



## U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre  
1155 21st Street, NW, Washington, DC 20581  
Telephone: (202) 418-5000  
Facsimile: (202) 418-5521  
[www.cftc.gov](http://www.cftc.gov)

### Division of Market Oversight

CFTC Letter No. 14-12  
No-Action  
February 10, 2014  
Division of Market Oversight

#### **No-Action Relief from the Commodity Exchange Act Sections 2(h)(8) and 5(d)(9) and from Commission Regulation § 37.9 for Swaps Executed as Part of a Package Transaction**

Ladies and Gentlemen:

This letter responds to requests received from multiple parties by the Division of Market Oversight (the “Division”) of the Commodity Futures Trading Commission (the “Commission”) for no-action relief from the trade execution requirement in Commodity Exchange Act (“CEA”) section 2(h)(8) for package transactions, as defined herein.<sup>1</sup>

#### **Background**

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”)<sup>2</sup> amended the CEA to establish a comprehensive new regulatory framework for swaps. Among other things, CEA section 2(h)(8) requires that transactions involving swaps subject to the CEA section 2(h)(1) clearing requirement be executed on a designated contract market (“DCM”) or swap execution facility (“SEF”), unless no DCM or SEF makes such swap available to trade or such swap transactions qualify for the clearing exception under CEA section 2(h)(7).<sup>3</sup>

To further implement CEA section 2(h)(8), the Commission adopted rules in parts 37 and 38 of the Commission’s regulations that specify procedures for DCMs and SEFs to make a swap available to trade, and thus subject to the trade execution requirement.<sup>4</sup> SEFs or DCMs may

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<sup>1</sup> This letter responds to no-action relief requested in the following: (1) Letter from International Swaps and Derivatives Association, Inc. (“ISDA”), Request for Relief from the Trade Execution Requirement for Packaged Transactions (January 10, 2014); (2) Letter from Managed Funds Association (“MFA”), Request for Relief from the Trade Execution Requirement for Swaps Executed as Part of Package Transactions in the Interest Rate Asset Class (January 24, 2014); and (3) Letter from TW SEF LLC (“Tradeweb”), Request for No-Action Relief from the Mandatory Trade Execution Requirement for Packaged Trades (January 31, 2014). Despite the scope of relief sought in these requests, relief is limited to that provided herein.

<sup>2</sup> Pub. L. 111-203, 124 Stat. 1376 (2010).

<sup>3</sup> 7 U.S.C. § 2(h)(8).

<sup>4</sup> See “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,” 78 Fed. Reg. 33606 (June 4, 2013).

submit an available-to-trade determination pursuant to the rule approval procedures under § 40.5 of the Commission's regulations or the self-certification procedures under § 40.6. At this time, four available-to-trade determinations for various interest rate and credit default swaps have been certified and have become effective pursuant to § 40.6.<sup>5</sup> Accordingly, these swaps, whether listed or offered for trading by any SEF or DCM, will become subject to the trade execution requirement 30 days after the certification's effective date.<sup>6</sup> All transactions involving swaps that are subject to the trade execution requirement must be executed on a DCM or a SEF. On a SEF, such swaps must be executed in accordance with the execution methods prescribed by § 37.9 of the Commission's regulations. Swaps that are subject to the trade execution requirement (and are not block trades as defined under § 43.2 of the Commission's regulations) and traded on a SEF are defined as Required Transactions. Under § 37.9(a)(2), Required Transactions must be executed on a SEF by either (1) an Order Book, as defined in § 37.3(a)(3); or (2) a Request for Quote System, as defined in § 37.9(a)(3), that operates in conjunction with an Order Book. On a DCM, such swaps must be executed pursuant to subpart J of part 38 of the Commission's regulations, which implements DCM Core Principle 9 under section 5(d)(9) of the CEA.<sup>7</sup>

### **Requested Relief**

The requesting parties assert that the commencement of the trade execution requirement will create difficulties associated with the execution and processing of groups of component trades known as "package transactions." Package transactions have been described as transactions involving more than one swap or financial instrument (often referred to as "component legs") and at least one swap subject to the trade execution requirement.<sup>8</sup>

The requesting parties state, for example, that the methods currently used by clearing members for the pre-trade screening of credit limits may not facilitate screening for package transactions,<sup>9</sup> and further, that derivatives clearing organizations ("DCOs") may lack the ability

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<sup>5</sup> Available-to-trade determinations for certain interest rate and credit default swaps were self-certified by Javelin SEF, LLC; trueEX LLC; TW SEF, LLC; and MarketAxess SEF Corporation. Those certifications became effective on January 16, 2014, January 22, 2014, January 27, 2014, and January 29, 2014, respectively. As a result of those self-certifications, transactions involving swaps in those determinations will be subject to the trade execution requirement, effective February 15, 2014, February 21, 2014, and February 26, 2014, as applicable.

<sup>6</sup> 17 C.F.R. § 37.12; 17 C.F.R. § 38.11.

<sup>7</sup> 7 U.S.C. § 7(d).

<sup>8</sup> See *infra* note 11 and accompanying text for the definition of "package transaction," as used only for purposes of the relief granted herein.

<sup>9</sup> The requesting parties state that clearing members currently check credit limits against each individual leg of a package transaction. They contend that examining the risk associated with each leg, rather than examining the net risk of all the legs together as a whole, could lead to the miscalculation of the level of pre-trade credit limit required, as the risk characteristics of a stand-alone leg may inadvertently cause credit limit breaches depending on the timing and order in which the leg is processed.

to simultaneously screen and accept all legs of a package transaction for clearing.<sup>10</sup> Similarly, the requesting parties state that SEFs and DCMs may face particular difficulties in facilitating specific types of package transactions, such as those that involve a swap paired with a U.S. Treasury security. The requesting parties also have asserted that market participants, SEFs, DCMs, futures commission merchants (“FCMs”), and DCOs are working to develop the infrastructure needed to process a package transaction from the time the transaction is executed to the time that it is cleared.

The requesting parties thus assert that no-action relief from the trade execution requirement for package transactions is needed to preserve market participants’ ability to execute such transactions as single packages until such time that the market infrastructure needed to process the package transactions as a whole, and in a manner that comports with CEA section 2(h)(8), is completed.

### **Discussion**

The Division is aware of the requesting parties’ concerns that the start of the trade execution requirement may present challenges with the processing of package transactions by FCMs and DCOs. The Division is also aware that SEFs and DCMs may face challenges in facilitating these package transactions in a manner compliant with § 37.9 of the Commission’s regulations and CEA section 5(d)(9). Indeed, pursuant to § 37.9, a market participant who wishes to use a SEF to execute a package transaction involving a trade execution requirement swap would only be able to do so through required methods of execution, *i.e.*, an Order Book or Request for Quote system. Similarly, a market participant who wishes to execute a package transaction on a DCM would be subject to the general requirement of CEA section 5(d)(9).

As industry participants currently are working on processing and execution solutions, the temporary relief granted in this letter is intended to enable those participants to continue their efforts towards compliance with the trade execution requirement and to allow Commission staff to address the issues surrounding package transactions where at least one component is not subject to the trade execution requirement. During this period of relief, the Division will further consider any operational issues concerning the building of transaction order entry and execution technology to facilitate the trading of such package transactions consistent with the trade execution requirement by holding a public roundtable on February 12, 2014. Based in part upon information obtained at the roundtable, the Division will further consider whether, and under what conditions, to grant relief for package transactions such that there is an appropriate balance between recognizing the commercial utility of package transactions while not compromising the policy goals of the trade execution requirement.

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<sup>10</sup> The requesting parties also state that the inability to screen and accept all component legs of a package transaction simultaneously could increase the possibility that the DCO will (1) reject one or more legs of the trade because it does not have a view of the package transaction’s net risk as a whole; or (2) reject one leg and accept the other leg. The rejected leg would be deemed *void ab initio*, but the accepted leg would expose counterparties to unhedged risk, without a way to unwind the leg.

**Time-Limited No-Action Relief for Counterparties to Package Transactions, SEFs, and DCMs**

For the reasons described above, the Division will grant time-limited no-action relief to: (1) entities or counterparties transacting “package transactions” from the requirements of CEA section 2(h)(8); and (2) SEFs and DCMs, with respect to “package transactions” for which they facilitate trading, from the requirements of § 37.9 of the Commission’s regulations and CEA section 5(d)(9), respectively, until 11:59 p.m. (eastern time) May 15, 2014. For purposes of the relief granted in this letter, a “package transaction” is a transaction involving two or more instruments: (1) that is executed between two counterparties; (2) that is priced or quoted as one economic transaction with simultaneous execution of all components; (3) that has at least one component that is a swap that is made available to trade and therefore is subject to the CEA section 2(h)(8) trade execution requirement; and (4) where the execution of each component is contingent upon the execution of all other components.<sup>11</sup>

The Division will grant the above time-limited no-action relief, and will not recommend that the Commission take enforcement action against any entity or counterparty which executes a “package transaction” without complying with CEA section 2(h)(8), or against any SEF or DCM which facilitates trading in a swap subject to CEA section 2(h)(8) as part of a “package transaction” without complying with § 37.9 of the Commission’s regulations or CEA section 5(d)(9), respectively.

Market participants should be aware that the no-action positions taken herein do not excuse affected persons from compliance with any other applicable requirements of the CEA or the Commission’s regulations thereunder, in particular, the applicable swap reporting requirements, clearing requirements, pre-execution credit check requirements, and straight-through processing requirements.<sup>12</sup> This letter, and the no-action positions taken herein, represent the views of the Division only, and do not necessarily represent the positions or views of the Commission or of any other division or office of the Commission’s staff. As with all no-action letters, the Division retains the authority to condition further, modify, suspend, terminate or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

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<sup>11</sup> Some common types of interest rate swap package transactions may include, but are not limited to, transactions commonly known as swap curves (package of two swaps of differing tenors), swap butterflies (package of three swaps of differing tenors), swap spreads (government securities vs. swaps typically within similar tenors), invoice spreads (Treasury-note or Treasury-bond futures vs. swaps), cash/futures basis (Eurodollar futures bundles vs. swaps), offsets/unwinds, delta neutral option packages (caps, floors, or swaptions vs. swaps), and mortgage-backed security basis (to-be-announced swaps (agency MBS) vs. swap spreads). Common credit default swap package transactions may include, but are not limited to, transactions commonly known as index options vs. index, tranches vs. index, and index vs. single name CDS.

<sup>12</sup> The applicable swap reporting requirements are set forth under parts 43, 45, and 50 of the Commission’s regulations. The applicable clearing requirements are set forth under CEA section 2(h)(1) and part 50 of the Commission’s regulations. The applicable pre-execution credit check requirements are set forth under § 1.73 of the Commission’s regulations. The applicable straight-through processing requirements are set forth under § 1.74, § 37.702(b), § 38.601, and § 39.12(b)(7) of the Commission’s regulations.

If you have any questions concerning this correspondence, please contact Nancy Markowitz, Deputy Director, Division of Market Oversight, at (202) 418-5453 or [nmarkowitz@cftc.gov](mailto:nmarkowitz@cftc.gov), Aaron Brodsky, Special Counsel, Division of Market Oversight, at (202) 418-5349 or [abrodsky@cftc.gov](mailto:abrodsky@cftc.gov), or Roger Smith, Attorney Advisor, Division of Market Oversight, at (202) 418-5344 or [rsmith@cftc.gov](mailto:rsmith@cftc.gov).

Sincerely,

Vincent A. McGonagle  
Director  
Division of Market Oversight