



## 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. 13-70  
No-Action  
November 15, 2013  
Division of Swap Dealer and Intermediary Oversight

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

Ladies and Gentlemen:

On June 27, 2013, the Division of Swap Dealer and Intermediary Oversight (“**Division**”) of the Commodity Futures Trading Commission (“**Commission**”) published No-Action Letter No. 13-33 (the “**June No-Action Letter**”), which responded to requests received by the Division 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> The June No-Action Letter provided no-action relief for these swaps 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.

Subsequent to issuance of the June No-Action Letter, circumstances in the market for swaps intended to be submitted for clearing contemporaneously with execution have changed. Specifically, as of October 2, 2013, swap execution facilities (“**SEFs**”) began mandatory registration with the Commission.<sup>2</sup> Further, on September 26, 2013, the Commission’s Division of Clearing and Risk and its Division of Market Oversight issued staff guidance on the Commission’s swaps straight-through-processing requirements (the “**STP Guidance**”).<sup>3</sup>

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<sup>1</sup> Although the relief contained in the June No-Action Letter was requested by ISDA and AMG on behalf of their members, such relief was made 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 in the June No-Action Letter.

<sup>2</sup> As of the date of this letter, 18 SEF’s have temporarily registered with the Commission, and for the week ending October 25, 2013, more than a quarter of a trillion dollars in notional amount of swaps was trading on such SEFs on average per day.

<sup>3</sup> The STP Guidance is available on the Commission’s website:  
<http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/stpguidance.pdf>.

Pursuant to the STP Guidance, such Divisions reminded futures commission merchants (“FCMs”), SEFs, designated contract markets (“DCMs”), and derivatives clearing organizations (“DCOs”) of their obligations to comply with the Commission’s straight-through-processing regulations with respect to swaps executed on a SEF or DCM that are intended to be cleared. Specifically, the Divisions reiterated the Commission’s regulations requiring FCMs, SEFs, DCMs, and DCOs to coordinate with each other to facilitate prompt and efficient processing by DCOs, and noted that pursuant to these regulations, there should be near-instantaneous acceptance or rejection of each trade for execution and clearing, thereby reducing risk. Further, the Division notes that the STP Guidance specifically stated that DCMs, SEFs, FCMs, and SDs “should not require breakage agreements as a condition for access to trading on a SEF or DCM.”

Given that a significant volume of trading is now occurring on a total of 18 registered SEFs and that such SEFs are expected to comply with their obligations with respect to facilitating straight-through-processing, the Division is now reissuing the no-action relief contained in the June No-Action Letter, but with modified conditions that recognize the required prompt and efficient processing of swaps from execution to clearing. In consequence of statements in the STP Guidance that swaps executed on or subject to the rules of a SEF or DCM and intended to be cleared, but fail to clear should be void *ab initio*,<sup>4</sup> the Division has removed those conditions that required a fallback or any other agreement (including breakage agreements) between an SD or MSP and its counterparty prior to execution of such swaps. In addition, the Division believes that no fallback or any other agreement (including breakage agreements) between and SD or MSP and its counterparty should be necessary for swaps that are intended to be cleared but not executed on or subject to the rules of a SEF or DCM so long as the swap is submitted for clearing within the same time frame that would be required if such swap were executed on a SEF or DCM.<sup>5</sup>

## **I. Background**

The following background discussion appeared in the June No-Action Letter and is repeated here for ease of reference, with minor updates and corrections.

On July 21, 2010, President Obama signed the Dodd-Frank Act.<sup>6</sup> Title VII of the Dodd-Frank Act<sup>7</sup> amended the Commodity Exchange Act (“CEA”)<sup>8</sup> to establish a comprehensive

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<sup>4</sup> *Id.*

<sup>5</sup> The STP Guidance reiterates the requirements of Commission regulation 39.12(b)(7) that a SEF must route trades to a DCO “as quickly after executed as would be technologically practicable if fully automated systems were used.” The Division notes that Commission regulation 39.12(b)(7)(i)(B) also requires each FCM, SD, and MSP to “establish systems that enable the clearing member, or the DCO acting on its behalf, to accept or reject each trade submitted to the DCO for clearing by or for the clearing member or a customer of the clearing member as quickly as would be technologically practicable if fully automated systems were used.” As stated in the STP Guidance, DCOs now accept at least 93% of trades within three seconds or less, and 99% of trades within ten seconds.

<sup>6</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>.

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 66 rules, orders, and guidance to implement Title VII of the Dodd-Frank Act. In 2012, 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>9</sup> as well as the regulations further defining the term "swap."<sup>10</sup> The Commission also adopted regulations setting forth a comprehensive scheme for the registration process for SDs and MSPs.<sup>11</sup> Other finalized rules include various substantive requirements applicable to SDs and MSPs under CEA section 4s,<sup>12</sup> which address reporting and recordkeeping,<sup>13</sup> business conduct standards,<sup>14</sup> documentation standards,<sup>15</sup> duties,<sup>16</sup> and designation of chief compliance officers.<sup>17</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

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<sup>7</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>8</sup> 7 U.S.C. 1 et seq.

<sup>9</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>10</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>11</sup> See Registration of Swap Dealers and Major Swap Participants, 77 FR 2613 (Jan. 19, 2012).

<sup>12</sup> 7 U.S.C 6s.

<sup>13</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>14</sup> See Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 FR 9734 (Feb. 17, 2012).

<sup>15</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>16</sup> See *supra* note 13.

<sup>17</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>18</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>19</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>20</sup> SDs and MSPs were required to comply with the External BCS by May 1, 2013.<sup>21</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>22</sup> Certain safe harbors under the External

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<sup>18</sup> Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 75 FR 80638 (proposed Dec. 22, 2010).

<sup>19</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>20</sup> Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 FR 9734 (Feb. 17, 2012).

<sup>21</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>22</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

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>23</sup>

### Swap Trading Relationship Documentation

Documentation standards for SDs and MSPs have been adopted by the Commission pursuant to Sections 4s(i)(1) and 4s(h) 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>24</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>25</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>26</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>27</sup> With 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

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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>23</sup> See § 23.402(d), (e), and (f).

<sup>24</sup> Swap Trading Relationship Documentation for Swap Dealers and Major Swap Participants, 76 FR 6715 (proposed Feb. 8, 2011).

<sup>25</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>26</sup> See § 23.504(a)(2).

<sup>27</sup> See § 23.504(b)(1) and (3).

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>28</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>29</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>30</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 clearing.<sup>31</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>32</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>33</sup> For swaps subject to 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>34</sup>

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<sup>28</sup> See § 23.504(b)(4)(i).

<sup>29</sup> See § 23.504(b)(4)(ii).

<sup>30</sup> See § 23.504(c).

<sup>31</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>32</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>33</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).

<sup>34</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

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>35</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>36 37</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>38</sup>

## **II. Relief Requested**

The Requesting Associations noted 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>39</sup>

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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>35</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>36</sup> See *id.* at 21307.

<sup>37</sup> The STP Guidance notes that DCOs now accept at least 93% of trades within three seconds or less, and 99% of trades within ten seconds, and therefore DCOs clearing swaps within 10 seconds after submission are compliant with the timing standard of Commission regulation 39.12(b)(7).

<sup>38</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>39</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 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

Similarly, the Requesting Associations observed 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>40</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.

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 sought

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§ 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>40</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.

relief that would extend such exceptions based on the same rationales outlined above. Thus, the Requesting Associations sought 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 (i) of a type accepted for clearing by a DCO, and (ii) intended to be submitted for clearing contemporaneously with execution (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>41</sup> Knowledge of its counterparty’s identity is, of course, essential to comply with these requirements under the External BCS, but the Requesting Associations argued that these requirements intended 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 argued 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.

### **III. Staff Position**

Based on the foregoing, the Division is of the view that all ITBC Swaps should be provided relief from the documentation requirements of § 23.504, subject to certain conditions.

In addition, with respect to the External BCS requirements, the Division is of the view that ITBC Swaps executed non-anonymously<sup>42</sup> on or subject to the rules of a SEF or DCM

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<sup>41</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).

<sup>42</sup> See *supra* note 39 for a list of exceptions from the External BCS where the SD or MSP does not know the identity of a counterparty prior to execution.

(“**Disclosed SEF/DCM Swaps**”) and currently accepted for clearing by a DCO, or subject to a mandatory clearing determination by the Commission, are sufficiently standardized such that relief from compliance with a broad scope of External BCS requirements is warranted.

However, the Division has no basis to conclude that Disclosed SEF/DCM Swaps that begin to be accepted for clearing by a DCO after the date of this letter will be sufficiently standardized to warrant relief from the same broad scope of External BCS, unless such swaps are subject to a mandatory clearing determination by the Commission. The Division is of the view that swaps that are found appropriate for a mandatory clearing determination by the Commission are likely to be sufficiently standardized to warrant the full scope of External BCS relief. Otherwise, the Division is of the view that only more limited relief from the External BCS requirements is warranted such that compliance with the core pre-execution material disclosure requirements of the External BCS is preserved.

In summary, the Division believes that no-action relief for SDs and MSPs is warranted with respect to certain External BCS requirements and the swap trading relationship documentation requirement under Commission regulation § 23.504 in the context of an ITBC Swap, subject to conditions, including whether or not the SD or MSP knows the identity of the counterparty prior to execution of the ITBC Swap, whether or not the swap is executed on or subject to the rules of a SEF or DCM, and whether or not the swap is currently cleared by a DCO or subject to a mandatory clearing determination by the Commission.

Accordingly, the Division will not recommend that the Commission commence an enforcement action against an SD or MSP for:

- (A) Failure to comply with the requirements of the External BCS specified in Table 1 of Appendix A attached hereto, or the requirements of Commission regulation § 23.504 (Swap trading relationship documentation) with respect to an ITBC Swap where:
  - (i) The SD or MSP does not know the identity of the counterparty prior to execution of the swap; and
  - (ii) The ITBC Swap is not executed on or subject to the rules of a SEF or DCM;<sup>43</sup> and
  - (iii) The SD or MSP ensures that both parties submit the ITBC Swap for clearing as quickly after execution as would be technologically practicable if fully automated systems were used; or
- (B) Failure to comply with the requirements of the External BCS specified in Table 1 of Appendix A attached hereto, or the requirements of Commission regulation § 23.504 (Swap trading relationship documentation) with respect to an ITBC Swap where:

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<sup>43</sup> Commission regulation 23.504 and many of the External BCS do not apply to swaps executed on or subject to the rules of a SEF or DCM and cleared on a DCO where the SD or MSP does not know the identity of the counterparty prior to execution of the swap. *See supra* note 39 and accompanying text.

- (i) The SD or MSP knows the identity of the counterparty prior to execution of the swap;
  - (ii) The ITBC Swap is executed on or subject to the rules of a SEF or DCM; and either
  - (iii) The ITBC Swap is of a type that is accepted for clearing by a DCO as of the date of this letter; or
  - (iv) The ITBC Swap is of a type that is, as of the date of execution, required to be cleared pursuant to 2(h)(1) of the CEA and part 50 of the Commission's regulations; or
- (C) Failure to comply with the requirements of the External BCS specified in Table 2 of Appendix A attached hereto, or the requirements of Commission regulation § 23.504 (Swap trading relationship documentation) with respect to an ITBC Swap where:
- (i) The SD or MSP knows the identity of the counterparty prior to execution of the swap;
  - (ii) The ITBC Swap is executed on or subject to the rules of a SEF or DCM;
  - (iii) The ITBC Swap is of a type that was not being accepted for clearing by a DCO as of the date of this letter; and
  - (iv) The ITBC Swap is not of a type that is, as of the date of execution, required to be cleared pursuant to 2(h)(1) of the CEA and part 50 of the Commission's regulations; or
- (D) Failure to comply with the requirements of Commission regulation § 23.504 (Swap trading relationship documentation) with respect to an ITBC Swap where:
- (i) The SD or MSP knows the identity of the counterparty prior to the execution of the swap; and
  - (ii) The ITBC Swap is not executed on or subject to the rules of a SEF or DCM; and
  - (iii) The SD or MSP ensures that both parties submit the ITBC Swap for clearing as quickly after execution as would be technologically practicable if fully automated systems were used.

The relief specified above is, in each case, subject to the following conditions:

1. The SD or MSP is either a clearing member of the DCO to which the ITBC Swap will be submitted, 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; and
2. The SD or MSP does not require the counterparty or its clearing FCM to enter into a breakage agreement or similar agreement as a condition to executing the ITBC Swap.

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.

This letter supersedes No-Action Letter No. 13-33. No person may rely upon the relief provided in such letter after the date hereof.

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

Jamila A. Piracci, OTC Derivatives  
National Futures Association, New York

**APPENDIX A**

**Specified External BCS Requirements**

<b>TABLE 1</b>	
<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

<b>TABLE 2</b>	
<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(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
§ 23.451	Political contributions by certain swap dealers