

## SWAP EXECUTION FACILITY CLARIFICATION ACT

DECEMBER 23, 2011.—Ordered to be printed

Mr. BACHUS, from the Committee on Financial Services,  
submitted the following

### R E P O R T

[To accompany H.R. 2586]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 2586) to refine the definition of swap execution facility in the provisions regulating swap markets added by title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike all after the enacting clause and insert the following:

#### SECTION 1. SHORT TITLE.

This Act may be cited as the “Swap Execution Facility Clarification Act”.

#### SEC. 2. DEFINITION OF SWAP EXECUTION FACILITY.

(a) COMMODITY EXCHANGE ACT.—Section 1a(50) of the Commodity Exchange Act (7 U.S.C. 1a(50)) is amended—

(1) by striking “The term” and inserting the following:

“(A) IN GENERAL.—The term”;

(2) by redesignating subparagraphs (A) and (B) as clauses (i) and (ii), respectively (and by moving the margins 2 ems to the right); and

(3) by adding at the end the following:

“(B) INTERPRETATION.—In interpreting or further defining the term ‘swap execution facility’, the Commission shall not require a swap execution facility to—

“(i) have a minimum number of participants receive a bid or offer or respond to any trading system or platform functionality;

“(ii) display or delay bids or offers for any period of time;

“(iii) limit the means of interstate commerce utilized by market participants to enter into and execute any swap transactions on the trading system or platform; or

“(iv) require bids or offers on one trading system or platform operated by the swap execution facility to interact with bids or offers on another trading system or platform operated by the swap execution facility”.

(b) SECURITIES EXCHANGE ACT OF 1934.—Section 3(a)(77) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(77)) is amended—

(1) by striking “The term” and inserting the following:

“(A) IN GENERAL.—The term”;

(2) by redesignating subparagraphs (A) and (B) as clauses (i) and (ii), respectively (and by moving the margins 2 ems to the right); and

(3) by adding at the end the following:

“(B) INTERPRETATION.—In interpreting or further defining the term ‘security-based swap execution facility’, the Commission shall not require a security-based swap execution facility to—

“(i) have a minimum number of participants receive a bid or offer or respond to any trading system or platform functionality;

“(ii) display or delay bids or offers for any period of time;

“(iii) limit the means of interstate commerce utilized by market participants to enter into and execute any security-based swap transactions on the ‘method of trading functionality; or

“(iv) require bids or offers on one trading system or platform operated by the swap execution facility to interact with bids or offers on another method of trading functionality operated by the swap execution facility.”.

#### PURPOSE AND SUMMARY

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (PL 111–203) requires that cleared swaps be executed either on exchanges or on swap execution facilities (SEFs) regulated by either the Commodity Futures Trading Commission (CFTC) or the Securities and Exchange Commission (SEC). The drafters of the Dodd-Frank Act intended for SEFs to serve as an alternative to exchanges by providing an execution facility for illiquid or thinly-traded swaps. The CFTC’s and SEC’s proposed rules for SEFs, however, fail to provide the flexibility necessary to execute illiquid or thinly-traded swaps. Introduced by Representatives Garrett, Maloney, Hurt, and Meeks, H.R. 2586, the “Swap Execution Facility Clarification Act,” directs the CFTC and SEC to promulgate SEF rules that would effectuate Congress’s intent that SEFs serve as an alternative to exchanges and provide an execution facility for illiquid or thinly-traded swaps.

In order to ensure that SEFs provide a viable means of execution for illiquid or thinly-traded swaps, H.R. 2586 prohibits the CFTC and the SEC from requiring a SEF to have a minimum number of participants receive bids or offers. The bill also prohibits the CFTC and the SEC from requiring that market participants request or receive more than one quote, and from requiring SEFs to display or delay bids or offers for a specific time period. H.R. 2586 permits market participants to use any means of interstate commerce to execute swap transactions and prohibits the CFTC or SEC from writing rules that allow only voice-based and hybrid trading models for the execution of block trades. Finally, the bill prohibits the CFTC and SEC from requiring SEFs that operate multiple trading systems to force those systems to interact with each other to execute swap transactions.

#### BACKGROUND AND NEED FOR LEGISLATION

The Dodd-Frank Act requires the CFTC and the SEC to draft rules governing SEFs. While Congress intended that SEFs would provide a venue for executing illiquid or thinly-traded swaps, market participants have pointed out that the proposed rules are overly prescriptive and would inhibit the execution of swap trades.

Market participants have identified the following shortcomings in the proposed rules. First, the CFTC's proposed rules would require market participants to obtain at least five quotes through a "request for quote" system before entering into a swap transaction. This requirement forces market participants to reveal confidential trading strategies to at least five market participants. Second, the SEC's and CFTC's proposed rules would require a SEF to display or delay quotes for a specific period of time. Market participants have pointed out that this rule is ill-suited for the swaps market, where timing delays will cause confusion and poor trade execution because swap markets do not have the continuous pricing and trading that characterize equity markets. Third, the CFTC's rules limit the means by which market participants may execute non-block trades on a SEF. Finally, under the SEC's proposed rule, multiple trading systems would be required to interact with each other on the same SEF, which would force large trades to be broken up and prevent market participants from executing large trades that fall short of a block trade. H.R. 2586 prohibits the SEC and CFTC from including these requirements in their SEF rules, thereby enabling market participants to more easily execute illiquid or thinly-traded swaps.

At a legislative hearing on H.R. 2586 held by the Subcommittee on Capital Markets and Government-Sponsored Enterprises on October 14, 2011, Conrad Voldstad, Chief Executive Officer of the International Swaps and Derivatives Association, explained that H.R. 2586 would "correct a number of flaws in the current proposed regulatory interpretation and better align the proposed rules with Congressional intent." Mr. Voldstad also testified that the proposed SEF rules "have the potential to significantly and adversely affect the dynamics of the swaps market by reducing liquidity and choice and by increasing costs and ultimately risks for OTC derivatives markets participants." During that same hearing, Shawn Bernardo, Chairman of the Wholesale Markets Brokers Association, testified that the "SEF Clarification Act will provide regulators with a clear expression of Congress' legislative intent and ensure that the final rules remain within the framework of competitive OTC markets." Brenda Boulwood, Chief Risk Officer and Senior Vice President of Constellation Energy, testified on behalf of the Coalition of Derivatives End-Users at the October 14 hearing and stated that "we support the goals of H.R. 2586," which she said seeks to "ensure that end-users will have a variety of options for hedging their risk."

#### HEARING

On October 14, 2011, the Subcommittee on Capital Markets and Government-Sponsored Enterprises held a hearing entitled "Legislative Proposals to Bring Certainty to the Over-the-Counter Derivatives Market," to consider H.R. 2586, and four other bills. This was a one-panel hearing, and the following witnesses testified:

- Mr. Keith Bailey, Managing Director, Fixed Income, Currencies and Commodities, Barclays Capital, on behalf of the Institute of International Bankers
- Mr. Shawn Bernardo, Senior Managing Director, Tullett Prebon, on behalf of the Wholesale Market Brokers' Association Americas

- Ms. Brenda Boulwood, Chief Risk Officer and Senior Vice President, CE Risk Management Division Office, Constellation Energy, on behalf of the Coalition of Derivatives End-Users
- Mr. James Cawley, CEO, Javelin Capital Markets LLC
- Mr. Kent Mason, Davis & Harman LLP, on behalf of the American Benefits Council and the Committee on the Investment of Employee Benefit Assets
- Mr. Conrad Voldstad, Chief Executive Officer, International Swaps and Derivatives Association

#### COMMITTEE CONSIDERATION

The Subcommittee on Capital Markets and Government-Sponsored Enterprises met in open session on November 15, 2011, and ordered H.R. 2586 favorably reported to the full Committee by voice vote.

On November 30, 2011, the Committee on Financial Services met in open session and ordered H.R. 2586, as amended, favorably reported to the House by voice vote.

#### COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. A motion by Chairman Bachus to report the bill, as amended, to the House with a favorable recommendation was agreed to by a voice vote.

During consideration of H.R. 2586 by the Committee, the following amendments were considered:

1. An amendment offered by Ms. Waters, no. 2, to strike all after the enacting clause and require, within three months, the SEC and CFTC to jointly establish rules to interpret and define the terms “swap execution facility” and “security-based swap execution facility,” was not agreed to by a record vote of 23 yeas and 31 nays (Record vote no. FC–54).

#### RECORD VOTE NO. FC–54

Representative	Aye	Nay	Present	Representative	Aye	Nay	Present
Mr. Bachus .....		X	.....	Mr. Frank (MA) .....	X		.....
Mr. Hensarling .....		X	.....	Ms. Waters .....	X		.....
Mr. King (NY) .....		X	.....	Mrs. Maloney .....	X		.....
Mr. Royce .....		X	.....	Mr. Gutierrez .....			.....
Mr. Lucas .....		X	.....	Ms. Velázquez .....			.....
Mr. Paul .....			.....	Mr. Watt .....	X		.....
Mr. Manzullo .....		X	.....	Mr. Ackerman .....	X		.....
Mr. Jones .....	X		.....	Mr. Sherman .....	X		.....
Mrs. Biggert .....		X	.....	Mr. Meeks .....	X		.....
Mr. Gary G. Miller (CA) .....		X	.....	Mr. Capuano .....	X		.....
Mrs. Capito .....		X	.....	Mr. Hinojosa .....	X		.....
Mr. Garrett .....		X	.....	Mr. Clay .....	X		.....
Mr. Neugebauer .....		X	.....	Mrs. McCarthy (NY) .....	X		.....
Mr. McHenry .....		X	.....	Mr. Baca .....	X		.....
Mr. Campbell .....		X	.....	Mr. Lynch .....	X		.....
Mrs. Bachmann .....			.....	Mr. Miller (NC) .....	X		.....
Mr. McCotter .....		X	.....	Mr. David Scott (GA) .....	X		.....
Mr. McCarthy (CA) .....		X	.....	Mr. Al Green (TX) .....			.....
Mr. Pearce .....		X	.....	Mr. Cleaver .....	X		.....
Mr. Posey .....		X	.....	Ms. Moore .....	X		.....
Mr. Fitzpatrick .....		X	.....	Mr. Ellison .....	X		.....
Mr. Westmoreland .....		X	.....	Mr. Perlmutter .....	X		.....

## RECORD VOTE NO. FC-54—Continued

Representative	Aye	Nay	Present	Representative	Aye	Nay	Present
Mr. Luetkemeyer .....		X	.....	Mr. Donnelly .....	X		.....
Mr. Huizenga .....		X	.....	Mr. Carson .....			.....
Mr. Duffy .....		X	.....	Mr. Himes .....	X		.....
Ms. Hayworth .....		X	.....	Mr. Peters .....	X		.....
Mr. Renacci .....		X	.....	Mr. Carney .....			.....
Mr. Hurt .....		X	.....				
Mr. Dold .....		X	.....				
Mr. Schweikert .....		X	.....				
Mr. Grimm .....		X	.....				
Mr. Canseco .....		X	.....				
Mr. Stivers .....		X	.....				
Mr. Fincher .....		X	.....				

The following amendment and motion were also considered by the Committee:

1. An amendment offered by Mr. Garrett, no. 1, to make technical changes, was agreed to by voice vote.
2. A motion offered by Mr. Hurt to move the previous question on H.R. 2586 was agreed to by voice vote.

## COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee has held hearings and made findings that are reflected in this report.

## PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee establishes the following performance related goals and objectives for this legislation:

The objective of H.R. 2586, the “Swap Execution Facility Clarification Act,” is to direct the Commodity Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) to promulgate rules governing the operations of swap execution facilities (SEFs) that would effectuate Congress’s intent that SEFs serve as an alternative to exchanges and provide an execution facility for illiquid or thinly-traded swaps. Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (PL 111–203) requires that cleared swaps be executed either on exchanges or on SEFs regulated by either the CFTC or the SEC. The drafters of the Dodd-Frank Act intended for SEFs to serve as an alternative to exchanges by providing an execution facility for illiquid or thinly-traded swaps. The CFTC’s and SEC’s proposed rules for SEFs, however, fail to provide the flexibility necessary to execute illiquid or thinly-traded swaps.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND  
TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

## COMMITTEE COST ESTIMATE

The Committee adopts as its own the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

## CONGRESSIONAL BUDGET OFFICE ESTIMATE

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

DECEMBER 14, 2011.

Hon. SPENCER BACHUS,  
*Chairman, Committee on Financial Services,  
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 2586, the Swap Execution Facility Clarification Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Susan Willie.

Sincerely,

DOUGLAS W. ELMENDORF.

Enclosure.

*H.R. 2586—Swap Execution Facility Clarification Act*

The Dodd-Frank Wall Street Reform and Consumer Protection Act established entities known as swap execution facilities (SEFs) where multiple parties are able to trade swaps. (A swap is a contract that calls for an exchange of cash between two participants based on an underlying rate or index, or on the performance of an asset).

H.R. 2586 would amend the definition of an SEF to prevent the regulatory agencies—the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC)—from imposing certain requirements on such facilities. The bill would prevent the agencies from developing regulations that require an SEF to follow certain business practices, such as setting a minimum number of participants to receive a bid.

Neither the CFTC nor the SEC has finalized regulations regarding swap execution facilities. Based on information from the two agencies, CBO expects that incorporating the provisions of H.R. 2586 at this point in the regulatory process would not have a significant effect on the workload of either agency. Therefore, CBO estimates that any change in discretionary spending to implement the legislation, which would be subject to the availability of appropriated funds, would not be significant. Enacting H.R. 2586 would not affect direct spending or revenues; therefore, pay-as-you-go procedures do not apply.

H.R. 2586 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would impose no costs on state, local, or tribal governments.

The CBO staff contact for this estimate is Susan Willie. The estimate was approved by Theresa Gullo, Deputy Assistant Director for Budget Analysis.

## FEDERAL MANDATES STATEMENT

The Committee adopts as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates Reform Act.

## ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

## APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

## EARMARK IDENTIFICATION

H.R. 2586 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9 of rule XXI.

## SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

*Section 1. Short title*

This section provides a short title to the bill by citing it as the “Swap Execution Facility Clarification Act.”

*Section 2. Definition of swap execution facility*

This section amends the definition of a “swap execution facility” in Section 1(a)(50) of the Commodity Exchange Act, and the definition of a “security-based swap execution facility” in Section 3(a)(77) of the Securities and Exchange Act of 1934, by prohibiting the Commodity Futures Trading Commission and the Securities Exchange Commission from requiring a swap execution facility or a securities-based swap execution facility to (i) have a minimum number of participants receive a bid or offer or respond to any trading system or platform functionality; (ii) display or delay bids or offers for any period of time; (iii) limit the means of interstate commerce utilized by market participants to enter into and execute any swap transactions on the trading system or platform; or (iv) require bids or offers on one trading system or platform operated by the swap execution facility to interact with bids or offers on another trading system or platform operated by the swap execution facility.

## CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

COMMODITY EXCHANGE ACT

\* \* \* \* \*

SEC. 1a. DEFINITIONS.

As used in this Act:

(1) \* \* \*

\* \* \* \* \*

(50) SWAP EXECUTION FACILITY.—[The term]

(A) IN GENERAL.—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)] (i) facilitates the execution of swaps between persons; and

[(B)] (ii) is not a designated contract market.

(B) INTERPRETATION.—In interpreting or further defining the term “swap execution facility”, the Commission shall not require a swap execution facility to—

(i) have a minimum number of participants receive a bid or offer or respond to any trading system or platform functionality;

(ii) display or delay bids or offers for any period of time;

(iii) limit the means of interstate commerce utilized by market participants to enter into and execute any swap transactions on the trading system or platform; or

(iv) require bids or offers on one trading system or platform operated by the swap execution facility to interact with bids or offers on another trading system or platform operated by the swap execution facility

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SECURITIES EXCHANGE ACT OF 1934

TITLE I—REGULATION OF SECURITIES EXCHANGES

\* \* \* \* \*

DEFINITIONS AND APPLICATION OF TITLE

SEC. 3. (a) When used in this title, unless the context otherwise requires—

(1) \* \* \*

\* \* \* \* \*

(77) SECURITY-BASED SWAP EXECUTION FACILITY.—[The term]

(A) IN GENERAL.—The term “security-based swap execution facility” means 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, including any trading facility, that—

**[(A)]** (i) facilitates the execution of security-based swaps between persons; and

**[(B)]** (ii) is not a national securities exchange.

(B) *INTERPRETATION.*—*In interpreting or further defining the term “security-based swap execution facility”, the Commission shall not require a security-based swap execution facility to—*

*(i) have a minimum number of participants receive a bid or offer or respond to any trading system or platform functionality;*

*(ii) display or delay bids or offers for any period of time;*

*(iii) limit the means of interstate commerce utilized by market participants to enter into and execute any security-based swap transactions on the method of trading functionality; or*

*(iv) require bids or offers on one trading system or platform operated by the swap execution facility to interact with bids or offers on another method of trading functionality operated by the swap execution facility.*

\* \* \* \* \*