



July 23, 2019

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Proposed Rule Amendments and Guidance Addressing Cross-Border Application of Certain Security-Based Swap Requirements (File No. S7-07-19)

Dear Ms. Countryman:

Citadel appreciates the opportunity to provide comments to the Securities and Exchange Commission (the “Commission”) on the proposed rules and guidance regarding the cross-border application of certain security-based swap requirements (the “Proposal”).¹

We strongly support the Commission’s continued efforts to finalize and fully implement the reforms to the security-based swaps market, which will promote market safety, stability and integrity, while improving conditions for investors through increased transparency and competition. In this regard, we agree with the Commission re-affirming its prior conclusion that security-based swap transactions arranged, negotiated or executed using personnel located in the United States (“ANE Transactions”) fall squarely within the Commission’s jurisdiction under the Securities Exchange Act (the “Exchange Act”), even if the transactions are booked to non-U.S. entities. These transactions clearly constitute security-based swap activity *in the United States* and, as the Commission has observed, can pose risks to the U.S. financial system.²

Given the Commission’s jurisdiction, and its supervisory interests and policy objectives, we urge the Commission to continue to require both regulatory reporting and public reporting of ANE Transactions as well as the registration of dealer firms engaging in ANE Transactions.

¹ 84 Fed. Reg. 24206 (May 24, 2019), available at: <https://www.govinfo.gov/content/pkg/FR-2019-05-24/pdf/2019-10016.pdf> (the “Proposal”).

² See Security-Based Swap Transactions Connected With a Non-U.S. Person’s Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent; Security-Based Swap Dealer De Minimis Exception, 81 Fed. Reg. 8598 (Feb. 19, 2016) at 8615-17, available at: <https://www.govinfo.gov/content/pkg/FR-2016-02-19/pdf/2016-03178.pdf> (“ANE Adopting Release”).

I. The Commission Has Jurisdiction Over ANE Transactions

ANE Transactions fall squarely within the Commission’s jurisdiction under the Exchange Act, as the transactions are arranged, negotiated or executed using personnel located in the U.S.³ The Commodity Futures Trading Commission (the “CFTC”) has repeatedly reached the same conclusion, asserting jurisdiction over ANE Transactions in its cross-border guidance,⁴ subsequent staff advisory,⁵ and most recent cross-border rule proposal.⁶

As the Commission correctly observes, failing to regulate ANE Transactions could enable firms to “exit the Title VII regulatory regime without exiting the U.S. market” and conduct “an unregistered security-based swap dealing business in the United States.”⁷ Such a regulatory gap would mean that rules designed to ensure financial soundness and mitigate systemic risk would not apply even though a default by the non-U.S. dealer could pose contagion risks to U.S. financial markets, including as a result of a U.S. financial group electing to stand behind the obligations of its offshore affiliate (even in the absence of an explicit guarantee). In addition, competitive disparities would be created between U.S. and non-U.S. dealers with respect to the regulatory requirements applicable to trading activities conducted by U.S. personnel. In light of the above, we strongly support the Commission exercising jurisdiction over ANE Transactions.

II. The Commission Should Continue to Apply Regulatory Reporting and Public Reporting Requirements to ANE Transactions

In determining how to appropriately exercise its jurisdiction over ANE Transactions, the Commission should take into account its supervisory interests and the policy objectives of mitigating systemic risk and increasing transparency, competition, and integrity in the security-based swaps market.⁸ These considerations lead to the conclusion that both regulatory and public reporting requirements should continue to apply to ANE Transactions.

The Commission has a strong supervisory interest in monitoring and surveilling trading activity that occurs in the U.S. As a result, regulatory reporting requirements should continue to apply to ANE Transactions, particularly since these transactions could account for a significant

³ See Section 30(c) of the Exchange Act.

⁴ 78 Fed. Reg. 45292 (July 26, 2013) at 45350 FN 513, available at: <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2013-17958a.pdf>.

⁵ CFTC Staff Advisory No. 13–69 (Nov. 14, 2013) (“Staff Advisory”), available at: <http://www.cftc.gov/idc/groups/public/@lrllettergeneral/documents/letter/13-69.pdf>.

⁶ Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, 81 Fed. Reg. 71946 (Oct. 18, 2016) at 71952, available at: <http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-24905a.pdf>

⁷ See Proposal at 24215, FN 80 and 81.

⁸ See ANE Adopting Release at 8615-17.

portion of total security-based swap dealing activity in the U.S.⁹ This will enable the Commission to better monitor for disruptive trading practices and will also provide the necessary data regarding overall market trading activity to allow the Commission to evaluate market trends and accurately assess the impact of other reforms implemented in the security-based swap market.

Public reporting requirements should also continue to apply to ANE Transactions in light of the policy objectives of increasing transparency and enhancing price discovery for U.S. market participants.¹⁰ The Commission has estimated that ANE Transactions may account for “a majority of security-based swap dealing activity in the United States, including most or all interdealer activity in the United States.”¹¹ Failing to provide U.S. investors with transparency regarding this important trading activity would leave the market opaque¹² and jeopardize the benefits that are intended to accrue to end investors as a result of implementing public reporting. Where public reporting is comprehensively implemented, market research consistently concludes that the benefits are material, including for CFTC-regulated OTC derivatives¹³ and Commission-regulated corporate bonds.¹⁴ However, leaving material gaps in the public reporting framework will impede the ability of U.S. investors to measure execution quality, perpetuating information asymmetries that benefit the incumbent liquidity providers and decreasing overall market competition.

⁹ See ANE Adopting Release at 8616.

¹⁰ See Exchange Act Section 13(m).

¹¹ ANE Adopting Release at 8616.

¹² See Application of Certain Title VII Requirements to Security-Based Swap Transactions Connected With a Non-U.S. Person’s Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent; Proposed Rules, 80 Fed. Reg. 27444 at 27484, available at: <https://www.govinfo.gov/content/pkg/FR-2015-05-13/pdf/2015-10382.pdf> (“the current market for security-based swaps is opaque”).

¹³ See, e.g., Loon, Y. C., Zhong, Z. K. The impact of central clearing on counterparty risk, liquidity, and trading: Evidence from the credit default swap market. *Journal of Financial Economics* (2013), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2176561; and Loon, Y. C., Zhong, Z. K. Does Dodd-Frank affect OTC transaction costs and liquidity? Evidence from real-time CDS trade reports. *Journal of Financial Economics*, (2015), available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2443654

¹⁴ See, e.g., Asquith, P., et al., “The Effects of Mandatory Transparency in Financial Market Design: Evidence from the Corporate Bond Market” (April 2019), available at: <https://www.nber.org/papers/w19417>; Bessembinder, H., et al., “Market transparency, liquidity externalities, and institutional trading costs in corporate bonds” (2006) *Journal of Financial Economics*, available at: https://www.researchgate.net/publication/222515781_Market_Transparency_Liquidity_Externalities_and_Institutional_Trading_Costs_in_Corporate_Bonds; Edwards, A. K., et al., “Corporate bond market transaction costs and transparency” (2007) *The Journal of Finance*, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=593823; and Jacobsen, S., et al., “Does trade reporting improve market quality in an institutional market? Evidence from 144A corporate bonds” (2018), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3171056.

We note that continuing to apply both regulatory and public reporting requirements to ANE Transactions is largely consistent with the CFTC’s regulatory framework. The CFTC has not granted an exemption from regulatory reporting for ANE Transactions.¹⁵ Similarly, the CFTC’s public reporting requirements apply to ANE Transactions,¹⁶ although no-action relief has been granted while the CFTC examines its overall cross-border approach to transaction-level requirements.¹⁷ More recent actions suggest it is unlikely that this examination will result in a significant narrowing of CFTC reporting requirements. In particular, in connection with granting equivalence to multilateral trading venues in certain non-U.S. jurisdictions, the CFTC has continued to apply both regulatory and public reporting requirements to transactions executed on these non-U.S. trading venues,¹⁸ despite claims that such a course of action would lead to significant implementation challenges.¹⁹

The CFTC’s approach to transactions executed on non-U.S. trading venues also reflects the fact that no jurisdiction has yet to implement comparable public reporting requirements for OTC derivatives.²⁰ This fact also supports the Commission continuing to apply public reporting requirements to ANE Transactions and negates any expressed concern about market participants being subject to duplicate requirements. ANE Transactions should not be granted a complete exemption from transparency requirements for the reasons detailed above. It is interesting to note that, following the CFTC granting no-action relief from public reporting and other transaction-level requirements for ANE Transactions, it has been documented that interdealer trading activity in EUR interest rate swaps began to be booked almost exclusively to non-U.S. entities, a fact pattern that is “consistent with (although not direct proof of) swap dealers strategically choosing the location of the desk executing a particular trade in order to avoid trading in a more transparent and competitive setting.”²¹ This market data further supports the Commission’s concerns about the amount of trading activity that may not be subject to public reporting and other key regulatory

¹⁵ See CFTC Part 45, available at: <https://www.ecfr.gov/cgi-bin/text-idx?SID=dcc01affdb1516ec5deeeea990771661&mc=true&node=pt17.2.45&rgn=div5>.

¹⁶ CFTC Staff Advisory No. 13–69 (Nov. 14, 2013), available at: <http://www.cftc.gov/idc/groups/public/@lrllettergeneral/documents/letter/13-69.pdf>.

¹⁷ CFTC No-Action Letter 17-36 (July 25, 2017), available at: <https://www.cftc.gov/PressRoom/PressReleases/pr7593-17>.

¹⁸ See, e.g., CFTC Order of Exemption (July 11, 2019) at page 5, available at: <https://www.cftc.gov/PressRoom/PressReleases/7968-19>.

¹⁹ See, e.g., A Practical Guide to Navigating Derivatives Trading on US/EU Recognized Trading Venues, ISDA (April 2018), available at: <https://www.isda.org/a/COMEE/A-Practical-Guide-to-Navigating-Derivatives-Trading-on-US-EU-Recognized-Trading-Venues.pdf>.

²⁰ We note that the EU MiFID II framework was intended to be comparable, but implementation and data quality issues have resulted in nearly all OTC derivatives being subject to a 4-week public reporting delay.

²¹ Benos, E., Payne, R., and Vasios, M., Centralized trading, transparency and interest rate swap market liquidity: evidence from the implementation of the Dodd-Frank Act, Bank of England Staff Working Paper (May 2018) at page 30, available at: <https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2018/centralized-trading-transparency-and-interest-rate-swap-market-liquidity-update>

requirements if ANE Transactions are exempted. We urge the Commission to maintain its current approach and apply both regulatory and public reporting requirements to ANE Transactions.

III. Additional Exemptions Should Not Be Granted for ANE Transactions

As detailed above, the Commission has clear jurisdiction over ANE Transactions and a strong supervisory interest in ensuring that certain regulatory requirements apply to this U.S.-based trading activity. However, the additional exemptions for ANE Transactions contemplated in the Proposal would unnecessarily complicate this oversight to the detriment of U.S. market participants.

Market Color

First, the Proposal would permit U.S.-based personnel to provide “market color” without being considered to have engaged in the “arranging, negotiation, or executing” that would trigger Commission jurisdiction. The proposed definition of “market color” is quite broad, encompassing a wide range of sales and trading activities, as long as the U.S.-based personnel do not have responsibility for the client involved in the relevant transaction and do not receive transaction-linked compensation.²² These criteria appear relatively easy for a dealer firm to structure around, thereby providing a broad exemption from Commission oversight for trading activities in the U.S. In addition, the proposed definition of “market color” is highly facts and circumstances-specific, complicating monitoring and surveillance by the Commission regarding whether dealer firms are appropriately classifying ANE Transactions. As a result, we are concerned that the proposed exemption for “market color” will result in the Commission losing oversight over the vast majority of transactions that are currently classified as ANE Transactions, with adverse consequences to U.S. market participants and U.S. financial markets. We urge the Commission to adopt a much narrower definition of “market color” that is closer to its current approach of regulating “market-facing activity normally associated with sales and trading” that occurs in the U.S.²³

Registration

Second, the Proposal would permit a non-U.S. dealer to exclude ANE Transactions when determining whether security-based swap dealer registration with the Commission is required, subject to certain conditions being satisfied, including that its U.S.-based personnel are associated with an affiliated entity that is registered as a security-based swap dealer (Alternative 1) or a broker (Alternative 2).²⁴ While we have concerns about permitting a dealer counterparty to engage in dealing activity using U.S.-based personnel without being appropriately registered with the Commission, in no event should the Commission adopt Alternative 2. This would allow a non-U.S. firm to engage in dealing activity in the U.S. in security-based swaps without either it, or an affiliate, being registered in the appropriate capacity with the Commission. As a result, key entity-

²² Proposal at 24217.

²³ ANE Adopting Release at 8622.

²⁴ Proposal at 24218-19.

level requirements designed specifically for firms engaged in security-based swap dealing activities would not apply. The Exchange Act is clear that “[i]t shall be unlawful for any person to act as a security-based swap dealer unless the person is registered *as a security-based swap dealer* with the Commission” (emphasis added).²⁵ ANE Transactions constitute dealing activity in the U.S. and therefore should be taken into account for security-based swap dealer registration.

IV. The Commission Should Rely on Substituted Compliance Rather Than Granting Additional Exemptions for ANE Transactions

Any concerns about the potential for overlapping or duplicate regulation are best addressed through substituted compliance. To the extent a foreign jurisdiction has adopted comparable requirements, the Commission can allow substituted compliance for certain transactions, including for ANE Transactions. We urge the Commission to finalize and fully implement its reforms to the security-based swaps market, and begin the process of analyzing comparability with foreign jurisdictions, rather than granting additional exemptions for security-based swap dealing activity that occurs in the U.S.

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We appreciate the opportunity to provide comments on the Proposal. Please feel free to call the undersigned at (██████████) with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger

Managing Director

Global Head of Government & Regulatory Policy

²⁵ Section 15F(a) of the Exchange Act.