



## U.S. COMMODITY FUTURES TRADING COMMISSION

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CFTC Letter No. 13-66

No-Action

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Division of Clearing and Risk  
Division of Market Oversight

### **Time-Limited No-Action Relief for Swap Execution Facilities from Compliance with Certain Requirements of Commission Regulation 37.9(a)(2) and 37.203(a)**

The Division of Clearing and Risk and the Division of Market Oversight (together, “the Divisions”) of the Commodity Futures Trading Commission (“Commission”) are issuing this letter to provide no-action relief for swap execution facilities (“SEFs”) from compliance with certain requirements of Commission Regulations 37.9(a)(2) and 37.203(a).<sup>1</sup> This no-action relief shall commence on the date of issuance of this letter and shall expire on June 30, 2014.

#### **I. Background**

On April 9, 2012, the Commission published regulations addressing the timing of acceptance for clearing and clearing member risk management.<sup>2</sup> Regulation 1.73 and Regulation 23.609 require futures commission merchants (“FCMs”) and swap dealers (“SDs”), respectively, that are clearing members of a registered derivatives clearing organization (“DCO”) to establish risk-based limits and screen orders for compliance with those limits. Regulation 37.702(b) requires a SEF to coordinate with each DCO to which it submits transactions for clearing, to develop rules and procedures to facilitate prompt and efficient transaction processing. Regulations 1.74, 23.610, and 39.12(b)(7) set forth time frames for FCMs, SDs, and DCOs, respectively, to accept or reject trades for clearing.

On June 4, 2013, the Commission published regulations governing SEFs.<sup>3</sup> Regulation 37.9(a)(2) establishes requirements for the method of execution of transactions on a SEF in swaps that are subject to the trade execution requirement of Section 2(h)(8) of the Commodity Exchange Act (“CEA”).<sup>4</sup> Regulation 37.203(a) requires a SEF to prohibit certain abusive trading

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<sup>1</sup> Commission regulations are codified in 17 C.F.R Ch. I.

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

<sup>3</sup> Core Principles and Other Requirements for Swap Execution Facilities, 78 FR 33476 (June 4, 2013).

<sup>4</sup> Under the trade execution requirement of the CEA, Section 2(h)(8) swap transactions that are subject to the clearing requirement of CEA Section 2(h)(1) must be traded on either a designated contract market (“DCM”) or a

practices, including pre-arranged trading (except for block trades or other types of transactions certified to or approved by the Commission).

On September 26, 2013, the Divisions issued Staff Guidance on Swaps Straight-Through Processing (“Staff Guidance”). In the guidance, the staff stated, among other things, that:

- (i) Clearing FCMs must screen orders for execution on a SEF pursuant to either Regulation 1.73(a)(2)(i) or (ii) regardless of the method of execution;<sup>5</sup>
- (ii) Pursuant to Regulation 37.702(b), each SEF must make it possible for Clearing FCMs to screen as required by Regulation 1.73 on an *order-by-order basis*;<sup>6</sup>
- (iii) SEFs must have rules stating that trades that are rejected from clearing are *void ab initio*;<sup>7</sup> and
- (iv) SEFs, FCMs, and SDs may not require breakage agreements as a condition for trading swaps intended for clearing on a SEF.<sup>8</sup>

The Divisions have been informed by market participants that from time to time swap trades are rejected by a DCO because of flaws that are readily correctable. For example, an operational error may cause the clearing submissions to fail to match on a material economic term.<sup>9</sup> Under current market practice, the parties to such a trade often mutually agree to correct the error and to resubmit the trade. The trade then clears subject to the originally agreed-upon terms.

## **II. No-Action Relief**

The Divisions are issuing this no-action letter to permit a similar procedure to be followed for trades executed on or subject to the rules of a SEF. Specifically, subject to the conditions listed below, the Divisions will not recommend that the Commission take any enforcement action against a SEF for failure to comply with Regulation 37.9(a)(2) regarding methods of execution for required or permitted transactions or Regulation 37.203(a)'s prohibition of pre-arranged trading, if, after a trade has been rejected for clearing, the SEF permits a new trade, with terms and conditions that match the terms and conditions of the original trade, other than any such error and the time of execution, to be submitted for clearing without having been executed pursuant to the methods set forth in Regulation 37.9(a)(2).

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SEF, unless no DCM or SEF makes the swap “available to trade” or the transaction is not subject to the clearing requirement under section 2(h)(7). Part 40 of the Commission’s regulations establishes a process whereby DCMs and SEFs can make a swap available to trade and thereby trigger the trade execution requirement. At the present time, no swap is yet subject to the trade execution requirement.

<sup>5</sup> Staff Guidance at 2.

<sup>6</sup> Id at 3.

<sup>7</sup> Id at 6.

<sup>8</sup> Id.

<sup>9</sup> These terms may include price, quantity, account number, tenor, etc.

Effectively, SEFs will be permitted to implement rules that establish a “new trade, old terms” procedure. This no-action relief shall commence on the date of issuance of this letter and shall expire on June 30, 2014.

The following conditions apply:

1. The procedure must only be available for trades that are rejected because of a clerical or operational error or omission resulting in a mismatch of the terms of the trade. For example, the procedure must not be available for trades that are rejected because a customer breached its credit limit at a clearing member or a clearing member breached its credit limit at a DCO.
2. The SEF must have rules stating that any trade executed on or subject to the rules of the SEF that is not accepted for clearing shall be *void ab initio*. The rules may not permit trades to be held in a suspended state and then re-submitted.
3. Both clearing members must agree to submit the new trade.
4. Each clearing member must obtain the consent of its customer, if any, to submit the new trade.
5. Neither a clearing member nor a SEF may require a customer to agree in advance to consent to the submission of the new trade. The consent must be sought on a case-by-case basis, after the trade has been rejected.
6. The new trade must be submitted as quickly as technologically practicable after receipt by the clearing members of notice of the rejection from clearing, but in any case no later than 30 minutes from the issuance of a notice of rejection by the DCO to the clearing members.
7. Both the original trade and the new trade must be subject to pre-execution credit checks that comply with Commission Regulation 1.73 and/or Regulation 23.609 and the Staff Guidance.
8. Both the original trade and the new trade must be processed in accordance with the time frames set forth in Commission Regulations 1.74, 23.610, 39.12(b)(7) and the Staff Guidance.
9. The SEF reports the swap transaction data to the relevant swap data repository (“SDR”) as soon as technologically practicable after the original trade is rejected by the DCO,<sup>10</sup> including:

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<sup>10</sup> The Divisions note that under a “new trade, old terms” procedure, the SEF must report the original trade and the newly executed trade to the SDR pursuant to Parts 43 and 45, in addition to reporting the appropriate messages to the relevant SDR for the original rejected trade, reflecting that it is void *ab initio*.

- i. A part 43 cancellation for the original trade;<sup>11</sup>
  - ii. A part 45 termination indicating that the original trade is void *ab initio*;
  - iii. Swap transaction data pursuant to Parts 43 and 45 for the newly executed trade. This data must reference the original cancelled trade and indicate that it has been reported pursuant to the procedures described in this letter. This data must also link the original trade to the new trade for both Parts 43 and 45 reporting to the relevant SDR.
10. The SEF must enable the relevant SDR to publicly disseminate the new trade—which may be at a price that is away from the current market—pursuant to Part 43 and in a manner that references the original cancelled trade that was previously publicly disseminated.<sup>12</sup>
11. The procedure established by the SEF does not operate in any way to impair impartial access to the SEF as required by Commission Regulation 37.202 and the Staff Guidance. In particular, SEF rules must not require breakage agreements<sup>13</sup> among participants as a condition of access and must prohibit a participant from requiring breakage agreements with other participants as a condition of trading with them.
12. The SEF must have rules stating that if the new trade is also rejected, it is *void ab initio* and the parties will not be provided a second opportunity to submit a new trade.

### **III. Conclusion**

This letter reflects the views of the Divisions only, and not necessarily the views of the Commission or of any other division or office of the Commission. The no-action position taken herein does not excuse affected persons from compliance with any other applicable requirements of the Commodity Exchange Act or the Commission's regulations. The Divisions retain the authority, in their discretion, to further condition, modify, suspend, terminate or otherwise restrict the terms of the no-action relief provided herein.

If you have any questions concerning this correspondence, please contact John C. Lawton, Deputy Director, Division of Clearing and Risk, at (202) 418-5480 or [jlawton@cftc.gov](mailto:jlawton@cftc.gov), Christopher Hower, Special Counsel, Division of Clearing and Risk, at (202) 418-6703 or [chower@cftc.gov](mailto:chower@cftc.gov), Nancy Markowitz, Deputy Director, Division of Market

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<sup>11</sup> Commission Regulation 43.3(e) governs the reporting of errors or omissions in previously reported real-time swap data. In adopting Part 43, the Commission noted that “[t]he correction of errors or omissions in real time is necessary to fulfill the price discovery mandate of section 727 of the Dodd-Frank Act. . . . For example, a cancellation may occur where a clearinghouse does not accept a particular swap for clearing . . .” Real-Time Public Reporting of Swap Transaction Data, 77 FR 1182, 1204 (Jan 9, 2012).

<sup>12</sup> A SEF may take up to 90 days from the issuance of this letter to implement and/or make appropriate arrangements with respect to meeting conditions 8 and 9 above.

<sup>13</sup> A breakage agreement is any arrangement, whether contained in an agreement between the parties or the rules of a SEF or DCM, that provides for the assessment of liability or payment of damages between the parties to a trade intended for clearing in the event that the trade is rejected from clearing.

Oversight, at (202) 418-5453 or [nmarkowitz@cftc.gov](mailto:nmarkowitz@cftc.gov), or Amir Zaidi, Special Counsel, Division of Market Oversight, at 202-418-6770 or [azaidi@cftc.gov](mailto:azaidi@cftc.gov).

Sincerely,

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