



U.S. COMMODITY FUTURES TRADING COMMISSION

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CFTC Letter No. 14-121
No-Action
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Division of Market Oversight
Division of Clearing and Risk

Extension of No-Action Relief for Swap Execution Facilities and Designated Contract Markets from Compliance with Certain Requirements of Commission Regulations § 37.9(a)(2), § 37.203(a) and § 38.152 for Package Transactions

On May 1, 2014, the Division of Market Oversight (“DMO”) and the Division of Clearing and Risk (“DCR”) (together “the Divisions”) of the Commodity Futures Trading Commission (“Commission” or “CFTC”) granted no-action relief from certain requirements of § 37.9(a)(2), § 37.203(a) and § 38.152 of the Commission’s regulations for package transactions, as defined herein. Absent further action from the Divisions, this no-action relief would expire on September 30, 2014. This letter extends the no-action relief period to February 16, 2015.

Clearing of Package Transactions

On April 9, 2012, the Commission published regulations addressing the timing of acceptance for clearing and clearing member risk management.¹ Section 1.73 and Section 23.609 of the Commission’s regulations require futures commission merchants (“FCMs”) and swap dealers (“SDs”), respectively, that are clearing members of a derivatives clearing organization (“DCO”) to establish risk-based limits and screen orders for compliance with those limits. Section 37.702(b) of the Commission’s regulations requires a swap execution facility (“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. Section 38.601(b) of the Commission’s regulations requires a designated contract market (“DCM”) to coordinate with each DCO to which it submits transactions for clearing, to develop rules and procedures to facilitate prompt and efficient transaction processing. Sections 1.74, 23.610, and 39.12(b)(7) of the Commission’s regulations set forth time frames for FCMs, SDs, and DCOs, respectively, to accept or reject trades for clearing.

On June 19, 2012, the Commission published regulations governing DCMs.² Section 38.152 of the Commission’s regulations requires a DCM to prohibit certain abusive trading practices, including pre-arranged trading (except for block trades or other types of transactions certified to or approved by the Commission).

¹ Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21278 (Apr. 9, 2012).

² Core Principles and Other Requirements for Designated Contract Markets, 77 Fed. Reg. 36611 (June 19, 2012).

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 or DCM pursuant to either Commission Regulation 1.73(a)(2)(i) or (ii) regardless of the method of execution;³
- (ii) Pursuant to Commission Regulations 37.702(b) and 38.601(b), each SEF and DCM must make it possible for Clearing FCMs to screen as required by Regulation 1.73 on an order-by-order basis;⁴
- (iii) SEFs and DCMs must have rules stating that trades that are rejected from clearing are void *ab initio*;⁵ and
- (iv) SEFs, DCMs, FCMs, and SDs may not require breakage agreements as a condition for trading swaps intended for clearing on a SEF.⁶

Market participants previously informed the Divisions that issues could arise as a result of the current clearing of the packages—on a leg-by-leg basis and not on the totality of the package. The Divisions were told that individual legs of a package transaction may be rejected by a DCO because the risk of a leg, measured in isolation, could cause the trader to exceed its credit limit. The market participants stated that if the legs of the package trade are measured together, then the net risk may not exceed the credit limit. Accordingly, the market participants requested relief from the straight-through processing requirements currently in place while the industry worked on solutions which would allow the legs of a package transaction to be measured together.

In response, on May 1, 2014, the Divisions granted no-action relief from certain requirements of § 37.9(a)(2), § 37.203(a) and § 38.152 of the Commission’s regulations for package transactions.⁷ The no-action relief granted in CFTC Letter No. 14-62 provided in part that subject to specified conditions, SEFs and DCMs would be permitted to establish a “new trade, old terms” procedure for legs of a package transaction that had been rejected from clearing because of the sequencing of submission of the legs of a package transaction.⁸ Since the grant of the no-action relief, market participants have worked on developing and implementing technological solutions that would allow for the legs of a package transaction to be measured together. According to market participants, however, these technological solutions will not be implemented by the expiration date of the relevant no-action relief granted in CFTC Letter No. 14-62.

³ Staff Guidance at 2.

⁴ Id. at 3.

⁵ Id. at 6.

⁶ Id.

⁷ CFTC Letter No. 14-62.

⁸ Id.

Time-Limited No-Action Relief

The Divisions are extending the no-action relief from certain requirements of § 37.9(a)(2), § 37.203(a) and § 38.152 of the Commission's regulations for package transactions. For purposes of this extended relief, a "package transaction" is a transaction involving two or more instruments: (1) that is executed between two or more counterparties; (2) that is priced or quoted as one economic transaction with simultaneous or near 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;⁹ and (4) where the execution of each component is contingent upon the execution of all other components.

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 Commission Regulation 37.9(a)(2) regarding methods of execution for Required Transactions or Commission Regulation 37.203(a)'s prohibition of pre-arranged trading if, after a leg of a "package transaction" has been rejected for clearing, the SEF permits a new trade,¹⁰ with terms and conditions that match the terms and conditions of the original trade, other than the time of execution, to be submitted for clearing without having been executed pursuant to the methods set forth in Commission Regulation 37.9(a)(2). The Divisions will also not recommend that the Commission take any enforcement action against a DCM for failure to comply with Commission Regulation 38.152's prohibition of pre-arranged trading, if, after a leg of a "package transaction" has been rejected for clearing, the DCM permits a new trade, with terms and conditions that match the terms and conditions of the original trade, other than the time of execution, to be submitted for clearing. Effectively, SEFs and DCMs will be permitted to continue to use a "new trade, old terms" procedure for package transactions. This no-action relief shall commence on the date of issuance of this letter and shall expire on February 16, 2015.

The following conditions apply:

1. The procedure must only be available for component legs of a package transaction that are rejected from clearing because of the sequencing of submission of the legs of a package transaction. The procedure must not be available for trades that are rejected because the package transaction as a whole breached a credit limit.

⁹ 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).

¹⁰ The term "trade," as used herein, does not refer to the entire package transaction, but rather the execution of the component leg that was rejected. For example, a risk-reducing component leg could be accepted for clearing, but a risk-increasing leg could be not accepted for clearing. This relief would not bust or cancel the leg that was accepted for clearing, but would allow the parties to resubmit the component leg that was not accepted for clearing, with terms and conditions that match the terms and conditions of the original trade of the component leg.

2. The SEF or DCM must have rules stating that for a package transaction executed on or subject to the rules of the SEF or DCM, if a component leg of the package is not accepted for clearing, that component leg 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. If the trade involves a customer, the customer must specifically consent to the submission of a new trade.
5. Neither a clearing member nor a SEF or DCM may require a customer to agree in advance to consent to the submission of the new trade.
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 120 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 Commission 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 or DCM 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,¹¹ including:
 - i. A part 43 cancellation for the original trade;¹²
 - ii. A part 45 termination indicating that the original component leg of the package transaction is void *ab initio*;¹³

¹¹ The Divisions note that under a “new trade, old terms” procedure, the SEF or DCM 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*.

¹² Section 43.3(e) of the Commission’s regulations 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).

¹³ Section 45.14 of the Commission’s regulations governs the reporting of errors or omissions in data previously reported to an SDR pursuant to part 45.

- iii. Swap transaction data pursuant to parts 43 and 45 of the Commission's regulations 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 and DCM 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.
 11. The procedure established by the SEF or DCM does not operate in any way to impair impartial access to the SEF or DCM as required by Commission Regulations 37.202 or 38.151, respectively, and the Staff Guidance. In particular, SEF or DCM rules must not require breakage agreements¹⁴ 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 or DCM 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.

I. Conclusion

Market participants should note 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.¹⁵ This letter, and the no-action positions taken herein, represent the positions of the Divisions only, and do not necessarily represent the positions of, or bind, the Commission, any other division or office of the Commission's staff, or any other Federal agency. As with all no-action letters, the Divisions retain the authority to condition further, modify, suspend, terminate or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

¹⁴ 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.

¹⁵ 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 John C. Lawton, Deputy Director, 202-418-5480, jlawton@cftc.gov, DCR or Roger Smith, Special Counsel, at (202) 418-5344 or rsmith@cftc.gov, DMO.

Sincerely,

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