



## U.S. COMMODITY FUTURES TRADING COMMISSION

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### Division of Market Oversight

CFTC Letter No. 17-60  
No-Action  
November 14, 2017  
Division of Market Oversight

#### **Re: Extension of No-Action Relief for Swap Execution Facilities from Certain “Block Trade” Requirements in Commission Regulation 43.2**

Ladies and Gentlemen:

This letter responds to a request received from the Wholesale Markets Brokers’ Association, Americas (“WMBAA”)<sup>1</sup>, on behalf of its members and other market participants that engage in swap block trades, that the Division of Market Oversight (“Division”) of the Commodity Futures Trading Commission (the “Commission” or “CFTC”) provide a permanent solution to swap execution facilities (“SEFs”) from the requirement in Commission regulation 43.2 that a swap block trade must “[o]ccur[ ] away from the registered [SEF’s]... trading system or platform.” In the meantime, the WMBAA requests that the Division again extend the relief provided in CFTC Letter No. 16-74. That letter provides that the Division will not recommend enforcement action against a SEF that has rules and/or procedures that provide for the use of a SEF trading system or platform to facilitate the execution of block trades for swaps that are intended to be cleared,<sup>2</sup> and thus is not compliant with Commission regulation 43.2, provided that certain conditions set forth in the letter are met. CFTC Letter No. 16-74 extended the relief provided under CFTC Letter Nos. 14-118 and 15-60. Absent further action from the Division, CFTC Letter No. 16-74 will expire November 15, 2017.

The Division continues to assess swap block trades, including establishing a permanent solution and will thus extend the no-action relief provided under CFTC Letter No. 16-74 until 11:59 pm (Eastern Time) November 15, 2020.

### **Background**

Commission regulation 43.2 defines a “block trade” as, among other things, a publicly reportable swap transaction that “[o]ccurs away from the registered [SEF’s]... trading system or platform and is executed pursuant to the registered [SEF’s]... rules and procedures” (hereinafter the “occurs away” requirement). In a subsequent rulemaking establishing appropriate minimum sizes for block trades, the Commission further clarified this language by stating that “[by] definition, a

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<sup>1</sup> The WMBAA is an independent industry body that represents BGC Derivatives Markets, L.P.; GFI Swaps Exchange LLC; tpSEF, Inc.; and Tradition SEF, Inc. Each of these WMBAA member firms is registered with the Commission as a SEF.

<sup>2</sup> Swaps that are intended to be cleared are swaps (i) of a type accepted for clearing by a derivatives clearing organization (“DCO”), and (ii) intended to be submitted for clearing contemporaneously with execution.

block trade must occur away from the SEF[’s] trading system or platform” and that “[a]ny swap that is executed on a SEF[’s]... trading system or platform, regardless of whether it is for a size at or above the appropriate minimum block size for such swap, is not a block trade under this definition....”<sup>3</sup>

According to the WMBAA, SEFs are unable to comply with the requirement in Commission regulation 37.702(b) that a SEF facilitate pre-execution credit checks for block trades that “occur away” from a SEF.<sup>4</sup> The WMBAA notes that there is no mechanism for registered future commission merchants (“FCMs”) to perform pre-execution credit checks for block trades that are executed away from a SEF. All credit checks utilize a SEF’s credit check functionality and must either occur after a swap has been executed away from the SEF or before a swap has been executed on the SEF.

The WMBAA states that market participants continue to grapple with the uncertainties caused by the definition and treatment of block trades under the Commission’s regulations. Accordingly, the WMBAA proposes that market participants be provided with a permanent solution. As an interim measure, however, the WMBAA believes that “an extension of the relief granted under [No-Action Letters] 14-118, 15-60 and 16-74 would allow the WMBAA member firms, other SEFs, market participants, and the Commission time to consider and develop best practices and a permanent solution to the issues attendant to block trades, including amendments to the Commission’s regulations.” Therefore, the WMBAA requests that the Division provide an extension of the no-action relief in No-Action Letter 16-74 until the effective date of Commission action that addresses block trades.

### **No-Action Relief and Compliance with Commission Regulation 37.702(b)**

Based on the representation in the WMBAA’s letter, the Division has determined to extend the no-action relief granted by CFTC Letter No. 16-74. During the extended period of relief, the Division will not recommend that the Commission take enforcement action against any SEF which has rules and/or procedures that provide for the use of a SEF trading system or platform to facilitate the execution of block trades that are intended to be cleared, provided that the following conditions are met:

- The block trade is not executed on the SEF’s Order Book functionality, as defined in Commission regulation 37.3(a)(3);<sup>5</sup> the SEF adopts rules pertaining to cleared block trades

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<sup>3</sup> See Procedures To Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 78 Fed. Reg. 32,866 at 32,904 n.425 (May 31, 2013).

<sup>4</sup> Commission regulation 37.702(b) requires that a SEF coordinate with each DCO to which it submits transactions for clearing and have rules and procedures to facilitate prompt and efficient processing by DCOs in accordance with Commission regulation 39.12(b)(7). Accordingly, staff guidance further specifies, among other things, that a SEF must facilitate pre-execution screening by each FCM that is a clearing member (“Clearing FCM”) on an order-by-order basis. See Staff Guidance on Swaps Straight Through Processing at 2 (Sept. 26, 2013) (“STP Guidance”).

<sup>5</sup> The Division notes that while block trades may not be facilitated through a SEF’s Order Book functionality, pursuant to this no-action relief, SEFs are permitted to use request-for-quote (“RFQ”) functionalities to facilitate the execution of a block trade. The Division notes also that a block trade executed through a SEF’s RFQ functionality pursuant to this no-action relief would not be subject to the minimum participant requirement set forth in Commission regulation 37.9(a)(3). Finally, the Division notes that trades above the minimum block size may

that indicate that the SEF relies on the relief provided in this no-action letter<sup>6</sup> and requires each cleared block trade execution on a non-Order Book trading system or platform to comply with the requirements set forth in the block trade definition in Commission regulation 43.2. Specifically, the block trade must:

1. involve a swap that is listed on a registered SEF;
  2. be executed pursuant to the SEF's rules and procedures;
  3. meet the notional or principal amount at or above the appropriate minimum block size applicable to the swap; and
  4. be reported to a swap data repository pursuant to the SEF's rules and procedures and the Commission's rules and regulations.
- The FCM completes the pre-execution credit check pursuant to Commission regulation 1.73 at the time the order for a block trade enters the SEF's non-Order Book trading system or platform;<sup>7</sup> and
  - The block trade is subject to void *ab initio* requirements where the swap is rejected on the basis of credit.<sup>8</sup>

This no-action relief shall commence on the date of issuance of this letter and shall expire on November 15, 2020 at 11:59 pm (Eastern Time).

As noted above, Commission regulation 37.702(b) requires that SEFs coordinate with each DCO to which they submit transactions for clearing and also have rules and procedures to facilitate prompt and efficient processing by DCOs in accordance with Commission regulation 39.12(b)(7). Among other things, SEFs must facilitate pre-execution screening by each Clearing FCM on an order-by-order basis.

Despite this rule, there continues to be some confusion among market participants, particularly with respect to the execution of off-SEF block trades, as to whether counterparties may execute intended to be cleared swaps subject to the rules of a SEF before a credit check has occurred. Staff confirms that if a SEF permitted the execution of an intended to be cleared swap, whether on or subject to the rules of a SEF, without a pre-execution credit check, it would be in violation of Commission regulation 37.702(b). Specifically, in the case of block trades, where counterparties use the SEF's credit check functionality, as currently allowed, the execution of that transaction must happen after the credit check on SEF. If parties want to execute a block trade away from a SEF, the parties to the trade must obtain a credit check before this execution.<sup>9</sup>

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occur on the SEF's Order Book; however, they will not receive treatment as block trades and will not be afforded a reporting time delay.

<sup>6</sup> These rules should include a citation to this no-action letter.

<sup>7</sup> Consistent with the STP Guidance and as noted below, the execution must occur after the required credit check.

<sup>8</sup> See STP Guidance at 5.

<sup>9</sup> For the avoidance of doubt, if the parties purport to execute a block trade away from the SEF without first obtaining a credit check, an FCM clearing unit that clears such trade and does not have knowledge of such purported execution is not in violation of the pre-execution credit check requirement under Commission regulation 1.73. Staff understands that currently no mechanism exists to enable a pre-execution credit check where blocks are executed away from a SEF; however, this letter does not preclude participants from developing and using such a mechanism in the future.

To comply with Commission regulation 37.702(b) and ensure there is a pre-execution credit check for all intended to be cleared swaps, staff notes that a SEF must have a rule, filed pursuant to part 40, which provides that an intended to be cleared swap cannot be executed before there has been a credit check. Staff will reach out to SEFs to confirm that these rules exist or are implemented, as appropriate.

## **Conclusion**

Market participants should be aware that the no-action position taken herein does not excuse affected persons from compliance with any other applicable requirements of the Commodity Exchange Act or the Commission's regulations thereunder, in particular, the applicable swap data reporting requirements, clearing requirements, pre-execution credit check requirements, and straight-through processing requirements.<sup>10</sup> This letter, and the no-action position taken herein, represent the views of the Division only, and do not represent the position or views of the Commission or of any other division or office of the Commission's staff. As with all no-action letters, the Division 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 this correspondence, please contact Nancy Markowitz, Deputy Director, Division of Market Oversight, at (202) 418-5453 or [nmarkowitz@cftc.gov](mailto:nmarkowitz@cftc.gov), or Jonathan Lave, Associate Director Division of Market Oversight, at (202) 418-5983 or [jlave@cftc.gov](mailto:jlave@cftc.gov), or Roger Smith, Special Counsel, Division of Market Oversight, at (202) 418-5344 or [rsmith@cftc.gov](mailto:rsmith@cftc.gov).

Sincerely,

Amir Zaidi  
Director  
Division of Market Oversight

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<sup>10</sup> The applicable swap data reporting requirements are set forth under parts 43, 45 and 50 of the Commission's regulations. The applicable clearing requirements are set forth under Commodity Exchange Act section 2(h)(1) and part 50 of the Commission's regulations. The applicable pre-execution credit check requirements are set forth under Commission regulation 1.73 of the Commission's regulations. The applicable straight-through processing requirements are set forth under Commission regulations 1.74, 37.702(b) and 39.12(b)(7).