



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and
Intermediary Oversight

Gary Barnett
Director

CFTC Letter No. 13-38
No-Action
June 27, 2013
Division of Swap Dealer and Intermediary Oversight

Re: Time-Limited No-Action Relief Regarding Certain Documentation Requirements for Swap Dealers (“SDs”) and Major Swap Participants (“MSPs”) with Foreign Exchange Counterparties

Ladies and Gentlemen:

This letter is in response to requests from the Global Financial Markets Association (“**GFMA**”), Global Foreign Exchange Division (“**GFXD**”), the Financial Services Roundtable (the “**Roundtable**”), State Street Bank and Trust Company, the Asset Management Group of the Securities Industry and Financial Markets Association, the Investment Company Institute, and the International Swaps and Derivatives Association (collectively, the “**Associations**”), on behalf of their members and other similarly situated persons, received by the Division of Swap Dealer and Intermediary Oversight (“**Division**”) of the Commodity Futures Trading Commission (“**Commission**”), requesting, among other things, time-limited no-action relief from the compliance dates for certain documentation obligations of swap dealers (“**SDs**”) and major swap participants (“**MSPs**”) in connection with (i) foreign exchange transactions that are swaps¹ (“**Swaps on FX**”), and (ii) physically-settled foreign exchange forwards and swap agreements that have been exempted from the definition of swap by the Secretary of the U.S. Department of the Treasury² (“**Exempt FX Transactions**” and together with Swaps on FX, the “**Covered Transactions**”).

¹ Swaps are defined in Section 1a(47) of the Commodity Exchange Act (the “**Act**” or “**CEA**”) and Commission regulation 1.3(xxx), 17 CFR 1.3(xxx). Commission Regulations are codified in Title 17 of the Code of Federal Regulations. Foreign exchange transactions that are swaps include, without limitation, non-deliverable forwards involving foreign exchange and foreign currency options. For purposes of this letter, cross-currency swaps are not foreign exchange transactions.

² See 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**”).

The Associations argue that time-limited relief should be granted with respect to Covered Transactions that are not covered by an ISDA Master Agreement or other equivalent type of relationship documentation that strictly meets the requirements of Regulation 23.504, which contains the Commission's swap trading relationship documentation requirements ("**STRD Rule**"),³ so long as such SD or MSP complies with an alternative compliance schedule.⁴ Specifically, the Associations seek an extension of the July 1, 2013 compliance deadline for Regulation 23.504, which prescribes obligations relating to swap trading relationship documentation.⁵ The Associations represent that market participants who engage in Covered Transactions require additional time to comply with the STRD Rule because, *inter alia*, (1) the vast majority of Covered Transactions have not traditionally been covered by ISDA Master Agreements or equivalent types of relationship documentation, and (2) there was an initial lack of awareness that the STRD Rule applied to Exempt FX Products thereby necessitating that counterparties enter into ISDA Master Agreements or other equivalent relationship documentation. The relief provided in this no-action letter is available to all SDs and MSPs

Applicable Regulatory Requirements

Section 731 of the Dodd-Frank Act⁶ amended the Commodity Exchange Act ("CEA") by adding a new Section 4s, which established requirements relating to the registration and regulation of swap dealers and major swap participants.⁷ CEA Section 4s(h)(1) requires that swap dealers and major swap participants comply with business conduct standards promulgated by the Commission in the categories set forth in Sections 4s(h)(1)(A)-(D) and 4s(h)(3). Additionally, CEA Section 4s(i) mandates that the Commission promulgate documentation standards relating to timely and accurate confirmation, processing, netting, documentation, and valuation of all swaps, and requires swap dealers and major swap participants to "conform with such standards."⁸

On February 17, 2012, the Commission issued final rules prescribing certain business conduct standards for swap dealers and major swap participants in their dealings with counterparties ("External Business Conduct Standards Rules").⁹ Among other things, the External Business Conduct Standards Rules imposed requirements relating to the prohibition on

³ 17 C.F.R. § 23.504.

⁴ See Letter from James Kemp, Managing Director, GFMA GFXD and Richard M. Whiting, Executive Director and General Counsel, the Roundtable, to Gary Barnett, Director, DSIO (June. 5, 2013) (requesting no-action relief with respect to the compliance dates for Commission Regulation ("Regulation") 23.504).

⁵ 17 C.F.R. § 23.504.

⁶ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).

⁷ 7 U.S.C. § 6s.

⁸ 7 U.S.C. § 6s(i).

⁹ See Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 FR 9734 (Feb. 17, 2012) (hereinafter "External Business Conduct Standards Rules").

fraud, manipulation, and other abusive practices; “know your counterparty” and verification of counterparty eligibility; disclosures of certain information to counterparties; fair dealing; recommendations to counterparties and institutional suitability; dealings with Special Entities; pay-to-play restrictions; and anti-evasion restrictions. The Adopting Release required that swap dealers and major swap participants be compliant with the External Business Conduct Standards Rules on the later of October 15, 2012, or the date on which the firm is required to apply for registration.¹⁰

On September 11, 2012, the Commission issued final rules prescribing, among other things, obligations of SDs and MSPs concerning swap trading relationship documentation (the “Documentation Rule”).¹¹

The Commission set forth the following compliance schedule for the swap trading relationship documentation requirements in Commission Regulation 23.504, differentiating the compliance date by the type of counterparty:

- (1) With respect to swap transactions with swap dealers, security-based swap dealers, major swap participants, major security-based swap participants, or any private fund, as defined in section 202(a) of the Investment Advisers Act of 1940, that is not a third-party subaccount (as defined below) and that executes 200 or more swaps per month based on a monthly average over the 12 months preceding the publication of the adopting release (“active funds”), swap dealers and major swap participants must comply by January 1, 2013.
- (2) With respect to swap transactions with commodity pools; private funds as defined in section 202(a) of the Investment Advisers Act of 1940 other than active funds; or persons predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act of 1956, provided that the entity is not an account that is managed by an investment manager that (1) is independent of and unaffiliated with the account’s beneficial owner or sponsor, and (2) is responsible for the documentation necessary for the account’s beneficial owner to document swaps as required under section 4s(i) of the CEA (“third-party subaccounts”), swap dealers and major swap participants must comply by April 1, 2013.
- (3) With respect to swap transactions with any other counterparty, swap dealers and major swap participants must comply by July 1, 2013.¹²

¹⁰ *Id.* at 9734.

¹¹ 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) (hereinafter “Documentation Rules”).

¹² *Id.* at 55,940.

In response to requests from market participants, on January 2, 2013, the Commission deferred the compliance date for Regulation 23.504 for all types of counterparties until July 1, 2013.¹³ Now the Commission and Division have received the requests from the Associations for an additional extension of the compliance date for Regulation 23.504 with respect to Covered Transactions.

Summary of Request for Relief

Among other various extensions of the 23.504 compliance date requested, some of the Associations have collectively proposed that the Commission provide time-limited no-action relief that establishes compliance deadlines based on a counterparty categorization approach that is similar to the approach used in the clearing requirement compliance schedule adopted in Regulation 50.25¹⁴, and the original compliance schedule for Regulation 23.504 outlined above. It is argued that this approach will more rapidly achieve compliance for a large volume of Covered Transactions while providing more time to SDs/MSPs (and counterparties) that need more time to establish compliant documentation for Covered Transactions.

The Associations state that the alternative compliance schedule is needed because, *inter alia*, (i) a significant number of institutions trade Covered Transactions that are not covered by documentation that complies with Regulation 23.504, (ii) many market participants were not aware until recently that the STRD Rule applied to Exempt FX Products, and (iii) the negotiations necessary to enter into new documentation (because such documentation does not exist, or to amend existing documentation to cover Covered Transactions) is likely to be lengthy. The Associations state that negotiations over swap documentation frequently take months or even years because, notwithstanding the use of standardized forms as the foundation of ISDA Master Agreements, those forms are highly detailed and precise across a large number of specific points, requiring careful review by counsel, and because, additionally, swap documentation can affect, or be affected by, other documentation, such as credit agreements, security documents and agreements involving other derivative transactions.

Division No-Action Position

Based upon the representations made by the Associations, the Division believes that time-limited no-action relief is warranted. However, the Division notes that the specific swap trading relationship requirement under Regulation 23.504 is that an SD or MSP “establish, maintain, and follow written policies and procedures reasonably designed to ensure that the SD or MSP executes written swap trading relationship documentation with its counterparty that

¹³ See Business Conduct and Documentation Requirements for Swap Dealers and Major Swap Participants; Extension of Compliance Date, 78 FR 17 (Jan. 2, 2013) (hereinafter, “Extension of Compliance Date”). The Extension of compliance dates announced on January 2, 2013 applied to several other Regulations, in addition to Regulation 23.504. *Id.*

¹⁴ See Swap Transaction Compliance and Implementation Schedule: Clearing Requirement Under Section 2(h) of the CEA, 77 FR 44441, 44456 (July 30, 2013).

complies with the requirements of [§ 23.504].” Given that an SD or MSP could partially comply with Regulation 23.504 by establishing and maintaining the required written policies and procedures, the Division has determined to grant only part of the relief requested. In addition, the Division is persuaded by the requesters that its no-action relief would best be structured by counterparty type to rapidly achieve compliance for a large volume of Covered Transactions while providing appropriate relief to the SDs, MSPs and counterparties that need more time to establish documentation compliant with Regulation 23.504. Accordingly, the Division will not recommend that the Commission take an enforcement action against an SD or MSP for failure to execute swap trading relationship documentation with a counterparty in compliance with Regulation 23.504 until (1) **September 1, 2013** with respect to a counterparty that is an active fund;¹⁵ or (2) **December 31, 2013** with respect to any other counterparty except a registered SD or MSP,¹⁶ subject to the following conditions:

- (a) The SD or MSP has established and is maintaining¹⁷ the written policies and procedures required under Regulation 23.504(a)(2);
- (b) The only swaps that are currently in effect between the SD or MSP and the counterparty as of the date of this letter are Covered Transactions;
- (c) From the date of this letter until the expiration of the no-action relief specified above, the SD or MSP only enters into swaps with the counterparty that are Covered Transactions; and
- (d) As of the date of this letter, the Covered Transactions currently in effect between the SD or MSP and the counterparty are not governed by relationship documentation that is, or is substantially similar to, an ISDA Master Agreement.

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

¹⁵ For purposes of this letter, “**active fund**” means any private fund as defined in section 202(a) of the Investment Advisers Act of 1940, that is not a third-party subaccount (as defined herein) and that executes 200 or more Covered Transactions per month based on a monthly average over the 12 months preceding the date of this letter; and “**third-party subaccount**” means an account that is managed by an investment manager that is independent of and unaffiliated with the account’s beneficial owner or sponsor, and is responsible for the documentation necessary for the account’s beneficial owner to document swaps as required under section 4s(i) of the CEA.

¹⁶ For the avoidance of doubt, the Division is not giving relief from Regulation 23.504 with respect to counterparties that are also SDs or MSPs. The compliance date for such counterparties is July 1, 2013.

¹⁷ In this context, “maintaining” means that the SD or MSP not only has created such policies and procedures, but has not withdrawn them, as distinguished from compliance with such policies and procedures, which is the subject of the no-action relief until the dates set forth above.

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; Frank Fisanich, Chief Counsel, at (202) 418-5949; or Ward Griffin, Associate Chief Counsel, at (202) 418-5425.

Very truly yours,

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