CFTC Letter No. 12-58
No-Action
December 18, 2012
Division of Swap Dealer and Intermediary Oversight

Re: Request for Relief Regarding Obligation to Provide Pre-Trade Mid-Market Mark for Certain Credit Default Swaps and Interest Rate Swaps

Ladies and Gentlemen:

This letter is in response to a request dated November 30, 2012, from the International Swaps and Derivatives Association, Inc. (“ISDA”) to the Division of Swap Dealer and Intermediary Oversight (“Division”) of the Commodity Futures Trading Commission (“Commission”), in which ISDA requested relief\(^1\) that would permit swap dealers and major swap participants to enter into certain derivatives 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). ISDA requested that swap dealers and major swap participants not be required to disclose pre-trade mid-market marks in connection with: (1) untranched credit default swaps referencing the on-the-run and most recent off-the-run series of the following indices: CDX.NA.IG 5Y, CDX.NA.HY 5Y, iTraxx Europe 5Y and iTraxx Europe Crossover 5yr (“Covered Credit Derivative Transactions”); and (2) interest rate swaps (A) in the “fixed-for-floating swap class” (as such term is used in Regulation 50.4(a)) denominated in USD or EUR, (B) for which the remaining term to the scheduled termination date is no more than 30 years, and (C) that have the specifications set out in the Regulation 50.4 (“Covered Rates Derivative Transactions,” and together with Covered Credit Derivative Transactions, “Covered Derivative Transactions”).

Applicable Regulatory Requirements

Section 4s(h)(3)(B) of the CEA directs the Commission to adopt business conduct standards for swap dealers and major swap participants that:

\(^1\) ISDA requested interpretative relief; in lieu of interpretative relief, the Division is issuing no-action relief in this letter.
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.²

On February 17, 2012, the Commission published final rules prescribing certain business conduct standards for swap dealers and major swap participants, which included Regulation 23.431.³ In relevant part, Regulation 23.431 reads as follows:

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 . . . [t]he 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 . . . ³

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.”⁵


⁴ Final Business Conduct Standards, supra note 3, at 9824.

⁵ 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).
Summary of Request for Relief

In its letter requesting relief, ISDA stated that the Covered Derivative Transactions “are highly-liquid, exhibit narrow bid-ask spreads and are widely quoted by SD/MSPs in the marketplace.” ISDA 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 Derivative Transactions, compliance with the Pre-Trade Mid-Market Mark Requirement does not provide any significant informational value. Many of ISDA’s buy-side members believe that a mid-price for Covered Derivative 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.

Further, ISDA noted that disclosing the pre-trade mid-market mark “would require SD/MSPs 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.” These new operational capabilities may add significant costs, according to ISDA. Lastly, ISDA stated that the delivery of the pre-trade mid-market mark for the Covered Derivative Transactions may “adversely affect counterparties by delaying the trade time, since delivery must be made [at] ‘a reasonably sufficient time prior’ to trading.”

Division No-Action Position

Based upon the representations made by ISDA concerning the Covered Derivative Transactions, the Division believes that no-action relief on the pre-trade mid-market mark requirement for the Covered Derivative Transactions is warranted. However, to ensure that counterparties are provided “with pricing information that facilitates negotiations and balances historical information asymmetry regarding swap pricing,” the Division believes that, upon the issuance of final rules governing the registration of swap execution facilities (“SEFs”), the no-action relief should be limited to Covered Derivative Transactions for which real-time executable bid and offer prices are available on a designated contract market (“DCM”) or SEF at the time that the Covered Derivative Transaction is executed. The Division anticipates that a Covered

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7 Id. at 2.
8 Id. at 4.
9 Id. at 4.
10 Final Business Conduct Standards, supra note 3, at 9766.
Derivative Transaction with executable bids and offers on a DCM or SEF will be indicative of available liquidity for the transaction.11

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 Derivative Transaction prior to the issuance of final Commission Regulations governing the registration of SEFs, subject to any compliance implementation period contained therein, provided that: (1) real-time tradeable bid and offer prices for the Covered Derivative Transaction are available electronically, in the marketplace, to the counterparty; and (2) the counterparty to the Covered Derivative Transaction agrees in advance, in writing, that the swap dealer or major swap participant need not disclose a pre-trade mid-market mark.

Further, 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 Derivative Transaction subsequent to the issuance of final Commission Regulations governing the registration of SEFs, subject to any compliance implementation period contained therein, provided that: (1) real-time executable bid and offer prices for the Covered Derivative Transaction are available on a DCM or SEF; and (2) the counterparty to the Covered Derivative 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 Derivative Transactions based on, among other things, ISDA’s representations that Covered Derivative 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 Derivative 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 Derivative 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 Derivative Transactions. However, the Division may consider extending this no-action relief to other transactions, if sufficient data and other relevant information are submitted to the Division establishing the appropriateness of an extension.12 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).


12 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.
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 Kezsboin, Special Counsel, at (202) 418-5372.

Very truly yours,

Gary Barnett
Director
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cc: Regina Thoele, Compliance
National Futures Association, Chicago