



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Market Oversight

CFTC Letter No. 13-86

No-Action

December 31, 2013

Division of Market Oversight

Re: Provision of Time-Limited No-Action Relief to DCOs and their Clearing Members from the SEF Registration Requirement and Trading Mandate under Part 37 and from Various Reporting Requirements under Part 45, all in Connection with CDS Clearing-Related Swaps

On September 18, 2013, the Chicago Mercantile Exchange, Inc. (“CME”), a Commission-registered derivatives clearing organization (“DCO”), on behalf of its clearing members and itself, submitted a request for no-action relief to the Division of Market Oversight (“DMO” or the “Division”) of the Commodity Futures Trading Commission (“Commission”).

In particular, CME requested that DMO confirm it will not recommend that the Commission commence an enforcement action against CME for not registering as a swap execution facility (“SEF”) pursuant to CFTC Regulation 37.3 in connection with its operation of the Price Quality Auction process. Additionally, CME requested that DMO confirm it will not recommend that the Commission commence an enforcement action against any CME clearing member for entering into a swap, which is subject to the trade execution requirement under Commodity Exchange Act (“CEA”) Section 2(h)(8), through the CME’s “Price Quality Auction” process and not on a SEF or designated contract market (“DCM”).

As discussed below, the relief provided herein is not limited to any particular DCO or clearing member, but rather applies to certain occasional, off-facility, cleared credit default swaps (“CDSs”), and the counterparties thereto, that are entered into pursuant to a DCO’s rules related to its price submission process for determining end-of-day settlement prices for cleared CDS. For the purposes of this relief, this settlement price process is referred to as the “CDS Settlement Price Process,” and the swaps associated with this process are referred to as “Clearing-Related Swaps.”¹

¹ CME refers to its CDS Settlement Price Process as the “Price Quality Auction” process. In addition to CME, three other registered DCOs are eligible to clear CDS at this time: ICE Clear Credit, ICE Clear Europe, and LCH.Clearnet SA; each DCO operates a similar CDS Settlement Price Process.

DMO has previously issued no-action relief in connection with the reporting requirements of Part 45, allowing the DCO to fulfill all of the reporting counterparty's obligations with respect to reporting certain CDS trades executed pursuant to a CDS Settlement Price Process.² The Division notes the expiration late this month of that previously issued relief.³ In addition to providing relief in connection with CME's request, in this letter DMO is extending the relief provided in CFTC Letter No. 13-36 without any substantive changes to the relief provided therein.

For purposes of this letter, the terms "CDS Settlement Price Process" and "Clearing-Related Swaps" have the same meaning as in the Division's two previous letters using these defined terms.⁴

I. **Background and Request for No-action Relief**

CDS Clearing-Related Swaps are swaps that are entered into by clearing members of a DCO, pursuant to the DCO's rules regarding the CDS Settlement Price Process.⁵ Each Commission-registered DCO that is eligible to clear CDS has unique policies and procedures in place to ensure accurate and reliable end-of-day pricing for cleared CDS products.⁶ Generally speaking, under the rules of those DCOs, clearing members are required to submit price quotes for any cleared CDS product in which the clearing member, or the clearing member's customers, has an open interest at the end of each day. The DCO relies on these quotes in setting the end-of-day settlement prices for all cleared CDS positions.⁷

In order to ensure that the prices submitted by clearing members as part of the CDS Settlement Price Process are reliable and accurate, DCOs require their clearing members, from

² By letter dated December 19, 2012, DMO granted a request from the International Swaps and Derivatives Association, Inc. ("ISDA"), dated December 13, 2012, on behalf of its members and other similarly situated persons that intended to register as SDs or MSPs, for no-action relief with respect to enforcement actions against an SD or MSP reporting counterparty for failure to comply with the obligations to report swap data for CDS Clearing-Related Swaps under part 45 of the Commission's regulations. CFTC Letter No. 12-59 (December 19, 2012). DMO extended this relief by letter dated on June 27, 2013. CFTC Letter No. 13-36 (June 27, 2013).

³ CFTC Letter No. 13-36 (issued June 27, 2013) expires, absent further action by the Division, on December 31, 2013.

⁴ CFTC Letters No. 12-59 (December 19, 2012) and No. 12-59 (December 19, 2012).

⁵ See, e.g., ICE Clear Europe Clearing Rules 401(a)(xi) and 503(g); and ICE Clear Europe's CDS Procedures Paragraph 8.

⁶ See *supra*, note 1.

⁷ For instance, and as stated in CME's request for no-action relief, CME clearing members are required under CME clearing rules to submit mid-price quotes for each cleared CDS product. These mid-prices are used by CME to generate end-of-day settlement prices for each CDS, through the Price Quality Auction process, the settlement prices are then used to calculate margin and net positions. According to CME, its Price Quality Auction process ensures sufficient reliable third party pricing data on CDS.

time to time, to enter into “firm” or “forced” trades that result in cleared CDS positions.⁸ According to the letters from CME and ISDA, requiring clearing members to enter into CDS Clearing-Related Swaps encourages the best quality submissions and ensures that clearing members provide only actionable quotes for purposes of the CDS Settlement Price Process.

II. Applicable Regulatory Requirements and Analysis

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) added to the CEA provisions regarding the trading of swaps.⁹ New Section 733 of the Dodd-Frank Act (CEA Section 5h(h)(a)(1)) requires any person who operates a facility for the trading of swaps to register as a SEF or as a DCM. In addition, new Section 723 of the Dodd-Frank Act (CEA Section 2(h)(8)) sets forth a trade execution requirement, which provides that swap transactions subject to the clearing requirement must be executed on a DCM or SEF, unless no DCM or SEF makes the swap available to trade or for swap transactions subject to the clearing exception under CEA Section 2(h)(7).

Pursuant to new CEA Section 5h concerning the registration and operation of SEFs, the Commission adopted implementing regulations under Part 37,¹⁰ including Commission Regulation 37.3, which addresses requirements and procedures for registration. In addition, the Commission adopted Commission Regulations 37.10 and 38.12¹¹ (which both address the made-available-to-trade process, on SEFs or DCMs, respectively) and Commission Regulations 37.12 and 38.11 (providing the timeline for compliance once the made-available-to-trade determination has been made), together triggering the mandate that the swap be executed on a DCM or SEF.¹²

Title VII of the Dodd-Frank Act added to the CEA provisions requiring the retention and reporting of data relating to all swap transactions. Pursuant to these newly added requirements,¹³ the Commission adopted implementing regulations under Part 45, to establish swap data recordkeeping and SDR reporting requirements.¹⁴ Among other things, Part 45 requires the reporting of both swap creation data and continuation data to SDRs, and establishes a hierarchy

⁸ For example, according to CME, it randomly selects at least one CDS product per matched interest day in which CDS clearing members submitting crossing bids and offers may be subject to being crossed in the Price Quality Auction process. During the Price Quality Auction process, the crossing bids and offers may be paired and assigned a trade at a price that is the average of their bid/offer. CME states that this requirement holds CDS clearing members accountable for sending high quality mid-prices to CME.

⁹ Pub. L. 111-203, 124 Stat. 1376 (2010).

¹⁰ 78 FR 33476 (“Core Principles and Other Requirements for Swap Execution Facilities”) (June 4, 2013).

¹¹ 78 FR 33606 (“Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available to Trade, Swap Transaction Compliance and Implementation Schedule, and Trade Execution Requirement Under the Commodity Exchange Act”) (June 4, 2013).

¹² 17 C.F.R. §§ 37.3, 37.10 and 37.12.

¹³ New CEA Section 2(a)(13)(G) requires that all swaps, both cleared and uncleared, be reported to a registered swap data repository (“SDR”). New CEA Section 21(b) directs the Commission to prescribe standards for swap data recordkeeping and reporting.

¹⁴ 76 Fed. Reg. 2197 (Jan. 13, 2012).

for determining which counterparty to a swap is the “reporting counterparty.”¹⁵ Moreover, the reporting burden of a reporting counterparty under Part 45 is dependent on whether the swap is executed on-facility or off-facility, and whether the swap is cleared. Under certain circumstances described in Part 45, SDs and MSPs are required to report PET data for off-facility swaps that are cleared by a DCO.¹⁶ SDs and MSPs also are required to report valuation data for all swaps for which they are the reporting counterparty.¹⁷

III. Scope of No-Action Relief

Based on the concerns raised by CME and ISDA, the facts and circumstances described by CME in its September 18, 2013 letter and those previously described in the December 13, 2012 request from ISDA,¹⁸ the Division will not recommend that the Commission take enforcement action against a DCO meeting the following specified conditions, for failure to register as a SEF pursuant to CFTC Regulation 37.3; additionally, the Division will not recommend that the Commission commence an enforcement action against any DCO clearing member for entering into a swap through the DCO’s CDS Settlement Price Process and not on a SEF or a DCM for CDS Clearing-Related Swaps, even if such swap is subject to CEA Section 2(h)(8)’s trade execution requirement, subject to the following conditions:

1. The no-action relief shall apply only to CDS Clearing-Related Swaps arising from, or entered into pursuant to, a DCO’s CDS Settlement Price Process, and executed as required by the DCO’s rules and procedures.
2. Each trade must involve a clearing member of a DCO that is eligible to clear CDS indices and must participate in that DCO’s CDS Settlement Price Process, and must be carried out by the DCO as part of equal and opposite paired transactions such that the DCO’s net exposure remains unchanged.¹⁹
3. The CDS Clearing-Related Swap trade is initiated solely by the DCO, pursuant to its rules and procedures.

In addition, based on the concerns raised by ISDA and the facts and circumstances described in its December 13, 2012 letter, the Division will not recommend that the Commission take enforcement action against a reporting counterparty for failure to comply with its

¹⁵ Required swap creation data means all primary economic terms (PET) data and all confirmation data for a swap. Required swap continuation data means all changes to PET data and all valuation data. 17 C.F.R. §§ 45.1, 45.8.

¹⁶ 17 C.F.R. § 45.3

¹⁷ 17 C.F.R. § 45.4(b)(2)(ii).

¹⁸ See *supra*, note 2.

¹⁹ This condition applies whether the DCO rules treat the trades as between two clearing members followed by novation (such that each of the two clearing members ultimately has equal and opposite transactions against the DCO) or as equal and opposite trades carried out directly between the DCO and each of the two different clearing members.

obligations to report swap data as required by Part 45 for CDS Clearing-Related Swaps,²⁰ subject to the following conditions:

1. The reporting counterparty, as defined in Part 45, must be a clearing member of a DCO that is eligible to clear CDS indices and must participate in that DCO's CDS Settlement Price Process.
2. The no-action relief shall apply only to CDS Clearing-Related Swaps arising from, or entered into pursuant to, a DCO's CDS Settlement Price Process, as required by the DCO's rules and procedures.
3. The reporting counterparty and DCO agree, as evidenced by private agreement or pursuant to a DCO's rules, that the DCO shall fulfill all of the reporting counterparty's obligations with respect to reporting CDS Clearing-Related Swaps pursuant to Part 45.

The no-action relief contained in this letter shall expire at 11:59 p.m. on September 30, 2014.

IV. Conclusion

This letter, and the no-action position taken herein, represent the views of the Division of Market Oversight only, and do not necessarily reflect the views of the Commission or any other division or office of the Commission's staff. Should the Commission promulgate rules in the future that are in conflict with any no-action relief granted in this letter, any such rules will supersede this letter. The no-action position taken herein does not excuse affected persons from compliance with any other applicable requirements of the CEA or the regulations promulgated thereunder. This position is based upon the representations contained in the September 18, 2013 CME request letter, and the December 13, 2012 ISDA request letter, and it should be noted that any different, changed, or omitted material facts or circumstances may require a different conclusion or render this no-action letter void. Finally, as noted above and as with all no-action letters, the Division of Market Oversight retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

If you have any questions concerning the content of this staff no-action letter, please contact David Van Wagner, Chief Counsel, Division of Market Oversight, at (202) 418-5481 or dvanwagner@cftc.gov, Riva Spear Adriance, Senior Special Counsel, Division of Market Oversight, at (202) 418-5494 or radiance@cftc.gov, or [Stuart Armstrong, Special Counsel, Division of Market Oversight](mailto:Stuart_Armstrong, Special Counsel, Division of Market Oversight), at (202) 418-5095 or sarmstrong@cftc.gov.

²⁰ The Division notes that while the relief provided herein addresses obligations to report swap data as required by Part 45, it does not address obligations required under Part 43; consequently this letter neither addresses nor grants any such relief, leaving Part 43 applicable under the terms contained therein.

Sincerely,

Vincent A. McGonagle
Director
Division of Market Oversight