



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and
Intermediary Oversight

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Director

CFTC Letter No. 13-13
No-Action
May 2, 2013
Division of Swap Dealer and Intermediary Oversight

Re: Time-Limited Relief for Swap Dealers and Major Swap Participants from Compliance with Business Conduct Standards in Foreign Exchange Transactions with a Settlement Cycle of No More than Seven Local Business Days

Ladies and Gentlemen:

This letter is in response to a request from the Asset Management Group of the Securities Industry and Financial Markets Association (“AMG”) to the Division of Swap Dealer and Intermediary Oversight (“Division”) of the Commodity Futures Trading Commission (“Commission”), in which AMG requested relief from the Division from compliance by swap dealers (“SDs”) and major swap participants (“MSPs”) with business conduct standards rules found in subpart H of part 23 of the Commission’s regulations¹ when entering into certain foreign exchange transactions with a settlement cycle of no more than seven local business days, as described further herein.

Applicable Regulatory Requirements

Section 4s(h) of the Commodity Exchange Act (“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 Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties as subpart H of part 23 of the Commission’s regulations.² There was a 60-day period for the public to comment on the proposing release. On May 4, 2011, the

¹ See 17 CFR §§ 23.400-23.451; Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 FR 9734 (Feb. 17, 2012) (hereinafter, the “External Business Conduct Standards”).

² Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 75 FR 80638 (proposed Dec. 22, 2010).

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, 2011.³ On February 17, 2012, the Commission published in the Federal Register final business conduct rules for SDs and MSPs as subpart H of part 23.⁴ The initial compliance date for the External Business Conduct Standards rules was the later of 180 days after the effective date of the External Business Conduct Standards rules or “the date on which swap dealers or major swap participants are required to apply for registration pursuant to Commission rule 3.10.”⁵ The Commission subsequently postponed the compliance date for a number of the provisions of the External Business Conduct Standards rules until May 1, 2013.⁶

The Division notes that pursuant to section 1a(47)(E) of the CEA,⁷ the Secretary of the Treasury (“Secretary”) is vested with the authority to determine whether foreign exchange swaps and forwards⁸ should be regulated as swaps under the CEA, provided that the Secretary makes a written determination satisfying certain criteria specified in CEA section 1b. On November 16, 2012, the Secretary issued a written determination that foreign exchange forwards and foreign exchange swaps should not be regulated as swaps under the CEA (“Treasury Determination”).⁹ Nonetheless, CEA section 1a(47)(E)(iv) states that, notwithstanding the Secretary’s written determination, “any party to [an Exempt FX Transaction¹⁰] that is a SD or MSP shall conform to the business conduct standards contained in section 4s(h).”¹¹ Thus, SDs and MSPs are required to comply with the business conduct standards adopted by the Commission in subpart H of part 23 of the Commission’s regulations with respect to Exempt FX Transactions by May 1, 2013.

³ 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).

⁴ *See supra* note 1.

⁵ External Business Conduct Standards at 9734.

⁶ In September 2013, the Commission changed the compliance date of §§ 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 to 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). The Commission later changed the compliance date for these provisions to May 1, 2013. *See* Business Conduct and Documentation Requirements for Swap Dealers and Major Swap Participants; Extension of Compliance Date, 78 FR 17, 20 (Jan. 2, 2013).

⁷ 7 U.S.C. 1a(47)(E).

⁸ Foreign exchange swaps and foreign exchange forwards are defined in Sections 1a(24) and 1a(25), respectively, of the Commodity Exchange Act.

⁹ Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act, 77 Fed. Reg. 69694 (Nov. 20, 2012) (hereinafter, the “Treasury Determination”).

¹⁰ Physically-settled foreign exchange forwards and swap agreements that have been exempted from the definition of swap by the U.S. Department of the Treasury are hereinafter referred to as “Exempt FX Transactions.” *See* Treasury Determination.

¹¹ Additionally, foreign exchange swaps and foreign exchange forwards are subject to reporting obligations, pursuant to Section 1a(47)(E)(iii) of the CEA, 7 U.S.C. § 1a(47)(E)(iii).

Summary of Request for Relief

AMG represents that some SDs, for operational reasons relating to regulatory compliance, are treating all foreign exchange transactions that settle on a greater than “T+2” basis, regardless of whether they would otherwise qualify as spot transactions, as potential foreign exchange forwards for administrative ease, notwithstanding the interpretation of the Commission in the adopting release for its rules further defining the term “swap” regarding the distinction between foreign exchange spot transactions and foreign exchange forwards, and the extension of the T+2 deadline for spot transactions in securities conversion transactions.¹²

According to AMG, treatment of these spot transactions as foreign exchange forwards by their counterparties is causing a significant impediment to normal operations, especially as they continue to try to get all of their clients that trade swaps or Exempt FX Transactions to provide all necessary information, representations and agreements to permit SDs to be in full compliance with the External Business Conduct Standards rules by May 1, 2013. Thus, because of the difficulties surrounding certain foreign exchange transactions settling on longer than a “T+2” basis, AMG requests that the Division provide no-action relief for an appropriate period while market participants develop the necessary systems and standards for distinguishing between foreign exchange spot transactions, foreign exchange forwards and other foreign exchange transactions that are not foreign exchange spot transactions, in accordance with the Commission’s interpretation.

For at least some foreign jurisdictions that AMG is aware of, the settlement cycle for certain securities conversion transactions, after giving effect to customary extensions, can be significantly longer than “T+2.” AMG believes therefore that temporary relief for foreign

¹² See Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48208, 48256-58 (Aug. 13, 2012), stating in relevant part that the Commission was:

. . . providing an interpretation that a bona fide foreign exchange spot transaction, *i.e.*, a foreign exchange transaction that is settled on the customary timeline of the relevant spot market, is not within the definition of the term “swap.” In general, a foreign exchange transaction will be considered a bona fide spot transaction if it settles via an actual delivery of the relevant currencies within two business days. In certain circumstances, however, a foreign exchange transaction with a longer settlement period concluding with the actual delivery of the relevant currencies may be considered a bona fide spot transaction depending on the customary timeline of the relevant market.

The CFTC will [also] consider the following to be a bona fide spot foreign exchange transaction: An agreement, contract or transaction for the purchase or sale of an amount of foreign currency equal to the price of a foreign security with respect to which (i) the security and related foreign currency transactions are executed contemporaneously in order to effect delivery by the relevant securities settlement deadline and (ii) actual delivery of the foreign security and foreign currency occurs by such deadline (such transaction, a “Securities Conversion Transaction”). For Securities Conversion Transactions, the CFTC will consider the relevant foreign exchange spot market settlement deadline to be the same as the securities settlement deadline.

exchange transactions with a settlement cycle of no more than “T+7” is appropriate to provide assurance that spot transactions will not be considered foreign exchange forwards during a brief period while market participants develop the necessary systems and standards for distinguishing between foreign exchange spot transactions, foreign exchange forwards and other foreign exchange transactions that are not foreign exchange spot transactions in accordance with the Commission’s interpretation. AMG argues that if SDs and MSPs are not required to comply with the External Business Conduct Standards rules for a transition period with respect to foreign exchange transactions with a settlement cycle of no more than “T+7” local business days, a large number of counterparties that believe they are only engaging in bona fide spot foreign exchange transactions could continue their activities without the potential for disruption.

Division No-Action Position

Based on the representations of AMG, the Division believes that relief is warranted with respect to the External Business Conduct Standards rules in the context of certain foreign exchange transactions that all parties involved intend to be foreign exchange spot transactions but that, solely due to current operational constraints, SDs are unable to readily recognize and treat as such. Accordingly, **prior to September 1, 2013**, the Division will not recommend that the Commission commence an enforcement action against an SD or MSP for failure to comply with the External Business Conduct Standards rules with respect to a foreign exchange transaction with an eligible contract participant that has a settlement cycle of no more than seven local business days in the place of settlement.

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. In particular, nothing in this letter is intended to interpret or amend the definition of foreign exchange forward, any type of swap involving foreign exchange, or any other foreign exchange transaction. 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. 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; Ward Griffin, Associate Chief Counsel, at (202) 418-5425; or Adam Kezsbom, Special Counsel, at (202) 418-5372.

Very truly yours,

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