



March 15, 2019

**VIA ONLINE SUBMISSION**

Christopher Kirkpatrick, Secretary  
Commodity Futures Trading Commission  
Three Lafayette Center  
1155 21<sup>st</sup> Street, N.W.  
Washington, D.C. 20581

**RE: Swap Execution Facilities and Trade Execution Requirement, RIN 3038-AE25**

Dear Mr. Kirkpatrick:

By this letter, the Natural Gas Supply Association ("NGSA") respectfully submits comments in response to the U.S. Commodity Futures Trading Commission's (the "CFTC's" or "Commission's") proposed amendments to regulations relating to the trade execution requirement under the Commodity Exchange Act ("CEA" or "Act"), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), and its amendments to existing regulations related to swap execution facilities ("SEFs") and designated contract markets ("DCMs") (collectively, the "SEF Proposal" or "Proposed Rule").

NGSA encourages the use of natural gas within a balanced national energy policy and promotes the benefits of competitive markets, thus encouraging increased supply and the reliable and efficient delivery of natural gas to U.S. customers. Founded in 1965, NGSA is the only Washington, D.C.-based trade association that focuses on producer/marketer issues related to the downstream natural gas industry.

As producers and suppliers of natural gas, NGSA members would not invest in the growth of the physical natural gas markets if they did not believe the market exhibited three key principles of health – integrity, transparency, and efficiency. NGSA believes that its comments in response to the Proposed Rule further promote these

principles and respectfully requests that the Commission consider and implement them.

NGSA appreciates the action taken by the CFTC in developing the Proposed Rule and acknowledges the Commission's interest in moving swaps transactions to SEFs. However, even if there is *a demand* for a particular transaction, sometimes there is simply not enough liquidity for listing and trading a swap on an electronic platform. Liquidity does not spring into existence in lock-step with hedging needs.

The continued ability for market participants to enter into bilateral, over-the-counter ("OTC") transactions and futures contracts to affordably hedge risk is central to NGSA's end user advocacy. Importantly, markets evolve and, as such, business risks change and evolve. The changing risks translate to changing hedging needs that appropriately differ between markets and companies. In ever-changing markets, there are no one-size-fits-all hedging practices. Policies that facilitate a variety of different tools for hedging make sense for consumers and market participants. This is where brokers play an important role for end users, market participants and the health of the market. **Voice brokers facilitate swaps trades that otherwise would not occur, such as those involving thinly traded commodities, unusual contract terms or out of the way locations.**

Prior to implementation of the Dodd-Frank Act, many energy swaps transactions were executed on the Intercontinental Exchange ("ICE"). Although not all of the ICE swaps were voluntarily cleared, many were. ICE has since converted their energy contracts to futures. Thus, today there are far fewer OTC energy swaps. Even though the energy market has changed dramatically in the years since the Dodd-Frank Act was signed into law, the need for customized hedging transactions has not changed.

Brokers help match different market participants with complementary transaction needs especially in small markets, such as natural gas delivered at illiquid points, facilitating the market participants' ability to structure bespoke hedging transactions. **This important role in creating and maintaining liquidity in such transactions should not be thwarted by imposition of a registration requirement on entities that do not fall within the four corners of the statutory definition of a SEF** under Section 1a(50) of the CEA, which provides:

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.

This definition explicitly requires that a SEF be a trading system or platform "in which multiple participants have the ability "to execute or trade" swaps. However, the SEF Proposal recognizes that brokers at most "allow" or "facilitate" the execution of swaps.<sup>1</sup> Simply put, participants do not have the ability to "execute or trade" swaps "within" a "trading system or platform" that *is* a broker. In this regard, the SEF Proposal tellingly must use quotation marks around the word "trading" to suggest that the facilitation of negotiation provided by brokers is "trading."<sup>2</sup> In fact, market participants do not *trade* within a broker.

Further, although the above definition of SEF does mention "facilitation," it specifically refers to any "trading facility" that facilitates the execution of swaps." Similar to the CEA's definition of SEF, the definition of "trading facility" in Section 1a(51) of the CEA is limited to a "physical or electronic system *in which* multiple participants *have the ability to execute or trade* agreements . . . ." Moreover, this definition explicitly excludes persons that might otherwise be construed as a "trading facility" solely because they maintain a system that enables participants to negotiate the terms of and enter into bilateral transactions as a result of communications exchanged by the parties and not from interaction of multiple bids and multiple offers within a predetermined, nondiscretionary automated trade matching and execution algorithm. Because brokers do not facilitate multiple participant to multiple participant interaction, they do not fall within this definition of a "trading facility," the fact that they may *facilitate* execution of swaps does not make them a SEF. At bottom, then, because they do not fall within the statutory definition of a SEF, brokers cannot be regulated as SEFs.

By layering a new compliance obligation into the market, the registration requirement for swaps brokering entities risks creating a substantial barrier to entry for brokers (many of whom are already subject to the Commission's registration and compliance requirements with respect to introducing brokers)<sup>3</sup> that have become an essential part of providing efficient, customized hedging opportunities in illiquid swaps markets where hedging needs continually evolve. The market is still grappling with changes and regulatory uncertainty stemming from the implementation of the Dodd-Frank Act. Capital investment depends on an ability to affordably hedge. The availability of the brokers described above is simply a market response to the lack of liquidity in certain commodity swaps and the need for customized hedges.

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<sup>1</sup> See SEF Proposal, 83 Fed. Reg. at 61959.

<sup>2</sup> See *id.*

<sup>3</sup> As noted in the SEF Proposal, many swap broking entities are registered with the Commission as introducing brokers and are thus subject to a host of regulatory requirements, including: registration, National Futures Association training standards and proficiency testing, financial reporting requirements, minimum financial requirements, trading standards, and prohibitions against fraud and manipulation. See SEF Proposal, 83 Fed. Reg. at 61957, 61989 n. 341.

Throughout the Commission's implementation of the Dodd-Frank Act, NGSA has remained focused on preserving hedging and transaction flexibility for market participants. A diverse, liquid market ensures market participant access to affordable hedging transactions. However, the proposed rule acknowledges that SEF regulation might have a larger impact on smaller entities or platforms and expose market participants who have used those entities to higher costs and reduced services.<sup>4</sup>

Because market participants have different business objectives and portfolios, hedging needs differ. Efficient hedging requires both transaction and counterparty diversity – futures and bilateral transactions, bank counterparties and non-bank counterparties, etc. **As hedging needs evolve with ever-changing markets, the appropriate or available hedge counterparty or hedge transaction is not always readily apparent in the market. In those instances, brokers play a critical role in "matching" two unique transaction needs and filling a void in the market that cannot otherwise be met.** If there was no market need for the broker, there would be no broker. Bilateral transactions and the means to support them play a critical role in market development. Arguably the exchanges and electronic platforms of today would not exist if the initial transactions were not brought together.

NGSA welcomes the opportunity to further discuss these comments with the Commission. If we can provide any additional information, please do not hesitate to contact us.

Respectfully submitted,



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<sup>4</sup> Proposed Rule at 62,054