



## U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre  
1155 21st Street, NW, Washington, DC 20581  
Telephone: (202) 418-5000

Division of Swap Dealer and  
Intermediary Oversight

Matthew B. Kulkin  
Director

March 22, 2019

### **Re: No-Action Position for Off-SEF Swaps Executed Pursuant to Prime Brokerage Arrangements**

Ladies and Gentlemen:

This letter presents a no-action position from the Division of Swap Dealer and Intermediary Oversight (“**DSIO**”) of the Commodity Futures Trading Commission (“**Commission**”) for swap dealers (“**SDs**”) registered with the Commission. This letter responds to a request from the private sector members of the Financial Markets Lawyers Group<sup>1</sup> on behalf of its members that are SDs (collectively, the “**Requestor**”)<sup>2</sup> that DSIO provide a position of no-action if an SD acting as a prime broker fails to provide certain disclosures required by Commission regulation 23.431 prior to entering into a swap so long as the swap is a “mirror” transaction to a swap executed on behalf of the SD anonymously on a swap execution facility (“**SEF**”) pursuant to a prime brokerage arrangement.

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<sup>1</sup>The Financial Markets Lawyers Group (the “FMLG”) comprises lawyers who support foreign exchange and other financial markets trading in leading worldwide financial institutions. Currently, the private sector members of the FMLG include representatives from Bank of America, N.A.; Bank of New York Mellon; Barclays; BNP Paribas; Cboe Global Markets, Inc.; Citigroup Global Markets Inc.; CLS Bank International; Deutsche Bank; Goldman, Sachs & Co.; HSBC Securities (USA) Inc.; JP Morgan Chase & Co.; Millennium Management LLC; Morgan Stanley; State Street Bank and Trust Company; The Bank of New York Mellon; and Wells Fargo. A list of FMLG members from those firms is attached to this letter as Exhibit A. The FMLG is sponsored by, but is not part of, the Federal Reserve Bank of New York. Any views expressed by the FMLG are the views of its private sector members, and do not necessarily represent the views of the Federal Reserve Bank of New York or the Federal Reserve System.

<sup>2</sup>Although requested by the SD members of the FMLG, the relief provided by this letter is available to all SDs registered with the Commission.

## I. Regulatory Background

The Commission's business conduct requirements for SDs under subpart H to part 23 of the Commission's regulations require SDs to provide certain disclosures to non-SD counterparties prior to execution of a swap.<sup>3</sup> As relevant here, Commission regulation 23.431(a) and (b) requires SDs, when entering into swaps with certain non-SD counterparties, to provide certain material information (the "**Required Disclosures**") concerning the swap to the counterparty prior to execution.<sup>4</sup> However, Commission regulation 23.431(c) (the "**Required Disclosures Exclusion**") provides that an SD is not required to make the Required Disclosures if the relevant transaction is:

- (1) Initiated on a designated contract market or a SEF; and
- (2) One in which the SD does not know the identity of the counterparty to the transaction prior to execution.

## II. Summary of Request for No-Action Position

As represented by the Requestor, in a typical prime brokerage structure on a SEF, a prime broker ("**PB**") that is an SD may allow certain clients that have entered into a prime brokerage arrangement with the PB and that are admitted by the SEF as participants on the SEF to enter into transactions as such prime broker's agent and for such prime broker's account (each, a "**Trading Counterparty**").

Such Trading Counterparty enters into swaps on the SEF as agent for its PB (the "**on-SEF transaction**") with another participant on the SEF (which may be a dealer, another prime brokerage client of the same or a different PB or other SEF participant). The PB then enters into an offsetting transaction with the Trading Counterparty that has equal but opposite cash flows to the on-SEF transaction. The execution of that "mirror" transaction occurs away from the SEF (the "**off-SEF transaction**"). In this way, the PB performs a credit intermediation role in the transaction because the Trading Counterparty is able to obtain a variety of prices from SEF participants but only faces its PB with respect to credit risk.

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<sup>3</sup> See Commission regulation 23.431, 17 CFR 23.431.

<sup>4</sup> Commission regulation 23.431(a) provides that an SD must, at a reasonably sufficient time prior to entering into a swap, a swap dealer shall disclose to any counterparty to the swap (other than a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant) material information concerning the swap in a manner reasonably designed to allow the counterparty to assess the material risks and characteristics of a swap, as well as any material incentives and conflicts of interest that the SD may have in connection with the swap. In addition, Commission regulation 23.431(b) permits a counterparty to request a scenario analysis for a swap to allow the counterparty to assess its potential exposure in connection with the swap.

In the case where a SEF operates an anonymous electronic trading platform, the exclusion afforded to its SD PBs under the Required Disclosures Exclusion accordingly (and appropriately) applies, relieving the SD PB of the obligation to make the Required Disclosures, as applicable, prior to entering into the on-SEF transaction. In order for the Required Disclosures Exclusion to be effective, however, the Requestor believes that it must necessarily apply in respect of the off-SEF transaction as well because the terms, including the price, of the off-SEF transaction are determined by the on-SEF transaction when executed. The Requestor argues that because the terms of the off-SEF transaction are set by execution of the on-SEF transaction and it is therefore impossible for the SD PB to provide the Required Disclosures prior to execution of the off-SEF transaction, a failure to recognize the applicability of the Required Disclosures Exclusion to the off-SEF transaction effectively prohibits SDs from participating in this form of on-SEF prime brokerage.

The Requestor believes that if DSIO provides a no-action position such that the Required Disclosures Exclusion would apply to off-SEF mirror transactions, as described above, more market participants would be encouraged to utilize SEFs in connection with prime brokerage transactions.

### **III. DSIO No-Action Position**

Given that PB SDs entering into swaps anonymously on SEFs are relieved from making the Required Disclosures by the Required Disclosures Exclusion and that the terms of the simultaneous off-SEF swap are determined by the terms of the on-SEF anonymous swap, DSIO believes that no-action relief is warranted. Accordingly, DSIO will not recommend that the Commission commence an enforcement action against an SD acting as a prime broker for failing to provide the Required Disclosures prior to entering into an off-SEF swap pursuant to a prime brokerage arrangement, the terms of which are determined by a swap entered by such SD that is:

- (1) Initiated on a SEF; and
- (2) One in which neither the SD nor its Trading Counterparty (acting as agent for the SD) knows the identity of the counterparty to the transaction prior to execution.

This letter, and the positions taken herein, represent the views of DSIO 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 CEA or in Commission regulations. Further, this letter, and the positions taken herein, is based upon the representations made to DSIO. Any different, changed, or omitted material facts or circumstances might render this no-action position void.

Questions concerning the relief provided by DSIO in this letter may be directed to me at (202) 418-5213 or mkulkin@cftc.gov; or Frank Fisanich, Chief Counsel, DSIO, at (202) 418-5949 or ffisanich@cftc.gov.

Very truly yours,

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Matthew B. Kulkin  
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