

MEMORANDUM

TO: File
FROM: Iliana Lundblad
RE: Meeting with MarkitSERV regarding Proposed Regulation of Security-Based Swap Execution Facilities (SB SEFs) under the Dodd-Frank Act of 2010
DATE: September 2, 2010

On August 25, 2010, Adam Glass, Haimera Workie, Michael Gaw, Darren Vieira, Geoff Pemble, Miles Treakle, David Dimitriou, Michael Reedich, Constance Kiggins, Michou Nguyen, Steven Varholik, Sarah Schandler, David Michehl, Sarah Albertson, Kathleen Gray, Thomas Eady and Iliana Lundblad, met with Jeff Gooch (CEO, MarkitSERV), Claire Lobo (Managing Director, MarkitSERV), Gina Ghent (Managing Director, MarkitSERV), Jeffrey T. Waddle (Managing Director and Senior Counsel, DTCC) and Peter Malyshev (Attorney, Winston & Strawn LLP).

The participants at the meeting discussed: (1) MarkitSERV's business operations; (2) Definition of SB SEF and security-based swap data repository; (3) Implications of the SB SEF definition on the market; (4) Proposals for rulemaking; (5) Business conduct standards; and (6) Regulatory reporting.

**Agenda for MarkitSERV Meeting with the SEC
Regarding Proposed Regulation of Swap Execution Facilities (SEFs)
Under the Dodd-Frank Act of 2010 (DFA)
on Wednesday, August 25, 2010, Washington DC, 3pm**

Attending from MarkitSERV: Jeff Gooch (CEO); Gina Ghent (managing director, equities); Claire Lobo (managing director, rates); Jeff Waddle (counsel); Peter Y Malyshev (Winston & Strawn LLP, counsel).

- 1) Overview of MarkitSERV's Business Operations
 - a) Business description / industry usage
 - b) Products / contracts covered
 - c) Confirmation of trades
 - d) Affirmation of trades

- 2) Definition of SEF
 - a) Language in the DFA
 - b) Review of the language
 - c) Entities likely covered

- 3) Discuss Implications of the SEF Definition
 - a) Compliance with the Trading Requirement
 - i) broad definition of SEF,
 - ii) increase entities covered under CFTC / SEC regulation, and
 - iii) expand reach of swaps traded, executed and trade processed on SEFs
 - b) Pre- and post-trade transparency

- 4) Proposals for Rulemaking
 - a) Define "trading", "execution", "trade processing", "make available for trading"
 - b) Define SEFs and the subcategories of 3 SEF functionalities specified in the DFA
 - i) Trading, execution and trade processing of swaps

- 5) Business Conduct Standards
 - a) Require electronic confirmation of all trades
 - b) Discuss benefits of confirmation of all swaps

- 6) Technical Assistance to the SEC and CFTC
 - a) Availability of market data
 - b) Ability to provide consolidated reports
 - c) Ability to fulfill statutory reporting functions
 - d) Aggregation function
 - e) Position limits control

- 7) Definition of SDR
 - a) Implications of practical application of SDR definition
 - b) Concurrent regulation of SEFs and SDRs

- 8) Regulatory Reporting / Public Reporting
 - a) Differences in data reported by SEFs and SDRs
 - b) Performing reporting functions for market participants



SEF Discussion

August 25, 2010



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Agenda

- Trade processing SEF market utility functions
- MarkitSERV business description
- Business environment
- Interpretation of SEF definition under the Dodd-Frank Act (DFA)
- Implications of the scope of SEF functionalities
- The "Trading Requirement" waterfall
- Categories of SEFs – trading, execution and trade processing
- SEF Diagram
- Matters to consider in rulemaking
- Business conduct standards – confirmation of all trades
- Regulatory reporting / public reporting
- Appendix A: Table with SEF categories under the DFA

MarkitSERV business description

- A trade processing facility
 - Facilitates electronic confirmation and affirmation of swap and security-based swap trades
 - Maintains an audit trail of trades and aggregates positions
- MarkitSERV processes
 - 99% of all credit default swaps for major participants
 - 77% of all interest rate swaps for major participants
 - 36% of all equity derivatives for major participants
 - Growing percentage of other commodity derivatives (fx, ag, energy)
- Interconnection for
 - 70 dealers, 70 inter-dealer brokers and 1,900 buy-side institutions and close to 20,000 funds / entities
 - Clearing houses
 - Execution platforms and facilities
 - Swap data repositories / security-based swap data repositories
 - System vendors

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Business environment

- Industry utility to drive move from paper confirmation to electronic confirmation
 - Full legal certainty of complete contract terms
 - Almost instantaneous confirmation (T+0)
 - Industry take up of straight-through-processing
 - Standardization of trade transaction format
 - Standardization of industry business practices and processes
 - Enables participants to monitor trade status during execution and life-cycle events and straight-through-process status notifications
 - Ability to report transactions and maintain the audit-trails
 - Real-time links to other platforms (execution venues, clearinghouses, compression providers, other vendor workflow platforms, trade repositories)

Interpretation of SEF definition under the Dodd-Frank Act (DFA)

- Definitional section in the DFA (§ 721) for "swap execution facilities" / (§ 761) for "security-based swap execution facilities"
 - Appears to cover only “trading facilities” and multiple-to-multiple execution and trading facilities.

BUT

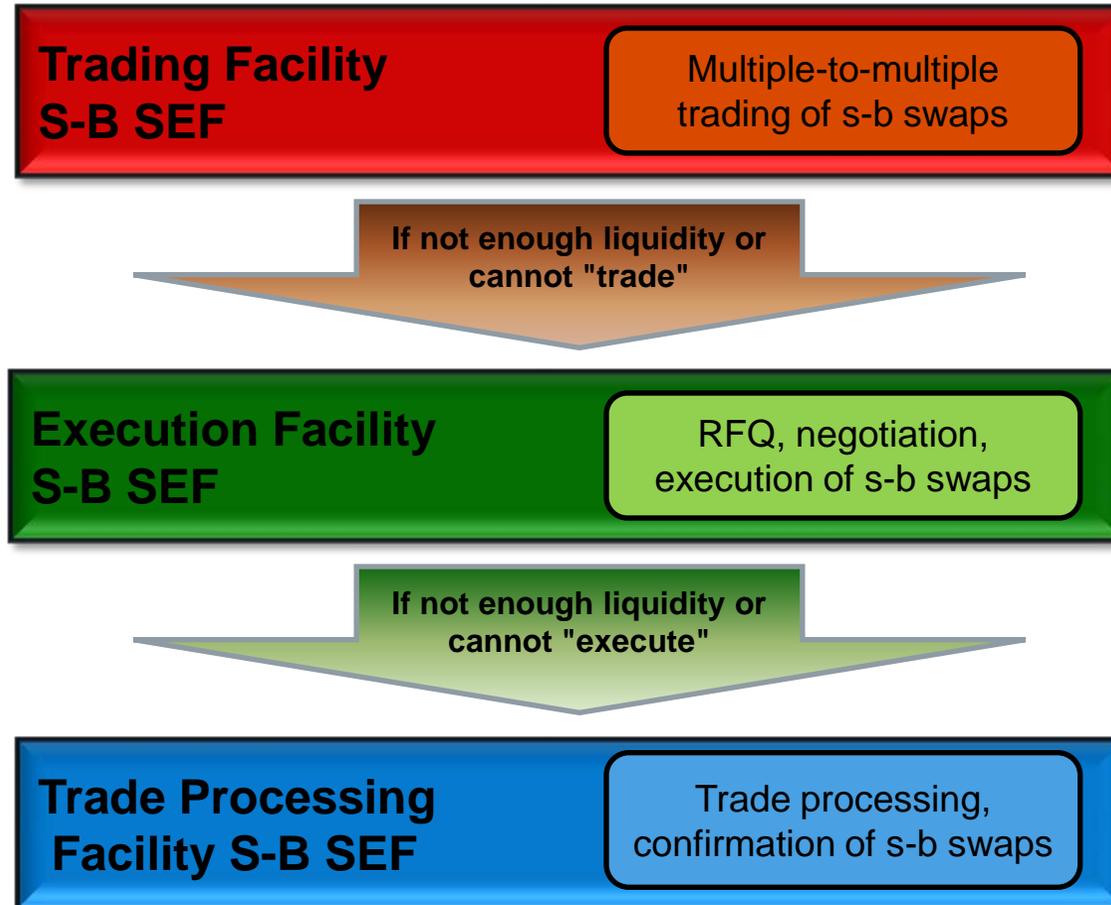
- Registration / operative provisions section of the DFA (§733) / (§763) for "security-based swap execution facilities"
 - Requires any entity that operates a facility for the *trading* OR *trade processing* of swaps must register.
 - Note, this provision does not require a SEF to register, but “any entity” that conducts regulated activities, such as trading OR trade processing of security-based swaps must register.
- The SEC / CFTC have the authority to further define the terms
- Separate registration for SEC-regulated security-based SEFs and CFTC-regulated SEFs
- MarkitSERV is a classic example of a “trade processing” facility

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Implications of the scope of SEF functionalities

- Compliance with the "Trading Requirement" in the DFA
 - For cleared swaps -
 - Trade, execute or trade process security-based swaps on a SEF or a national securities exchange (NSE),
 - provided that SEF or NSE makes them available for trading (subject to SEC's specific designation)
- Implications
 - The broader the definition of SEF:
 - the broader the functionalities that SEFs can perform,
 - the more entities covered and supervised under CFTC / SEC regulation, and
 - the more swaps traded, executed and trade processed on SEFs
 - The narrower the definition of SEF:
 - the opposite is true
- Suitability of SEF or NSE for "trading"
 - Several illiquid futures contracts failed in the past on CFTC-regulated DCMs
 - Inherent lack of liquidity for some swaps

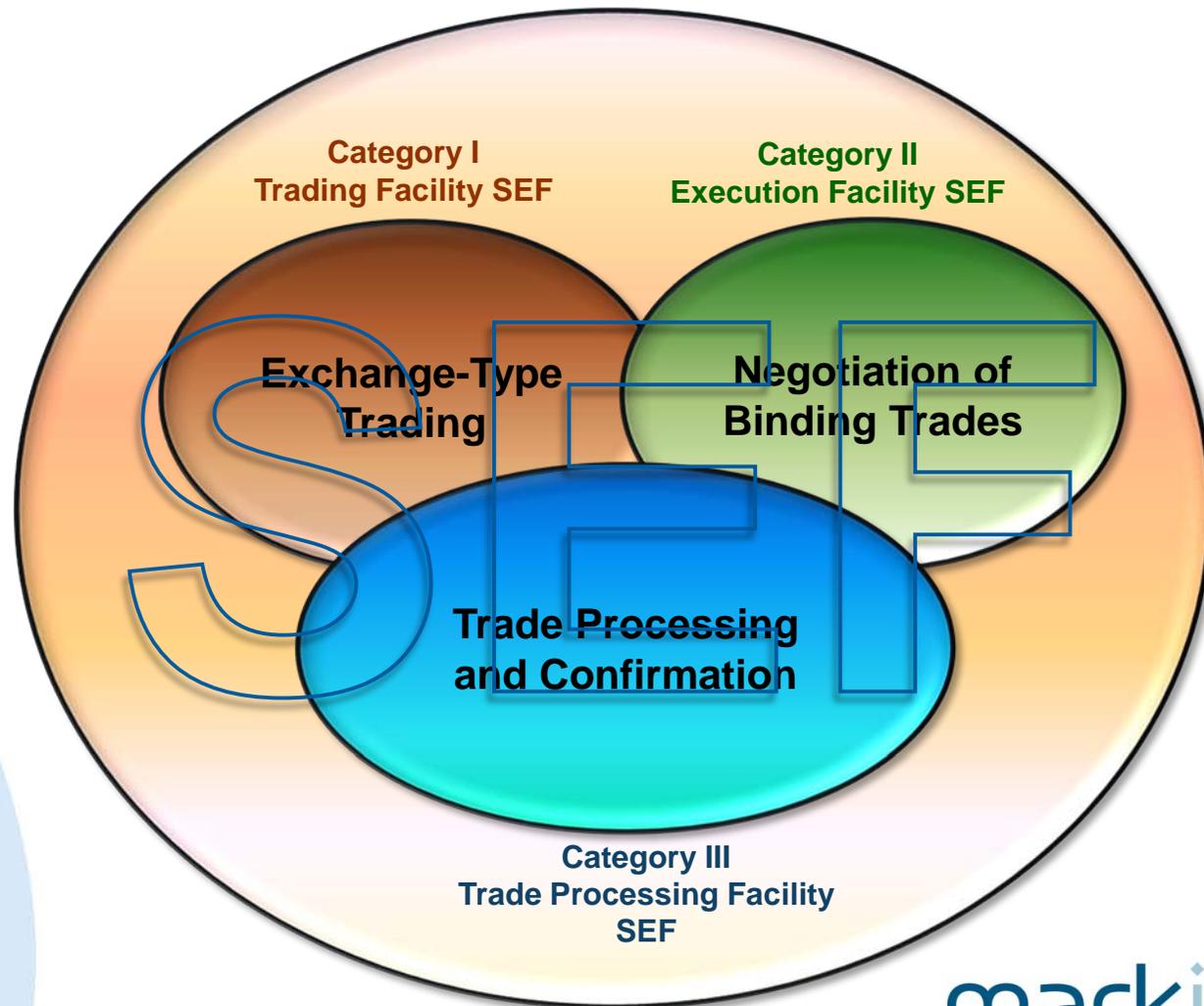
The "Trading Requirement" waterfall



Categories of SEFs

- Based on the DFA language, the following could qualify as SEFs:
 - Category I – “**Trading Facility SEF**”
 - An exchange, open order book, many-to-many
 - Eligible to fulfill the "Trading Requirement"
 - Category II – “**Execution Facility SEF**”
 - An RFQ, inter-dealer system, many-to-many, 1-to-many, negotiation facility, other similar facilities where a binding swap is executed on the facility
 - Eligible to fulfill the "Trading Requirement" if unavailable on Category I SEF
 - Category III – “**Trade Processing SEF**”
 - A trade processing / confirmation / affirmation facility
 - Eligible to fulfill the "Trading Requirement" if:
 - swap cannot trade on or be executed on Category I or Category II SEF, or
 - If non-competitively executed and posted on such SEF (e.g., block trade, ESS)
- One entity can register and qualify as all 3 categories, or can register as any separate category:
 - All trades must be confirmed through Category III SEF or by other categories of SEFs with Category III functionality and registration.

S-B SEF diagram



Matters to consider in rulemaking

- Definitions
 - “trading”, “execution”, “trade processing”, “make available for trading any swap”; and “facilitate trade processing of any swap”

- Unintended consequences
 - Narrow definition of S-B SEF will:
 - Leave many facilities unregulated
 - Limit participants’ ability to comply with the "Trading Requirement"
 - Reduce trade transparency below current levels

- Aggregation of positions
 - An interconnected S-B SEF can perform a critical function of aggregating open positions for swaps per asset category

Business conduct standards – confirmation of all trades

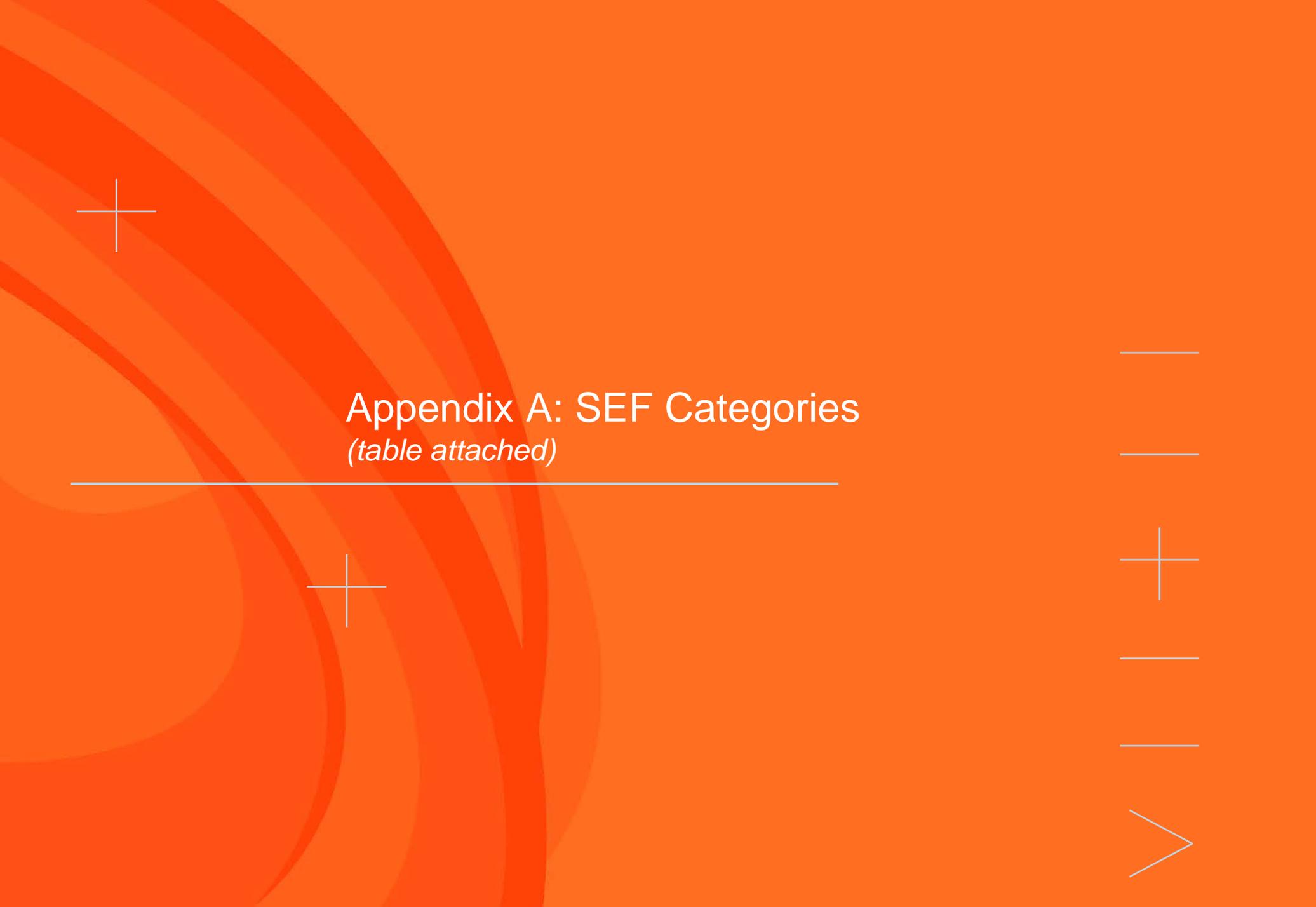
- Consider
 - Requirement that all (cleared and non-cleared) swaps be trade processed and electronically confirmed by swap dealers and major swap participants
 - In conjunction with the requirement of reporting of all swaps
- Quality of data and legal certainty for all asset classes
 - Requirement to confirm will ensure that transaction data (in addition to open positions) is captured on all trade levels and for all life cycle events (e.g., novations, unwinds, amendments, terminations, corporate actions)
- Universal audit-trail
 - This requirement will ensure that:
 - all swaps will be accompanied with an audit-trail
 - in addition to the mandatory reporting requirement of s-b swaps open positions

Regulatory reporting / public reporting

- Differences in data capture between S-B SEFs (with Category III functionality) and S-B SDRs
 - SEFs:
 - Capture dynamic data, create an audit trail, document corporate life cycle events
 - (e.g., detailed account statement for your checking account)
 - SDRs:
 - Capture a snapshot of an open position
 - (e.g., monthly ending balance of your checking account)
- SEF of Category III
 - Can act as a universal adapter for all other SEFs, CCP / DCOs, NSEs/ DCMs, S-B SDRs / SDRs, s-b swap dealers and major swap participants and other market participants in fulfilling regulatory and public reporting functions
 - All trades on Category I or II SEFs must be confirmed on a separate Category III SEF or as part of their own Category III SEF business.

Trade processing SEF market utility functions

- Summary
 - Perform trade processing (pre-confirmation and confirmation services)
 - Fulfill the “Trading Requirement” for illiquid and non-competitively negotiated swaps
 - Ensure transparency
 - Electronically confirm all swap transactions
 - Maintain an audit trail
 - Provide position aggregation functions
 - Perform regulatory and public reporting



Appendix A: SEF Categories

(table attached)

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Discussion Topics Concerning Swap Execution Facilities (SEFs) under the Dodd-Frank Act (DFA)

The SEF definition as well as the operative provisions of the DFA specify that SEFs perform three discrete functions – they provide the platform to: (i) “trade”; (ii) “execute”; and (iii) “trade process” the swaps.¹ Because the legislator used these specific and distinct terms, it appears that the legislative intent is to describe three separate and distinct functions of the SEFs, which are accordingly grouped into three categories described below: (a) Category I – the “*Trading Facility SEF*”; (b) Category II – the “*Execution Facility SEF*” (with three subcategories A, B, and C); and (c) Category III – the “*Trade Processing / Confirmation Facility SEF*” (or a Non-Execution Facility SEF). It also appears that the legislative intent was to require that all transactions benefit from legal confirmation, processing, netting, documentation, and valuation of all swaps, aggregate reporting and other services provided by Category III SEFs. It is possible that the same SEF entity would be able to qualify as Category I, II and III SEF or as either of these categories taken separately.

Categories of SEFs	Applicable Provisions in the DFA and the CEA	Functionality	Liquidity / Frequency of Trades	Regulation / Comments	Existing Examples	Regulatory Implications / the “Trading Requirement” Waterfall
Category I “Trading Facility” SEF	- “Multiple participants have the ability to execute or trade agreements, contracts, or transactions... through the interaction of multiple bids or multiple offers within a system with a predetermined non-discretionary automated trade matching and execution algorithm” ; (CEA 1a(34)(A)(ii)) ² - Makes “available for trading any swap” (DFA, CEA 5(h)(b)(1)(A)) ³	Exchange-type <i>algorithmic matching</i> and an open order book of trades	Liquidity High, Multiple bids / offers	SEF Definition ⁴ and SEF operative provisions. ⁵ SEF definition specifically includes “trading facilities”. Regardless of the method of trading and execution, all trades must be confirmed on Category III SEF (or by Category I SEF with Category III SEF functionality).	Many existing exempt commercial markets (ECMs) – trading facilities	<i>Exchange-Type or Trading Facility.</i> For exchange-type “trading facilities”; most of the rules and regulations applicable to ECMs and the SEF new core principles will apply in full. Mandatory trading requirement for cleared swaps with sufficient trading characteristics <i>will be</i> satisfied on these SEFs.

¹ See suggested definitions for these terms provided at the end of this document in Explanatory Notes.

² See Commodity Exchange Act (CEA) Sec. 1a(34)(A)(ii) – numbering before the amendment by the DFA.

³ CEA after amendment by the DFA. Also, see B. Lincoln colloquy to the Senate below.

⁴ DFA §721 “(50) SWAP EXECUTION FACILITY.-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 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.”

⁵ DFA §733. “5h. SWAP EXECUTION FACILITIES. (a) REGISTRATION.- (1) IN GENERAL.-No person may operate a facility for the trading or processing of swaps unless the facility is registered as a swap execution facility or as a designated contract market under this section. (2) DUAL REGISTRATION.- Any person that is registered as a swap execution facility under this section shall register with the Commission regardless of whether the person also is registered with the Securities and Exchange Commission as a swap execution facility.(b) TRADING AND TRADE PROCESSING.- (1) IN GENERAL.-Except as specified in paragraph (2), a swap execution facility that is registered under subsection (a) may-(A) make available for trading any swap; and (B) facilitate trade processing of any swap. (2) AGRICULTURAL SWAPS.-A swap execution facility may not list for trading or confirm the execution of any swap in an agricultural commodity (as defined by the Commission) except pursuant to a rule or regulation of the Commission allowing the swap under such terms and conditions as the Commission shall prescribe. (c) IDENTIFICATION OF FACILITY USED TO TRADE SWAPS BY CONTRACT MARKETS.- A board of trade that operates a contract market shall, to the extent that the board of trade also operates a swap execution facility and uses the same electronic trade execution system for listing and executing trades of swaps on or through the contract market and the swap execution facility, identify whether the electronic trading of such swaps is taking place on or through the contract market or the swap execution facility. (d) RULE-WRITING.- (1) The

Categories of SEFs	Applicable Provisions in the DFA and the CEA	Functionality	Liquidity / Frequency of Trades	Regulation / Comments	Existing Examples	Regulatory Implications / the “Trading Requirement” Waterfall
Category II Execution Facility SEF <i>(with 3 sub-categories A, B, and C)</i>	- “Multiple participants have the ability to execute or trade agreements, contracts, or transactions...by accepting bids of offers made by other participants that are open to multiple participants in the facility or system” (CEA . 1a(34)(A)(i))	Facility where <i>trades are binding</i> when executed on the platform, but no algorithmic matching	Liquidity High, Multiple bids / offers	Meets the definition of a “trading facility” in the CEA (first prong of the definition). Regardless of the method of execution, all trades must be confirmed on Category III SEF (or by Category II SEF with Category III SEF functionality).	Execution facility	(A) Multiple Participant Execution Facility. Most of the ECM provisions and new core principles will apply, except that automatic algorithmic matching provisions need not apply. Mandatory trading requirement for cleared swaps with sufficient trading characteristics <i>will be</i> satisfied on these SEFs.
	- “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 any means of interstate commerce ... that-	Implies only <i>multiple to multiple</i> trading and execution is included	Liquidity High, Multiple bids / offers	SEF definition in the DFA that describes SEFs that are other than “trading facilities”. It is possible to demonstrate multiple-to-multiple participation on some (request for quote) RFQ platforms.	RFQ, <i>interdealer</i> platforms with active participation of multiple participants will qualify	
	- facilitates the execution of swaps between persons” (DFA, CEA 1a(50)) - Makes “available for trading any swap” (DFA, CEA 5(h)(b)(1)(A)). ⁶	“have the ability” and “facilitates” may imply that 1-to-1, 1-to-many, illiquid RFQ, voice brokerage facilities may be included	Liquidity Low, Very few or no multiple bids / offers	Some non-multiple to multiple facilities will qualify. The definition of the SEF clearly shows legislative intent to include in the definition some facilities <i>in addition to</i> simply “trading facilities”; otherwise legislator would have simply merged the SEF definition with the DCM (exchange – trading facility) definition.	Illiquid RFQ facility; voice brokerage facility; <i>intra</i> dealer platforms	(B) Non-Multiple Participant Execution Facility. Some of the new core principles will apply. Mandatory trading requirement for cleared products <i>will be</i> satisfied on these SEFs, provided that: (i) they are registered; (ii) the contract is “illiquid” to fulfill multiple-to-multiple trading requirement; and (iii) real time reporting requirements are

Securities and Exchange Commission and Commodity Futures Trading Commission may promulgate rules defining the universe of swaps that can be executed on a swap execution facility. These rules shall take into account the price and nonprice requirements of the counterparties to a swap and the goal of this section as set forth in subsection (e). (2) For all swaps that are not required to be executed through a swap execution facility as defined in paragraph (1), such trades may be executed through any other available means of interstate commerce. (3) The Securities and Exchange Commission and Commodity Futures Trading Commission shall update these rules as necessary to account for technological and other innovation. (e) RULE OF CONSTRUCTION.-The goal of this section is to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market.

⁶ In connection with this phrase, note that Senate Agriculture Committee Chairman B. Lincoln in her colloquy stated: “the CFTC should take a practical rather than a formal or legalistic approach...whether, as a practical matter, it is in fact possible to trade a swap on the facility... should consider... whether there is a minimum amount of liquidity such that the swap can actually be traded on the facility, without a minimum amount of liquidity to make trade possible, should not be sufficient to trigger the Trade Execution Requirement.” (“**Lincoln Colloquy**” – Congressional Record – S5919, July 15, 2010).

Categories of SEFs	Applicable Provisions in the DFA and the CEA	Functionality	Liquidity / Frequency of Trades	Regulation / Comments	Existing Examples	Regulatory Implications / the “Trading Requirement” Waterfall
						met (as specified for this facility).
		“have the ability” and “facilitates” implies that negotiation of <i>non-binding</i> trades is possible if “facilitates” execution of swaps	Liquidity Low, No multiple bids / offers	Not all of the core principles will apply. This type of facility allows participants to negotiate and execute a binding trade on the facility. Regardless of the method of execution, all trades must be confirmed on Category III SEF (or by Category II SEF with Category III SEF functionality).	Negotiation facility; bulletin board-type facility	<i>(C) Negotiation Facility.</i> Some of the new core principles will apply. Mandatory trading requirement for cleared products will be satisfied on these SEFs, provided that: (i) they are registered; (ii) the contract is “illiquid” to fulfill multiple-to-multiple trading requirement; and (iii) real time reporting requirements are met (as specified for this facility).
Category III Trade Processing / Confirmation Facility SEF	- “No person may operate a facility for the trading or processing of swaps unless the facility is registered as a swap execution facility... under this section.” (DFA, CEA 5(h)(a)(1)). - “ facilitate trade processing of any swap” (DFA, CEA 5(h)(b)(1)(B)).	Electronic screen based trade processing and confirmation process. Trading (and execution) functionality is captured by Categories I and II. No algorithmically matched or executed trades occur on the platform; multiple is likely satisfied by open access to the platform; block trades	High or Low, or None (e.g., only two participants in the market) Can accommodate trade processing of every possible transaction regardless of how it is traded, executed, negotiated	This provision is much broader than the definition of the SEF because mandates <i>any entity</i> trading or processing swaps to register as a SEF. Note, the definition does not say that a SEF must register, but states instead that any entity that performs trading or trade processing functions must register as a SEF §733. Will depend on how the CFTC further defines “trading or processing of swaps” (see suggested definitions below). Such facility need not both trade and process, merely trade	Electronic trade processing and confirmation facilities	Trade Processing and Confirmation Facility (the non-execution SEF). Some of the new core principles will apply. Mandatory trading requirement for cleared products will be satisfied on these SEFs, provided that: (i) they are registered; (ii) the contract is “illiquid” to fulfill multiple-to-multiple requirement; and (iii) real time reporting requirements are met (as specified for this facility). To fulfill the confirmation requirement in business standards, swap dealers and major swap participants must trade process, confirm or affirm trades on SEFs of this category or on facilities that perform the

Categories of SEFs	Applicable Provisions in the DFA and the CEA	Functionality	Liquidity / Frequency of Trades	Regulation / Comments	Existing Examples	Regulatory Implications / the “Trading Requirement” Waterfall
		are possible and other non-competitive forms of execution (analogy to EFP, EFS, give-ups, etc.). Provides trade information capture, legal confirmation, audit trails, etc.	or cleared.	processing is sufficient to be subject to registration if this SEF intends to fulfill the mandatory trading requirement in the DFA on this facility.		trade processing functions (that by definition in the DFA must register as SEFs). ⁷ Category I and Category II SEFs may contract with or delegate to Category III SEF to fulfill their “trade processing” requirements of data capture, legal confirmation, etc.

Explanatory Notes:

“Trading” – The term “trading” of swaps on a swap execution facility means the interaction of multiple bids or multiple offers within a system with a predetermined non-discretionary automated trade matching and execution algorithm.

“Execution” – The term “execution” of swaps on a swap execution facility means accepting bids or offers made by other participants that are open to multiple participants in the facility or system.

“Trade processing” – The term “processing” or “trade processing” of swaps on a swap execution facility means: (i) electronic confirmation, affirmation or any other electronically recordable method of interstate communication used by two participants to document a legally binding swap; or (ii) electronic negotiation of the terms of and entering into bilateral transactions in swaps as a result of communications exchanged by participants and not as a result of trading or execution of swaps; or (iii) posting on the swap execution facility of non-competitively executed swaps entered into by two participants by means of block trades, give ups, exchanges of risk, or any other lawful method of competitive or non-competitive execution authorized by the Commission.

“Make available for trading” – The phrase “make available for trading” means: (i) making the swap execution facility available for trading by participants of an instrument that the CFTC has determined is subject to the trading requirement in section 2(h)(8) of the Act⁸ and the swap

⁷ See DFA §731; CEA §4s(i) as amended by the DFA. To carry out documentation and recordkeeping requirements of the DFA, the CFTC should consider adopting a rule requiring that all swap trades, regardless of whether they are cleared or not, be documented, trade processed, confirmed or affirmed on SEFs of Category III (unless they are already documented or confirmed on SEFs of Categories I and II via the functionalities of Category III).

execution facility can demonstrate sufficient liquidity in the instrument consistent with prevailing market practices; (ii) making the swap execution facility available for execution by participants of an instrument that the CFTC has determined is subject to the trading requirement in section 2(h)(8) of the Act; and (iii) trade processing of such swap in the event that trading or execution is not possible as a result of insufficient market liquidity for such swap, a small number of participants trading or executing such swap, or a high degree of customization of such swap. The phrase “facilitates the execution of swaps between persons” shall have the same meaning.

Additional Requirement to Consider (under DFA §731 and CEA §4s(i) – Documentation Standards for Swap Dealers and Major Swap Participants):

To ensure that swap dealers and major swap participants not only report their open positions to the swaps data repositories and the Commission, but also maintain an audit trail of all their trades, the swap dealers and major swap participants must be obligated to electronically confirm their swap trades to maintain detailed electronic audit trails of all their transactions in swaps. The requirement of “trading” and “execution” of swaps will ensure that swap execution facilities and the designated contract markets will maintain their audit trails and will generate confirmations; particularly, if the SEFs and DCMs are required to perform all the confirmation, affirmation and data capture functions performed by the Category III SEFs. However those swaps that are not traded or executed on the SEFs or the DCMs, and are either cleared or not cleared – must be trade processed to ensure that they are properly confirmed and that a detailed audit trail is created in every instance.

“It shall be unlawful for a swap dealer or a major swap participant to enter into swaps unless such swap dealer or a major swap participant trades, executes, or trade processes the swap on a swap execution facility.”

⁸ It is expected that the CFTC rule-making will require two components of “make available for trading” for Category I SEFs: (1) the CFTC has determined that the particular instrument has appropriate characteristics (liquidity, standardization, *etc.*) such that it may be traded on a Category I SEF, ***and*** (2) a Category I SEF actually offers the instrument for trading (with “offers for trading” being defined to require specific liquidity metrics, *e.g.*, minimum number of bids/offers, spreads, *etc.*). The regulations should not require a particular manner of trading or execution that cannot be achieved, thereby actually eliminating liquidity that exists today.