



**Testimony
Before the
House Agriculture Subcommittee
On Commodity Exchanges, Energy and Credit**

“Reauthorizing the CFTC: Market Participant Views”

March 25, 2015

Shawn Bernardo

**Chief Executive Officer
tpSEF, Inc.**

Wholesale Markets Brokers Association, Americas

Introduction

Thank you, Chairman Scott, Ranking Member Scott, and members of the Subcommittee for providing this opportunity to participate in today's hearing.

My name is Shawn Bernardo. I am the Chief Executive Officer of tpSEF, Inc., Tullett Prebon's temporarily-registered swap execution facility (SEF). Tullett Prebon is a founding member of the Wholesale Markets Brokers Association, Americas (WMBAA), an independent industry body whose membership includes the largest North American inter-dealer brokers.¹

I appear before you today in my capacity as a WMBAA officer and board member.

Tullett Prebon is a leading global inter-dealer broker of over-the-counter (OTC) financial products.² My company has a global presence and the business covers money market and foreign exchange products, fixed income, interest rate derivatives, equities, and energy products, and offers voice, hybrid, and electronic broking solutions for these products. Tullett also offers a variety of market information services through its inter-dealer broker market data division, Tullett Prebon Information.

My career began in the inter-dealer broker industry in 1996 as a US Treasuries broker. As you may know, the secondary market in US Treasuries trades exclusively over-the-counter, both electronically and via voice, and stands as an example of one of the most liquid and efficient markets in the world. My experience as a broker allowed me to help create electronic brokering systems for US Treasuries, US repurchase agreements, credit default swap index products, and interest rate swaps. I have spent the vast majority of the past 15 years building various electronic and hybrid brokering platforms to promote more efficient markets in Fixed Income, Energy, Credit, FX Options, and Interest Rates.

WMBAA Supports Recent CFTC Statements to Revisit Issues Related to SEF and Swap Trading Rules

The WMBAA is encouraged by recent statements by the Commissioners of the Commodity Futures Trading Commission (CFTC or Commission) suggesting that the Commission may consider potential revisions to various aspects of its swap regulations promulgated pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), including reforms specifically related to SEFs and swap trading. We support these efforts and continue to support steps to preserve and promote the clear Congressional intent for SEFs to operate "through any means of interstate commerce."³

¹ The WMBAA is an independent industry body representing the largest inter-dealer brokers. The five founding members of the group—BGC Partners, GFI Group, ICAP, Tradition, and Tullett Prebon—operate globally, including in the North American wholesale markets, in a broad range of financial products, and have received temporary registration as swap execution facilities. The WMBAA membership collectively employs approximately 4,000 people in the United States; not only in New York City, but in Stamford, Connecticut; Chicago, Illinois; Louisville, Kentucky; Jersey City, New Jersey; Raleigh, North Carolina; and Houston and Sugar Land, Texas. For more information, please see www.wmbaa.org.

² For more information, please see www.tullettprebon.com.

³ 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

As the Congress considers Commodity Exchange Act reauthorization, the WMBAA urges legislators to ensure that the implementing agencies honor the statute's expectation that swap trading rules will, consistent with the CFTC's "principles-based" approach to regulation, allow for the flexibility that benefits all types of market participants and ensure that US financial markets remain the most competitive and liquid in the world. In reviewing the evolution of the SEF definition throughout the legislative debate, one can see that each of the words was measured and selected with extreme precision.⁴

Recently, before the full House Committee on Agriculture, Chairman Tim Massad expressed an openness "to looking at how [the CFTC] can fine-tune and improve rules to enhance trading."⁵ Calls for the Commission to consider potential revisions to its Dodd-Frank Act regulations have also been raised by Commissioner Mark Wetjen,⁶ Commissioner Sharon Bowen,⁷ and Commissioner J. Christopher Giancarlo with the recent release of his white paper on these topics.⁸

The WMBAA appreciates the Commission's careful and deliberative approach to the regulation of SEFs. The implementation of the SEF regime has not been without its challenges and, given the unique characteristics of the OTC swap market, certain requirements have proven to be impracticable to implement or detrimental to market liquidity. Accordingly, the WMBAA supports the Commissioners' recognition that the regulations should be reassessed on an ongoing basis and appropriately modified based on its experience.⁹

Since the Commission's adoption of final SEF regulations in June 2013, the WMBAA member firms have been working diligently to implement various requirements and have actively engaged

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.

⁴ See Letter from Stephen Merkel, Chairman, and Shawn Bernardo, Vice Chairman, WMBAA, to the Honorable Michael Dunn, Commissioner, CFTC, dated June 21, 2011, *available at* http://www.wmbaa.com/wp-content/uploads/2012/01/14_Letter_MDunn_SEF_06-21-11.pdf.

⁵ 2015 *Agenda for CFTC: Hearing Before the House Committee on Agriculture*, 114th Cong. (Feb. 12, 2015).

⁶ See Remarks of Commissioner Wetjen, Nov. 14, 2014 (suggesting certain actions that the CFTC should consider related to trade execution in order to minimize fragmentation), *available at* <http://www.cftc.gov/PressRoom/SpeechesTestimony/opawetjen-10>.

⁷ See Statement of Commissioner Bowen, Dec. 1, 2014 (stating that "the best way of viewing changes to [the CFTC's Dodd-Frank Act rulemakings] is not that [the CFTC is] tweaking them, but rather that [the CFTC is] enhancing them. Sometimes that may mean making the rules more cost-effective and leaner, but at other times that will mean making them stronger than before. Enhancing a rule can mean reducing burdens to business while strengthening protections for the public"), *available at* <http://www.cftc.gov/PressRoom/SpeechesTestimony/bowenstatement120114>.

⁸ See Commissioner Giancarlo White Paper, "Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank" (Jan. 29, 2015), *available at* <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf>.

⁹ See remarks by CFTC Commissioner Mark Wetjen, Open Meeting on the 29th Series of Rulemakings Under the Dodd-Frank Act, May 16, 2013, *available at* http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission_051613-trans.pdf ("The Commission, therefore, must remain open to reassessing the policy judgments in these final rules as the markets evolve, as the Commission has provided new information, and as the Commission benefits from its experience overseeing the new SEF market structure. In short, the Commission must remain open to course correction where necessary and ensure that the swap regulatory regime keeps pace with the markets that it governs.").

Commission staff throughout the implementation process. The WMBAA continues to be committed to working with the Commission and its staff to ensure that the regulations are implemented in accordance with the underlying statutory intent of the Dodd-Frank Act and seeks to accomplish the legislation's goal to "promote the trading of swaps on swap execution facilities."

Committed Focus on Permanent SEF Registration

While each of the WMBAA member firms' SEFs has received temporary registration, our members recognize the importance of permanent SEF registration to providing the market with the certainty and stability needed for swap trading to flourish.¹⁰ Accordingly, the WMBAA is hopeful that continued active engagement with the Commission and its staff on these implementation issues will serve to expedite the permanent registration process.

SEF applications have been pending with the CFTC since the summer of 2013. Our association's members have each filed a Form SEF and associated registration materials with the Commission; participated in a series of staff visits and conference calls; and responded to document requests, exhaustive questionnaires, and rulebook provision inquiries. We continue to treat these requests with the seriousness and attention they deserve as each company strives to attain permanent registration. We have been working very closely with the staff to address these issues, and the WMBAA remains hopeful that SEF registrations will be issued later this year so that we can dedicate more of our resources to providing competitive, vibrant, and transparent trading platforms.

Concern about CFTC Policymaking through Staff Guidance and No-Action Relief

WMBAA SEFs have dedicated significant resources over the last few years to ensure that OTC swap trading remains competitive and transparent. Our association was encouraged that the final rules were adopted in a "technology neutral" manner that would foster future innovation in the industry.¹¹

However, notwithstanding the promulgation of final Part 37 rules, the SEF regulatory landscape continues to shift as CFTC staff continues to issue numerous no-action letters and interpretive guidance and develops new interpretations to the preamble (and footnotes to preamble discussion) of the Part 37 rules. To be clear, we appreciate the hard work and dedication of the CFTC staff engaged on these issues. Our concern is that the Commission's actions, in their entirety, have been difficult to comply with and lack the permanence needed to build systems and platforms to their requirements.

¹⁰ In 2014, SEF average daily notional volumes accounted for 52.4% of reported rates volume and 62.3% of reported credit volume. In addition, cleared interest rate and cleared CDS index transactions grew as a percentage of total volume in 2014, accounting for 76.5% of notional volume in rates and 74.7% of notional volume in CDS index trades. *See* ISDA SwapsInfo 2014 Year in Review (Mar. 2015), *available at* <http://www2.isda.org/functional-areas/research/research-notes/>.

¹¹ *See* remarks by CFTC Chairman Gary Gensler, Open Meeting on the 29th Series of Rulemakings under the Dodd-Frank Act, May 16, 2013, *available at* http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission_051613-trans.pdf ("In addition, as Congress said in the definition of a swap execution facility that it could be by any means of interstate commerce. This rule is technology neutral. Telephones work. Maybe it's because I'm 55 years old, but I think Congress made the decision, and we're just implementing that decision that this rule is technology neutral. As long as there is an order book and somebody can do the minimum functionality around requests for quotes, have an audit trail and the other provisions of the rule, it's technology neutral.").

I'd like to share one example that demonstrates some of the concerns we have about how certain requirements have been implemented. CFTC regulation 37.6 requires a SEF to “provide each counterparty to a transaction that is entered into on or pursuant to the rules of the [SEF] with a written record of all of the terms of the transaction which shall legally supersede any previous agreement and serve as a confirmation of the transaction. The confirmation of all terms of the transaction shall take place at the same time as execution.”

In the preamble, the Commission explains how it has considered and responded to the many comments submitted in response to its proposed rule before adopting the final regulation. However, in a corresponding footnote in the preamble – footnote 195 – the Commission states that “[t]here is no reason why a SEF’s written confirmation terms cannot incorporate by reference the privately negotiated terms of a freestanding master agreement for these types of transactions, provided that the master agreement is submitted to the SEF ahead of execution and the counterparties ensure that nothing in the confirmation terms contradict the standardized terms intended to be incorporated from the master agreement.”

When SEFs discovered this footnote buried in the preamble discussion of the final rule, they joined other market participants in immediately engaging the CFTC and its staff to determine how a SEF could demonstrate compliance with this statement. Following a series of conversations and three separate formal industry petitions for relief, the Division of Market Oversight ultimately issued no-action relief allowing a SEF to incorporate the underlying terms by reference and waiving the requirement that a SEF must receive or maintain each underlying agreement on record. At the same time, however, the no-action relief imposed a new obligation on SEFs to “glean all confirmation data” from executed swaps “[w]here a SEF has incorporated the swap’s governing documents by reference.”¹² The Division of Market Oversight and the Commission did not provide any guidance on how a SEF could comply with its new duty to “glean” this information and, as a result, fell short in providing meaningful relief.

There remain several other pressing implementation issues that continue to frustrate the SEF registration and swap trading process. For example, other issues relate to the time between a SEF disseminating trade data to its participants and reporting the trade to a swap data repository, referred to as the “Embargo Rule”; specific audit trail requirements for voice-based platforms; the calculation of financial resources that a SEF must maintain; the “made available to trade” or “MAT” process; SEF monitoring for position limits violations; the disparate regulatory treatment of economically equivalent swaps and futures products; how to resolve swaps executed with operational or clerical errors; and a series of questions related to the cross-border application of SEF and swap trading rules.

Conclusion

The WMBAA thanks the Subcommittee for the opportunity to comment on these very important issues. I would be happy to answer any questions you may have.

¹² See CFTC Letter No. 14-108 (Aug. 14, 2014), *available at* <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/14-108.pdf>.