

# FXC – Forum on Dodd-Frank Act & the Foreign Exchange Market

SEF Panel

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# The Panel

## Panelists:

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## Moderator:

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# Agenda

- Regulatory Overview
- Products
- Registration and Access
- Execution Alternatives in SEF Proposal
- Impact on Dealer to Client Relationships
- Navigating as a Client

# Questions To Consider

- What are the Requirements?
- Which Products will trade on SEFs?
- Alternatives to SEFs?
- How do I access SEFs?
- How do I execute Trades in SEFs?
- Does the client / dealer relationship change with SEF execution?



# How FX Instruments are Impacted

- Products that are being cleared today may be subject to mandatory clearing and trading and SEF Trading
- Products that are not likely to be cleared soon (*e.g.*, bespoke products) will not be subject to SEF Trading

Instrument	Reported to Swaps Data Repository (SDR)	Cleared	Traded on Swaps Execution Facility (SEF)
FX Options	✓	✓	✓
NDFs	✓	✓	✓
FX Swaps	✓		
FX Forwards	✓		
FX Spot			

Note: Blocks are required to trade under SEF rules and be reported to a SEF, but are not subject to specific execution requirements, such as RFQ to a minimum number of providers.

# FX product landscape

Out of scope	Currently cleared (primarily D2D)	Expected mandatory for clearing / SEF execution in medium term	Not expected mandatory for clearing / SEF execution in medium term
<ul style="list-style-type: none"><li>• Spot</li><li>• Forwards</li><li>• Swaps</li></ul>	<ul style="list-style-type: none"><li>• Liquid NDF currencies (e.g., CNY, INR, KRW, BRL, CLP)</li></ul>	<ul style="list-style-type: none"><li>• Liquid NDF currencies</li><li>• G10 vanilla options (timeframe unclear)</li></ul>	<ul style="list-style-type: none"><li>• Illiquid NDF currencies</li><li>• Exotic options</li></ul>

# How will NDFs Become Mandatory-Traded on a SEF?

- Pre-requisite: Clearing mandates
  - CFTC, in conjunction with clearinghouses (DCOs), determines which NDF currency pairs are required to be cleared
- SEFs make NDFs ‘available for trading’
  - SEFs independently choose from the mandatory clearing list which NDFs they wish to list
  - Once a SEF lists an NDF pair, that pair can only be traded via SEF (including other competing SEFs)



# Registration and Access

- Execution is only limited to ECPs (unlike DCM execution, which is open to retail).
- Buy-side need to register with a SEF -- which may result in buy-side submission to the SEF rules.
- Two potential SEF access modalities (CFTC SEF rulemaking is not yet final).
  - Buy-side direct access to a SEF (requires buy-side to have a relationship with one or more clearing firms).
  - Buy-side interface with single-dealer platform, which is operationally linked to a SEF.
- Why does this matter?
  - Potential for information leakage and conflict of interest
  - Transaction fees

# Trading in a Regulated/Non-regulated platform

Assume a mandatory-cleared, below-block size contract (e.g., 3M BRL/USD)...

Regulatory classification	Can trade on a SEF	Can trade on a non-SEF	Caveats
Subject to DFA, Joins a SEF	Yes	No	But can trade only with other SEF participants
Subject to DFA, Does not join a SEF	No	No	Can only trade NDFs under the End User Exemption
Not subject to DFA, Joins a SEF (to trade with US counterparties)	Yes	Yes	Can trade with anyone, regardless of DFA jurisdiction
Not subject to DFA, Does not join a SEF	No	Yes	But can trade only with others not subject to DFA

# Execution Alternatives in SEF Proposal

## – *Execution Alternatives*

- SEF RFQ. Differences from current RFQ.
- Central limit order book. Post or see interest from the market.
- Block Trades:
  - CFTC defined sizes to denote “big” trades. Can be executed off SEF platform but subject to SEF rules

## – *Constraints*

- Minimum RFQ
- Block proposals
- Proposals that affect flow internalization (15 second rule)
- Voice
- Liquidity – fragmentation / regionalization

# Evolving Services and Relationships

- Access and Aggregation Service
- Single Dealer Platform as gateway to SEFs
- Dealer and Agency models
- Spot, exempt FX, and non-exempt FX could be allocated across platforms

# Navigating as a Client

- Precursor to trading on a SEF is clearing
  - Choosing Clearing Broker(s)
  - Choosing Clearing House(s)
- How many SEFS per asset class is enough?
- Aggregated or Direct Access?
- How do you make sure the liquidity is there for you?
- Comparing NDFs and Futures
  - SEF and DCM trading models

# Appendix

# Navigating as a Client

## Reporting

- Trades on a SEF (Swap Execution Facility) -> SEF will report
- Non-SEF trades that are cleared -> clearing firm will report
- Non-SEF trades that are not cleared ->
  - SD (Swap Dealer) reports all trades where it is counterparty
  - If there is no SD counterparty, MSP (Major Swap Participant) reports the trade
  - If there is no SD or MSP counterparty, ECP (Eligible Contract Participant) reports the trade
- Regardless of who reports your trades, you must register as an ECP with the DTCC (Depository Trust & Clearing Corporation) and obtain a LEI (Legal Entity Identifier)

## Clearing

- NDF (Non-Deliverable Forward) trades (and in the future, options) in mandatory cleared currency pairs must be cleared, unless you utilize the End User Exception
- If your trades need to be cleared you must establish a relationship with a clearing firm or prime broker
- Non-financial ECPs must decide whether to pursue the End User Exception, which provides relief from mandatory trading and clearing requirements

## SEF Trading

- ECPs that do not qualify as End Users must join a SEF to trade their NDFs (and in the future, options) in mandatory cleared currency pairs
- ECPs that will use the End User Exception for some trades will need to join a SEF. Notify the SEF of clearing and data repository relationships
- If you use a SEF's RFQ (Request for Quotation) mechanism to trade non-block NDFs, you must RFQ to a minimum number of providers