



F M L G | F I N A N C I A L M A R K E T S L A W Y E R S G R O U P

February 28, 2019

Via Electronic Mail (dsioletters@cftc.gov)

Mr. Matthew Kulkin, Director
Division of Swap Dealer and Intermediary Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Request for no-action relief regarding certain external business conduct requirements as they relate to off-SEF “mirror” transactions in the prime brokerage context

Dear Mr. Kulkin:

The private sector members of the Financial Markets Lawyers Group (the “*FMLG*”)¹ respectfully request that the Division of Swap Dealer and Intermediary Oversight (“*DSIO*”) of the Commodity Futures Trading Commission (the “*Commission*”) provide no-action relief with respect to the applicability of the EBC Disclosures Exclusion (as defined below) to so-called off-SEF “mirror” transactions, particularly as such exclusion may apply in the context of foreign exchange prime brokerage.²

The request for no-action relief in this letter is limited to the specific EBC Disclosures Exclusion issue described below and is, therefore, without prejudice to (and not intended as a substitute or alternative for) the on-going engagement of the International Swaps and Derivatives Association with DSIO (as well as the Division of Market Oversight (“*DMO*”)) to more fully address challenges in prime brokerage arrangements,

¹ The FMLG comprises lawyers who support foreign exchange and other financial markets trading in leading worldwide financial institutions. Currently, the private sector members of the FMLG include representatives from Bank of America, N.A.; Bank of New York Mellon; Barclays; BNP Paribas; Cboe Global Markets, Inc.; Citigroup Global Markets Inc.; CLS Bank International; Deutsche Bank; Goldman, Sachs & Co.; HSBC Securities (USA) Inc.; JP Morgan Chase & Co.; Millennium Management LLC; Morgan Stanley; State Street Bank and Trust Company; The Bank of New York Mellon; and Wells Fargo. A list of FMLG members from those firms is attached to this letter as Exhibit A. The FMLG is sponsored by, but is not part of, the Federal Reserve Bank of New York. Any views expressed by the FMLG are the views of its private sector members, and do not necessarily represent the views of the Federal Reserve Bank of New York or the Federal Reserve System.

² While the FMLG is focused on the support of foreign exchange markets, the matter raised in this letter may not be limited to FX products.

including any rulemaking proposals thereof that DSIO (and DMO) may be exploring as part of the Commission's Project KISS swaps rules simplification efforts.³

In a typical FX Prime Brokerage structure on a swap execution facility (a "**SEF**") that may offer the trading of non-deliverable forward foreign exchange transactions, among other swaps, a prime broker (a "**Prime Broker**") may allow certain of its prime brokerage clients that are admitted by the SEF as participants on the SEF (each, a "**Trading Counterparty**") to enter into transactions as such Prime Broker's agent and for such Prime Broker's account.

A Prime Broker on a SEF will typically be a swap dealer, as such term is defined in Section 1a(49) of the Commodity Exchange Act (the "**CEA**" or the "**Act**"), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**"). Section 23.431 (a) and (b) of the swap dealer business conduct standards⁴, which standards were introduced to implement Section 4s(h) of the CEA, requires swap dealers, when entering into swaps with certain non-swap dealer counterparties, to provide certain material information (the "**EBC Disclosures**") concerning the swap to the counterparty prior to execution. Such material information includes the material risks of the proposed swap, its material characteristics, and, in the case of swaps that are not made available for trading as provided in Section 2(h)(8) of the Act, certain scenario analysis upon request. However, Section 23.431(c) of the swap dealer business conduct standards (the "**EBC Disclosures Exclusion**") provides that a swap dealer is not required to make the EBC Disclosures to its counterparty if the relevant transaction is:

- "(1) Initiated on a designated contract market or a swap execution facility; and
- (2) One in which the swap dealer or major swap participant does not know the identity of the counterparty to the transaction prior to execution."

In the most common form of prime brokerage trading arrangement on a SEF: a Trading Counterparty, which is a client of a Prime Broker, enters into transactions on the SEF for the account of its Prime Broker (the "**on-SEF transaction**") with another participant on the SEF (which may be a dealer, another prime brokerage client of the same or a different prime broker or other SEF participant); and the Prime Broker enters into an offsetting transaction with the Trading Counterparty that is a mirror of the on-SEF transaction and does not represent a new price forming event, with the execution of that "mirror" transaction occurring off the SEF (the "**off-SEF transaction**"). In the case where a SEF operates an anonymous electronic trading platform, the exclusion afforded to its Prime Brokers under the EBC Disclosures Exclusion accordingly (and appropriately) applies, relieving the Prime Broker of the obligation to make the EBC Disclosures, as applicable, prior to entering into the on-SEF transaction. In order for the EBC Disclosures Exclusion to be

³ The FMLG acknowledges that several additional requests for clarification and/or relief relating to the FX prime brokerage trading model have been presented to the Commission in recent years. In focusing exclusively on the issue set forth in this letter, the FMLG does not wish to represent that any or all of such other issues are no longer requiring such clarification or are no longer the subject of communications with Commission staff for future resolution. The FMLG is also aware that representatives from one of its member firms—Cboe Global Markets, Inc, which owns Cboe SEF, LLC—has communicated with CFTC staff about the issues addressed in this letter.

⁴ 17 CFR 23.431.

effective, it is our assumption that it must necessarily apply in respect of the off-SEF transaction as well, as it does not represent a new price forming event. However, a literal construction of Section 23.431(c) leads to some interpretative uncertainty (which we believe is not intended) on whether the EBC Disclosures Exclusion is only applicable to the on-SEF transaction and not to the off-SEF transaction.

The off-SEF transaction mirrors the terms of the on-SEF transaction as executed by the Trading Counterparty on behalf of the Prime Broker, with the sole price forming event with respect to the off-SEF transaction being the execution of the on-SEF transaction. As a result, similar to the on-SEF transaction, there is no basis on which the Prime Broker could make the pre-trade EBC Disclosures to the Trading Counterparty with respect to the off-SEF transaction. Further, to read the EBC Disclosures Exclusion as applying only to the on-SEF transaction and not to the off-SEF transaction would, we believe, create an impossibility on the part of the swap dealers to comply with the EBC Disclosures in respect of the off-SEF transaction in the FX Prime Brokerage context.

The private sector members of the FMLG believe that providing no-action relief confirming that the Commission will not take action against a swap dealer for failing to make the pre-trade EBC Disclosures in respect of off-SEF mirror transactions, as described above, would encourage more market participants to utilize SEFs in connection with prime brokerage transactions, and we respectfully request that DSIO provide such relief. We would be happy to discuss any questions that DSIO staff may have with respect to this request. Please don't hesitate to contact the FMLG's representative member, Lisa A. Shemie of Cboe Global Markets, Inc., at lshemie@cboe.com, or at 646-856-8814.

Sincerely,

The Financial Markets Lawyers Group

By: 

Lisa A. Shemie

EXHIBIT A

Private Sector Members of the FMLG

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Assistant General Counsel
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