



SEC: Swap Execution Facilities. March 2011

The Dodd-Frank Wall Street Reform and Consumer Protection Act authorised the Securities Exchange Commission (“SEC”) to implement a system or framework for security-based swaps (and other derivatives) that are normally traded in OTC (Over The Counter) markets with little transparency and supervision. The Dodd-Frank Act refers to that framework as a *“trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce.”*

On 2 February the SEC published, for public consultation, a proposal to define the characteristics of this new security-based swap trading or execution system (swap execution facilities), which is a new category of “market”, whose goal The concept of “security-based swaps” includes swaps or derivatives based not only on individual securities, but also on loans, on narrow-based groups or indices of securities and on events relating to an issuer or issuers of securities in a narrow-based security index.

Definition and characteristics of swap execution facilities

The proposal includes the following interpretation of the swap execution facilities definition: it is a system or platform that allows more than one participant to interact with the trading interest of more than one participant on the system or platform. Following this interpretation, various types of systems or platforms would be accepted: for example, it would be possible to use a limit order book system or a request for quote system, where a participant has the ability to send a single request for quote to all liquidity providing participants, or to choose to send the request to fewer participants among those who offer to acquire the position.

The system should not be able to limit the number of liquidity providing participants. However, it should be able to let the quote requesting participant choose to send its request for a quote to fewer than all liquidity providing participants.

The system or platform should be designed to include an operating functionality allowing any participant the ability to make and display executable bids and offers accessible to all other participants. Also, it should be able to create and disseminate indicative quotes for all swaps that trade on the system to all participants.

Requirements for swap execution facilities

The systems would be required to register with the SEC and the information included in the form should be updated if it becomes inaccurate. A form with the amendments should be submitted annually. In addition, these systems should report their process for changing the regulation and for admitting new products.

The systems should also ensure in their provisions compliance with the core 14 principles outlined in the Dodd-Frank Act, such as: regulate the terms and conditions of security-based swaps, any limitation on access to the facility, trade processing and participation and the operation of the facility (Principle 2); establish rules for entering, executing and processing trades and to monitor trading to prevent manipulation, price distortion and disruptions through surveillance, including real-time trade monitoring and trade reconstructions (Principle 4);

have systems to capture information necessary to carry out its regulatory responsibilities and share the information with the SEC (Principle 5); establish rules and procedures to ensure the financial integrity of swaps entered on the facility, including the clearance and settlement phases of those swaps (Principle 6); make public necessary post-trade information (including price, trading volume and other data) in the time prescribed by the SEC (Principle 8); have rules designed to minimise and resolve conflicts of interest and a chief compliance officer that performs certain duties relating to the oversight and compliance monitoring of the facility and that submits financial and compliance reports to the SEC (Principles 11 and 14).

Finally, the document of the SEC proposes to expressly exempt these systems from the consideration or definition of exchange and, consequently, from the application of broker regulation.

To read the full proposal, please click here:

<http://www.sec.gov/rules/proposed/2011/34-63825.pdf>