ISDA® Safe, Efficient Markets

Request for Interpretative Letter - Commission Regulations Part 43 and Part 45

December 3, 2012

Richard Shilts
Director, Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Request for Interpretative Letter for Post-priced Swaps

Dear Mr. Shilts:

The International Swaps and Derivatives Association, Inc. ("**ISDA**"), on behalf of its members with reporting obligations under Part 43 and Part 45 of the Regulations ("**Reporting Rules**")[1] of the Commodity Futures Trading Commission (the "**Commission**") and other similarly situated persons, is seeking an interpretative letter from the Commission regarding the reporting of certain "post-priced" swaps.

ISDA's mission is to foster safe and efficient derivatives markets to facilitate effective risk management for all users of derivative products. ISDA has more than 800 members from 58 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers.

ISDA recognizes the importance of the various Reporting Rules and strongly supports initiatives to increase regulatory transparency. We also appreciate the efforts of Commission staff over the past several months to provide direction and clarification where possible as our members begin preparations for complying with the new Reporting Rules.

Many Equity Swaps are different in nature versus Interest Rate or Credit Default Swaps whereby they have both an "equity delta" and a "funding" component, and in many structures these components are determined at one or more times different than the client's transaction request. Accordingly, we are concerned that an interpretation of the rules regarding the reporting of post-

[1] See, 17 CFR Part 45 Swap Data Recordkeeping and Reporting Requirements, and 17 CFR Part 43 Real-Time Public Reporting of Swap Transaction Data.

priced equity swaps before the related market activity or observation period on the underlying "equity delta" is completed would have a negative impact on market participants – money managers, insurance companies, hedge funds, pension plans, etc. – which trade these products as it relates to the price they receive on that equity delta. Specifically, our concern is that reporting post-priced equity swaps prior to price and size being finally determined is equivalent to reporting open unfilled "orders," and thus we recommend that, for purposes of Parts 43 and 45, post-priced swap transactions should be deemed "executed" (and hence reportable) only when the price and size are finally determined.

We discuss these concerns in detail below and include a request for an interpretative letter clarifying the requirements applicable to such swaps.

I. Introduction

A post-priced swap is a transaction in which the price and/or its size is determined by reference to market activity or an observation period that occurs after the client places its order. As the Commission staff is undoubtedly aware, for swap transaction categories that are not post-priced, a swap dealer ("**SD**") and its client have agreed on all terms of the transaction, including price, funding, bid/offer, transaction costs and size, at the point of execution. In these situations, the SD is committing capital and is therefore at risk on the position. While the SD may or may not hedge that transaction, all Rule 43 and 45 terms are known at the point of execution and thus can be fully and meaningfully reported to the market with no additional risk to the client.

Post-priced swaps, which occur across asset classes but most commonly in the delta-one equity space, work differently. In these situations, the client makes a transaction request (either by phone or electronically) for a swap with the SD. For equity swaps, the pricing typically involves two primary components: the funding leg (LIBOR +/- a spread) and the strike price on the underlying equity (the "equity delta"). Furthermore, in the case of a "best efforts" client order (as described below), there is no agreement as to quantity of the swap. The nature of the client's order will depend on their objectives and the market environment. Examples of post-priced client order types are: (1) a "guaranteed" price (e.g., MOO, MOC or a market observable volume weighted average price or "VWAP" published on Bloomberg) with or without a set notional size, or (2) "best efforts" price based on the prices of the SD's hedge executions with or without a benchmark ("Execution Pricing") whereby executions could be subject to a price or volume limit (e.g., "Limit Pricing"), or even a combination of some or all of the above, as clients often modify their order throughout the day in reaction to price movements and/or market developments.

Regardless of the combination of variables, in all of these scenarios, the ultimate size and/or price is not known at the time the client makes the transaction request,[2] and market activity subsequent to the client's transaction request will impact the price received by the client and the actual size of the swap. Accordingly, exposing that client request before the subsequent market activity in the underlying equity delta is complete will be harmful to the client. On some occasions, clients do request a "risk" price on an equity swap whereby the SD (as mentioned

[2] We note that this discussion does not purport to portray the complete spectrum of client activity in this market segment.

above) is committing capital and is at risk on the position. These risk price situations are similar to interest rate and credit default swaps, and thus this request for relief does not apply to risk-priced equity swaps.

We outline some of the order types more specifically below along with the potential concerns related to disclosing the order to the market BEFORE the equity delta has been traded in the market:

Order Type for which Relief is Requested	**Funding Leg Price**	**Equity Delta Strike Price**	**Considerations:**
Guaranteed	Agreed up front either for the specific trade or based on prenegotiated defaults	A price determined after order placement (not known at the time of order); Examples: • Guaranteed VWAP • Guaranteed Closing Price (MOC) • Guaranteed TWAP • Guaranteed Opening Price (MOO)	The underlying equity delta is traded based on the order type in the cash market. As the equity delta is executed, those cash executions are being printed/ disclosed in accordance with applicable existing regulations; having to pre-advise the market of the order type/ size before those executions have been completed allows for other market participants to trade in advance of that and ultimately negatively effects the Open, VWAP, TWAP or Closing price on the corresponding underlier for the SD and thus a worse fill price on the swap for the end user/client
Best Efforts	Agreed up front either for the specific trade or based on prenegotiated defaults	Price determined by price SD achieves on equity delta (not known up front how much will get done and at what level); Client instructions can vary and often do change frequently throughout the day; Typical order types include : • Target VWAP • Target TWAP • Limit orders (price/ volume) • Target Volume % • Contingent (e.g., if the price of A hits $B, then sell C units of D Index)	The client instructions inform how the SD hedges the underling equity delta; As the equity delta is executed, those cash executions are being printed/ disclosed in accordance with applicable existing regulations; having to pre-advise the market of the order type/ size before those executions have been done allow for other market participants to trade in advance of that and ultimately negatively effects the fill on the corresponding underlier for the SD and thus a worse fill price on the swap for the end user/client
Risk Orders	Agreed up front	Agreed up front	There is no concerns with immediate reporting of Risk Orders because they are not Post Priced Swaps

To reiterate some of the considerations mentioned with regards to specific order types above, we also outline some of the challenges on the particular component parts to be reported below:

- Size **-** While it may be that the size specified by the client in the initial transaction request will be the ultimate size of the transaction, the SD does not guarantee execution of the size requested for all types of orders (e.g., best efforts orders) and may reduce the size of the transaction to reflect the SD's ability to execute its hedge at the specified pricing methodology. For example, if an early closure, trading halt or other market disruption event occurs that affects positions that would be established to hedge a transaction, or if the pricing methodology specified in the transaction request includes pricing conditions (e.g., Limit Pricing) that could not be met because market prices in underliers that would have been used to establish a hedge transaction were not within the relevant parameters, the size of the transaction will be reduced to reflect the portion, if any, of the transaction the SD was able to hedge. If the SD could not establish any hedge, the transaction request will not result in a swap transaction.

- Price – In addition and more critically, the price of a post-priced swap is not known until after the SD has completed its hedge or the observation period has occurred in the cases of MOO, MOC, Limit, guaranteed VWAP, TWAP or Best Efforts orders. For "best efforts" pricing methodologies, such as Execution Pricing with a target of VWAP, the price of the transaction will be the price of the SD's hedges. Even for "guaranteed" benchmark transactions, the price will not be determined until that benchmark is known. Accordingly, in both cases – "best efforts" pricing and "guarantee" pricing – transactions in the swap underlier, components of the swap underlier or related securities/futures by other market participants during the hedging period will impact the price of the client's transaction. If the client's transaction request is known to the market at the time it is made rather than after the market activity or observation period has occurred, other market participants, knowing that there will likely be market activity corresponding to positions that would be established to hedge the transaction, will be able to take advantage of this information to the detriment of the client.

II. Request for Interpretative Letter

ISDA requests that, for the reasons discussed below, the Commission's Division of Market Oversight issue a Interpretative Letter, for purposes of Parts 43 and 45, that post-priced swap transactions should be deemed "executed" (and hence reportable) only when the underlying equity delta is fully executed, the relevant observation period has occurred or both parties agree on the equity strike price such that price and size are finally determined.

Under Part 43, "execution" is defined both as (a) agreement by the parties to the terms of a swap that legally binds the parties under applicable law and (b) occurring simultaneously with or immediately following "affirmation" of the transaction. The rule defines "affirmation" to mean the process by which the parties verify that they agree on all the Primary Economic Terms

("**PETs**") of the swap. Although Part 45 does not provide an express definition of "execution," the preamble states that execution only occurs after all of a swap's PETs have been agreed.[3]

In the case of post-priced swaps, while some PETs for a particular trade may be agreed at the time of the transaction request for a swap, the actual price and size of the transaction, if any, will be determined at some point later as a result of the specified pricing methodology and availability of the SD's hedge.

For example, a swap priced using a volume-weighted average price, time-weighted average price, market on open, market on close, or other pricing formula based on subsequent cash market transactions will not have a price until the relevant pricing period for that pricing methodology is complete. Further, if the SD is unable to execute a hedge for the full size specified in the client's transaction request, then the size of the swap transaction between the SD and its client will be reduced to that amount which the SD actually was able to hedge using the pricing methodology specified in the transaction request.

ISDA believes that the requested interpretative letter is consistent with the approach that currently applies to analogous cash market trades that are priced by reference to a formula, i.e., the way that VWAP trades are reporting in the U.S. equities market only when the final price and size are known. This is done for exactly the same reason that ISDA seeks relief here, i.e., exposing the order to the market prior to price and size being finalized would be harmful to the terms ultimately obtained by the client. Another good example would be in the listed futures market whereby a client might advise their broker at 2pm that they're looking to buy 10,000 S&P500 futures contracts at the closing price. In such a case, it would be harmful to that client to have to divulge the order to the general market in advance of that transaction being completed.

The requested interpretation will not adversely affect overall market transparency, as the underlying markets that are the basis for the pricing are completely transparent, so reporting of the swap prior to finalization of the pricing terms will not perform a price discovery function. As the underlying equity delta is traded in the various cash markets (stocks, futures), those trades would be transparently reported to the market as per normal course in those regulated markets already.

III. Conclusion

As set forth above, reporting post-priced swaps before the underlying equity delta is traded and the final price and quantity are established is equivalent of disclosing an "order" prior to its execution. If such disclosure of an order were required, the information prematurely in the market would negatively impact the price ultimately obtained by the client. The effect of this would be to add a material transaction cost to trading a post-priced swap as compared to cash, listed options or future markets. These costs would not be offset with any additional transparency to the marketplace since the SD's corresponding hedges in the cash markets already are subject to transaction reporting.

[3] 77 Fed. Reg. 2148 (January 13, 2012).

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Thank you for your consideration of these concerns. Please contact me or ISDA staff if you have any questions or concerns.

Sincerely,

Robert Pickel
Chief Executive Officer

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Certification Pursuant to Commission Regulation 140.99(c)(3)

As required by Commission Regulation 140.99(c)(3), I hereby (i) certify that the material facts set forth in the attached letter dated December 3, 2012 are true and complete to the best of my knowledge; and (ii) undertake to advise the Commission, prior to the issuance of a response thereto, if any material representation contained therein ceases to be true and complete.