



## U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre  
1155 21st Street, NW, Washington, DC 20581  
Telephone: (202) 418-5977  
Facsimile: (202) 418-5407  
[gbarnett@cftc.gov](mailto:gbarnett@cftc.gov)

Division of Swap Dealer and  
Intermediary Oversight

Gary Barnett  
Director

CFTC Letter No. 13-33 Corrected  
No-Action  
June 27, 2013  
Division of Swap Dealer and Intermediary Oversight

### **Re: No-Action Relief: Swaps Intended to be Cleared**

Ladies and Gentlemen:

This letter responds to requests received by the Division of Swap Dealer and Intermediary Oversight (“**Division**”) of the Commodity Futures Trading Commission (“**Commission**”) from the International Swaps and Derivatives Association (“**ISDA**”) and the Asset Management Group of the Securities Industry and Financial Markets Association (“**AMG**”) and, together with ISDA, the “**Requesting Associations**”), each on behalf of its members who enter into swaps that are intended to be submitted for clearing contemporaneously with execution.<sup>1</sup> For these swaps, the Requesting Associations seek relief from certain disclosure and notice requirements and other duties imposed on swap dealers (“**SDs**”) and major swap participants (“**MSPs**”) pursuant to Commission regulations §§ 23.402, 23.430, 23.431, 23.432, 23.434, 23.440, 23.450, and 23.451, as well as certain documentation requirements imposed on SDs and MSPs pursuant to Commission regulation § 23.504.

### **I. Background**

On July 21, 2010, President Obama signed the Dodd-Frank Act.<sup>2</sup> Title VII of the Dodd-Frank Act<sup>3</sup> amended the Commodity Exchange Act (“**CEA**”)<sup>4</sup> to establish a comprehensive

---

<sup>1</sup> Although the relief contained herein was requested by ISDA and AMG on behalf of their members, such relief is available to all swap market participants that enter into swaps intended to be submitted for clearing contemporaneously with execution, subject to the conditions set forth herein.

<sup>2</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at:  
<http://www.cftc.gov/LawRegulation/OTCDERIVATIVES/index.htm>.

<sup>3</sup> Pursuant to Section 701 of the Dodd-Frank Act, Title VII may be cited as the “Wall Street Transparency and Accountability Act of 2010.”

<sup>4</sup> 7 U.S.C. 1 et seq.

regulatory framework to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) providing for the registration and comprehensive regulation of SDs and MSPs; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating rigorous recordkeeping and real-time reporting regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to all registered entities and intermediaries subject to the Commission's oversight.

In the nearly three years since its enactment, the Commission has finalized approximately 50 rules to implement Title VII of the Dodd-Frank Act. Earlier this year, the Commission, jointly with the Securities and Exchange Commission, finalized the main foundational elements of the Dodd-Frank regulatory framework by adopting regulations further defining the terms "swap dealer" and "major swap participant,"<sup>5</sup> as well as the regulations further defining the term "swap."<sup>6</sup> The Commission also adopted regulations setting forth a comprehensive scheme for the registration process for SDs and MSPs.<sup>7</sup> Other finalized rules include various substantive requirements applicable to SDs and MSPs under CEA section 4s,<sup>8</sup> which address reporting and recordkeeping,<sup>9</sup> business conduct standards,<sup>10</sup> documentation standards,<sup>11</sup> duties,<sup>12</sup> and designation of chief compliance officers.<sup>13</sup>

Among other things, upon registration, an SD or MSP must submit documentation demonstrating its compliance with any Commission regulation issued pursuant to section 4s(e), (f), (g), (h), (i), (j), (k), and (l) of the CEA that is applicable to it and for which the compliance date has passed. Such Commission regulations include business conduct standards under subpart H of part 23 of the Commission's regulations promulgated under section 4s(h) of the CEA, and

---

<sup>5</sup> See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant," 77 FR 30596 (May 23, 2012).

<sup>6</sup> See Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48208 (Aug. 13, 2012).

<sup>7</sup> See Registration of Swap Dealers and Major Swap Participants, 77 FR 2613 (Jan. 19, 2012).

<sup>8</sup> 7 U.S.C 6s.

<sup>9</sup> See Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 FR 20128 (Apr. 3, 2012).

<sup>10</sup> See Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 FR 9734 (Feb. 17, 2012).

<sup>11</sup> See Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 FR 55904 (Sept. 11, 2012).

<sup>12</sup> See *supra* note 9.

<sup>13</sup> *Id.*

documentation standards under subpart I of part 23 of the Commission's regulations promulgated under section 4s(i) of the CEA.

### Business Conduct Standards with Counterparties

With respect to business conduct standards with counterparties, section 4s(h) of the CEA provides the Commission with both mandatory and discretionary rulemaking authority to impose business conduct standards on SDs and MSPs in their dealings with counterparties, including Special Entities.

Pursuant to section 4s(h) of the CEA, on December 22, 2010, the Commission published in the Federal Register proposed subpart H of part 23 of the Commission's regulations.<sup>14</sup> There was a 60-day period for the public to comment on the proposing release. On May 4, 2011, the Commission published in the Federal Register a notice to re-open the public comment period for an additional 30 days, which ended on June 3, 2011.<sup>15</sup> On February 17, 2012, the Commission adopted as final rules subpart H to part 23, which set forth business conduct standards for swap dealers and major swap participants in their dealings with counterparties (the "**External BCS**").<sup>16</sup> SDs and MSPs were required to comply with the External BCS by May 1, 2013.<sup>17</sup>

Of note in relation to this letter, a number of the Commission's rules under the External BCS require SDs and MSPs to provide or obtain specific information from their counterparties, to obtain specific representations in writing from their counterparties, and to perform certain due diligence inquiries with respect to their counterparties prior to entering into (or in some cases, offering to enter into) a swap with such counterparties.<sup>18</sup> Certain safe harbors under the External

---

<sup>14</sup> Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 75 FR 80638 (proposed Dec. 22, 2010).

<sup>15</sup> Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 FR 25274 (May 4, 2011).

<sup>16</sup> Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 FR 9734 (Feb. 17, 2012).

<sup>17</sup> The External BCS final rules required that SDs and MSPs must comply with the rules in subpart H of part 23 on the later of 180 days after the effective date of these rules or the date no which swap dealers or major swap participants are required to apply for registration pursuant to Commission rule 3.10. However, in subsequent rulemakings, the compliance date for §§ 23.402; 23.410(c); 23.430; 23.431(a)-(c); 23.432; 23.434(a)(2), (b), and (c); 23.440; and 23.450 was deferred first until January 1, 2013 (*see* Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 FR 55904, 55942 (Sept. 11, 2012)), and then again until May 1, 2013 (*see* Business Conduct and Documentation Requirements for Swap Dealers and Major Swap Participants; Extension of Compliance Date, 78 FR 17 (Jan. 2, 2013)).

<sup>18</sup> *See* Commission regulation § 23.402(b) (requiring SDs to obtain essential facts about their counterparty prior to execution of a transaction); § 23.430(a) (requiring SDs and MSPs to verify that a counterparty meets the eligibility standards for an eligible contract participant before offering to enter into or entering into a swap with such counterparty); § 23.431(a) (requiring SDs and MSPs to provide material information concerning a swap to its counterparty at a reasonably sufficient time prior to entering into the swap); § 23.431(b) (requiring SDs and MSPs to

BCS permit SDs and MSPs to rely on written representations from their counterparties and standardized disclosures, each of which may require amendments or supplements to an SD's or MSP's relationship documentation with such counterparties prior to entering into a swap with such counterparties.<sup>19</sup>

### Swap Trading Relationship Documentation

Documentation standards for SDs and MSPs have been adopted by the Commission pursuant to Section 4s(i)(1) of the CEA, which requires SDs and MSPs to “conform with such standards as may be prescribed by the Commission by rule or regulation that relate to timely and accurate confirmation, processing, netting, documentation, and valuation of all swaps,” and Section 4s(i)(2) of the CEA, which requires the Commission to adopt rules “governing documentation standards for swap dealers and major swap participants.” On February 8, 2011, the Commission proposed regulations governing swap trading relationship documentation.<sup>20</sup> There was a 60-day comment period for the proposal. On September 11, 2012, the Commission issued final rules governing swap trading relationship documentation (§ 23.504).<sup>21</sup> Commission regulation § 23.504 requires that an SD or MSP execute swap trading relationship documentation meeting the requirements of the rule with a counterparty prior to or contemporaneously with entering into a swap transaction with such counterparty.<sup>22</sup>

Regarding the content of swap trading relationship documentation, each SD and MSP must establish policies and procedures reasonably designed to ensure that the parties have agreed in writing to all terms governing their trading relationship, including, among other things, terms related to credit support arrangements, such as initial and variation margin requirements and custodial arrangements, and terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon termination, transfer of rights and obligations, governing law, valuation, and dispute resolution.<sup>23</sup> With

---

provide notice to counterparties that they can request and consult on the design of a scenario analysis; § 23.431(d) (requiring SDs and MSPs to provide notice to counterparties of the right to receive the daily mark from a DCO for cleared swaps); § 23.432 (requiring SDs and MSPs to provide notice to counterparties of the right to select clearing and the DCO on which a swap is to be cleared); § 23.434 (requiring SDs and MSPs that recommend a swap to have a reasonable basis to believe that the swap is suitable for the counterparty); § 23.440 (requiring SDs and MSPs that act as an advisor to a Special Entity to act in such entity's best interest); § 23.450 (requiring SDs and MSPs to inquire into the knowledge and status of a representative of a counterparty that is a Special Entity); and § 23.451 (prohibiting SDs from entering into swaps with certain governmental entities if it has made political contributions to an official of such entity).

<sup>19</sup> See § 23.402(d), (e), and (f).

<sup>20</sup> Swap Trading Relationship Documentation for Swap Dealers and Major Swap Participants, 76 FR 6715 (proposed Feb. 8, 2011).

<sup>21</sup> Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 FR 55904 (Sept. 11, 2012).

<sup>22</sup> See § 23.504(a)(2).

<sup>23</sup> See § 23.504(b)(1) and (3).

respect to valuation of swaps, SDs and MSPs must include agreement on the process for determining the value of each swap at any time from execution to the termination, maturity, or expiration of the swap, for the purposes of complying with: (1) the margin requirements under section 4s(e) of the CEA and Commission regulations; and (2) the risk management requirements under section 4s(j) of the CEA and Commission regulations.<sup>24</sup> The documentation also must include either: (1) alternative methods for determining the value of the swap, in the event of the unavailability or other failure of any input required to value the swap; or (2) a valuation dispute resolution process.<sup>25</sup> SDs and MSPs are also required to perform a periodic audit of their swap trading relationship documentation, and the audit must be sufficient to identify any material weakness in documentation policies and procedures.<sup>26</sup>

### Straight-Through-Processing of Cleared Swaps

A number of Commission regulations, acting in concert, require that swaps that are intended to be cleared are in fact cleared within a reasonably short period of time. Ensuring a short period between swap execution and acceptance for clearing by a derivatives clearing organization (“**DCO**”) mitigates the credit risk that exists from the swap prior to novation to the DCO.<sup>27</sup>

Relevant for this letter, Commission regulation § 23.506 (Swap processing and clearing) requires each SD and MSP to have the capacity to route swap transactions intended to be cleared, but not executed on a SEF or DCM<sup>28</sup>, to a DCO in coordination with the DCO to facilitate prompt and efficient swap transaction processing in accordance with the requirements of Commission regulation § 39.12(b)(7) (Time frame for clearing).<sup>29</sup> For swaps subject to

---

<sup>24</sup> See § 23.504(b)(4)(i).

<sup>25</sup> See § 23.504(b)(4)(ii).

<sup>26</sup> See § 23.504(c).

<sup>27</sup> See Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 FR 21278, 21284 (Apr. 9, 2012), stating:

Minimizing the time between trade execution and acceptance into clearing is an important risk mitigant. This time lag potentially presents credit risk to the swap counterparties, clearing members, and the DCO because the value of a position may change significantly between the time of execution and the time of novation, thereby allowing financial exposure to accumulate in the absence of daily mark-to-market. Among the purposes of clearing are the reduction of risk and the enhancement of financial certainty, and this time lag diminishes the benefits of clearing swaps that Congress sought to promote in the Dodd-Frank Act.

<sup>28</sup> Pursuant to Commission regulations §§ 37.702 and 38.601, each SEF and DCM must coordinate with each DCO to which it submits transactions for clearing in the development of rules and procedures to facilitate prompt and efficient transaction processing to meet the requirements § 39.12(b)(7). Commission regulation § 39.12(b)(7)(ii) requires a DCO to accept or reject swaps executed on a SEF or DCM for clearing “as quickly after execution as would be technologically practicable if fully automated systems were used.” See *id.* at 21309.

<sup>29</sup> See 17 CFR §§ 23.506(a) and Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 FR 21278, 21307 (Apr. 9, 2012).

mandatory clearing, an SD or MSP must submit the swap to the DCO as soon as technologically practicable but no later than the close of business on the day of execution; swaps not subject to mandatory clearing must be submitted by the next business day after execution of the swap.<sup>30</sup>

Regulation § 39.12(b)(7) in turn requires DCOs to accept or reject swaps not executed on a SEF or DCM “as quickly after submission to the derivatives clearing organization as would be technologically practicable if fully automated systems were used.”<sup>31</sup> In addition, Commission regulation § 1.74 (FCM acceptance for clearing) requires each futures commission merchant (“FCM”) that is a clearing member of a DCO to establish systems that enable the FCM to accept or reject each trade submitted to the DCO by the FCM for a customer of the FCM as quickly as would be technologically practicable if fully automated systems were used.<sup>32</sup>

Finally, Commission regulation § 1.35 (Records of commodity interest and cash commodity transactions) allows for bunched orders to be executed in a single trade with the intention that the position will be allocated among multiple counterparties after execution (such as when an asset manager executes a single swap with the intention to allocate the swap to multiple accounts under its management). For such bunched orders in swaps not executed on a SEF or DCM, but submitted for clearing by a DCO, the swap must be allocated “no later than a time sufficiently before the end of the day the order is executed to ensure that clearing records identify the ultimate customer for each trade.”<sup>33</sup>

## **II. Relief Requested**

The Requesting Associations note that many of the Commission’s regulations under the External BCS do not apply either (i) when the SD or MSP does not know the identity of the counterparty to a swap prior to the execution of the swap, or (ii) when the swap is initiated on a designated contract market (“DCM”) or swap execution facility (“SEF”) and the SD or MSP does not know the identity of the counterparty to a swap prior to the execution of the swap.<sup>34</sup>

---

<sup>30</sup> See 17 CFR §§ 23.506(b) and Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 FR 21278, 21307-08 (Apr. 9, 2012). See also 17 CFR § 50.2 and Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284, 74335-36 (Dec. 13, 2012) (requiring all swaps subject to a clearing requirement to be submitted to a DCO as soon as technologically practicable after execution, but in any event by the end of the day of execution).

<sup>31</sup> See 17 CFR §§ 23.506(a) and 39.12(b)(7)(iii), and Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 FR 21278, 21306-10 (Apr. 9, 2012). As stated in the adopting release, these rules, taken as a whole, “require SEFs, DCMs, SDs, MSPs, and DCOs to coordinate in order to facilitate real time acceptance or rejection of trades for clearing.” Id. at 21296.

<sup>32</sup> See id. at 21307.

<sup>33</sup> See 17 CFR § 1.35(b)(5)(iv)(A) and Adaptation of Regulations to Incorporate Swaps, 77 FR 66288, 66326 (Nov. 2, 2012).

<sup>34</sup> See § 23.402(b) and (c) (requiring SDs and MSPs to obtain and retain certain information only about each counterparty “whose identity is known to the SD or MSP prior to the execution of the transaction”), § 23.430(e) (not

Similarly, the Requesting Associations observe that § 23.504 contains an exception to the requirement that an SD or MSP execute swap trading relationship documentation with a counterparty prior to or contemporaneously with entering into a swap transaction with such counterparty. Section 23.504(a)(1) states that such documentation is not required with respect to swaps executed on a DCM or anonymously on a SEF if such swaps are cleared by a DCO and all terms of the swaps conform to the rules of the DCO and § 39.12(b)(6) of the Commission's regulations.<sup>35</sup>

The Division recognizes that rationales for these exceptions include: (i) the impossibility or impracticability of compliance with certain rules, or the full extent of certain rules, by an SD or MSP when the identity of the counterparty is not known prior to execution; (ii) the likelihood that swaps initiated anonymously on a DCM or SEF will be standardized and, thus, information about the material risks and characteristics of such swaps is likely to be available from the DCM or SEF or other widely available source (including the product specifications of a DCO if the swaps are accepted for clearing); and (iii) the fact that following clearing of a swap, the SD or MSP and its counterparty have no further obligations to each other, so there is no on-going relationship that would be governed by the trading relationship documentation required by Commission regulation § 23.504. The Division also notes that relief from certain requirements of the External BCS for swaps initiated anonymously on a DCM or SEF would provide an incentive to transact on such platforms, enhancing transparency in the swaps market, a major policy goal of the Dodd-Frank Act. Similarly, the relief from the swap trading relationship documentation requirements for swaps submitted for clearing would provide an incentive to clear swaps, another major policy goal of the Dodd-Frank Act.

---

requiring SDs and MSPs to verify counterparty eligibility when a transaction is entered on a DCM or SEF and the SD or MSP does not know the identity of the counterparty prior to execution), § 23.431(c) (not requiring disclosure of material information about a swap if initiated on a DCM or SEF and the SD or MSP does not know the identity of the counterparty prior to execution), § 23.450(h) (not requiring SDs and MSPs to have a reasonable basis to believe that a Special Entity has a qualified, independent representative if the transaction with the Special Entity is initiated on a DCM or SEF and the SD or MSP does not know the identity of the Special Entity prior to execution), and § 23.451(b)(2)(iii) (disapplying the prohibition on entering into swaps with a governmental Special Entity within two years after any contribution to an official of such governmental Special Entity if the swap is initiated on a DCM or SEF and the SD or MSP does not know the identity of the Special Entity prior to execution).

<sup>35</sup> Section 39.12(b)(6) of the Commission's regulations provides:

(6) A derivatives clearing organization that clears swaps shall have rules providing that, upon acceptance of a swap by the derivatives clearing organization for clearing:

- (i) The original swap is extinguished;
- (ii) The original swap is replaced by an equal and opposite swap between the derivatives clearing organization and each clearing member acting as principal for a house trade or acting as agent for a customer trade;
- (iii) All terms of a cleared swap must conform to product specifications established under derivatives clearing organization rules; and
- (iv) If a swap is cleared by a clearing member on behalf of a customer, all terms of the swap, as carried in the customer account on the books of the clearing member, must conform to the terms of the cleared swap established under the derivatives clearing organization's rules.

Recognizing the exceptions to the documentation requirements and the External BCS outlined above, and encouraged by the pre-clearing risk mitigation provided by compliance with the Commission's regulations for straight-through-processing of swaps intended to be cleared in parts 1, 23, 39, and 50 of the Commission's regulations, the Requesting Associations are seeking relief that would extend such exceptions based on the same rationales outlined above. Thus, the Requesting Associations seek relief from certain requirements under the External BCS and certain aspects of the documentation requirements of Commission regulation § 23.504 that the Requesting Associations find superfluous, and therefore unduly burdensome, in the execution and post-trade processing of swaps that are not executed on a SEF or DCM, but (i) are executed without the SD or MSP knowing the identity of the counterparty, in some instances, and (ii) intended to be submitted for clearing contemporaneously with execution, in all instances (such swaps, "**Intended-To-Be-Cleared Swaps**" or "**ITBC Swaps**").

As noted above, many of the External BCS require SDs and MSPs to provide notices or disclosures to, or obtain specific information or representations from, their counterparties prior to entering into (or in some cases, offering to enter into) a swap with such counterparties.<sup>36</sup> Knowledge of its counterparty's identity is, of course, essential to comply with these requirements under the External BCS, but the Requesting Associations argue that these requirements meant to protect counterparties are either impossible to perform if the counterparty's identity is not known prior to execution of an ITBC Swap, or only meaningful or effective where an SD or MSP has an on-going relationship with the counterparty, which it will not in the case of ITBC Swaps.

Similarly the Requesting Associations argue that the swap trading relationship documentation required by § 23.504 is not relevant for ITBC Swaps because there is no on-going relationship between the SD or MSP and its counterparty once the swap is accepted for clearing by a DCO.

With respect to the acceptance for clearing by a DCO, the Requesting Associations acknowledge that the consequences of the failure of an ITBC Swap to clear may raise issues with respect to both the External BCS and the swap trading relationship documentation requirement. Specifically, if the result of the failure of an ITBC Swap to clear is that the SD or MSP and its

---

<sup>36</sup> See Commission regulation § 23.402(b) (requiring SDs to obtain essential facts about their counterparty prior to execution of a transaction); § 23.430(a) (requiring SDs and MSPs to verify that a counterparty meets the eligibility standards for an eligible contract participant before offering to enter into or entering into a swap with such counterparty); § 23.431(a) (requiring SDs and MSPs to provide material information concerning a swap to its counterparty at a reasonably sufficient time prior to entering into the swap); § 23.431(b) (requiring SDs and MSPs to provide notice to counterparties that they can request and consult on the design of a scenario analysis; § 23.431(d) (requiring SDs and MSPs to provide notice to counterparties of the right to receive the daily mark from a DCO for cleared swaps); § 23.432 (requiring SDs and MSPs to provide notice to counterparties of the right to select clearing and the DCO on which a swap is to be cleared); § 23.434 (requiring SDs and MSPs that recommend a swap to have a reasonable basis to believe that the swap is suitable for the counterparty); § 23.440 (requiring SDs and MSPs that act as an advisor to a Special Entity to act in such entity's best interest); § 23.450 (requiring SDs and MSPs to inquire into the knowledge and status of a representative of a counterparty that is a Special Entity); and § 23.451 (prohibiting SDs from entering into swaps with certain governmental entities if it has made political contributions to an official of such entity).



counterparty will be deemed to have entered into a bilateral swap, with on-going obligations to each other, than the rationales for relief from the External BCS and documentation requirements are not present.

Because it is possible that an ITBC Swap may, due to unforeseen circumstances, fail to be accepted for clearing by a DCO, for purposes of this relief the Requesting Associations have represented that the result of such failure will not, in any event, be a bilateral swap between the SD or MSP and its counterparty. Rather, the Requesting Associations have represented that an ITBC Swap that fails to be accepted for clearing by a DCO will be subject to an agreement between the SD or MSP and its counterparty requiring either:

- (i) That the ITBC Swap will immediately be resubmitted for clearing with:
  - (A) The clearing member for the SD or MSP as party to the ITBC Swap if the SD or MSP is responsible for the ITBC Swap's failure to clear; or
  - (B) The clearing member for the counterparty as party to the ITBC Swap if the counterparty is responsible for the ITBC Swap's failure to clear; or
  - (C) Both the clearing member for the SD or MSP and the clearing member for the counterparty as parties to the ITBC Swap if both the SD or MSP and the counterparty are responsible for the ITBC Swap's failure to clear; or
- (ii) That the ITBC Swap is void or automatically terminated as of the time that the ITBC Swap fails to clear, with any cost or other amount attributable to automatic termination to be payable as agreed between the parties.

### **III. Staff Position**

Based on the foregoing, the Division believes that no-action relief for SDs and MSPs is warranted with respect to certain External BCS requirements (enumerated below) and the swap trading relationship documentation requirement under Commission regulation § 23.504 in the context of an ITBC Swap where the SD or MSP does not know the identity of the counterparty to the ITBC Swap. In addition, the Division believes that no-action relief for SDs and MSPs is warranted with respect to the swap trading relationship documentation requirement under Commission regulation § 23.504 in the context of an ITBC Swap, even if the SD or MSP knows the identity of the counterparty.

Accordingly, the Division will not recommend that the Commission commence an enforcement action against an SD or MSP for either (A) failure to comply with the requirements of the External BCS specified on Appendix A attached hereto, or the requirements of Commission regulation § 23.504 (Swap trading relationship documentation) with respect to an ITBC Swap where the SD or MSP does not know the identity of the counterparty prior to execution of the swap (an "**Anonymous ITBC Swap**"), or (B) failure to comply with the requirements of Commission regulation § 23.504 (Swap trading relationship documentation)

with respect to an ITBC Swap where the SD or MSP does know the identity of the counterparty prior to the execution of the swap, subject to the following conditions:

1. If the ITBC Swap is an Anonymous ITBC Swap, such swap is not of a type that:
  - (a) Has been listed on any DCM for more than thirty (30) days;
  - (b) Is a required transaction<sup>37</sup> that is listed on any SEF; or
  - (c) Is a permitted transaction<sup>38</sup> that has been listed on any SEF for more than thirty (30) days;
2. Such ITBC Swap is of a type accepted for clearing by a DCO;
3. The SD or MSP is either a clearing member of such DCO, or has entered into an agreement with a clearing member of such DCO for clearing of swaps of the same type as the ITBC Swap;
4. The SD or MSP has a reasonable basis to conclude that the counterparty is either a clearing member of such DCO, or has entered into an agreement with a clearing member of such DCO for clearing of swaps of the same type as the ITBC Swap;
5. Prior to execution of the ITBC Swap:
  - (a) The SD or MSP and the counterparty (or the counterparty's duly authorized representative) have agreed in writing that the ITBC Swap will be submitted for clearing by both the SD or MSP and the counterparty to either the DCO, or to their respective clearing members as quickly after execution as technologically practicable; or
  - (b) In the case of an Anonymous ITBC Swap executed as a bunched order by an eligible account manager (as defined in Commission regulation § 1.35(b)(5)<sup>39</sup>), the SD or MSP, the counterparty (or the counterparty's duly authorized representative), and such eligible account manager have agreed in writing that:
    - (i) The Anonymous ITBC Swap will be submitted for clearing by both the SD or MSP and the counterparty to either the DCO, or to their respective clearing members within:

---

<sup>37</sup> As defined in Commission regulation § 39.7. See Core Principles and Other Requirements for Swap Execution Facilities at 431, available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister051613b.pdf>.

<sup>38</sup> As defined in Commission regulation § 39.7. See *id* at 433.

<sup>39</sup> See Adaptation of Regulations to Incorporate Swaps, 77 FR 66288, 66325 (Nov. 2, 2012).

- (A) Two (2) hours after execution during the 60 day period from the date of this letter; or
  - (B) One (1) hour after execution during the 30 day period beginning 60 days from the date of this letter; or
  - (C) As quickly after execution as technologically practicable from and after the date that is 90 days after the date of this letter; and
- (ii) The eligible account manager has agreed to be responsible for any obligations of the counterparty under the ITBC Swap, whether in the form of trade breakage costs or as otherwise agreed between the eligible account manager and the SD or MSP, from execution until the swap is accepted or rejected for clearing by the counterparty's clearing member, an interim clearing member, or the DCO; and
- (c) The SD or MSP and the counterparty (or the counterparty's duly authorized representative) have agreed in writing (a "**fallback agreement**") that in the event the ITBC Swap fails to be accepted for clearing by a clearing member or the DCO:
- (i) The ITBC Swap will be:
    - (A) Immediately resubmitted for clearing by the DCO under alternative arrangements agreed<sup>40</sup> in the fallback agreement;
    - (B) Void as of execution, with no cost or other amount payable to either party; or
    - (C) Automatically terminated as of the time that the ITBC Swap fails to clear, with costs or other amounts attributable to such automatic termination to be payable as agreed between the SD or MSP and the counterparty (or the counterparty's duly authorized representative), if any; and
  - (ii) If the ITBC Swap fails to be accepted for clearing by a clearing member or the DCO under the alternative arrangements agreed in the fallback agreement, the ITBC Swap will be:
    - (A) Void as of execution, with no cost or other amount payable to either party; or

---

<sup>40</sup> Such alternative arrangements may consist of multiple fallback arrangements (i.e., a so-called "waterfall") so long as each fallback is applied immediately upon the failure of the previous fallback and the arrangements have been agreed in good faith and not with the intention to delay clearing of the ITBC Swap.

- (B) Automatically terminated as of the time that the ITBC Swap fails to clear, with costs or other amounts attributable to such automatic termination to be payable as agreed between the SD or MSP and the counterparty (or the counterparty's duly authorized representative), if any; and
6. Each SD or MSP that relies on this letter makes and retains a record of each fallback agreement required by this letter in accordance with Commission regulation § 23.203 (Records; retention and inspection).

For the avoidance of doubt, no SD or MSP may fail to comply with the External BCS or the swap trading relationship documentation requirements in reliance on this letter unless it shall first have entered into a fallback agreement that meets the conditions of this letter with the applicable counterparty (or its duly authorized representative).

This letter, and the positions taken herein, represent the view of this Division only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse persons relying on it from compliance with any other applicable requirements contained in the Act or in the Regulations issued thereunder, including all antifraud provisions of the Act. Specifically, the relief issued by this letter does not relieve any person from an obligation to report a swap or information concerning a swap under part 43 or part 45 of the Commission's regulations. Further, this letter, and the relief contained herein, is based upon the representations made to the Division. Any different, changed or omitted material facts or circumstances might render this no-action relief void.

Should you have any questions, please do not hesitate to contact me at 202-418-5977, or Frank Fisanich, Chief Counsel, at 202-418-5949.

Very truly yours,

Gary Barnett  
Director  
Division of Swap Dealer and  
Intermediary Oversight

cc: Regina Thoele, Compliance  
National Futures Association, Chicago

**APPENDIX A**

**Specified External BCS Requirements**

<b><u>Commission Regulation</u></b>	<b><u>Subject Matter</u></b>
§ 23.402(b)-(f)	Know your counterparty, True name and owner, Reasonable reliance on representations, Manner of disclosure, and Disclosures in a standard format
§ 23.430	Verification of counterparty eligibility
§ 23.431(a)	Material risks, characteristics, incentives, mid-market mark
§ 23.431(b)	Scenario analysis
§ 23.431(d)(1)	Notice of right to receive daily mark from DCO for cleared swaps
§ 23.432(a)	Notice of right to select DCO
§ 23.432(b)	Notice of right to clearing
§ 23.434	Recommendations to counterparties--institutional suitability
§ 23.440	Requirements for swap dealers acting as advisors to Special Entities
§ 23.450	Requirements for swap dealers and major swap participants acting as counterparties to Special Entities
§ 23.451	Political contributions by certain swap dealers