



## U.S. COMMODITY FUTURES TRADING COMMISSION

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### Division of Market Oversight

CFTC Letter No. 14-119  
No-Action  
September 29, 2014  
Division of Market Oversight

**Re: Extension of Time-Limited No-Action Relief to DCOs and their Clearing Members from the SEF Registration Requirement and Trading Mandate under Part 37 and from Various Reporting Requirements under Part 45, all in Connection with CDS Clearing-Related Swaps**

On September 12, 2014 and September 15, 2014, respectively, ICE Clear Credit LLC (“ICE Clear Credit”) and the Chicago Mercantile Exchange, Inc. (“CME”), each a Commission-registered derivatives clearing organization (“DCO”), submitted requests for an extension of the no-action relief granted by the Division of Market Oversight (the “Division”) of the Commodity Futures Trading Commission (“CFTC” or “Commission”) in CFTC Letter No. 13-86, which will expire on September 30, 2014 (the “CDS Settlement Price Process No-Action Relief”).<sup>1</sup> In CFTC Letter No. 13-86, the Division confirmed that it would not recommend that the Commission take enforcement action: (1) against a DCO meeting certain specified conditions for failure to register as a swap execution facility (“SEF”) pursuant to CFTC Regulation 37.3; (2) against a DCO clearing member for entering into a swap through the DCO’s credit default swaps (“CDS”) Settlement Price Process for CDS Clearing-Related Swaps<sup>2</sup> rather than on a SEF or a designated contract market (“DCM”) in instances where the Commodity Exchange Act (“CEA” or “Act”) Section 2(h)(8) trade execution requirement applies to such swap, subject to certain specified conditions; or (3) against a swap reporting counterparty for failure to comply with its obligations to report swap data as required by Part 45 of the Commission’s regulations for CDS Clearing-Related Swaps, subject to certain specified conditions.

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<sup>1</sup> CFTC Letter No. 13-86 (Dec. 31, 2013), available at: <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/13-86.pdf>.

<sup>2</sup> For purposes of this letter, the terms “CDS Settlement Price Process” and “CDS Clearing-Related Swaps” have the same meaning as in the Division’s three previous letters using these terms. *See* CFTC Letters No. 13-86 (Dec. 31, 2013); No. 13-36 (June 27, 2013); and No. 12-59 (Dec. 19, 2012).

The CDS Settlement Price Process No-Action Relief applies to certain occasional, off-facility, cleared CDS, and the counterparties thereto, that are entered into pursuant to a DCO's rules related to its price submission process for determining end-of-day settlement prices for cleared CDS. As discussed in CFTC Letter No. 13-86, each Commission-registered DCO that is eligible to clear CDS has unique policies and procedures in place to facilitate accurate and reliable end-of-day pricing for cleared CDS products.<sup>3</sup> Generally speaking, under the rules of those DCOs, clearing members are required to submit price quotes for any cleared CDS product in which the clearing member, or the clearing member's customers, has open interest at the end of each day. The DCO relies on these quotes in setting the end-of-day settlement prices for all cleared CDS positions. In order to ensure that the prices submitted by clearing members as part of the CDS Settlement Price Process are reliable and reflect current market conditions, DCOs require their clearing members, from time to time, to enter into "firm" or "forced" trades at their submitted price quotes, which then result in cleared CDS positions.

According to ICE Clear Credit, the CDS Settlement Price Process provides reliable, market-driven prices for use in determining settlement prices for each instrument. In addition, ICE Clear Credit states that a procedure that requires clearing members to enter into CDS Clearing-Related Swaps at their submitted price quotes encourages clearing members to provide high quality quotes in connection with the clearing members' obligation to support the price discovery process related to determining end-of-day settlement prices. CME states that the potential of crossing CDS clearing members at submitted bids and offers continues to serve as an appropriate incentive for CDS clearing members to provide high quality quotes to the settlement price process. Based on such representations, the Division understands that this process facilitates a DCO's determination of accurate pricing for CDS, particularly, although not exclusively, when liquidity is limited (for example, for new products or off-the-run CDS).

The CDS Settlement Price Process is implemented through a unique set of policies and procedures developed by each DCO to establish reliable settlement prices for the CDS instruments it clears, in association with the DCO's efforts to fulfill its responsibilities in conducting settlements under Section 5b(c)(2)(E) of the Act (DCO Core Principle E) and Commission Regulation 39.14. The process is not one through which clearing members submit or competitively accept bids and offers through the clearinghouse. Rather, the swap execution that occurs occasionally as part of the CDS Settlement Price Process results from the requisite submissions by CDS clearing members of mid-prices for certain CDS products to the clearinghouse.

Although the required execution of swaps pursuant to the CDS Settlement Price Process does not represent the typical voluntary swaps activity between counterparties seeking to achieve their respective financial objectives, the execution of a CDS Clearing-Related Swap nonetheless has implications for SEF registration requirements, trade execution requirements, and swap data reporting. In this regard, under CEA Section 5h(a)(1) and Commission Regulation 37.3, multilateral facilities that provide for the execution of swaps transactions are

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<sup>3</sup> While the phrase "CDS Settlement Price Process" is used herein by the Division, DMO notes that the various DCOs may each use their own term. For example, CME refers to its CDS Settlement Price Process as the "Price Quality Auction" process, while ICE Clear Credit refers to its process as the "End-Of-Day" or "EOD" process.

required to register as a DCM or a SEF, while under CEA Section 2(h)(8) and Commission Regulations 37.10 and 38.12, swaps that are subject to clearing and have been made available to trade must be executed on a DCM or SEF. Moreover, CEA Section 2(a)(13)(G) requires all swaps, whether cleared or uncleared, to be reported to a registered swap data repository. For off-facility swaps, part 45 places the reporting obligation on the Reporting Counterparty as determined by Commission Regulation 45.8.

#### Extension of Grant of No-Action Relief

The CDS Settlement Price Process No-Action Relief is scheduled to expire on September 30, 2014. ICE Clear Credit represented that the market for CDS products benefits from the use of the CDS Settlement Price Process, that it believes is the best solution currently available for determining settlement prices for CDS, and that the extension of no-action relief would allow for continued analysis of industry developments over a period significant enough for meaningful industry change. According to CME, during the extension period, it would continue to analyze market data to consider whether there are alternatives to the CDS Settlement Price Process that would not require the relief provided under CFTC Letter No. 13-86 and are at least as efficient and effective as the current process, noting that the extension would allow sufficient time for the research, development, testing and implementation of any potential alternative. In addition, ICE Clear Credit and CME indicate their interest in the implementation on a permanent basis of relief that would achieve high-quality end-of-day settlement prices.

In light of the ongoing use by DCOs of the CDS Settlement Price Process in conjunction with the DCOs' efforts to fulfill their responsibilities in conducting settlements, and in consideration that no comparably effective alternative approach has been developed, the Division will therefore extend the CDS Settlement Price Process No-Action Relief to the earlier of: (i) 11:59 p.m. on September 30, 2015; or (ii) the effective date of any Division or Commission action to facilitate a longer term approach to establishing settlement prices for CDSs. The extension should provide a reasonable amount of time for CME, ICE Clear Credit and similarly situated DCOs to obtain additional experience using the CDS Settlement Price Process, to collect additional price data, and to consider possible viable alternatives, all of which can assist the Division in considering a permanent approach to this issue.

Based on the facts presented and the representations made by CME and ICE Clear Credit, the Division will not recommend that the Commission take enforcement action against any DCO meeting the following specified conditions, for failure to register as a SEF pursuant to CFTC Regulation 37.3; additionally, the Division will not recommend that the Commission commence an enforcement action against any DCO clearing member for entering into a swap through the DCO's CDS Settlement Price Process and not on a SEF or a DCM for CDS Clearing-Related Swaps, even if such swap is subject to CEA Section 2(h)(8)'s trade execution requirement, subject to the following conditions:

1. The no-action relief shall apply only to CDS Clearing-Related Swaps arising from, or entered into pursuant to, a DCO's CDS Settlement Price Process, and executed as required by the DCO's rules and procedures.

2. Each trade must involve a clearing member of a DCO that is eligible to clear CDS indices and must participate in that DCO's CDS Settlement Price Process, and must be carried out by the DCO as part of equal and opposite paired transactions such that the DCO's net exposure remains unchanged.
3. The CDS Clearing-Related Swap trade is initiated solely by the DCO, pursuant to its rules and procedures.
4. A DCO relying on this relief will, upon request, promptly make available to any representative of the Commission, information regarding the CDS Settlement Price Process, in the form and manner specified.

In addition, the Division will not recommend that the Commission take enforcement action against a reporting counterparty for failure to comply with its obligations to report swap data as required by Part 45 for CDS Clearing-Related Swaps,<sup>4</sup> subject to the following conditions:

1. The reporting counterparty, as defined in Part 45, must be a clearing member of a DCO that is eligible to clear CDS indices and must participate in that DCO's CDS Settlement Price Process.
2. The no-action relief shall apply only to CDS Clearing-Related Swaps arising from, or entered into pursuant to, a DCO's CDS Settlement Price Process, as required by the DCO's rules and procedures.
3. The reporting counterparty and DCO agree, as evidenced by private agreement or pursuant to a DCO's rules, that the DCO shall fulfill all of the reporting counterparty's obligations with respect to reporting CDS Clearing-Related Swaps pursuant to Part 45.

The no-action relief contained in this letter shall expire on the earlier of: (i) 11:59 p.m. on September 30, 2015; or (ii) the effective date of any Division or Commission action to facilitate a longer term approach to establishing settlement prices for CDSs.

This letter, and the no-action position taken herein, represent the views of the Division of Market Oversight only, and do not necessarily reflect the views of the Commission or any other division or office of the Commission's staff. Should the Commission promulgate rules in the future that are in conflict with any no-action relief granted in this letter, any such rules will supersede this letter. The no-action position taken herein does not excuse affected persons from compliance with any other applicable requirements of the CEA or the regulations promulgated thereunder. This position is based upon the representations contained in the ICE Clear Credit

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<sup>4</sup> The Division notes that the No-Action Relief in CFTC Letter 13-86 did not grant any relief under Part 43 of the Commission's regulations. This extension, therefore, does not address Part 43.

and CME request letters dated September 12 and 15, 2014, respectively, and it should be noted that any different, changed, or omitted material facts or circumstances may require a different conclusion or render this no-action letter void. Finally, as noted above, and as with all no-action letters, the Division of Market Oversight retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

If you have any questions concerning the content of this staff no-action letter, please contact David Van Wagner, Chief Counsel, Division of Market Oversight, at (202) 418-5481 or [dvanwagner@cftc.gov](mailto:dvanwagner@cftc.gov), or Riva Spear Adriance, Senior Special Counsel, Division of Market Oversight, at (202) 418-5494 or [radriance@cftc.gov](mailto:radriance@cftc.gov).

Sincerely,

Vincent A. McGonagle  
Director  
Division of Market Oversight