

CLIENT UPDATE

MANDATORY EXCHANGE-TRADING FOR SWAPS

NEW YORK

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We are providing this update to inform you that you may have to execute certain swaps on an exchange or trading platform starting early next year instead of entering into such swaps over the counter. The Dodd-Frank Wall Street Reform and Consumer Protection Act requires that swaps subject to the mandatory clearing requirement¹ must be executed on a designated contract market (“DCM”) or a swap execution facility (“SEF”) if a DCM or SEF “makes the swap available to trade.”

WHO IS SUBJECT TO THE TRADE EXECUTION REQUIREMENT?

The trade execution requirement applies to swaps subject to mandatory clearing entered into between two financial entities. The term “financial entity” includes a private fund, commodity pool, employee benefit plan, swap dealer, bank, insurance company and any other entity that is predominantly engaged in certain financial activities.

The trade execution requirement does not apply to a swap entered into by a non-financial entity end-user for hedging or other risk mitigation purposes (*i.e.*, where the “end-user exception” from

¹ The Commodity Futures Trading Commission (the “CFTC”) is authorized to determine from time to time that a particular swap or group, category, type or class of swaps is required to be cleared. As of today, mandatory clearing is limited to four classes of interest rate swaps and two classes of credit default swaps listed in section 50.4 of the CFTC regulations, which is available at:
<http://www.ecfr.gov/cgi-bin/text-idx?SID=aa1153f6f50f4e4e8f8e553b1aeb6bc6&node=17:1.0.1.1.42.1.7.4&rgn=div8>.

clearing is available).² However, the trade execution requirement does apply to swaps where one or both of the counterparties are non-financial entities that are not eligible for the end-user exception.

WHICH SWAPS MUST BE EXECUTED ON A DCM OR SEF?

A DCM is an exchange (such as the CME) for trading futures and options on futures, which is permitted to make swaps available for trading. A SEF is an electronic trading platform or facility in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by other participants through an order book or request-for-quote system.

The trade execution requirement applies to swaps that are “made available to trade” by a DCM or SEF. As a preliminary matter, a DCM or SEF must submit to the Commodity Futures Trading Commission (the “CFTC”) a determination that one or more swaps (or groups, categories, types or classes of swaps) is available to trade (a “MAT determination”) and this MAT determination must either be approved by the CFTC or self-certified by the DCM or SEF. Once so approved or self-certified, each such swap (or group, category, type or class of swaps) will be deemed available to trade on all DCMs and/or SEFs offering such swap for trading, and market participants will be obligated to execute any such swap (or group, category, type or class of swaps) on one of such DCMs or SEFs.

With respect to MAT determinations submitted for self-certification, if the CFTC does not object to or stay the MAT determination, such self-certification will become effective on the 10th day after submission, and swaps covered by the determination will be subject to the trade execution requirement beginning on that date. However, the CFTC may stay the certification of a MAT determination on several possible grounds, including that the determination presents novel and complex issues that require additional time to analyze.

WHO HAS SUBMITTED MAT DETERMINATIONS?

As of December 12, 2013, five SEFs³ have submitted MAT determinations, each self-certifying for the trading of certain interest rate swaps (“IRS”) and/or index-based credit

² For additional detail on the end-user exception from clearing, see our client memorandum, “CFTC Final Rules on End-User Exception and Proposed Rules on Cooperative Exception from Swap Clearing,” at: <http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=55afe714-de09-4954-9cb1-2de1baf17a52>.

³ MAT determinations have been submitted by Javelin, trueEX, TW SEF, MarketAxess and Bloomberg. While trueEX operates as both a DCM and a SEF, it submitted its MAT determination in its capacity as a DCM, rather than as a SEF. However, since only eligible contract participants will be permitted to enter into trades subject to the MAT

default swaps (“CDS”).⁴ Such self-certified MAT determinations would normally become effective 10 days after submission, but the CFTC has stayed all five of the MAT submissions for 90 days (from the date the relevant stay was issued). The CFTC therefore has until mid-to-late January 2014⁵ to review four of the MAT submissions (*i.e.*, those of Javelin⁶, trueEX⁷, TW SEF and MarketAxess⁸) and until March 9, 2014 to review the fifth submission.⁹ Absent a finding by the CFTC that a MAT determination is inconsistent with the CEA or the CFTC regulations, the MAT determination will be self-certified upon the expiration of the relevant stay and the swaps subject to the MAT determination will become subject to the trade execution requirement on such date.

HOW DO YOU EXECUTE A SWAP ON A SEF?

Only members of a SEF (“Participants”) may transmit swap orders and execute swap transactions on the SEF. A non-Participant may enter into a brokerage agreement with a Participant registered with the CFTC to act as a broker (referred to as an introducing broker or futures commission merchant) appointing such Participant as its agent to execute swaps on its behalf on the exchange.¹⁰

determination that are executed on trueEX’s platform and since only futures commission merchants will be permitted to intermediate such trades on behalf of another entity, all of the statements made in this client memorandum apply equally to trueEX’s MAT determination and the other four MAT determinations, regardless of the fact that trueEX submitted that determination as a DCM.

⁴ As of today, these five MAT submissions are available at:

<http://sirt.cftc.gov/sirt/sirt.aspx?Topic=SwapsMadeAvailableToTradeDetermination>.

⁵ Specifically, the CFTC has until January 16, 2014 to review the Javelin SEF, LLC (“Javelin”) MAT submission; January 20 for the trueEX, LLC (“trueEX”) submission; January 27 for the TW SEF LLC (“TW SEF”) submission; and January 29 for the MarketAxess SEF Corporation (“MarketAxess”) submission.

⁶ The Javelin MAT submission is the broadest in scope, covering IRS with tenors between 3 days and 31 years, payable at various intervals, including monthly, quarterly, semi-annually and annually and denominated in: (1) U.S. Dollars, with a floating rate index based on LIBOR; (2) British Pounds, with a floating rate index based on LIBOR and (3) Euros, with a floating rate index based on EURIBOR.

⁷ The trueEX MAT determination covers only IRS with the most common tenors that have the greatest liquidity and that trade with the highest frequency: swaps with tenors of 2, 3, 5, 7, 10, 15, 20 and 30 years, payable semi-annually, and with a floating rate index based on LIBOR.

⁸ The TW SEF and MarketAxess MAT determinations cover: (1) both the current series and the series immediately preceding the current series for CDS based on the following indices: CDX.N.A.IG 5Y, CDX.NA.HY 5Y, iTraxx Europe 5Y and iTraxx Crossover 5Y; and (2) fixed-to-floating IRS based on LIBOR and EURIBOR with tenors of 2, 3, 4, 5, 6, 7, 10, 15, 20 and 30 years.

⁹ The Bloomberg SEF LLC MAT determination covers: (1) the current series for CDS based on CDX.NA.IG 5Y and iTraxx Europe 5Y; and (2) fixed-to-floating IRS based on LIBOR and EURIBOR with tenors of 2, 3, 5, 7, 10, 15, 20 and 30 years.

¹⁰ For instance, according to Bloomberg, the dealers planning to participate in its new SEF will be Barclays, BNP Paribas, Bank of America Merrill Lynch, Citigroup, Credit Agricole CIB, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, Morgan Stanley, Nomura, RBS, Société Générale, UBS and Wells Fargo Securities.

In order to qualify as a Participant, an entity must complete and submit an application and must enter into certain agreements with the relevant SEF. Since each SEF is a self-regulatory organization, a Participant will be bound by the SEF's rules governing all trading by the entity on the SEF and will be subject to the SEF's jurisdiction with respect to such trading. Additionally, when a Participant executes a trade on behalf of a non-Participant customer, the customer (and the Participant) will be bound by the rules of the relevant SEF and will be subject to its jurisdiction in connection with such trading.

While each SEF has its own set of rules which differ from one another in certain respects, as a general matter, a Participant will be required to pay certain dues, assessments and/or fees to the relevant SEF and may be subject to inquiries, investigations, disciplinary proceedings, fines, suspensions and other summary actions by the SEF for any violation of the SEF rules, including any requirement to: (1) pay fees, costs, charges or fines to the SEF or a designated clearing organization ("DCO"); (2) timely submit accurate notices, reports or other information required by the SEF's rules or (3) keep any records required by such rules. A Participant may have its trading privileges revoked, suspended or limited under certain circumstances, including where the Participant fails to meet any of the qualifications for trading privileges (or any condition placed on such privileges by the SEF) or violates any SEF rule or any agreement with the SEF or a DCO.

The CFTC regulations and the SEF rules require each Participant of a SEF to keep records, including pertinent data and memoranda (in a form and manner identifiable and searchable by transaction), of all transactions relating to (and prepared in the course of) its business of dealing in commodity interests and related cash or forward transactions and to produce for inspection (by the SEF or the CFTC) all documents on which trade information is originally recorded. However, Participants that are not registered (or required to register) with the CFTC in any capacity will not be required to keep records of oral communications concerning quotes, solicitations, bids, offers, instructions, trading and prices for a transaction.

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Please feel free to contact us with any questions.

December 12, 2013