



## U.S. COMMODITY FUTURES TRADING COMMISSION

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

Division of Market Oversight

**Re: Supplemental No-Action Relief for Swap Execution Facilities and Designated Contract Markets in Connection with Swaps with Operational or Clerical Errors Executed on a Swap Execution Facility or Designated Contract Market**

Ladies and Gentlemen:

This letter responds to a request received by the Division of Market Oversight (“DMO”) of the Commodity Futures Trading Commission (the “Commission”) from Managed Funds Association (“MFA”) requesting no-action relief to allow an alternative method for correcting swaps with errors. The alternative method at issue enables trading counterparties on registered swap execution facilities (“SEFs”) and designated contract markets (“DCMs”) to remediate such error trades more efficiently, with *ex post facto* review by the SEF or DCM. This method is in addition to the current process for correcting swap errors contemplated by CFTC Letter 17-27 dated May 30, 2017 (“NAL 17-27”).<sup>1</sup> This letter supplements, and does not replace, NAL 17-27.

### **Background**

Pursuant to NAL 17-27, DMO and the Division of Clearing and Risk (“DCR,” and together with DMO, the “Divisions”) provided relief in the case of an operational or clerical error that is not discovered until after a swap has been cleared. Subject to conditions set forth in NAL 17-27, a SEF or DCM may, when a swap trade error is discovered following clearance, permit a pre-arranged transaction between the original parties that offsets the swap carried on the derivatives clearing organization’s (“DCO”) books, without that trade having been executed pursuant to the methods required in Commission Regulations 37.9(a)(2) and 38.500. The SEF or DCM may also permit the original or intended counterparties to enter into a pre-arranged transaction that reflects the terms to which the parties mutually assented without that trade having been executed pursuant to the methods set forth in Commission Regulations 37.9(a)(2) and 38.500.<sup>2</sup> The relief was subject to a set of conditions reprinted below:<sup>3</sup>

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<sup>1</sup> CFTC No-Action Letter 17-27, issued on May 30, 2017, available at: <https://www.cftc.gov/sites/default/files/csl/pdfs/17/17-27.pdf>.

<sup>2</sup> NAL 17-27 also addressed the case where a trade has been rejected from clearing for non-credit reasons. The relief granted pursuant to this letter only applies to cleared erroneous trades.

1. The pre-arranged transactions subject to this relief must be only (1) for the correction of an operational or clerical error or omission made by the SEF, DCM, one of the counterparties, or an agent of one of the counterparties that causes a trade to be rejected from clearing and *void ab initio*, or (2) for the purpose of offsetting swaps carried on a DCO's books where a clerical or operational error or omission made by the SEF, DCM, counterparty, or an agent of the counterparty is not identified until after the trade has been cleared. In the latter situation, a new transaction that corrects the errors in the original transaction also is subject to this relief.
2. The SEF or DCM must have error trade rules that are consistent with Commission regulations and provide for trade price adjustments or trade cancellations and rules that are transparent to the market and subject to standards that are clear, fair and publicly available. Further, consistent with the obligations of SEFs and DCMs to prevent market abuses, such standards should account for whether a transaction cancellation or price adjustment will adversely impact market integrity, facilitate market manipulation or other illegitimate activity, or otherwise violate the Commodity Exchange Act ("CEA"), Commission regulations, or the SEF's or DCM's rules.
3. For swaps rejected for non-credit reasons, the new trade must be executed on the SEF or DCM and submitted for clearing as quickly as technologically practicable after receipt of notice of the rejection by the DCO to the clearing members, but, in any event, no later than one hour from the issuance of the notice. For erroneous cleared swaps, the trade to offset the swaps carried on the DCO's books and the new transaction that corrects the errors in the original transaction must be executed and submitted for clearing no later than three days after the erroneous cleared swap was executed.
4. The SEF or DCM must have rules setting forth the conditions, if any, under which it will determine that an error has occurred, and the procedures it will follow to execute a trade subject to the relief set forth in this letter. The rules must provide that if the facility is able to determine how to correct an error, the facility will execute the new trades without obtaining consent from the counterparties. The rules must also provide what the facility will do if it is unable to determine how to correct an error. In such cases, the facility may either not fix the error, or it may seek guidance on how to address the error from the counterparties. Any such guidance may not be implemented without consent from both counterparties.
5. With respect to swaps rejected from clearing for non-credit reasons, if the new transaction that corrects the errors in the original transaction is also rejected for clearing, it is *void ab initio*, and the parties will not be provided a second opportunity to submit a new trade subject to the relief provided herein.

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<sup>3</sup> For complete context and to rely on the terms and conditions provided in NAL 17-27, please refer to the original letter.

6. In making its determination whether to permit the execution of a trade subject to this relief, a SEF or DCM must make an affirmative finding that the trade or some term therein resulted from an error.
7. The SEF or DCM must report the swap transaction data to the relevant swap data repository as soon as technologically practicable after the original trade is rejected by the DCO, including:
  - i. A part 43 cancellation for the original trade;
  - ii. A part 45 termination indicating that the original trade is *void ab initio*; and
  - iii. Swap transaction data pursuant to Parts 43 and 45 for the newly executed trade(s).<sup>4</sup>

### **Requested Relief**

In its request, MFA sought revisions to current no-action relief in order to enable trading counterparties on SEFs and DCMs to remediate swap error trades more efficiently. Specifically, MFA requested modifications to conditions #4 and #6 in NAL 17-27. MFA indicated that delays in the error correction process expose trading counterparties to market, credit, and operational risks. MFA suggested that modifying certain conditions could improve efficiency of the error correction process for market participants on electronic “dealer-to-client” SEFs.

MFA requested that SEFs and DCMs be permitted to conduct an *ex post facto* review of corrected error trades, consistent with their general monitoring and surveillance responsibilities. Specifically, MFA requested that DMO modify condition #4 of NAL 17-27 to allow the swap counterparties to determine that an error has occurred and to execute a correcting trade, subject to *ex post facto* review by the SEF or DCM. MFA also requested that DMO modify condition #6 to allow the SEF or DCM to conduct an *ex post facto* review of whether an error trade had occurred and had been appropriately corrected by the swap counterparties.

### **No-Action Relief**

DMO is issuing this no-action letter to allow for SEF and DCM *ex post facto* review of corrected error swap trades. Specifically, DMO will not recommend that the Commission take any enforcement action against a SEF for failure to comply with Commission regulation

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<sup>4</sup> NAL 17-27 further provided that the erroneous trade and any subsequent trade were subject to pre-execution credit checks that complied with Commission Regulation 1.73 and/or Regulation 23.609 and Staff Guidance on Swaps Straight-Through Processing (Sept. 26, 2013), available at <https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/stpguidance.pdf> (the “Staff Guidance”). In addition, both the erroneous trade and any subsequent trade had to be processed in accordance with the time frames set forth in Commission Regulations 1.74, 23.610, 39.12(b)(7), 43.3(e), 45.14, and the Staff Guidance.

37.9(a)(2) or against a DCM for failure to comply with Commission regulation 38.500, regarding methods of execution, or failure to comply with the prohibition against pre-arranged trading in Commission regulations 37.203 and 38.152, if, after an error is discovered following the clearance of a trade, the SEF or DCM permits a pre-arranged transaction between the original parties that offsets the error trade, and another pre-arranged transaction that reflects the terms to which the parties originally mutually assented.

The relief provided in NAL 17-27 remains in full effect. In other words, SEFs and DCMs may still use the relief provided in NAL 17-27 to correct erroneous cleared swaps, subject to all conditions set forth in that letter. The *ex post facto* process set forth in this letter is an alternative option available to SEFs and DCMs. Specifically, DMO modifies conditions #3, #4, and #6 of NAL 17-27 as follows (added text reflected in bold):<sup>5</sup>

3. For swaps rejected for non-credit reasons, the new trade must be executed on the SEF or DCM and submitted for clearing as quickly as technologically practicable after receipt of notice of the rejection by the DCO to the clearing members, but, in any event, no later than one hour from the issuance of the notice. For erroneous cleared swaps, the trade to offset the swaps carried on the DCO's books and the new transaction that corrects the errors in the original transaction must be executed and submitted for clearing no later than three days after the erroneous cleared swap was executed, **with the exception provided in 4(a) below.**
4. The SEF or DCM must have rules setting forth the conditions, if any, under which it will determine that an error has occurred, and the procedures it will follow to execute a trade subject to the relief set forth in this letter. The rules must provide that if the facility is able to determine how to correct an error, the facility will execute the new trades without obtaining consent from the counterparties. The rules must also provide what the facility will do if it is unable to determine how to correct an error. In such cases, the facility may either not fix the error, or it may seek guidance on how to address the error from the counterparties. Any such guidance may not be implemented without consent from both counterparties.
  - 4(a). Alternatively, for cleared swaps, the SEF or DCM may use an *ex post facto* review process in which the counterparties determine that an error has occurred and correct the error. The offsetting trade and the correct transaction must be executed and submitted for clearing as quickly as technologically practicable, but no later than 24 hours after the erroneous cleared swap was executed.**

**The SEF or DCM must have transparent procedures concerning error trade correction by counterparties, including the standards by which counterparties may determine that an error trade has**

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<sup>5</sup> While MFA did not seek modification of condition #3, DMO added the reference to new 4(a) to clarify that a 24-hour time frame, rather than a three-day time frame, applies to SEF or DCM procedures permitting an *ex post facto* review process.

**occurred, how it will be corrected, notification to the SEF or DCM of correction, and the timeframe by which they must complete such correction.**

**The SEF or DCM must conduct an *ex post facto* review of the error trade, offsetting trade, and correct trade on a T+1 basis. Such review must consider the factors listed in condition #2: whether a transaction cancellation or price adjustment will adversely impact market integrity, facilitate market manipulation or other illegitimate activity, or otherwise violate the CEA, Commission regulations, or the SEF's or DCM's rules.**

6. In making its determination whether to permit the execution of a trade subject to this relief, a SEF or DCM must make an affirmative finding that the trade or some term therein resulted from an error. **If the SEF or DCM employs the error correction process set forth in condition 4(a), the SEF or DCM must make such affirmative finding that there was an error as part of its *ex post facto* review.**<sup>6</sup>

The remaining conditions and provisions of the NAL 17-27 applicable to erroneous cleared swaps remain in effect. For example, SEFs or DCMs employing an *ex post facto* correction process must continue to comply with condition #1 (describing the types of errors that may be corrected), condition #2 (SEF and DCM error trade rules must be clear, fair and publicly available), condition #5 (addressing swaps rejected from clearing for a second time), condition #7 (reporting to swap data repository), as well as Commission Regulations 1.73, 1.74, 23.609, 23.610, 39.12(b)(7), 43.3(e), 45.14, and the Staff Guidance.

This relief does not alter monitoring and surveillance responsibilities required by Commission regulations. Further, DMO clarifies that the alternative process set forth in condition #4(a) is optional; SEFs and DCMs may continue to implement a trade correction policy consistent with NAL 17-27 and its original conditions.

**Consistent with NAL 17-27, this relief shall expire on the effective date of revised Commission regulations that establish a permanent, practicable solution for swaps with operational or clerical errors executed on a SEF or DCM.**

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This letter and the positions taken herein represent the views of DMO only, and do not necessarily represent the views of the Commission or of any other division or office of the

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<sup>6</sup> If the SEF or DCM makes an affirmative finding of no error as part of an *ex post facto* review process, DMO staff would not expect the offsetting trade and corrective trade to be voided or reversed. However, DMO would expect the SEF or DCM to take appropriate disciplinary action against the participants, such as a warning letter, fine or other sanction, commensurate with the violation and sufficient to deter recidivism.

Commission. Further, this letter, and the relief contained herein, is based upon the representations made to DMO by MFA. It should be noted that any different, changed, or omitted material facts or circumstances may render this letter void. Finally, as with all no-action letters, DMO retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the relief provided herein in its discretion.

If you have any questions concerning this correspondence, please contact David Steinberg, Associate Director, Division of Market Oversight, at 202-418-5102 or [dsteinberg@cftc.gov](mailto:dsteinberg@cftc.gov), or Marilee Dahlman, Special Counsel, Division of Market Oversight, at 202-418-5264 or [mdahlman@cftc.gov](mailto:mdahlman@cftc.gov).

Sincerely,

Rachel Berdansky  
Deputy Director  
Division of Market Oversight