



U.S. COMMODITY FUTURES TRADING COMMISSION

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CFTC Letter No. 13-62
No-Action
September 30, 2013
Division of Clearing and Risk
Division of Market Oversight

Time-Limited No-Action Relief for (1) Futures Commission Merchants from Requirement to Comply with Commission Regulations 1.73(a)(2)(i) and (a)(2)(ii); and (2) Temporarily Registered Swap Execution Facilities from Requirement to Comply with Commission Regulation 37.702(b)

The Division of Clearing and Risk and the Division of Market Oversight (together, “the Divisions”) of the Commodity Futures Trading Commission (“Commission”) are issuing this letter to provide time-limited and specific no-action relief for futures commission merchants (“FCMs”) from the requirement to comply with Commission Regulations 1.73(a)(2)(i) and (a)(2)(ii).¹ The Divisions are also providing time-limited and specific no-action relief for temporarily registered swap execution facilities (“SEFs”) from the requirement to comply with Commission Regulation 37.702(b). This no-action relief shall commence on the date of issuance of this letter and shall expire on November 1, 2013.

I. Background

On April 9, 2012, the Commission published clearing member risk management regulations.² The regulations are codified in Part 1 of the Commission’s regulations and became effective on October 1, 2012. Regulation 1.73 requires an FCM that is a clearing member (“Clearing FCM”) of a registered derivatives clearing organization (“DCO”) to establish risk-based limits and screen orders for compliance with those limits. Regulation 1.73 applies to Clearing FCMs that clear products for which the clearing organization is registered with the Commission as a DCO. Regulation 37.702(b) requires a SEF to coordinate with each DCO to which it submits transactions for clearing, to develop rules and procedures to facilitate prompt and efficient transaction processing in accordance with the requirements of Regulation 39.12(b)(7). Regulation 39.12(b)(7) sets forth time frames for DCOs to accept or reject trades for clearing.

¹ Commission regulations are codified in 17 C.F.R Ch. I.

² Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21,278 (Apr. 9, 2012).

Regulation 1.73(a)(1) requires each Clearing FCM to establish risk-based limits for each proprietary account and each customer account, which are based on position size, order size, margin requirements, or similar factors. Regulation 1.73(a)(2) requires each Clearing FCM to screen orders for compliance with those limits.

Regulation 1.73(a)(2)(i) states that when a Clearing FCM provides electronic market access to a designated contract market (“DCM”) or SEF or accepts orders for automated execution on a DCM or SEF, the Clearing FCM shall use automated means to screen orders for compliance with such risk-based limits.

Regulation 1.73(a)(2)(ii) provides that when a Clearing FCM accepts orders for non-automated execution, it shall establish and maintain systems of risk controls reasonably designed to ensure compliance with the limits. The Commission has noted that orders executed by non-automated means (*e.g.*, voice broker) can be screened automatically if they are routed automatically.³

Regulation 37.702(b)(2) directs SEFs to have rules and procedures to facilitate prompt and efficient processing by DCOs in accordance with Regulation 39.12(b)(7). Subparagraph (ii) of Regulation 39.12(b)(7), in turn, requires DCOs to accept or reject all trades executed competitively on a SEF or DCM as quickly as would be technologically practicable as if fully automated systems were used.

In Staff Guidance on Swaps Straight-Through Processing issued on September 26, 2013 (“Staff Guidance”), the Divisions noted that Clearing FCMs must screen orders for execution on a SEF or DCM pursuant to either paragraph (a)(2)(i) or (a)(2)(ii) of Regulation 1.73, regardless of the method of execution. The Divisions also noted that a SEF must facilitate pre-execution screening by each Clearing FCM in accordance with Regulation 1.73 on an order-by-order basis. That is, the SEF should make it possible for Clearing FCMs to screen in accordance with Regulation 1.73 on an order-by-order basis.

II. Compliance with FCM and SEF Regulations

The Divisions have been informed by some Clearing FCMs and temporarily registered SEFs that they are facing several obstacles to achieving compliance with the specific requirements, noted above, of Commission Regulations 1.73(a)(2)(i) and (a)(2)(ii), and 37.702(b), prior to the October 2, 2013 compliance date for the SEF final rules. According to some Clearing FCMs and SEFs, the process of pre-execution screening of orders presents certain administrative and operational challenges for swaps market participants. One of the challenges highlighted is that SEFs have not had an adequate amount of time to update their rulebooks or implement means to facilitate pre-execution credit checks by Clearing FCMs.

While recognizing the important regulatory objectives underlying Commission Regulations 1.73(a)(2)(i) and (a)(2)(ii) and 37.702(b), the Divisions nevertheless believe that SEFs should be provided additional time to comply with the requirements of Commission

³ See 77 Fed. Reg. at 21,288.

Regulation 37.702(b) to facilitate pre-execution credit checks by Clearing FCMs. The Divisions further believe that Clearing FCMs should be provided additional time to comply with Commission Regulations 1.73(a)(2)(i) and (a)(2)(ii) for swaps executed on or subject to the rules of any SEF that does not currently facilitate pre-execution screening on an order-by-order basis by Clearing FCMs in accordance with Regulation 1.73.

The Divisions emphasize that the relief provided by this letter does not apply in instances where a SEF does have the ability to facilitate pre-execution screening of orders by Clearing FCMs. Any Clearing FCM that provides electronic market access or accepts orders for execution on such SEFs is not eligible for the relief granted herein.

III. Scope of No-Action Relief

The Divisions are issuing this no-action letter to provide time-limited and specific relief for Clearing FCMs to comply with Commission Regulations 1.73(a)(2)(i) and (a)(2)(ii) for swaps trading on or subject to the rules of any SEF that does not currently have the rules and procedure to facilitate pre-execution screening by Clearing FCMs in accordance with Regulation 1.73 on an order-by-order basis. If a SEF does facilitate such screening, then Clearing FCMs are not relieved of their obligation to conduct pre-execution screening. The Divisions are also issuing this no-action letter to provide time-limited and specific relief for SEFs that are temporarily registered as of October 2, 2013, from the requirement of Commission Regulation 37.702(b) that they facilitate pre-execution screening by each Clearing FCM in accordance with Commission Regulation 1.73 on an order-by-order basis, if the SEFs do not already have the ability to facilitate pre-execution screening.

Under this relief, the Divisions will not recommend that the Commission take any enforcement action against Clearing FCMs that do not screen orders in accordance with Regulation 1.73, only with respect to trades executed on SEFs that do not facilitate such screening. In addition, the Divisions will not recommend that the Commission take any enforcement action against SEFs that do not already facilitate pre-execution screening by Clearing FCMs in accordance with Regulation 1.73 on an order-by-order basis. This no-action relief shall commence on the date of issuance of this letter and shall expire on November 1, 2013, at 12:01 am EST.

The no-action relief in this letter only applies to a Clearing FCM's obligation to comply with Commission Regulation 1.73 for swaps trading on any SEF that does not currently facilitate pre-execution screening by Clearing FCMs in accordance with Regulation 1.73 on an order-by-order basis, or a SEF's obligation to comply with Commission Regulation 37.702(b) by facilitating pre-execution screening by each Clearing FCM in accordance with Commission Regulation 1.73 on an order-by-order basis, if the SEF does not already. This letter does not relieve FCMs or SEFs from any other requirements applicable to FCMs or SEFs under the Commodity Exchange Act or the Commission's regulations thereunder.

In addition, any SEF that intends to avail itself of the relief provided herein, shall, as a condition of obtaining such relief, submit to the Secretary of the Commission, no later than October 10, 2013:

- (1) Pursuant to Commission Regulation 40.6, any rule amendments that are necessary for full compliance with Commission Regulation 37.702(b), and any rule amendments that are necessary to facilitate full compliance with Commission Regulation 1.73(a)(2)(i) and (a)(2)(ii), in accordance with the Staff Guidance;⁴ and
- (2) A written representation that the SEF is undertaking all steps necessary to fully comply with Commission Regulation 37.702(b), and is undertaking all steps necessary to facilitate full compliance with Commission Regulation 1.73(a)(2)(i) and (a)(2)(ii), in accordance with the Staff Guidance.

IV. Conclusion

This letter, and the no-action position taken herein, reflects the views of the Divisions only, and not necessarily the position or views of the Commission or of any other division or office of the Commission's staff. The no-action position taken herein does not excuse affected persons from compliance with any other applicable requirements of the Commodity Exchange Act or the Commission's regulations thereunder. As with all no-action letters, the Divisions retains the authority, in its discretion, to further condition, modify, suspend, terminate or otherwise restrict the terms of the no-action relief provided herein.⁵

If you have any questions concerning this correspondence, please contact John C. Lawton, Deputy Director, Division of Clearing and Risk, at (202) 418-5480 or jlawton@cftc.gov, Chris Hower, Special Counsel, Division of Clearing and Risk, at (202) 418-6703 or chower@cftc.gov, Nancy Markowitz, Deputy Director, Division of Market Oversight, at (202) 418-5453 or nmarkowitz@cftc.gov, or Amir Zaidi, Special Counsel, Division of Market Oversight, at 202-418-6770 or azaidi@cftc.gov.

Sincerely,

Ananda Radhakrishnan
Director
Division of Clearing and Risk

David P. Van Wagner
Chief Counsel
Division of Market Oversight

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Division of Market Oversight

⁴ The Divisions note that under Regulation 40.6(a)(2), a SEF must post a notice of pending certification on the SEF's web site concurrently with the filing of a submission to the Commission.

⁵ Commission guidance or action taken during the pendency of this no-action relief, could supersede the relief granted herein.

