Discussion with the CFTC & SEC

Execution Requirement and Swap Execution Facilities

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Agenda

- Key Objectives and Guiding Principles
- Definition
- Characteristics
- Product Eligibility Requirements
- Block Exemptions
- Other Considerations
- Case Study: U.S. Treasuries Cash Market

Key Objectives and Guiding Principles

- **In drafting Dodd-Frank, Congress recognized the importance of promoting transparency and maintaining liquid markets**

- **Under Dodd-Frank, the CFTC and SEC were provided broad discretion to determine:**
  - Which transactions must be executed on a SEF
  - Minimum requirements for the manner of execution

- **These determinations should take into account:**
  - The relevant market
  - Its liquidity characteristics
  - The needs of market participants

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Definition

- **SEF definition as set forth in Dodd-Frank**
  - — "*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*"

- **Requires that multiple participants, acting independently, have the ability to execute swaps by accepting bids/offers made by multiple participants**
  - — The Core Principles applicable to SEFs track most of the Core Principles applicable to exchanges (designated contract markets or DCMs) but importantly do not include DCM Core Principle 9
  - — The omission of Core Principle 9 supports conclusion that SEFs need not provide the same type of open market required of DCMs

- **Based on the foregoing, Dodd-Frank contemplates the following construct:**
  - — A regulated trading system or platform that provides pre-trade transparency by allowing a participant to simultaneously receive multiple executable prices for a particular transaction and with access to automated post-trade flows, such as confirmation and access to clearing houses

Characteristics

- A SEF can define the execution method

- SEFs do not have to offer all products or segments

- SEF can set its own objective access rules, including:
  — Different roles for different participants (e.g. price maker vs. price taker)

Product Eligibility Requirements

- **Ability to clear a swap is not a sufficient condition for mandating SEF execution**
  - Swaps must be available to be traded
  - Necessary for the regulators to determine that sufficient liquidity in the swap exists

- **The liquid “benchmarks” in each asset class should be subject to mandatory SEF execution**
  - “Benchmark” determined according to agreed measures of liquidity, e.g.: for IRS the 2, 5, 10, 30 year outright swaps; for CDS on-the-run 5 year points (for both indices and constituent single names)
  - Where index licenses are needed, providers should grant them to SEFs broadly and on commercial terms
  - Intra-group trades, where the entities have the same beneficial owner, should be excluded

- **Would result in a major shift in how products are traded today**
  - Significant percentage of IRS and CDS trades will be moved to electronic SEFs

Block Exemptions

- **Large trades that meet a certain size threshold should be permitted to be traded “off SEF”**
  - Trades subject to different post trade reporting requirements
- **Block trading thresholds must be set at levels that accommodate:**
  - Overall size of market, level of liquidity and average ticket size
  - Number of participants
  - Velocity of trading activity
  - Needs of market participants in the relevant asset class
- **Block thresholds should be re-evaluated as commonly observed market liquidity changes**

Other Considerations

- SEFs should be required to offer routing to multiple clearing houses
- Clearing houses should be open to accepting matched or executed trades from multiple SEFs
- Competition among SEFs (and DCMs that offer swap execution services) should be a goal
- Encourage standardization and centralization of the processes supporting the products
- Retain ability to customize instruments tailored to hedging/taking risk

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Case Study: U.S. Treasuries Cash Market

- **Treasury market overview**
  - Participants have several trading options when looking to execute / hedge risk associated with U.S. treasuries
  - They can decide on the proper venue depending on multiple factors including specificity of risk, size, timing, participants, operational efficiency and anonymity
- **Multi-dealer RFQs**
  - Venues: Bloomberg and Tradeweb
  - Buy-side clients can query one or more market makers simultaneously for executable prices
  - Clients would potentially use this method of execution if they had a larger trade size than could be executed with a single party on either Brokertec or eSpeed
- **Central limit order book trading**
  - Venues: Brokertec and eSpeed
  - Transparent and liquid markets where counterparties can view, post or aggress anonymously against live executable prices. Access is open to both traditional buy-side and sell-side participants
  - Trading on these venues is typically higher velocity and smaller size - akin to typical equity exchanges
- **Single Dealer Platforms or Voice**
  - Venues: phone or proprietary dealer platforms
  - Clients can view where the market is trading via the venues above, however, if they want to do large size, they will enter into a bi-lateral negotiation with a market maker in order to get the best quote