



## U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre  
1155 21st Street, NW, Washington, DC 20581  
Telephone: (202) 418-5430  
Facsimile: (202) 418-5547  
[aradhakrishnan@cftc.gov](mailto:aradhakrishnan@cftc.gov)

Division of Clearing and Risk

Ananda Radhakrishnan  
Director

CFTC Letter No. 13-01  
No-Action  
March 18, 2013  
Division of Clearing and Risk

### **Re: No-Action Relief from Required Clearing for Swaps Resulting from Multilateral Portfolio Compression Exercises**

Dear Ladies and Gentlemen:

This letter is in response to a request dated February 19, 2013, from TriOptima, an entity that offers multilateral portfolio compression services,<sup>1</sup> to the Division of Clearing and Risk (Division) of the Commodity Futures Trading Commission (Commission), in which TriOptima requested relief on behalf of swap market participants that participate in multilateral portfolio compression exercises in the form of confirmation from Division staff that the clearing requirement under section 2(h)(1)(A) of the Commodity Exchange Act (CEA) and part 50 of Commission regulations does not apply to (1) swaps that are amended in order to reduce notional value as part of a multilateral portfolio compression exercise and (2) new swaps that are entered into to replace the original swaps as a result of a multilateral portfolio compression exercise in order to reduce notional exposures or aggregate outstanding gross notional exposure. The request focuses on swaps that were executed prior to the date on which the counterparties must begin complying with the clearing requirement (and therefore, not required to be cleared),<sup>2</sup> but

---

<sup>1</sup> Although the relief contained herein was requested by a particular service provider, such relief is available to all participants in any multilateral portfolio compression exercise, as defined in Commission regulation 23.500(h), subject to the conditions specified herein.

<sup>2</sup> The Commission set forth a specific compliance schedule for market participants to bring their swaps into compliance with the clearing requirement. *See* Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284, 74319-20 (Dec. 13, 2012) [hereinafter "Clearing Requirement Determination"]. Swap dealers (SDs), major swap participants (MSPs), and private funds active in the swaps market (active funds) are required to comply beginning on March 11, 2013, for swaps they enter into on or after that date. All other financial entities are required to clear swaps beginning on June 10, 2013, for swaps entered into on or after that date, except for accounts managed by third-party investment managers, as well as ERISA pension plans, which have until September 9, 2013, to begin clearing swaps entered into on or after that date. With regard to the credit default swap indices on European corporate names, iTraxx, the Clearing Requirement Determination provided that, if no derivatives clearing organization (DCO) offers iTraxx for client clearing by February 11, 2013, the Commission will delay compliance for those swaps until 60 days after an eligible DCO offers iTraxx indices for client clearing. The Commission recently announced that iTraxx clearing will commence on April 26, 2013, for SDs, MSPs, and active funds. Financial entities other than accounts managed by third-party investment managers and ERISA plans are required to

are subsequently amended or replaced in connection with a multilateral portfolio compression exercise.

As discussed below, the proposed relief would permit market participants to continue to use multilateral portfolio compression exercises for reducing the risk of uncleared swaps that were entered into prior to an applicable compliance date as set forth by the Commission (and therefore, not required to be cleared), provided that certain conditions are met.

### **Factual Background and Request for Relief**

Multilateral portfolio compression allows swap market participants to net down the size and/or number of outstanding swaps among them, lower the aggregate gross notional value of outstanding swaps, and decrease the number of outstanding swaps or the aggregate notional value of such swaps, thereby reducing operational risk and, in some instances, reducing counterparty credit risk. For purposes of this letter, the term “multilateral portfolio compression exercise” has the meaning given to the term in Commission regulation § 23.500(h).<sup>3</sup> Commission regulation § 23.500(h) defines the term to mean “an exercise in which multiple swap counterparties wholly terminate or change the notional value of some or all of the swaps submitted by the counterparties for inclusion in the portfolio compression exercise and, depending on the methodology employed, replace the terminated swaps with other swaps whose combined notional value (or some other measure of risk) is less than the combined notional value (or some other measure of risk) of the terminated swaps in the compression exercise.”

In a multilateral portfolio compression exercise for uncleared swaps, the compression service provider analyzes the uncleared swap portfolios of multiple swap market participants and publishes the optimal solution for the compression cycle based on one of two methods. Under the first method, the outstanding notional value of the original swap between two counterparties is reduced by amending the original swap. This “amended swap” method is the predominant method used in compressions of uncleared interest rate swaps. Under the second method, one or more existing swaps are terminated and replaced by new swaps that reflect a netting down of existing notional exposure between the counterparties.<sup>4</sup> This “replacement swap” method is predominantly used in compression exercises for uncleared credit default swaps, but it can also be used for interest rate swap compression exercises. Counterparties have the option of electing either of the two methods of compression.

Under the rules of the compression exercise, for either method of compression — amended swap or replacement swap — the counterparties to the original swap do not change. In

---

begin clearing iTraxx index swaps entered into on or after July 25, 2013, and all other entities are required to begin clearing iTraxx index swaps on October 23, 2013, for swaps entered into on or after that date.

<sup>3</sup> See Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 FR 55904, 55960 (Sept. 11, 2012).

<sup>4</sup> In the vast majority of compression exercises there is a reduction in the notional exposures due to netting. However, in some exercises there is merely an aggregation of outstanding gross exposures arising from multiple swaps into one replacement swap with no net reduction in notional exposures.

addition, the reference entity and the maximum maturity do not change. Finally, the overall market risk of the portfolios of the market participants in the compression exercise does not change.

TriOptima requests that Division staff clarify that amended and replacement swaps, where the original swap was not required to be cleared at the time of execution but that is subsequently amended or replaced in connection with a multilateral portfolio compression exercise after the relevant clearing requirement compliance date (*e.g.*, after March 11, 2013 for a swap between two SDs), are not required to be cleared solely by virtue of being amended or replaced through a multilateral portfolio compression exercise.

TriOptima represents that requiring amended swaps or replacement swaps resulting from a compression exercise to be cleared would alter the credit risk profile for those participating in the compression exercise because counterparties to the amended or replacement swaps would be required to face a derivatives clearing organization (DCO) instead of the original bilateral counterparty. Further, TriOptima represents that because participants would not know in advance which swaps may be subject to an amendment or replacement, or the notional amount to be amended or replaced, market participants likely would reconsider their participation in these industry-wide risk reduction exercises. As a result, TriOptima represents that changing the required clearing status of the swaps would discourage participation in compression exercises and inhibit the risk reduction benefits that such exercises provide.

### **Applicable Regulatory Requirements and Analysis**

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,<sup>5</sup> in relevant part, amended section 2(h)(1)(A) of the CEA, which states that “it shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a [DCO] that is registered under [the CEA] or a [DCO] that is exempt from registration under [the CEA] if the swap is required to be cleared.”<sup>6</sup>

On December 13, 2012, the Commission published its first clearing requirement determination. The determination requires market participants to clear swaps meeting the specifications of two classes of credit default swaps based on North American and European corporate entities and four classes of interest rate swaps.<sup>7</sup> Commission regulation 50.5(b) provides that swaps entered into before the relevant compliance date for a particular swap are not subject to the clearing requirement.<sup>8</sup> As described above, the Commission set forth a series of

---

<sup>5</sup> Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>6</sup> 7 U.S.C. § 2(h)(1)(A).

<sup>7</sup> *See* Clearing Requirement Determination, 77 FR at 74336-37 (establishing Commission regulation 50.4, which sets forth the classes of swaps that are required to be cleared).

<sup>8</sup> *Id.* at 74337.

compliance dates to phase in compliance with the clearing requirement. Swaps entered into before those compliance dates are not required to be cleared.

In the final rulemaking, the Commission clarified that the clearing requirement applies to all new swaps, as well as changes in the ownership of a swap, including assignment, novation, exchange, transfer, or conveyance.<sup>9</sup>

For purposes of the analysis in this letter, Division staff will assume that the amended or replacement swaps discussed herein are subject to the clearing requirement under section 2(h) of the CEA and Commission regulations. In other words, staff is assuming that all swaps subject to this letter fall within a class of swaps with the specifications set forth in Commission regulation 50.4(a) or (b).

In order to promote the benefits of compression for uncleared swaps, the Division has determined that it will not recommend enforcement action for failure of market participants to submit to a DCO for clearing amended swaps or replacement swaps that are generated as part of a multilateral portfolio compression exercise and are subject to required clearing under Commission regulation 50.4(a) or (b), provided that certain conditions are met, as described below.

### **Division No-Action Position**

Based on the foregoing, the Division believes that granting relief is warranted. Accordingly, the Division will not recommend that the Commission take an enforcement action against any person for failure to comply with the requirement under section 2(h)(1)(A) of the CEA and part 50 of Commission regulations to clear an amended swap or a replacement swap that is generated as part of a multilateral portfolio compression exercise, provided that the following five conditions are met:

1. The “multilateral portfolio compression exercise” generating the amended and replacement swaps must meet the definition set forth in Commission regulation 23.500(h) and must involve more than two market participants.
2. No original swap submitted by market participants as part of the multilateral portfolio compression exercise shall include any swap that has been cleared by a DCO.
3. No original swap submitted by market participants as part of the multilateral portfolio compression exercise shall include any swap that is required to be cleared under 2(h)(1)(A) of the CEA and part 50 of Commission regulations because it was executed on or after an applicable compliance date.
4. Each amended swap(s) or replacement swap(s) generated by the multilateral portfolio compression exercise must:

---

<sup>9</sup> *Id.* at 74316.

- a. be generated in accordance with a multilateral portfolio compression service provider's established rules and parameters for multilateral portfolio compression exercises;
  - b. be entered into between the same counterparties as the original swap(s) that is amended or terminated;
  - c. with the exception of reducing the notional amount, have the same material terms as the original swap(s), as defined in part 45 of Commission regulations,<sup>10</sup> including the reference entity, the maximum maturity of the swap, and the average weighted maturity of the swap; and
  - d. be entered into for the sole purpose of reducing operational or counterparty credit risk.
5. Once the original swaps have been selected and submitted by market participants as part of the multilateral portfolio compression exercise, the multilateral portfolio compression methodology does not permit participants to specify which swaps may be amended or replaced.

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 CEA or in the Commission regulations issued thereunder.<sup>11</sup> It does not create or confer any rights for or obligations on any person or persons subject to compliance with the CEA that bind the Commission or any of its other offices or divisions.

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 Sarah Josephson, Deputy Director, at (202) 418-5684, or Brian O'Keefe, Associate Director, at (202) 418-5658.

Sincerely,

Ananda Radhakrishnan

---

<sup>10</sup> For purposes of this letter, "material terms" means all terms of a swap required to be reported in accordance with part 45 of Commission regulations.

<sup>11</sup> For example, the relief provided herein does not excuse persons from any applicable swap reporting requirements or any requirement under section 2(h)(8) of the CEA.