similar written records, that record the submission of the annual compliance report to an SEF's board of directors or its senior officer; and (iv) any other records relevant to an SEF's annual report. The records required to be maintained pursuant to this section are designed to provide Commission staff with a basis to determine whether a SEF has complied with the CEA and applicable Commission regulations. The Commission also wants to preserve its ability to reconstruct why certain information was included or excluded in an annual report, in the event that such reconstruction becomes necessary under a future audit or investigation.

The SEF would be required to maintain these records in accordance with § 1.31 of the Commission's regulations. Following § 1.31, all records must be kept for a period of five years.

#### *Request for Comment:*

The Commission requests comment regarding whether the requirements of proposed § 37.1501(g) are sufficient to create a complete and easily auditable record of a board of directors' or senior officer's review of an annual compliance report to ensure that the report, as drafted by the CCO, was not altered.

### III. Effective Date and Transition Period

The statutory deadline for final regulations is July 15, 2011. Final regulations may become effective sixty (60) days after their publication in the **Federal Register**, but no earlier than July 15, 2011. The Commission is proposing that the effective date for the proposed regulations be 90 days after publication of final regulations in the **Federal Register**. The Commission believes that the effective date would be appropriate to allow potential SEFs and market participants time to adapt to the new regulatory regime for the trading of swaps in an efficient and orderly manner. In addition, the Commission believes that this would give any entities then operating a marketplace for the execution or trading of swaps adequate time to submit a SEF application and meet the conditions to receive relief under the grandfather provisions.

#### *Request for Comment:*

The Commission requests comment on whether the proposed effective date is appropriate and, if not, the Commission further requests comment on possible alternative effective dates and the basis for any such alternative dates.

### IV. Related Matters

#### *A. Regulatory Flexibility Act*

The Regulatory Flexibility Act ("RFA")<sup>109</sup> requires Federal agencies, in promulgating regulations, to consider the impact of those regulations on small businesses. 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.<sup>110</sup> In its previous determinations, the Commission has concluded that DCMs, derivatives transaction execution facilities ("DTEFs"), ECMs, EBOTs and DCOs are not small entities for the purpose of the RFA.<sup>111</sup>

While SEFs are new entities to be regulated by the Commission pursuant to the Dodd-Frank Act,<sup>112</sup> in a recent rulemaking proposal,<sup>113</sup> the Commission proposed that SEFs should not be considered as small entities for the purpose of the RFA. The Dodd-Frank Act defines a SEF to mean "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."<sup>114</sup> In its recent rulemaking, the Commission proposed that SEFs not be considered to be "small entities" for essentially the same reasons that DCMs and DCOs have previously been determined not to be small entities.

<sup>109</sup> 5 U.S.C. 601 *et seq.*

<sup>110</sup> 47 FR 18618–21 (Apr. 30, 1982).

<sup>111</sup> 47 FR 18618, 18619 (April 30, 1982) discussing contract markets; 66 FR 42256, 42268 (August 10, 2001) discussing derivatives transaction execution facilities, exempt commercial markets and exempt boards of trade; and 66 FR 45604, 45609 (August 29, 2001) discussing DCOs.

<sup>112</sup> Dodd Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).

<sup>113</sup> 75 FR 63745–46 (October 18, 2010).

<sup>114</sup> See CEA Section 1a(50). The Commission anticipates proposing regulations that would further specify those entities that must register as a SEF. The Commission does not believe that such proposals would alter its determination that a SEF is not a "small entity" for purposes of the RFA.

These reasons include the fact that the Commission designates a DCM or registers a DCO only when it meets specific criteria including expenditure of sufficient resources to establish and maintain adequate self-regulatory programs. Likewise, the Commission will register an entity as a SEF only after it has met specific criteria including the expenditure of sufficient resources to establish and maintain an adequate self-regulatory program. In addition, once registered, a SEF will be required to comply with the additional requirements set forth in the final form of this proposed Part 37 rulemaking. In addition, the Commission proposes that SEFs should not be considered small entities based on, among other things, the central role SEFs will play in the national regulatory scheme overseeing the trading of swaps. Not only will SEFs play a vital role in the national economy, but they will be subject to Commission oversight with statutory duties to enforce the regulations adopted by their own governing bodies.

Accordingly, the Commission does not expect the regulations, as proposed herein, to have a significant economic impact on a substantial number of small entities. Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the proposed regulations will not have a significant economic impact on a substantial number of small entities. The Commission invites the public to comment on whether SEFs covered by these rules should be considered small entities for purposes of the RFA.

#### *B. Paperwork Reduction Act*

The Paperwork Reduction Act ("PRA")<sup>115</sup> 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. This proposed rulemaking will result in new collection of information requirements within the meaning of the PRA. The Commission therefore is submitting this proposal to the Office of Management and Budget (OMB) for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for this collection of information is "Part 37—Swap Execution Facilities" (OMB control number 3038–NEW). If adopted, responses to this collection of information would be mandatory. The Commission will protect proprietary

<sup>115</sup> 44 U.S.C. 3501 *et seq.*



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."<sup>116</sup> The Commission is also required to protect certain information contained in a government system of records according to the Privacy Act of 1974.<sup>117</sup>

#### 1. Collection of Information— Regulations Relating to Part 37, Swap Execution Facilities

The proposed regulations require each respondent to file information with the Commission. For instance, SEFs must file applications with the Commission for registration pursuant to § 37.3. SEFs must either request approval with, or certify to, the Commission rules and products, pursuant to § 37.4. SEFs must disclose information related to prices, trading volume, and other trading data on swaps pursuant to Core Principle 9 (Timely Publication of Trading Information).

Commission staff has previously estimated hourly burdens for DCMs and DTEFs pursuant to the Commodity Futures Modernization Act of 2000 ("CFMA").<sup>118</sup> More recently, Commission staff estimated hourly burdens for ECMs with significant price discovery contracts ("SPDCs"). While the Commission has no way of knowing the exact hourly burden upon a registered entity prior to implementation of the regulations governing that registered entity, staff believes the estimated burden for a SEF would be within the range of previously estimated hours of burden for the above registered entities. Those hourly burdens are noted below:

*Initial estimate of DCM's annual burden*<sup>119</sup>: 300 hours per DCM.

*Estimate of DCM's annual burden as of 2006*<sup>120</sup>: 370 hours per DCM.

*Current estimate of DCM's annual burden*<sup>121</sup>: 440 hours per DCM.

*Initial estimate of DTEF's annual burden*<sup>122</sup>: 200 hours per DTEF.

*Initial estimate of ECM's with SPDCs annual burden*<sup>123</sup>: 233 hours per ECM.

Based on the proposed regulations, Commission staff believes that a SEF will have *more* reporting responsibilities than an ECM with a SPDC and a DTEF, but *fewer* reporting hours than a DCM (as most recently calculated).<sup>124</sup> Based on its experience with administering registered entities' submission requirements since implementation of the CFMA, Commission staff estimates an annual reporting burden for SEFs to be an average of the above noted estimates for DCMs, DTEFs and ECMs with SPDCs.

Staff estimates that each respondent would, on average, have an annual burden of 308 hours of reporting time. Staff estimates that 30–40 SEFs will register with the Commission as a result of the Dodd-Frank Act.<sup>125</sup> Accordingly, the burden in terms of hours would in the aggregate be 308 hours annually per respondent and 10,780 hours annually for all respondents.

Commission staff estimates that respondents could expend up to \$16,016 annually based on an hourly rate of \$52 to comply with the proposed regulations. This would result in an aggregated cost of \$560,560 per annum (35 respondents × \$16,016).

*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 burden: 10,780.*

#### 2. Information Collection Comments

Copies of the supporting statements for the collections of information from the Commission to OMB are available by visiting RegInfo.gov. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission will consider public comments on the proposed information requirements in order to:

- (1) Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;
- (2) Evaluate the accuracy of the estimated burden of the proposed information collection requirements, including the degree

to which the methodology and the assumptions that the Commission employed were valid;

(3) Enhance the quality, utility, and clarity of the information proposed to be collected; and

(4) Minimize the burden of the proposed information collection requirements on DCOs, DCMs, and SEFs, including through the use of appropriate automated, electronic, mechanical, or other technological information collection techniques, e.g., permitting electronic submission of responses.

Organizations and individuals desiring to submit comments on the proposed information collection requirements should contact the Office of Information and Regulatory Affairs, Office of Management and Budget by fax at (202) 395–6566 or by e-mail at [OIRASubmission@omb.eop.gov](mailto:OIRASubmission@omb.eop.gov). Please provide the Commission with a copy of submitted comments so that they may be summarized and address in the final rulemaking. Refer to the **ADDRESSES** section of this notice of proposed rulemaking for comment submission instructions to the Commission.

OMB is required to make a decision concerning the proposed information collection requirements between 30 and 60 days after publication of this Release in the **Federal Register**. Therefore, a comment to OMB is best assured of receiving full consideration if OMB receives it within 30 days of publication of this Release. Nothing in the foregoing affects the deadline enumerated above for public comment to the Commission on the proposed regulations.

#### C. Cost-Benefit Analysis

Section 15(a) of the CEA<sup>126</sup> requires that the Commission consider the costs and benefits of its actions before issuing a regulation under the CEA. By its terms, Section 15(a) does not require the Commission to quantify the costs and benefits of a new rule or determine whether the benefits of the rulemaking outweigh its costs; rather, Section 15(a) requires the Commission to "consider" the costs and benefits of its actions.

Section 15(a) further specifies that costs and benefits shall be evaluated in light of 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 practices; and (5) other public interest considerations. Accordingly, the Commission could, in its discretion, give greater weight to any one of the five considerations and could, in its discretion, determine that,

<sup>116</sup> 7 U.S.C. 12(a)(1).

<sup>117</sup> 5 U.S.C. 552a.

<sup>118</sup> Appendix E of Public Law 106–554, 114 Stat. 2763 (2000).

<sup>119</sup> 66 FR 38992 (June 22, 2000).

<sup>120</sup> 71 FR 38748 (July 7, 2006).

<sup>121</sup> See, *supra* note 10, DCM NPRM.

<sup>122</sup> 65 FR 38993 (June 22, 2000).

<sup>123</sup> 73 FR 75901 (December 12, 2008).

<sup>124</sup> ECMs with SPDCs are subject to 9 core principles, DTEFs are subject to 9 core principles, DCMs are currently subject to 18 core principles, (but will be subject to 23 core principles upon finalization of the Part 38 regulations implementing the Dodd-Frank Act). SEFs will be subject to 15 core principles upon finalization of the regulations to implement the Dodd-Frank Act.

<sup>125</sup> For hourly reporting requirements, an average of 35 SEFs was used for calculation purposes.

<sup>126</sup> 7 U.S.C. 19(a).

notwithstanding its costs, a particular rule was necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the CEA.

#### Summary of Proposed Requirements

The proposed rulemaking would provide, pursuant to the Dodd-Frank Act, for the trading or processing of swaps on a registered SEF subject to 15 core principles. This rulemaking will implement, in Part 37 of the Commission's regulations, these provisions of the CEA. The proposal includes regulations as well as guidance and acceptable practices to implement these core principles. In general, the proposed regulations implementing core principles for SEFs are consistent with the existing or proposed regulations for similar or identical core principles applicable to DCMs.

#### Costs

As highlighted by recent events in the global credit markets, transacting of swaps in unregulated, over-the-counter markets does not contribute to the goal of stability in the broader financial markets. The public would continue to be at risk to such financial instability if certain derivatives were allowed to trade over the counter rather than on regulated exchanges. SEFs that determine to register with the Commission in order to provide for the transacting of swaps will be subject to core principles for transacting of swaps. If swaps were allowed to continue to be transacted bilaterally, rather than on the regulated market of a SEF, price discovery and transparency in the swaps markets would continue to be inhibited. These procedures are mandatory pursuant to the Dodd-Frank Act and any additional costs associated with these procedures are required by the implementation of the Dodd-Frank Act.

#### Benefits

The Commission believes that the benefits of the rulemaking are significant. The proposed regulations provide for the transacting of swaps on SEFs. SEFs will compete with DCMs that make certain swaps available for trading, while certain swaps will continue to transact bilaterally. This competition will benefit the marketplace. Providing market participants with the ability to trade certain swaps openly and competitively on a SEF complying with all of the SEF core principles as well as on DCMs complying with DCM core principles will provide market participants with

additional choices and will enhance price transparency resulting in protection of market participants and the public. The proposed regulations will necessitate that SEFs that determine to make certain swaps available for trading will have to coordinate with DCOs in order to effect clearing and thus be subject to the DCO's risk management and margining procedures.

#### *Request for Comment:*

The Commission invites public comment on its cost-benefit considerations. Commenters are also invited to submit any data or other information that they may have quantifying or qualifying the costs and benefits of the proposal with their comment letters.

### V. Text of the Proposed Regulations, Guidance and Acceptable Practices

#### List of Subjects in 17 CFR Part 37

Swaps, Swap execution facilities, Registration application, Registered entities, Reporting and recordkeeping requirements.

In light of the foregoing, and pursuant to authority in the CEA, and, in particular, Sections 3, 5, 5c(c), 8a(5) and 21 of the CEA, the Commission hereby proposes to revise part 37 of Title 17 of the Code of Federal Regulations to read as follows:

### PART 37—SWAP EXECUTION FACILITIES

#### Subpart A—General Provisions

- Sec.
- 37.1 Scope.
- 37.2 Applicable provisions.
- 37.3 Requirements 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 Permitted execution methods.
- 37.10 Assessments regarding transactional tiers or platform and swaps made available for trading.
- 37.11 Identification of non-cleared swaps or swaps not made available to trade.

#### 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 requirements.
- 37.206 Disciplinary procedures and sanctions.
- 37.207 Swaps subject to mandatory clearing.

#### Subpart D—Swaps Not Readily Susceptible to Manipulation

- Sec.
- 37.300 Core Principle 3—Swaps not readily susceptible to manipulation.
- 37.301 General requirement.

#### 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 Additional rules required.

#### 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 Position limits or accountability.

#### Subpart H—Financial Integrity of Transactions

- Sec.
- 37.700 Core Principle 7—Financial integrity of transactions.
- 37.701 Mandatory 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 requirement.
- 37.902 Capacity of swap execution facility.

#### Subpart K—Recordkeeping and Reporting

- Sec.
- 37.1000 Core Principle 10—Recordkeeping and reporting.

- 37.1001 Recordkeeping required.  
 37.1002 Reporting to the commission required.  
 37.1003 Inspection and examination by the Securities and Exchange Commission.

#### 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 financial resource requirement.  
 37.1304 Valuation of financial resources.  
 37.1305 Liquidity of financial resources.  
 37.1306 Reporting requirements.

#### 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 37 shall apply to every swap execution facility that is registered, has been 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, the swap execution facility's operator and transactions traded on or through a swap execution facility under Section 5h of the Act shall comply with the requirements of this part 37, and §§ 1.3, 1.12(e), 1.31, 1.37(c)–(d), 1.52, 1.59(d), 1.60, 1.63(c), 1.67, 33.10, part 9, parts 15

through 21, part 40, part 41, part 43, part 45, part 46, part 49, part 151, and part 190 of this chapter, including any related definitions and cross-referenced sections.

##### § 37.3 Requirements for registration.

(a) *Application procedures.* (1) An applicant seeking registration as a swap execution facility must file electronically an application for registration with the Secretary of the Commission, in the form and manner as provided by the Commission. The Commission shall approve or deny the application or, if deemed appropriate, register the applicant as a swap execution facility subject to conditions.

(2) The application must include information sufficient to demonstrate compliance with the core principles specified in Section 5h of the Act. The Application Form SEF consists of instructions, general questions and a list of Exhibits (documents, information and evidence) the Commission requires in order to be able to determine whether an applicant is able to comply with the core principles. An application will not be considered to be materially complete unless the applicant has submitted, at a minimum, the Exhibits as required in Application Form SEF. If the application is not materially complete, the Commission shall notify the applicant that the application will not be deemed to have been submitted for purposes of the Commission's review.

(3) An applicant seeking registration must 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.

(4) An applicant seeking registration must 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.

(5) 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.

(6) If any information contained in the application or any Exhibit is or becomes inaccurate for any reason, an amendment to the application or a submission filed under Part 40 of this Chapter must be filed promptly correcting such information.

(7) 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 the applicant seeking registration that the application is materially incomplete and the review is stayed. 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.

(b) *Temporary Grandfather Relief from Registration.* Concurrent with the completion of the application procedures under paragraph (a) of this section, an applicant may submit a notice requesting that the Commission grant the applicant temporary grandfather relief from the registration requirement, allowing it to continue operating during the pendency of the application process.

(1) The Commission may grant such request for temporary grandfather relief from the registration requirement if the applicant has:

(i) Satisfied all the requirements under paragraph (a) of this section,

(ii) Provided 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 the request, and

(iii) Provided a certification that the applicant believes that when it operates under temporary grandfather relief it will meet the requirements of this Part 37.

(2) The temporary grandfather relief for a swap execution facility shall expire on the earlier of:

(i) The date that the Commission grants or denies registration of the swap execution facility; or

(ii) The date that the Commission rescinds the temporary grandfather relief provided to the swap execution facility.

(3) The grant of temporary grandfather relief from the registration requirement by the Commission does not affect the right of the Commission to grant or deny permanent registration as provided under paragraph (a)(1) of this section. This paragraph shall terminate 365 days from the effectiveness of this regulation.

(c) *Reinstatement of dormant registration.* Before making any swaps available for trading, a dormant swap execution facility as defined in § 40.1 of this Chapter must reinstate its registration under the procedures of paragraph (a) of this section; provided, however, that an application for reinstatement may rely upon previously submitted materials that still pertain to,

and accurately describe, current conditions.

(d) *Request for transfer of registration.* (1) Request for transfer of registration. A swap execution facility that wants to request the transfer of its registration from its current legal entity to a new legal entity, as a result of a corporate reorganization or otherwise, must file a request with the Commission for approval to transfer the registration. Such request must be filed electronically with the Secretary of the Commission at its Washington, DC headquarters at [submissions@cftc.gov](mailto:submissions@cftc.gov) and the Division of Market Oversight at [DMOSubmissions@cftc.gov](mailto:DMOSubmissions@cftc.gov).

(2) *Timing of submission.* The request must be filed no later than three months prior to the anticipated corporate change; *provided that* the swap execution facility may file a request with the Commission later than three months prior to the anticipated change if the swap execution facility does not know and reasonably could not have known of the anticipated change three months prior to the anticipated change. In such event, the swap execution facility shall be required to immediately file the request with the Commission as soon as it knows of such change with an explanation as to the timing of the request.

(3) *Required information.* The request shall include the following:

(i) The underlying agreement that governs the corporate change;

(ii) A narrative 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 corporation and successor-in-interest to the transferor swap execution facility and will retain and assume, without limitation, all 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 Part 37 and Appendices thereto;

(C) Will assume, maintain and enforce all rules implementing and complying with these core principles, 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 the Commission's regulations; and

(D) Will comply with all self-regulatory responsibilities except if otherwise indicated in the request, and will maintain and enforce all self-regulatory programs.

(vii) A representation by the transferee that upon the transfer:

(A) It will assume responsibility for and maintain compliance with product core principles for all swaps previously made available for trading through the transferor, whether by certification or approval; and

(B) That none of the proposed rule changes will affect the rights and obligations of any participant.

(viii) A representation by the transferee that market participants will be notified of all changes to the transferor's rulebook prior to the transfer and will be further notified of the concurrent transfer of the registration to the transferee upon Commission approval and issuance of an order permitting this transfer.

(4) *Commission determination.* The Commission will review a request as soon as practicable and such request will be approved or denied pursuant to a Commission order and based on the Commission's determination as to the transferee's ability to continue to operate the swap execution facility in compliance with the Act and the Commission's regulations thereunder.

(e) *Request for withdrawal of application for registration.* An applicant for registration may withdraw its application submitted pursuant to paragraph (a) of this section by filing such a request with the Commission at its Washington, DC headquarters. 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 for registration was pending with the Commission.

(f) *Request for vacation of registration.* A swap execution facility may vacate its registration under Section 7 of the Act by filing electronically such a request with the Commission at its Washington, DC headquarters. 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.

#### **§ 37.4 Procedures for Listing Products and Implementing Rules.**

(a) *Request for Commission approval of rules and products.* (1) An applicant for designation, or a swap execution facility, may request that the Commission approve under Section 5c(c) of the Act, any or all of its rules and contract terms and conditions, and subsequent amendments thereto, prior to their implementation or, notwithstanding the provisions of Section 5c(c)(2) of the Act, at anytime thereafter, under the procedures of §§ 40.3 or 40.5 of this chapter, as applicable. A swap execution facility should label a swap in its rules as "Listed for trading pursuant to Commission approval," if the swap and its terms or conditions have been submitted to the Commission for approval, and it may label as "Approved by the Commission" only those rules that have been so approved.

(2) Notwithstanding the timeline under §§ 40.3(b) and 40.5(b) of this Chapter, the operating rules and terms and conditions of swaps submitted for Commission approval that have been submitted at the same time as an application for swap execution facility registration or an application under § 37.3(c) to reinstate the registration of a dormant swap execution facility as defined in § 40.1 of this Chapter, or while one of the foregoing is pending, will be deemed approved by the Commission no earlier than when the swap execution facility is deemed to be registered or reinstated.

(b) *Self-certification of rules and products.* Rules of a swap execution facility and subsequent amendments thereto, including both the operational rules and the terms or conditions of swaps listed for trading on the facility, not voluntarily submitted for prior Commission approval pursuant to paragraph (a) of this regulation, must be submitted to the Commission with a certification that the rule or rule amendment of the swap complies with the Act or rules thereunder pursuant to the procedures of § 40.2 or § 40.6 of this Chapter, as applicable.

(c) *Section 15 consideration.* An applicant for registration, or a registered swap execution facility, may request that the Commission consider under the provisions of Section 15(b) of the Act any of the swap execution facility's rules or policies, including both the operational rules and the terms or conditions of swaps listed for trading.

### § 37.5 Information Relating to Swap Execution Facility Compliance.

(a) *Requests for information.* Upon request by the Commission, a swap execution facility must file with the Commission such information related to its business as a swap execution facility, including information relating to data entry and trade details, in the form and manner and within the time as specified by the Commission in its request.

(b) *Demonstration of compliance.* Upon request by the Commission, a swap execution facility must file with the Commission a written demonstration, containing such supporting data, information and documents, in the form and manner and within such time as the Commission may specify, that the swap execution facility is in compliance with one or more core principles as specified in the request, or that is requested by the Commission to satisfy its obligations under the Act.

(c) *Equity interest transfers.* (1) Equity transfer notification. Upon entering into any agreement(s) that could result in an equity interest transfer of ten percent or more in the swap execution facility, the swap execution facility must file a notification of the equity interest transfer with the Secretary of the Commission at its Washington, DC headquarters at [submissions@cftc.gov](mailto:submissions@cftc.gov) and the Division of Market Oversight at [DMOSubmissions@cftc.gov](mailto:DMOSubmissions@cftc.gov), no later than the business day, as defined in § 40.1 of this Chapter, following the date on which the swap execution facility enters into a firm obligation to transfer the equity interest.

(2) Required information. The notification must include and be accompanied by: Any relevant agreement(s), including any preliminary agreements; any associated changes to relevant corporate documents; a chart outlining any new ownership or corporate or organizational structure; a brief description of the purpose and any impact of the equity interest transfer; and a representation from the swap execution facility that it meets all of the requirements of Section 5h of the Act and Commission regulations adopted thereunder. The swap execution facility must keep the Commission apprised of the projected date that the transaction resulting in the equity interest transfer will be consummated, and must provide to the Commission any new agreements or modifications to the original agreement(s) filed pursuant to this section. The swap execution facility must notify the Commission of the consummation of the transaction on the day on which it occurs.

(3) Certification. (i) Upon a transfer of an equity interest of ten percent or more in a swap execution facility, the swap execution facility must file with the Secretary of the Commission at its Washington, DC headquarters, at [submissions@cftc.gov](mailto:submissions@cftc.gov), and the Division of Market Oversight, at [DMOSubmissions@cftc.gov](mailto:DMOSubmissions@cftc.gov), a certification that the swap execution facility meets all of the requirements of Section 5h of the Act and Commission regulations adopted thereunder, no later than two business days, as defined in § 40.1 of this Chapter, following the date on which the equity interest of ten percent or more was acquired. Such certification must state whether changes to any aspects of the swap execution facility's operations were made as a result of such change in ownership, and include a description of any such change(s).

(ii) The certification required under paragraph (c)(3) of this section may rely on and be supported by reference to an application for registration or prior filings made pursuant to a product or rule submission requirement, along with any necessary new filings, including new filings that provide any and all material updates of prior submissions.

(d) *Delegation of authority.* The Commission hereby delegates, until it orders otherwise, the authority set forth in paragraph (b) of this regulation 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 registered swap execution facility shall not be void, voidable, subject to rescission or otherwise invalidated or rendered unenforceable as a result of:

(1) A violation by the registered swap execution facility of the provisions of Section 5h of the Act or this part 37; or

(2) Any Commission proceeding to alter or supplement a rule, term or condition under Section 8a(7) of the Act, to declare an emergency under Section 8a(9) of the Act, or any other proceeding the effect of which is to alter, supplement, or require a registered 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 transaction entered into on or pursuant to the rules of a registered swap execution facility shall include written documentation that memorializes all of the terms of the transaction and legally supersedes any previous agreement. The confirmation of all terms of the transaction shall take place at the same time as execution.

### § 37.7 Prohibited use of data collected for regulatory purposes.

A swap execution facility may 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, where necessary, may share such information with one or more swap execution facilities, or designated contract markets registered with the Commission, for regulatory purposes.

### § 37.8 Boards of trade operating both a designated contract market and a swap execution facility.

(a) A board of trade that operates a designated contract market and intends to also operate a swap execution facility must separately register the swap execution facility, pursuant to the swap execution facility registration requirements set forth in this Part 37, and on an ongoing basis, comply with the core principles under Section 5h of the Act, and the regulations under this part 37.

(b) A board of trade 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 that it uses for executing and trading swaps on the designated contract market must 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 Permitted execution methods.

(a) *Definitions.* (1) As used in this part 37:

(i) *Order Book* means:

(A) An electronic trading facility, as that term is defined in section 1a(16) of the Act;

(B) A trading facility, as that term is defined in section 1a(51) of the Act;

(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.

(ii) *Request for Quote System* means:

(A) A trading system or platform in which a market participant must transmit a request for a 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. 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; or

(B) 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; or

(C) Any such other trading system or platform as may be determined by the Commission.

(iii) *Voice-Based System* means 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.

(iv) *Required Transactions* means transactions that are subject to the execution requirements under this Act and are made available for trading pursuant to § 37.10, and are not block trades.

(v) *Permitted Transactions* means transactions that meet any of these 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.

(b) *Required Transactions.* (1)

Required Transactions may be executed on an Order Book or a Request for Quote System.

(2) An applicant seeking registration as a swap execution facility 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 swap execution facility.

(3) Swap execution facilities 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 those 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.

(4) The Commission may, in its discretion, determine to require the swap execution facility to provide its participants a different trading method for a particular swap.

(c) *Permitted Transactions.* (1) Permitted Transactions may be executed by an Order Book, Request for Quote System, a Voice-Based System, or any such other system for trading as may be permitted by the Commission.

(2) A registered swap execution facility may submit a request to the Commission to offer trading services to facilitate Permitted Transactions. When submitting such request, the swap execution facility must certify its compliance with § 37.11.

#### **§ 37.10 Swaps made available for trading.**

(a) A swap execution facility must conduct an annual review (or at the Commission's request) of whether the swap execution facility has made a swap available for trading.

(b) When conducting reviews and assessments regarding whether the swap execution facility has made a swap available for trading, a swap execution facility may consider:

(1) The frequency of transactions in this or similar swaps;

(2) The open interest in this or similar swaps; and

(3) Any other factor requested by the Commission.

(c)(1) If at least one swap execution facility has made the same or an economically equivalent swap available for trading, all swap execution facilities are required to treat the swap as made available for trading.

(2) After conducting its review and assessment of whether a swap is made available for trading, the swap execution facility must provide electronically to the Commission a report of its assessment not more than 30 days after completion of the assessment.

#### **§ 37.11 Identification of non-cleared swaps or swaps not made available to trade.**

(a) A swap execution facility may allow:

(1) The execution and trading of swaps that have not been determined to be subject to the clearing mandate under Section 2(h) of the Act;

(2) Transactions subject to an exception from the clearing mandate provided under Section 2(h)(7) of the Act; or

(3) The execution and trading of swaps that have not been made available for trading pursuant to § 37.10.

(b) A swap execution facility that chooses to offer to facilitate bilateral trading for swaps detailed in paragraph (a) of this section must clearly identify to market participants that the particular swap is to be executed bilaterally between the parties pursuant to one of the applicable exemption from execution and clearing.

### **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) All 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), 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 must 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 45 of this chapter, if offered.

(b) A swap execution facility must 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 clearing requirements.

**§ 37.202 Access requirements.**

(a) *Impartial access by members and market participants.* 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), providing—

(1) Criteria that are impartial, transparent, and applied in a fair and nondiscriminatory manner;

(2) A process by which 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 being granted access to the swap execution facility; and

(3) Comparable fees for participants receiving comparable access to, or services from, a swap execution facility.

(b) *Jurisdiction.* Prior to granting any eligible contract participant access to its

facilities, a swap execution facility must require that the eligible contract participant consents to its jurisdiction.

(c) *Limitations on access.* A swap execution facility must establish and impartially enforce rules governing any decision to allow, deny, suspend, or permanently bar participants' access to the swap execution facility, including such decisions when made as part of a disciplinary or emergency action taken by the swap execution facility.

**§ 37.203 Rule enforcement program.**

A swap execution facility must establish and enforce trading, trade processing, and participation rules that will deter abuses and it must have the capacity to detect, investigate and enforce those rules.

(a) *Abusive Trading Practices Prohibited.* A swap execution facility must prohibit abusive trading practices on its markets by members and market participants. Specific trading practices that must be prohibited by all swap execution facilities include front-running, wash trading, pre-arranged trading, fraudulent trading, money passes and any other trading practices that a swap execution facility deems to be abusive. In addition, a swap execution facility also must prohibit any other manipulative or disruptive trading practices prohibited by the Act or by the Commission pursuant to Commission regulation. Swap execution facilities that permit intermediation must prohibit customer-related abuses including, but not limited to, trading ahead of customer orders, trading against customer orders, accommodation trading, and improper cross trading.

(b) *Capacity to Detect and Investigate Rule Violations.* A swap execution facility must have arrangements and resources for effective enforcement of its rules. Such arrangements must 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 market participants. A swap execution facility's arrangements and resources must 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.* (1) *Sufficient compliance staff.* A swap execution facility must establish and maintain sufficient compliance department resources and staff 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 must 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).

(2) *Ongoing monitoring of compliance staff resources.* A swap execution facility must 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. In determining the appropriate level of compliance resources and staff, the swap execution facility should consider trading volume increases, the number of new products or swaps listed for trading, any new responsibilities assigned to compliance staff, the results of any internal review demonstrating that work is not completed in an effective or timely manner, the recommendation of any Commission rule enforcement review or evaluation of the swap execution facility and any other factors suggesting the need for increased resources and staff.

(d) *Automated Trade Surveillance System.* A swap execution facility must maintain an automated trade surveillance system capable of detecting and investigating potential trade practice violations. Such system must maintain all data reflecting the details of each order entered into the trading system or platform, including all order modifications and cancellations, and maintain all data reflecting transactions executed on the swap execution facility. The automated system must load and process daily orders and trades no later than 24 hours after the completion of the trading day. In addition, the automated trade surveillance system must 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 futures-equivalent positions; reconstruct the sequence of market activity; perform market analyses; and enable system users to perform in-depth analyses and ad hoc queries of trade-related data.

(e) *Real-time Market Monitoring.* A swap execution facility must conduct real-time market monitoring of all trading activity on its electronic trading platform(s) to ensure orderly trading and identify any market or system anomalies. A swap execution facility must have the authority to adjust trade prices or cancel trades when necessary to mitigate market disrupting events caused by malfunctions in its electronic trading platform(s) or errors in orders submitted by members and market participants. Any trade price



adjustments or trade cancellations must 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 must establish and maintain procedures that require its compliance staff to conduct investigations of possible rule violations. An investigation must be commenced upon the receipt of a request from Commission staff or upon the discovery or receipt of information (such as data produced by automated surveillance systems) by the swap execution facility that, in the judgment of its compliance staff, indicates a possible basis for finding that a violation has occurred or will occur.

(2) *Timeliness.* Each compliance staff investigation must 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 must 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 must 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. The report must also include the member or market participant's disciplinary history at the swap execution facility, including copies of warning letters.

(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 violation, it must prepare a written report including the reason the investigation was initiated; a summary of the complaint, if any; the relevant facts; compliance staff's analysis and conclusions; and if applicable, any recommendation that a disciplinary committee issue a warning

letter in accordance with § 37.203(f)(5). If compliance staff recommends that a warning letter be issued to a member or market participant pursuant to § 37.203(f)(5), the investigation report must include a copy of the letter as well as the member or market participant's disciplinary history at the swap execution facility, including copies of warning letters.

(5) *Warning letters.* In addition to the action required to be taken under §§ 37.203(f)(3) and 37.203(f)(4), the rules of a swap execution facility may authorize compliance staff to issue a warning letter to a person or entity under investigation or to recommend that a disciplinary committee take such an action. 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. A copy of a warning letter issued by compliance staff must be included in the investigation report required by §§ 37.203(f)(3) and 37.203(f)(4). No more than one warning letter for the same potential violation may be issued to the same person or entity during a rolling 12-month period.

(g) *Additional Rules Required.* A swap execution facility must adopt and enforce any additional rules that it believes are necessary to comply with the requirements of § 37.203.

#### **§ 37.204 Regulatory services provided by a third party.**

(a) *Use of third-party 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, (collectively, "regulatory service provider"), for the provision of services to assist in complying with the core principles, as approved by the Commission. Any swap execution facility that chooses to contract with a regulatory service provider must ensure that its regulatory service 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 will 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 third party.* A swap execution facility that elects to use the service of a regulatory service provider must 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 must 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 must also conduct periodic reviews of the adequacy and effectiveness of services provided on its behalf. Such reviews must 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 must 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, denials of access to the trading platform for disciplinary reasons, and any decision to open an investigation into a possible rule violation. A swap execution facility must document any instances where its actions differ from those recommended by its regulatory service provider.

#### **§ 37.205 Audit trail.**

A swap execution facility must 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 must capture and retain all audit trail data necessary to detect, investigate and prevent customer and market abuses. Such data must be sufficient to reconstruct all transactions 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 must also permit the swap execution facility to track a customer order from the time of receipt through fill, allocation, or other disposition, and must 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 must 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) must reflect the terms of the order, a unique account identifier that relates

back to the account(s) owner(s) and the time of order entry. Swap execution facilities 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. If an order or request for quote cannot be immediately entered into the trading system or platform, an electronic record that includes the account identifier that relates to the account owner, time of receipt, and terms of the order or request for quote must immediately be created, and the order or request for quote must be entered into the trading system or platform as soon as practicable.

(2) *Transaction history database.* A swap execution facility's audit trail program must include an electronic transaction history database. An adequate transaction history database includes a history of all orders and trades, and also includes:

(i) All data that are input into the trade entry or matching system for the transaction to match and clear;

(ii) The categories of participant for which each trade is executed, including whether the person executing a trade was executing it for his/her own account or an account for which he/she has discretion, his/her clearing member's house account, the account of another member or the account of any other customer;

(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 must include electronic analysis capability with respect to all audit trail data in the transaction history database. An adequate electronic analysis capability must permit the sorting and presentation of data in the transaction history database so as to reconstruct trading 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 must include the capability to safely store all audit trail data retained in its transaction history database. Such safe storage capability must 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 must 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 37.

(c) *Enforcement of Audit Trail Requirements.* (1) *Annual audit trail and recordkeeping reviews.* A swap execution facility must enforce its audit trail and recordkeeping requirements through at least annual reviews of all members and market participants to verify their compliance with the swap execution facility's audit trail and recordkeeping requirements. Such reviews must 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 must establish a program for effective enforcement of its audit trail and recordkeeping requirements. An effective program must identify members and market participants that have failed to maintain high levels of compliance with such requirements, and levy meaningful sanctions when deficiencies are found. Sanctions must be sufficient to deter recidivist behavior, and may not include more than one warning letter for the same violation within a rolling twelve month period.

#### **§ 37.206 Disciplinary procedures and sanctions.**

A swap execution facility 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.

(a) *Enforcement staff.* A swap execution facility must 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. A swap execution facility must also monitor the size and workload of its enforcement staff annually, and increase its enforcement resources and staff as appropriate. The enforcement staff may not include either members of the swap execution facility or persons whose interests conflict with their enforcement duties. A member of the enforcement staff may 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.

(b) *Disciplinary panels.* (1) *Disciplinary panels required.* A swap execution facility must establish one or more Review Panels and one or more Hearing Panels (collectively, "disciplinary panels") that are authorized to fulfill their obligations under the rules of this Subpart. Disciplinary panels must meet the composition requirements of § 40.9(c)(3)(ii), and must 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.

(2) *Review panels.* A swap execution facility's Review Panel(s) must be responsible for determining whether a reasonable basis exists for finding a violation of swap execution facility rules, and for authorizing the issuance of notices of charges against persons alleged to have committed violations if the Review Panel believes that the matter should be adjudicated.

(3) *Hearing Panels.* A swap execution facility's Hearing Panel(s) must be responsible for adjudicating disciplinary cases pursuant to a notice of charges authorized by a Review Panel, and must also be responsible for such other duties as are specified in this Subpart.

(c) *Review of investigation report.* Promptly after receiving a completed investigation report pursuant to § 37.203(f)(3), a Review Panel must promptly review the report and, within 30 days of such receipt, must take one of the following actions:

(1) If the Review Panel determines that additional investigation or evidence is needed, it must promptly direct the compliance staff to conduct further investigation.

(2) If the Review Panel determines that no reasonable basis exists for finding a violation or that prosecution is otherwise unwarranted, it may direct that no further action be taken. Such determination must be in writing, and must include a written statement setting forth the facts and analysis supporting the decision.

(3) If the Review Panel determines that a reasonable basis exists for finding a violation and adjudication is warranted, it must direct that the person or entity alleged to have committed the violation be served with a notice of charges and must proceed in accordance with the rules of this section.

(d) *Notice of charges.* A notice of charges must 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);

and prescribe the period within which a hearing on the charges may be requested. The notice must also advise the respondent charged that he is entitled, upon request, to a hearing on the charges; and if the rules of the swap execution facility so provide:

(1) The 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

(2) The failure to answer or to deny expressly a charge may be deemed to be an admission of such charge.

(e) *Right to representation.* Upon being served with a notice of charges, a respondent must have the right to be represented by legal counsel or any other representative of its choosing in all succeeding stages of the disciplinary process.

(f) *Answer to charges.* A respondent must be given a reasonable period of time to file an answer to a notice of charges. The rules of a swap execution facility may require 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. A statement of a lack of sufficient information shall have the effect of a denial of an allegation;

(2) Failure to file an answer on a timely basis shall be deemed an admission of all allegations contained 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.

(g) *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 Hearing 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:

(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 pursuant to § 37.206(g)(1) and advise the respondent that it may request a hearing on such sanction within a specified period of time;

(3) The rules of a swap execution facility may provide that if a respondent fails to request a hearing within the period of time specified in the notice, the respondent will be deemed to have accepted the sanction.

(h) *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 Hearing Panel pursuant to Section 37.206(g), the respondent must be given an opportunity for a hearing in accordance with the requirements of § 37.206(j). The swap execution facility's rules may provide that, except for good cause, the hearing must be concerned only with those charges denied and/or sanctions set by the Hearing Panel under § 37.206(g) for which a hearing has been requested.

(i) *Settlement offers.* (1) The rules of a swap execution facility may permit a respondent to submit a written offer of settlement at any time after the 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.

(2) 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.

(3) If an offer of settlement is accepted, the panel accepting the offer must 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 must include full customer restitution where customer harm is demonstrated. If an offer of settlement is accepted without the agreement of the enforcement staff, the decision must adequately support the Hearing Panel's acceptance of the settlement. Where applicable, the decision must also include a statement that the respondent has accepted the sanctions imposed without either admitting or denying the rule violations.

(4) The respondent may withdraw his or her offer of settlement at any time before final acceptance by a 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.

(j) *Hearings.* (1) A swap execution facility must adopt rules that provide for the following minimum requirements for any hearing conducted pursuant to a notice of charges:

(i) The hearing must be fair, must be conducted before members of the Hearing Panel, and must be promptly

convened after reasonable notice to the respondent. The formal rules of evidence need not apply; nevertheless, the procedures for the hearing may not be so informal as to deny a fair hearing. No member of the Hearing 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 must be entitled to examine all books, documents, or other evidence in the possession or under the control of the swap execution facility that are to be relied upon by the enforcement staff in presenting the charges contained in the notice of charges or that are relevant to those charges.

(iii) The swap execution facility's enforcement and compliance staffs must be parties to the hearing, and the enforcement staff must present their case on those charges and sanctions that are the subject of the hearing.

(iv) The respondent must be entitled to appear personally at the hearing, must be entitled to cross-examine any persons appearing as witnesses at the hearing, and must be entitled to call witnesses and to present such evidence as may be relevant to the charges.

(v) The swap execution facility must require that persons within its jurisdiction who are called as witnesses participate in the hearing and produce evidence. It must make reasonable efforts to secure the presence of all other persons called as witnesses whose testimony would be relevant.

(vi) If the respondent has requested a hearing, a copy of the hearing must be made and must become a part of the record of the proceeding. The record must be one that is capable of being accurately transcribed; however, it need not be transcribed unless the transcript is requested by Commission staff or the respondent, the decision is appealed pursuant to § 37.206(l), or 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.

(vii) The rules of a swap execution facility may provide that the cost of transcribing the record of the hearing must be borne by a respondent who requests the transcript, appeals the decision pursuant to § 37.206(l), or whose application for Commission review of the disciplinary action has been granted. In all other instances, the cost of transcribing the record must be borne by the swap execution facility.

(2) 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.

(k) *Decisions.* Promptly following a hearing conducted in accordance with § 37.206(j), the Hearing Panel must render a written decision based upon the weight of the evidence contained in the record of the proceeding and must provide a copy to the respondent. The decision must 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;

(6) A declaration of all sanctions imposed against the respondent, including the basis for such sanctions and the effective date of such sanctions.

(l) *Right to appeal.* The rules of a swap execution facility may permit the parties to a proceeding to appeal promptly an adverse decision of the Hearing 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 must have the opportunity to appeal and the swap execution facility must provide for the following:

(1) The swap execution facility must establish an appellate panel that must 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 the Hearing Panel within a reasonable period of time after the decision has been rendered.

(2) The composition of the appellate panel must be consistent with § 40.9(c)(iv), and must 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 must provide for the appeal proceeding to be conducted before all of the members of the board of appeals or a panel thereof.

(3) Except for good cause shown, the appeal or review must be conducted solely on the record before the Hearing Panel, the written exceptions filed by

the parties, and the oral or written arguments of the parties.

(4) Promptly following the appeal or review proceeding, the board of appeals must issue a written decision and must provide a copy to the respondent. The decision issued by the board of appeals must adhere to all the requirement of § 37.206(k), to the extent that a different conclusion is reached from that issued by the Hearing Panel.

(m) *Final decisions.* Each swap execution facility must establish rules setting forth when a decision rendered pursuant to this section will become the final decision of such swap execution facility.

(n) *Disciplinary sanctions.* All disciplinary sanctions imposed by a swap execution facility or its disciplinary panels must be commensurate with the violations committed and must be clearly sufficient to deter recidivism or similar violations by other market participants. All disciplinary sanctions must take into account the respondent's disciplinary history. In the event of demonstrated customer harm, any disciplinary sanction must also include full customer restitution.

(o) *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 timely submission of 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, provided that no more than one warning letter may be issued per rolling 12-month period for the same violation. If adopted, a summary fine schedule must provide for progressively larger fines for recurring violations.

(p) *Emergency disciplinary actions.*

(1) 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.

(2) Any emergency disciplinary action must be taken in accordance with a swap execution facility's procedures that provide for the following:

(i) If practicable, a respondent must be served with a notice before the action is

taken, or otherwise at the earliest possible opportunity. The notice must state the action, briefly state the reasons for the action, and state the effective time and date, and the duration of the action.

(ii) The respondent must 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 must be given the opportunity for a hearing as soon as reasonably practicable and the hearing must be conducted before the Hearing Panel pursuant to the requirements of § 37.206(j).

(iii) Promptly following the hearing provided for in this rule, the swap execution facility must render a written decision based upon the weight of the evidence contained in the record of the proceeding and must provide a copy to the respondent. The decision must 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.

#### **§ 37.207 Swaps subject to mandatory clearing.**

A swap execution facility shall provide by its rules that when a swap dealer or major swap participant enters into or facilitates a swap transaction 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).

#### **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 requirement.**

(a) To demonstrate to the Commission compliance with the requirements of § 37.300, a swap execution facility must submit new swap contracts in advance to the Commission pursuant to part 40 of this chapter, either by:

(1) Requesting prior approval from the Commission; or

(2) Self-certification for new product submissions.

(b) Furthermore, the swap execution facility must provide evidence that the swap complies with Core Principle 3 by providing the applicable information as set forth in appendix C to part 38—Demonstration of Compliance that a contract is not readily susceptible to manipulation.

### 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 must:

(a) 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;

(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) Have the capacity to conduct real-time monitoring of trading and comprehensive and accurate trade reconstruction. The monitoring of intraday trading must include the capacity to detect abnormal price movements, unusual trading volumes, impairments to market liquidity, and position-limit violations; and

(d) Have either manual processes or automated alerts that are effective in detecting and preventing trading abuses.

#### § 37.402 Additional requirements for physical-delivery swaps.

(a) For physical-delivery swaps, the swap execution facility must:

(1) Monitor a swap's terms and conditions;

(2) Monitor that the deliverable supply is adequate so that the swap will

not be conducive to price manipulation or distortion;

(3) Assess whether the deliverable commodity reasonably can be expected to be available to traders responsible for making the delivery and salable or usable by traders receiving delivery at its market value in normal cash marketing channels; and

(4) When available, monitor data related to the size and ownership of deliverable supplies.

(b) The swap execution facility must continually monitor the appropriateness of the swap's terms and conditions, including the delivery instrument, the delivery locations and location differentials, and the commodity characteristics and related differentials. The swap execution facility must act promptly to address the conditions that are causing price distortions or market disruptions, including, when appropriate, changes to contract terms.

#### § 37.403 Additional requirements for cash-settled swaps.

(a) For cash-settled swaps, the swap execution facility must monitor:

(1) The availability and pricing of the commodity making up the index to which the swap will be settled; and

(2) The continued appropriateness of the methodology for deriving the index. For those swap execution facilities that compute their own indices, they must promptly amend any methodologies that result, or are likely to result, in manipulation, price distortions, or market disruptions, or must impose new methodologies to resolve the threat of disruptions or distortions.

(b) If a swap listed on a swap execution facility is settled by reference to the price of a swap traded in another venue, including a price or index derived from prices on another swap execution facility, the swap execution facility must have an information sharing agreement with the other venue or swap execution facility. In lieu of an information sharing agreement, the swap execution facility must have the capacity to assess whether positions or trading in the swap or commodity to which its swap is cash-settled are being manipulated in order to affect prices on its market.

#### § 37.404 Ability to obtain information.

(a) The swap execution facility must have rules that require traders in its swaps to keep records of their trading, including records of their activity in the underlying commodity and related derivatives markets and make such records available, upon request, to the swap execution facility and the Commission.

(b) A swap execution facility with customers trading through intermediaries must either use a comprehensive large-trader reporting system (LTRS) or be able to demonstrate that it can obtain position data from other sources in order to conduct an effective surveillance program.

#### § 37.405 Risk controls for trading.

The swap execution facility must establish and maintain risk control mechanisms 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 swap execution facility. If a swap is linked to, or a substitute for, other swaps on the swap execution facility or on other trading venues, such risk controls must, 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 must, to the extent practicable, be coordinated with any similar controls placed on national security exchanges.

#### § 37.406 Trade reconstruction.

The swap execution facility must have the ability to comprehensively and accurately reconstruct all trading on its trading facility. All audit-trail data and reconstructions must be made available to the Commission in a form, manner, and time as determined by the Commission.

#### § 37.407 Additional rules required.

A swap execution facility must adopt and enforce any additional rules that it believes are necessary to comply with the requirements of subpart E of this part.

### 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 this section;

(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 must 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 37, including the capacity to carry out international information-sharing agreements as the Commission may require.

#### **§ 37.502 Collection of information.**

A swap execution facility must 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.

#### **§ 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 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 Position limits or accountability.**

(a) 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 on the facility, as is necessary and appropriate, position limitations or position accountability for speculators.

(b) For any contract that is subject to a position limitation established by the Commission pursuant to Section 4a(a), the swap execution facility shall:

(1) Set its position limitation at a level no higher than the Commission limitation;

(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.

(c) The swap execution facility must establish the position limits in accordance with the requirements set forth in part 151.

### **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 Mandatory clearing.**

Transactions executed on or through the swap execution facility must be cleared through a Commission-registered derivatives clearing organization unless:

(a) The transaction is exempted from clearing under Section 2(h)(7) of the Act; or

(b) The Commission has not determined that the clearing requirement under Section 2(h)(1) is applicable.

#### **§ 37.702 General financial integrity.**

A swap execution facility must 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) For transactions cleared by a derivatives clearing organization, by ensuring that the swap execution facility has the capacity to route

transactions to the derivative clearing organization in a manner acceptable to the derivatives clearing organization for purposes of ongoing risk management;

(c) For transactions not cleared by a derivatives clearing organization, by requiring 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 may be adopted by the swap execution facility; and

(d) By implementing any additional safeguards as may be required by Commission regulations.

#### **§ 37.703 Monitoring for financial soundness.**

A swap execution facility must monitor members' compliance with the swap execution facility's minimum financial standards and, therefore, must routinely receive and promptly review financial and related information from its members.

### **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.**

Applicants and swap execution facilities 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 § 37.800.

### **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 requirement.**

With respect to swaps traded on or through a swap execution facility, each swap execution facility must:

- (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.

**§ 37.902 Capacity of swap execution facility.**

The swap execution facility must have the capacity to electronically capture trade information with respect to transactions executed on the facility.

**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 5 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 required.**

A swap execution facility must 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 5 years. A swap execution facility must 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.

**§ 37.1002 Reporting to the commission required.**

A swap execution facility must 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 its duties under the Act.

**§ 37.1003 Inspection and examination by the Securities and Exchange Commission.**

A swap execution facility must 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.

**Subpart L—Antitrust Considerations****§ 37.1100 Core Principle 11—Antitrust considerations.**

Unless necessary or appropriate to achieve the purposes of this 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.**

Applicants and swap execution facilities 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 § 37.1100.

**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 also shall comply with the financial resource requirements of § 39.11.

(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, or applicant for designation as such, 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; and
- (b) Any other financial resource deemed acceptable by the Commission.

**§ 37.1303 Computation of financial resource requirement.**

A swap execution facility shall, on a quarterly basis, based upon its fiscal year, 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.**

At appropriate intervals, but not less than quarterly, a swap execution facility shall compute the current market value of each financial resource used to meet its obligations under § 37.701. 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 must 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 requirements.**

(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 this § 37.1306 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 report required by this § 37.1306 shall be filed not later than 17 business days after the end of the swap execution facility's fiscal quarter, or at such later time as the Commission may permit, in its discretion, upon request by the swap execution facility.

#### 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) Each swap execution facility shall:

(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 swap execution facility; and

(3) Periodically conduct tests to verify that backup resources are sufficient to ensure continued order processing and trade matching, transmission of matched orders to a designated clearing organization for clearing, price reporting, market surveillance, and maintenance of a comprehensive and accurate audit trail.

(b) A swap execution facility's program of risk analysis and oversight with respect to its operations and automated systems must address each of the following categories of risk analysis and oversight:

(1) Information security;

(2) Business continuity-disaster recovery ("BC-DR") planning and resources;

(3) Capacity and performance planning;

(4) Systems operations;

(5) Systems development and quality assurance; and

(6) Physical security and environmental controls.

(c) In addressing the categories of risk analysis and oversight required under paragraph (b) of this section, 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.

(d) A swap execution facility must maintain a BC-DR plan and BC-DR 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 BC-DR 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 are subject to more stringent requirements in this regard, set forth in Section 40.9 of the Commission's regulations.

(e) 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 trading and clearing during the next business day following a disruption 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.

(f) A swap execution facility must notify Commission staff promptly of all:

(1) Electronic trading halts and systems malfunctions;

(2) Cyber security incidents or targeted threats that actually or potentially jeopardize automated system operation, reliability, security, or capacity; and

(3) Any activation of the swap execution facility's BC-DR plan.

(g) A swap execution facility must give Commission staff timely advance notice of all:

(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.

(h) A swap execution facility must provide to the Commission upon request current copies of its BC-DR 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.

(i) A swap execution facility must conduct regular, periodic, objective testing and review of its automated systems to ensure that they are reliable, secure, and have adequate scalable capacity. It must also conduct regular, periodic testing and review of its BC-DR capabilities. Both types of testing 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. Pursuant to Core Principle 10 under Section 5h of the Act (Recordkeeping and Reporting), and §§ 37.1000 through 37.1003, the swap execution facility must keep records of all such tests, and make all test results available to the Commission upon request.

(j) To the extent practicable, a swap execution facility should:

(1) Coordinate its BC-DR plan with those of the market participants upon whom it depends 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 BC-DR plan;

(2) Initiate and coordinate periodic, synchronized testing of its BC-DR plan and the BC-DR plans of the market participants upon whom it depends to provide liquidity; and

(3) Ensure that its BC-DR plan takes into account the BC-DR plans of its telecommunications, power, water, and other essential service providers.

(k) Part 46 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 this section; 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 this section; 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 37, the term "board of directors" means the board of

directors of a registered 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 registered 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 in furtherance of the chief compliance officer's statutory, regulatory, and self-regulatory obligations.

(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.

(i) No individual disqualified from registration pursuant to Sections 8a(2) or 8a(3) of the Act may serve as a chief compliance officer.

(ii) The chief compliance officer may not be a member of the swap execution facility's legal department and may not serve as its general counsel.

(c) *Appointment, Supervision, and Removal of Chief Compliance Officer.*

(1) *Appointment and Compensation of Chief Compliance Officer Determined by Board of Directors.* A registered swap execution facility's chief compliance officer shall be appointed by its board of directors. The board of directors must also approve the compensation of the chief compliance officer and shall meet with the chief compliance officer at least annually. The chief compliance officer shall also meet with the regulatory oversight committee, as defined in § 37.19(b), at least quarterly. The chief compliance officer shall provide any information regarding the swap execution facility's regulatory program that is requested by the board of directors or the regulatory oversight committee. The appointment of the chief compliance officer and approval of the chief compliance officer's compensation shall require the approval of a majority of the board of directors. The senior officer of the swap execution facility may fulfill these responsibilities. A swap execution facility shall notify

the Commission of the appointment of a new chief compliance officer within two business days of such appointment.

(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 by Board of Directors.* Removal of a registered 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. The swap execution facility shall notify the Commission and explain the reasons for the departure within two business days. The swap execution facility shall immediately appoint an interim chief compliance officer, and shall appoint a permanent chief compliance officer as soon as reasonably practicable. The swap execution facility shall notify the Commission within two business days of appointing any new chief compliance officer, whether interim or permanent.

(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, or the senior officer of the swap execution facility, resolving any conflicts of interest that may arise:

(i) Conflicts between business considerations and compliance requirements;

(ii) Conflicts between business considerations and the requirement that the registered swap execution facility provide fair, open, and impartial access as set forth in § 37.202 of this part; and;

(iii) Conflicts between a registered swap execution facility's management and members of the board of directors;

(3) Establishing and administering written policies and procedures reasonably designed to prevent violation of the Act and any rules adopted by the Commission;

(4) Ensuring compliance with the Act and Commission regulations relating to agreements, contracts, or transactions, and with Commission regulations under Section 5h of the Act;

(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 a compliance manual designed to promote compliance with the applicable laws, rules, and regulations and administering 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 registered futures association or other registered entity in accordance with § 37.204.

(e) *Annual Compliance Report Prepared by Chief Compliance Officer.* The chief compliance officer shall, not less than annually, prepare 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 registered 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 ensure compliance with each subsection and the core principle, including each duty specified in Section 5h(f)(15)(B);

(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 registered 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 explains how they were resolved;

(6) Any objections to the annual compliance report by those persons who have oversight responsibility for the chief compliance officer; and

(7) 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 by Chief Compliance Officer to the Commission.*

(1) Prior to submission of the annual compliance report to the Commission, the chief compliance officer shall provide the annual compliance report to the board of the registered swap execution facility for its review. If the swap execution facility does not have a board, then the annual compliance report shall be provided to the senior officer for their review. Members of the board and the senior officer may not require the chief compliance officer to make any changes to the report. Submission of the report to the board or the senior officer, and any subsequent discussion of the report, shall be recorded in board minutes or similar written record, as evidence of compliance with this requirement.

(2) The annual compliance report shall be provided electronically to the Commission not more than 60 days after the end of the registered swap execution facility's fiscal year.

(3) Promptly upon discovery of any material error or omission made in a previously filed compliance report, the chief compliance officer shall file an amendment with the Commission to

correct any material error or omission. An amendment shall contain the oath or certification required under paragraph (e)(7) of this section.

(4) A registered swap execution facility may request the Commission for an extension of time to file its compliance report based on substantial, undue hardship. Extensions for the filing deadline may be granted at the discretion of the Commission.

(5) Annual compliance reports filed pursuant to this section will be treated as exempt from mandatory public disclosure for purposes of the Freedom of Information Act and the Government in the Sunshine Act and parts 145 and 147 of this chapter, but will be available for official use by any official or employee of the United States and any State, by any self-regulatory organization of which the person filing the report is a member, and by any other person to whom the Commission believes disclosure is in the public interest.

(g) *Recordkeeping.* (1) The registered swap execution facility must 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)(6) and (d)(7) 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 similar written record of such review, that record the submission of the annual compliance report to the board of directors or senior officer; and

(iv) Any records relevant to the registered 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 registered swap execution facility shall maintain records in accordance with § 1.31 and part 45 of this chapter.

## **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 the 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.

### **GENERAL INSTRUCTIONS**

1. Form SEF and Exhibits thereto are to be filed with the Commission by applicants for registration as a swap execution facility, or by a swap execution facility amending such registration, 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 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 shall be effective unless the Commission, by order, grants such registration.

2. For the purposes of this Form, the term "Applicant" shall include any applicant for registration as a swap execution facility or any registered swap execution facility that is seeking an amendment to its order of registration.

3. Individuals' names, except the executing signature in Item 11, shall be given in full (Last Name, First Name, Middle Name).

4. Signatures on all copies of the Form SEF filed with the Commission can be executed electronically. If the Form SEF is filed by a limited liability company, it must be signed in the name of the limited liability company by a 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; if filed by a corporation, it shall be signed in the name of the corporation by a principal officer duly authorized.

5. If Form SEF is being filed as an application for registration, all applicable items must be answered in full. If any item is not applicable, indicate by "none," "not applicable," or "N/A" as appropriate.

6. For the purposes of this Form SEF, the term "Applicant" shall include any applicant for registration as a swap execution facility or any swap execution facility that is amending Form SEF.

7. 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 of the information specified on this Form SEF is mandatory prior to the start of the processing of an application for registration as a swap execution facility. The information provided with 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 further may determine that other and additional information is required from the Applicant in order to process its application. 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. **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.**

### **UPDATING INFORMATION ON THE FORM SEF**

1. Part 37 of the Commission's regulations requires that if any

information contained in this application, or any supplement or amendment thereto, is or becomes inaccurate for any reason, an amendment to Form SEF, or a submission under Part 40, in either case correcting such information must be filed promptly with the Commission.

2. Swap execution facilities filing Form SEF as an amendment need file only the facing page, the signature page (Item 10), and any pages on which an answer is being amended, together with any exhibits that are being amended. The submission of an amendment represents that the remaining items and exhibits remain true, current and complete as previously filed.

#### WHERE TO FILE

The Application Form SEF and appropriate exhibits must be filed electronically with the Secretary of the Commission in the form and manner as provided by the Commission.

#### COMMODITY FUTURES TRADING COMMISSION

#### FORM SEF

#### SWAP EXECUTION FACILITY

#### APPLICATION OR AMENDMENT TO APPLICATION FOR REGISTRATION

**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 registration, list all items that are amended and check here

#### GENERAL INFORMATION

1. Name under which business of the swap execution facility will be conducted, if different than name specified on facing sheet:

2. If name of swap execution facility is hereby amended, state previous swap execution facility name:

3. Mailing address, if different than address specified on facing sheet:

**Number and Street**

**City, State, Zip Code**

3(a). Additional contact information:

**Fax**

**Phone**

**Website**

4. List of principal office(s) and address(es) where swap execution facility activities are/will be conducted:

**Office Address**

#### BUSINESS ORGANIZATION

5. Applicant is a:

- ☐ Corporation  
☐ Partnership  
☐ Limited Liability Company  
☐ Other form of organization

(specify)

6. If Applicant is a corporation:

a. Date of incorporation:

b. State of incorporation:

7. If Applicant is a partnership:

a. Date of filing of partnership articles:

b. State in which filed:

8. If Applicant is a limited liability company:

a. Date of filing of Articles of Organization/Certificate of Formation:

b. State in which filed:

9. Applicant agrees and consents that the notice of any proceeding before the Commission in connection with its application for registration as a swap execution facility may be given by sending such notice by certified mail or confirmed telegram to the officer specified or person named below at the address given.

**Name of person (if Applicant is a corporation, limited liability company or partnership, title of officer)**

**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**

**Manual signature of Member, General Partner, Managing Agent, or Principal Agent**

**Title**

#### EXHIBITS INSTRUCTIONS

The following exhibits must be filed with the Commission by Applicants seeking 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 should be labeled according to the items specified in this Form SEF. If any exhibit is not applicable, please specify the exhibit letter and indicate by "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, the applicant should provide pro forma financial statements for the most recent six months or since inception, whichever is less.

#### EXHIBITS—BUSINESS ORGANIZATION

1. Attach as **Exhibit A**, the name of any person(s) who own(s) 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 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 or 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 you 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 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 the 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, and 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 statements certified by an independent public accountant are available, that balance sheet and statement 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 as of the end of the most recent fiscal year of each such affiliate, and each affiliate of the swap execution facility that engages in designated contract market activities.

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 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, so state 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 supporting documents that may be provided under other Exhibits herein, that describe the manner in which the Applicant is able to comply with each core principle. The Applicant should include an explanation, and any other forms of documentation the Applicant thinks will be helpful to its explanation, demonstrating how the swap execution facility will be able to comply with 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 forms of documentation the Applicant thinks will be helpful to its explanation, demonstrating how the swap execution facility will be able to comply with each core principle and 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 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 a 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 the arrangements for alternative dispute resolution.

17. Attach as **Exhibit Q**, as applicable, an explanation regarding:

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 provides all orders and trades in an electronic form, and the timeliness in which the trading system or platform does so;

(2) How all market participants have the ability to immediately see and have the ability to transact on all bids and offers through the applicant's electronic automated trade-matching system or platform; and

(3) The trade matching algorithm 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 on request for quote systems:

(1) How a market participant transmits a request for a 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.

(2) How resting bids or offers may be taken into account.

c. For trading systems or platforms that enable market participants to engage in transactions via voice:

(1) How the terms of voice-based transactions are entered into the electronic trading system or platform.

d. How the timing delay described under § 37.9 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 (link). The Technology 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.

#### **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, under §§ 37.3 and 37.5 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) all 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), 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.* [Reserved]

(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 must 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. If the final settlement price is manipulated, then the swap 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 guidance in Appendix C to Part 38—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.* [Reserved]

(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 this section;

(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.* [Reserved]

(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.* In consultation and cooperation with the Commission, 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. 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 17 CFR 40.11, 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. 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 swap execution facility should also have rules that allow it to take market actions as may be directed by the Commission. The Commission should be notified promptly of the swap execution facility's 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 5 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 this 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.* [Reserved]

(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 this section; 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), 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 this section; 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]

Dated: December 16, 2010.

By the Commission.

David A. Stawick,  
Secretary.

### **Appendices to Core Principles and Other Requirements for Swap Execution Facilities—Commission Voting Summary and Statements of Commissioners**

**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 Dunn, Chilton and O'Malia voted in the affirmative; Commissioner Sommers voted in the negative.

#### **Appendix 2—Statement of Chairman Gary Gensler**

I support the proposed rulemaking to fulfill Congress's mandate to have rules and core principles requirements for swap execution facilities (SEFs). The proposed rule also fulfills Congress's mandate to promote transparency through the trading of swaps on SEFS.

The proposed rule will provide for all market participants an ability to execute or trade with other market participants. It will afford market participants with the ability to make firm bids or offers to all other market participants. It also will allow them to make indications of interest—or what is often referred to as “indicative quotes”—to other participants. Furthermore, it will allow participants to request quotes from other market participants. These methods will provide hedgers, investors and Main Street businesses both the flexibility to execute and trade by a number of methods, but also the benefits of transparency and more market competition. I believe that transparency and competition in markets is consistent with Congress mandated in the definition of a swap execution facility, whereby all market participants can communicate with all market participants such that everybody gets the benefit of a competitive and transparent price discovery process.

The proposal does allow participants, though, to do request for quotes, whereby they would reach out to a minimum number of other market participants for quotes. It also allows that, for block transactions, swap transactions involving non-financial end-users, swaps that are not “made available for trading” and bilateral transactions, market

participants can get the benefits of the swap execution facilities' greater transparency or, if they wish, would still be allowed to execute by voice or other means of trading.

To fulfill Congress's mandate that, the rule requires SEFs to provide impartial access to market participants for trading on the platform or system.

The proposed rule also would require SEFs to—on a yearly basis—state which contracts are deemed “available for trading,” based on factors including trading activity and open interest. The rule, if finalized, goes into effect in January 2012. This will give the markets time to adapt, allow SEFs to tell the market what contracts are available for trading.

### Appendix 3—Statement of Commissioner Sommers

I disagree with several aspects of the Swap Execution Facility (SEF) proposal the Commission is issuing today and seek public comment on alternative language for Section 37.9, *Permitted Execution Methods*.

Dodd-Frank 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.” As I have pointed out in my public speaking engagements over the past few months, the term “trading facility” is defined in the Commodity Exchange Act (Act), but the terms “trading system” and “platform” are not. By introducing these new, undefined terms into the Act, and by specifying that SEFs should facilitate the trading of swaps through any means of interstate commerce, I believe Congress intended a broad model for executing swaps on SEFs, both cleared, uncleared, liquid or bespoke. The goals identified by Dodd-Frank for registering SEFs are “to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market.” In my view, the best way to achieve these twin goals is to adopt a model that provides the maximum amount of flexibility as to the method of trading. Unfortunately, this proposal does not do that.

Section 37.9, which governs the types of execution methods that SEFs may offer, is a key provision of this proposed regulation. While it permits alternative methods of execution, such as the trading facility model and the request for quote model, it also requires that to be registered as a SEF an applicant must, at a minimum, provide 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 swap execution facility.” In my view this provision is not mandated by Dodd-Frank and may limit competition by shutting out applicants who wish to offer request for quote services without this functionality. I believe this interpretation of the statute, and other requirements within this section, are far too restrictive.

As a result of my concerns, we worked throughout the past week to include alternative language for Section 37.9 in the proposal. I believe this alternative language complies with Dodd-Frank and would promote both pre-trade price transparency and the trading of swaps on SEFs. Including the alternative would have given the public an opportunity to comment, in accordance with the Administrative Procedure Act, on both the alternative language and the language contained in the proposed rule. I am deeply disappointed that despite a commitment to a transparent process in promulgating the Dodd-Frank rules, the alternative language is not in the proposal today and we are not giving the public the opportunity to comment on it. That alternative language is set forth below.

#### § 37.9 Permitted Execution Methods.

##### (a) *Definitions.*

##### (1) As used in this Part 37:

##### (i) *Order Book System* means:

(A) An electronic trading facility, as that term is defined in section 1a(16) of the Act;

(B) A trading facility, as that term is defined in section 1a(51) of the Act;

(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.

##### (ii) *Request for Quote System* means:

(A) A trading system or platform in which a market participant transmits a request for a quote to buy or sell a specific instrument to all other market participants in the trading system or platform to which all market participants may respond;

(B) A trading system or platform in which a market participant transmits a request for a quote to buy or sell a

specific instrument to more than one potential counterparty. Upon receipt of responsive quotes from any of the potential counterparties, the original requester may accept a responsive quote and complete a transaction with any one of the responsive counterparties;

(C) A trading system or platform in which multiple market participants can both (i) view real-time electronic streaming quotes, both firm or indicative, from multiple potential counterparties on a centralized screen; and (ii) have the option to complete a transaction by (A) accepting a firm streaming quote, or (B) transmitting a request for a quote to more than one market participant, 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; or

(D) Any such other trading system or platform as may be determined by the Commission.

##### (iii) *Voice-Based System* means:

(A) A trading system or platform in which a market participant executes or trades a swap using a telephonic line or other voice-based service.

(2) Swaps subject the clearing requirements under the Act that are made available for trading pursuant to § 37.10 may be executed or traded on an Order Book System, a Request for Quote System, or any such other trading system or platform as may be determined by the Commission.

(3) Swaps not subject to the clearing requirements under the Act may be executed or traded on an Order Book System, a Request for Quote System, a Voice-Based System, or any such other trading system or platform as may be determined by the Commission.

(4) A swap execution facility can be an Order Book System, a Request for Quote System, or any such other trading system or platform as may be determined by the Commission, or any combination of the aforementioned systems.

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