Re: Request for Relief Regarding Obligation to Provide Pre-Trade Mid-Market Mark for Certain Foreign Exchange Transactions

Ladies and Gentlemen:

This letter is in response to a request dated November 16, 2012, from the Foreign Exchange Committee (“FXC”) and the Financial Markets Lawyers Group (“FMLG”) to the Division of Swap Dealer and Intermediary Oversight (“Division”) of the Commodity Futures Trading Commission (“Commission”), in which FXC and FMLG requested relief\(^1\) from the Division that would permit swap dealers and major swap participants to enter into certain foreign exchange (“forex”) transactions without disclosing a pre-trade mid-market mark to the counterparty of the transaction as required under Commission Regulation (“Regulation”) 23.431(a)(3)(i). \(^2\) FXC and FMLG requested that swap dealers and major swap participants not be required to disclose pre-trade mid-market marks in connection with: (1) forex swaps and forwards \(^3\) that, by their terms, are physically settled, where each currency is one that is included among the top 13 deliverable currencies (by volume) described in the Bank for International Settlements’ Triennial Central Bank Survey, Report on Global Foreign Exchange Market Activity in 2010 (the “BIS 13 Currencies”), \(^4\) and where the transaction has a stated maturity of

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\(^1\) FXC and FMLG requested interpretative relief; in lieu of interpretive relief, the Division is issuing no-action relief in this letter.

\(^2\) Signatories to the letter included representatives from both FMLG and FXC, including the Buy Side Chair of the FXC. Although FMLG and FXC are sponsored by the Federal Reserve Bank of New York, the letter requesting relief was not endorsed by the Federal Reserve Bank of New York or the Federal Reserve System.

\(^3\) For purposes of this letter, the phrase “forex swaps and forwards” refers to foreign exchange forwards and foreign exchange swaps, as those terms are defined in Sections 1a(24) and 1a(25), respectively, of the Commodity Exchange Act.

\(^4\) Excluding the Korean won, which is a restricted currency, the top thirteen deliverable currencies by volume are the US dollar, Euro, Japanese yen, Pound sterling, Australian dollar, Swiss franc, Canadian dollar, Hong Kong dollar, Swedish krona, New Zealand dollar, Singapore dollar, Norwegian krone and Mexican peso.  

one year or less; and (2) vanilla forex options that, by their terms, are physically settled, where each currency is one included among the BIS 13 Currencies, and where the option has a stated maturity of six months or less (together, the “Covered Forex Transactions”).

Applicable Regulatory Requirements

Pursuant to Section 1a(47)(E) of the Commodity Exchange Act (“CEA”), the Secretary of the Treasury (“Secretary”) is vested with the authority to determine whether forex swaps and forwards should be regulated as swaps under the CEA, provided that the Secretary makes a written determination satisfying certain criteria specified in CEA Section 1b. On November 16, 2012, the Secretary issued a written determination that forex swaps and forwards should not be regulated as swaps under the CEA.

Nonetheless, CEA Section 1a(47)(E)(iv) states that, notwithstanding the Secretary’s written determination, “any party to a foreign exchange swap or forward that is a swap dealer or major swap participant shall conform to the business conduct standards contained in section 4s(h).” Section 4s(h)(3)(B) of the CEA directs the Commission to adopt business conduct standards for swap dealers and major swap participants that:

require disclosure by the swap dealer or major swap participant to any counterparty to the transaction (other than a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant) of –

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(iii) (I) for cleared swaps, upon the request of the counterparty, receipt of the daily mark of the transaction from the appropriate derivatives clearing organization; and (II) for uncleared swaps, receipt of the daily mark of the transaction from the swap dealer or the major swap participant.

On February 17, 2012, the Commission issued final rules prescribing certain business conduct standards for swap dealers and major swap participants, which included Regulation 23.431. In relevant part, Regulation 23.431 reads as follows:

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5 7 U.S.C. 1a(47)(E).
7 Additionally, forex swaps and forwards are subject to reporting obligations, pursuant to Section 1a(47)(E)(iii) of the CEA, 7 U.S.C. § 1a(47)(E)(iii).
9 Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 Fed. Reg. 9734 (Feb. 17, 2012) (hereinafter “Final Business Conduct Standards”). In the proposed business conduct standards rules, the Commission proposed Regulation 23.431 to “provide specificity with respect to certain material information that must be disclosed” by swap dealers and major swap participants. Business Conduct Standards for
At a reasonably sufficient time prior to entering into a swap, a swap dealer or major swap participant 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 incentives and conflicts of interest that the swap dealer or major swap participant may have in connection with a particular swap, which shall include: (i) [w]ith respect to disclosure of the price of the swap, the price of the swap and the mid-market mark of the swap as set forth in paragraph (d)(2) of this section . . . .10

In describing the purpose of requiring swap dealers and major swap participants to disclose the pre-trade mid-market mark, the Commission stated that “the spread between the quote and mid-market mark is relevant to disclosures regarding material incentives and provides the counterparty with pricing information that facilitates negotiations and balances historical information asymmetry regarding swap pricing.”11

**Summary of Request for Relief**

In their letter requesting relief, FXC and FMLG stated that the Covered Forex Transactions “involve highly-liquid currencies, exhibit narrow bid-ask spreads and are widely quoted by FX Dealers in the marketplace.”12 With the letter, FXC and FMLG submitted data collected from forex dealers and public sources showing that the pre-trade mid-market mark that would be disclosed by swap dealers and major swap participants in connection with the Covered Forex Transactions would be substantially similar to publicly available information.13 FXC and FMLG went on to note that:

[i]n light of the ready availability of reliable pricing information in the market, the transparency of the pricing information, the competitiveness and tightness of spreads and ongoing liquidity of these Covered [Forex] Transactions, compliance with the Pre-Trade Mid-Market Mark Requirement does not provide any significant informational value. The FXC’s buy-side institutions believe that a

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10 Final Business Conduct Standards at 9824.

11 Id. at 9766. In the preamble to the proposed rule, the Commission noted that the “mid-market [mark] is a transparent measure that would assist counterparties in calculating valuations for their own internal risk management purposes.” Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 75 Fed. Reg. 80638, 80646 (proposed Dec. 22, 2010).

12 Letter from FXC and FMLG to Gary Barnett at 2 (Nov. 16, 2012).

13 In data submitted by the FXC and FMLG that was collected from major forex dealers and Bloomberg, “the typical deviation from a publicly available mid (as provided by Bloomberg) is just $36 on a $1m notional EUR/USD forward deal, $77 on a $1m notional AUD/USD forward deal and $254 on a $1m notional USD/MXN forward deal.” Id. at A-1.
mid-price for Covered [Forex] Transactions is not material and, thus, should not be required as it does not reflect a tradeable price. They are primarily interested in where they can best transact, which is at the best bid or ask.\textsuperscript{14}

It is the Division’s understanding that real-time tradeable bid and offer prices for each of the Covered Forex Transactions are available electronically, in the marketplace, to counterparties.

Further, FXC and FMLG noted that disclosing the pre-trade mid-market mark “would require FX Dealers to create a new price stream when quotes are provided electronically and would add additional operational requirements for dealers when quotes are conveyed by voice.”\textsuperscript{15} These new operational capabilities may add significant costs, according to FXC and FMLG. Lastly, FXC and FMLG stated that the delivery of the pre-trade mid-market mark for the Covered Forex Transactions may “adversely affect counterparties by delaying the trade time, since delivery must be made ‘a reasonably sufficient time prior’ to trading.”\textsuperscript{16}

**Division No-Action Position**

Based upon the representations made by FXC and FMLG concerning the Covered Forex Transactions, the Division believes that no-action relief on the pre-trade mid-market mark requirement for the Covered Forex Transactions is warranted. Accordingly, the Division will not recommend that the Commission take an enforcement action against a swap dealer or major swap participant for failure to disclose the pre-trade mid-market mark, as required by Regulation 23.431(a)(3), to a counterparty in a Covered Forex Transaction, provided that: (1) real-time tradeable bid and offer prices for the Covered Forex Transaction are available electronically, in the marketplace, to the counterparty; and (2) the counterparty to the Covered Forex Transaction agrees in advance, in writing, that the swap dealer or major swap participant need not disclose a pre-trade mid-market mark.

The Division is applying this no-action relief to the Covered Forex Transactions based on, among other things, FXC’s and FMLG’s representations that Covered Forex Transactions benefit from a combination of high liquidity, narrow bid and offer spreads, and the existence of a significant amount of publicly available information with respect thereto. The Division will continue to monitor market data with respect to the liquidity, bid and offer spreads, and publicly available information of the Covered Forex Transactions, and if the circumstances change, the Division may limit, impose additional or different conditions on, or revoke this no-action relief. The Division notes that this no-action relief is applicable only with respect to the Covered Forex Transactions and does not affect any obligations of a swap dealer or major swap participant to disclose pre-trade mid-market marks for contracts other than the Covered Forex Transactions. However, the Division may consider extending this no-action relief to other transactions, if

\textsuperscript{14} Id. at 2-3.
\textsuperscript{15} Id. at 3.
\textsuperscript{16} Id. at 3.
sufficient data and other relevant information are submitted to the Division establishing the appropriateness of an extension. The Division also notes that this no-action relief is applicable only to pre-trade mid-market marks and does not affect any obligation to provide a daily mark pursuant to Regulation 23.431(d).

This letter, and the positions taken herein, represent the view of this Division 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 Act or in the Regulations issued thereunder. Further, this letter, and the relief contained herein, is based upon the representations made to the Division. Any different, changed or omitted material facts or circumstances might render this no-action relief void.

Should you have any questions, please do not hesitate to contact me at (202) 418-5977; Katherine Driscoll, Associate Director, at (202) 418-5544; Ward Griffin, Associate Chief Counsel, at (202) 418-5425; or Adam Kezsomb, Special Counsel, at (202) 418-5372.

Very truly yours,

Gary Barnett
Director
Division of Swap Dealer and Intermediary Oversight

cc: Regina Thoele, Compliance
    National Futures Association, Chicago

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17 Any requests to extend this relief to other transactions should be submitted, along with data and other relevant information, in accordance with Regulation 140.99, 17 CFR 140.99.