



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and Risk  
Division of Market Oversight

CFTC Letter No.15-67  
Other Written Communication  
December 21, 2015  
Division of Clearing and Risk  
Division of Market Oversight

Steven Kennedy  
Global Head of Public Policy  
International Swaps and Derivatives Association, Inc.  
1101 Pennsylvania Avenue  
Suite 600  
Washington, DC 20004

### **Re: Straight Through Processing and Affirmation of SEF Cleared Swaps**

Dear Mr. Kennedy,

This letter responds to a letter received from the International Swaps and Derivatives Association, Inc. (“ISDA”) on July 27, 2015, that the Commodity Futures Trading Commission (“Commission”) accept ISDA’s proposed compliance with the requirement that derivatives clearing organizations (“DCOs”), swap execution facilities (“SEFs”) and designated contract markets (“DCMs”) develop rules and procedures so that DCOs can accept or reject trades for clearing as quickly after execution as would be technologically practicable if fully automated systems were used (“AQATP”).

### **Discussion**

Prompt clearing reduces market risk by eliminating counterparty risk, provides certainty of execution and clearing, and reduces costs to market participants.<sup>1</sup> The Commission’s regulations requiring prompt clearing include: (i) Regulation 39.12(b)(7), which provides that DCOs must coordinate with each SEF and DCM in developing rules and procedures to accept or reject trades for clearing AQATP; (ii) Regulation 37.702(b), which provides that SEFs must coordinate with DCOs in developing rules and procedures to facilitate prompt and efficient

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<sup>1</sup> September 26, 2013, Staff Guidance on Swaps Straight-Through Processing (“2013 Staff Guidance”) at 2.

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transaction processing in accordance with the requirements of Regulation 39.12(b)(7); and (iii) Regulation 38.601(b), which provides that DCMs must coordinate with DCOs in developing rules and procedures to facilitate prompt and efficient transaction processing in accordance with the requirements of Regulation 39.12(b)(7).

As discussed in the adopting release to the Commission's final rule, AQATP is a timing requirement intended to track the evolving industry standard.<sup>2</sup> Currently, trades can be promptly submitted directly to DCOs either through a direct connection between the SEF or DCM and the DCO or the use of a third-party service provider acting as agent for the SEF or DCM. Separately, the Divisions previously notified market participants in the 2013 Staff Guidance that the use of third-party hubs to route a swap from a SEF or DCM to a DCO is permissible if the swap is routed AQATP.<sup>3</sup>

Although all trades can be submitted directly to a DCO and cleared within seconds after execution, some trades are routed through third-party hubs that also provide a manual post-execution affirmation process. Such hubs will send the terms of an executed trade to the counterparties to be affirmed and then route that trade to a DCO after it receives such affirmation. Market participants have advised the Divisions that the time period for post-execution affirmation currently range from minutes to hours, and occasionally overnight.

According to ISDA, the manual post-execution affirmation process is useful to identify errors before a trade is submitted for clearing because some methods of execution currently have higher error rates. Submitting a trade for clearing within seconds of execution would result in erroneous trades being rejected, or worse, accepted by a DCO. If an erroneous swap is cleared immediately after execution, the errors would have to be addressed after clearing, which may be difficult and costly.<sup>4</sup> Additionally, counterparties may have to bear significant margin costs until an error is corrected because of a swap being cleared at the wrong DCO, having the wrong counterparty or having the wrong economic terms, as examples.<sup>5</sup>

### **Routing Time applicable to DCOs, SEFs and DCMs**

The 2013 Staff Guidance stated that the Commission designed the AQATP standard to evolve with technological developments that continue to reduce trade processing times in order to minimize costs and enhance trade.<sup>6</sup> The Guidance did not address the incidence of errors.

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<sup>2</sup> Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21,278 at 21,286 (Apr. 9, 2012).

<sup>3</sup> 2013 Staff Guidance at 3-4.

<sup>4</sup> No-Action Letter 15-24 provides a procedure for market participants to correct erroneous swaps. That letter expires June 15, 2016.

<sup>5</sup> The Divisions remind market participants that breakage requirements are not permitted for trading on a SEF or DCM. 2013 Staff Guidance at 5-6.

<sup>6</sup> Id. at 4.

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As ISDA notes, some trades have errors and market participants are unwilling and unable to allow certain trades to be routed to a DCO without first being reviewed for errors. As noted above, such manual post-execution affirmation can last as long as overnight.

Consequently, the Divisions are supplementing, in part, the previous 2013 Staff Guidance with this letter. Staff believes that the Commission intended for the AQATP standard to take into account the need to refine and reduce errors in order to facilitate prompt and efficient transaction processing.

ISDA indicates that the industry should be able to review all swaps within 10 minutes after execution by May 1, 2016. Other industry participants have indicated that they should be able to do so by August 1, 2016. Therefore, the AQATP standard may be met if trades are routed to and received by the relevant DCO no more than 10 minutes after the execution of the trade, effective on August 1, 2016 and thereafter.<sup>7</sup> Staff notes that the reporting obligations of SEFs and DCMs contained in Regulations 43 and 45 are not affected by this letter. In particular, a SEF or DCM must report a swap transaction to the appropriate Swap Data Repository as soon as technologically practicable after execution of the swap in accordance with Regulations 43.3 and 45.3 regardless of when the swap is submitted for clearing.

This letter is intended to provide market participants with an opportunity to continue efforts to reduce error rates and facilitate prompt and efficient transaction processing. It is the staff's expectation that industry will continue to reduce the timeframes for transaction processing. Staff will monitor the timeframe for improvements in industry standards and may take further action as warranted. As such, this letter is conditioned on the basis that market participants, DCOs, SEFs, and DCMs do not increase their current post-execution affirmation timeframes or otherwise introduce delays into the process through which trades are submitted to DCOs. The Divisions expect that where the ability to affirm trades after execution fully automatically is reasonably practicable, those trades should be affirmed after execution fully automatically. The Divisions understand that not all trades will need the full 10 minutes for routing from the time of execution to the time of receipt by the DCO.

## **Conclusion**

Market participants should be aware that the 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 data reporting requirements, clearing requirements, pre-execution credit check requirements, and straight-through processing requirements.<sup>8</sup> This letter represents the views of the Divisions only, and

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<sup>7</sup> The Divisions understand that if an error is detected within the period set forth herein, it may take longer than 10 minutes to complete correction of the error.

<sup>8</sup> The applicable swap data 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), and § 39.12(b)(7) of the Commission's regulations.

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does not necessarily represent the positions or views of the Commission or of any other division or office of the Commission's staff.

Sincerely,

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Director, Division of Market Oversight