CLIENT UPDATE

RECENT CFTC ACTIONS RELATING TO MANDATORY EXCHANGE-TRADING OF SWAPS

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On February 10, 2014, the Commodity Futures Trading Commission (the "CFTC") took several actions relating to mandatory exchange-trading of swaps under section 2(h)(8) of the Commodity Exchange Act (the "CEA").[1] First, in order to protect the identities of counterparties trading on swap execution facilities ("SEFs") and designated contract markets ("DCMs") and to incentivize anonymous trading on exchanges, the CFTC issued an interim final rule (the "Interim Final Rule") clarifying that a party to an anonymous trade executed on a SEF or DCM cannot access information in a swap data repository ("SDR") in order to obtain the identity of its counterparty or such counterparty's clearing member for the swap. The Interim Final Rule is effective upon its publication in the Federal Register.

Second, the CFTC issued a no-action letter (the "No-Action Letter") granting temporary relief to the counterparties to certain "package transactions" from the trade execution requirement with respect to

[1] The Dodd-Frank Wall Street Reform and Consumer Protection Act requires that swaps subject to the mandatory clearing requirement 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". For additional information on SEFs and DCMs, the mandatory trade execution requirement and which types of entities are subject to such requirement, see our client memorandum, "Mandatory Exchange-Trading for Swaps" (Dec. 12, 2014), available at http://www.debevoise.com/clientupdate20131212a/.

such transactions and to SEFs and DCMs from the requirement that certain execution methods be followed when executing package transactions on a SEF or DCM. The relief expires on May 15, 2014.

Finally, the CFTC published guidance ("Guidance") clarifying that a SEF need not obtain an affirmative written consent to its jurisdiction from each eligible contract participant ("ECP") executing a swap on its facilities and that a SEF may instead satisfy this consent requirement by providing in its rulebook that any person initiating or executing a swap on the SEF consents to the SEF's jurisdiction.

INTERIM FINAL RULE ON PROTECTION OF COUNTERPARTY IDENTITY

Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act added new section 21 to the CEA addressing the registration and regulation of SDRs and setting forth duties and core principles with which an SDR must comply in order to register and maintain registration. One of those duties, set forth in section 21(c)(6) of the CEA, is that an SDR must "maintain the privacy of any and all swap transaction information that [it] receives from a swap dealer, counterparty, or any other registered entity."

The CFTC has adopted final rules under section 21 of the CEA addressing, among other things, access to the data and information reported to and maintained by a registered SDR. While Regulation 49.17(f)(1) provides that access to such data is generally prohibited, subsection (f)(2) provides that data and information related to a "particular swap" that is maintained by a registered SDR may be accessed by either counterparty to the swap. Absent the clarification provided in the Interim Final Rule, subsection (f)(2) might be interpreted to mean that when a swap is executed anonymously on a SEF or DCM and cleared in accordance with the CFTC's straight-through processing requirements, either counterparty to the swap may obtain identifying information with respect to the other counterparty from an SDR.

Interim Final Rule

The Interim Final Rule clarifies that, for a swap executed anonymously on a SEF or DCM and then cleared in accordance with the CFTC's straight-through processing requirements (such that the swap counterparties would not otherwise be known to one another), the data maintained by a registered SDR that may be accessed by either counterparty shall not include the identity or legal entity identifier ("LEI")[2] of the other counterparty to the swap or of such counterparty's clearing member for the swap.

In the adopting release accompanying the Interim Final Rule, the CFTC explains that, as a matter of construction, the exception in Regulation 49.17(f)(2) (for data and information related to a "particular swap") must be read with reference to, and must fall within the bounds of, the statutory requirements in section 21(c)(6) of the CEA. Therefore, the CFTC clarifies that the exception in Regulation 49.17(f)(2) "includes an implicit condition" that counterparty access to SDR data and information related to a particular swap is authorized only to the extent that such access is consistent with the SDR's statutory obligation to maintain privacy with respect to the identity and LEI of each swap counterparty and its clearing member for the swap.

NO-ACTION RELIEF FOR PACKAGE TRANSACTIONS

Background and Requests for Relief

The CFTC received requests from the International Swaps and Derivatives Association, the Managed Funds Association and Tradeweb's SEF (TW SEF LLC) for no-action relief from the trade execution requirement for groups of component trades known as "package transactions." Package transactions are defined in the No-Action Letter as transactions involving two or more instruments: (1) that are executed between two counterparties, (2) that are priced or quoted as one economic transaction with simultaneous execution of all components, (3) that have at least one component that is a swap that is subject to the trade execution requirement and (4) where the execution of each component is contingent upon the execution of all other components.[3]

The requesting parties asserted that the commencement of the trade execution requirement would create various difficulties associated with the execution and processing of package

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[2] For purposes of the Interim Final Rule, the term legal entity identifier (or LEI) refers to an LEI, a "pre-LEI" or a CFTC Interim Compliant Identifier ("CICI"), as the context requires.

[3] The No-Action Letter includes the following non-exhaustive list of common interest rate swap package transactions: swap curves (package of two swaps of differing tenors), swap butterflies (package of three swaps of differing tenors), swap spreads (government securities vs. swaps typically within similar tenors) invoice spreads (Treasury-note or Treasury-bond futures vs. swaps), cash/futures basis (Eurodollar futures bundles vs. swaps), offsets/unwinds, delta neutral option packages (caps, floors or swaptions vs. swaps) and mortgage-backed security basis (TBA swaps vs. swap spreads). The No-Action Letter also includes the following non-exhaustive list of common credit default swap package transactions: index options vs. index, tranches vs. index and index vs. single name CDS.

transactions[4] and that no-action relief is therefore needed to preserve market participants' ability to execute such transactions as single packages until the market infrastructure necessary to process such transactions as a whole, and in compliance with the trade execution requirement, is completed.

No-Action Letter

In the No-Action Letter, the CFTC acknowledges that the commencement of the trade execution requirement may present challenges with the processing of package transactions by futures commission merchants ("FCMs") and derivatives clearing organizations ("DCOs"), and that SEFs and DCMs may also face challenges in facilitating these transactions in compliance with the execution methods prescribed in Regulation 37.9 (for transactions executed on a SEF) and section 5(d)(9) of the CEA (for transactions executed on a DCM).[5]

Therefore, the No-Action Letter provides temporary no-action relief to: (1) allow counterparties to trade "package transactions" without complying with the trade execution requirement in section 2(h)(8) of the CEA and (2) SEFs and DCMs with respect to package transactions for which they facilitate trading from the requirements of Regulation 37.9 and section 5(d)(9) of the CEA, respectively. The relief expires at 11:59p.m. (eastern time) on May 15, 2014.

In the No-Action Letter, the CFTC notes that the temporary no-action relief is intended to enable industry participants that are currently working on processing and execution solutions to continue their efforts and to allow CFTC staff to address the issues surrounding package transactions where at least one component is not subject to the trade execution requirement. As part of the CFTC's continued review of whether further relief may be granted with respect to package transactions, the CFTC held a public roundtable

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4 For instance, the requesting parties stated that the methods currently used by clearing members for the pre-trade screening of credit limits may not facilitate screening for package transactions, and that derivatives clearing organizations ("DCOs") may lack the ability to simultaneously screen and accept all legs of a package transaction for clearing. The requesting parties also asserted that market participants, SEFs, DCMs, DCOs and futures commission merchants ("FCMs") are working to develop the necessary infrastructure to process package transactions from the time of execution to clearing.

5 Regulation 37.9(a)(2) provides that swaps that are subject to the trade execution requirement and are traded on a SEF must be executed on a SEF by either an Order Book or a Request for Quote System that operates in conjunction with an Order Book. On a DCM, such swaps must be executed pursuant to subpart J of part 38 of the Regulations, which implements DCM Core Principle 9 under section 5(d)(9) of the CEA.

on February 12, 2014, during which it has considered certain operational issues concerning the building of transaction order entry and execution technology to facilitate the trading of package transactions consistent with the trade execution requirement.

GUIDANCE ON SWAP EXECUTION FACILITY JURISDICTION

Regulation 37.202(b) provides that "prior to granting any [ECP] access to its facilities, a [SEF] shall require that the [ECP] consent to its jurisdiction."

The Guidance clarifies that while a SEF must obtain consent to its jurisdiction from all market participants that either directly or indirectly effect transactions on its facility, such consent need not be obtained by the SEF through an affirmative writing. Rather, a SEF may comply with this requirement by providing in its rulebook that any person initiating or executing a transaction on or subject to the rules of the SEF directly or through an intermediary, and any person for whose benefit such a transaction has been initiated or executed, consents to the jurisdiction of the SEF.

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Please do not hesitate to contact us with any questions.

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