

June 15, 2015

Mr. Christopher Kirkpatrick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st, N.W.  
Washington, DC 20581

Re: Petition for Rulemaking to Amend Parts 1 (General Regulations under the Commodity Exchange Act), 37 (Swap Execution Facilities) and 43 (Real-Time Public Reporting) of the Commodity Futures Trading Commission Regulations

Dear Mr. Kirkpatrick:

The International Swaps and Derivatives Association (ISDA) respectfully petitions the Commodity Futures Trading Commission (the Commission or CFTC) under Commission regulation 13.2 to amend certain provisions in Parts 1, 37 and 43 of the Commission's regulations.

For the reasons set forth below, we request that the Commission amend certain provisions of the Commission's regulations to more closely adhere to Congressional intent to establish a swaps trading platform regime that allows for flexible execution of swaps, to reduce undesirable regulatory outcomes that threaten the efficient functioning of markets, and to achieve cross-border harmonization of execution rules. The information required by Commission regulation 13.2 follows:

**I. Text of Proposed Rule Amendments**

Part 37—Swap Execution Facilities

Add new § 37.6(c):

*Confirmation of the transactions not intended to be cleared.* (1) In satisfaction of the obligations imposed on a swap execution facility under paragraph (b) of this section: (i) Each confirmation of the transaction shall incorporate by reference the previously-negotiated documents and agreements (including, without limitation, ISDA master agreements,

other master agreements, terms supplements, master confirmation agreements, and incorporated industry definitions) governing such transaction existing at the time of execution between the counterparties.

(ii) In the event of any inconsistency between a swap execution facility confirmation and the underlying previously-negotiated freestanding agreements, the terms of the swap execution facility confirmation shall legally supersede any conflicting terms. (iii) A swap execution facility shall incorporate by reference terms from previously-negotiated agreements between the counterparties, without obligating participants to provide copies of referenced agreements or documents; provided that:

(A) Upon request by a swap execution facility, counterparties to a transaction shall provide such swap execution facility with any underlying freestanding documents or agreements governing such transaction existing at the time of the execution between the counterparties; and

(B) Upon request from the Commission, the swap execution facility shall request from counterparties the underlying freestanding documents or agreements governing such transaction existing at the time of execution between the counterparties and the swap execution facility shall furnish such documents or agreements to the Commission as soon as they are available.

Add new § 37.9(a)(2)(C)

Other Methods of Execution as approved by the Commission under new paragraph (d) of this section.

Add new § 37.9(a)(4)

*Exception for correction of errors or omissions.* (i) A swap execution facility may, with consent of the counterparties, permit: (A) execution of a new transaction, with terms and conditions that match the terms and conditions of an intended to be cleared transaction rejected for clearing or (B) execution of one or more cleared transactions to offset and replace a transaction to correctly reflect the terms to which the parties mutually assented. Such transactions need not be executed pursuant to the methods set forth in paragraph (a)(2) of this section when executed for the correction of an operational or clerical error or omission made by the swap execution facility, either or both of the counterparties, or an agent of either or both of the counterparties. Such transactions shall not violate the requirements contained in § 37.203 of this chapter. (ii) This

paragraph shall apply to the leg of a package transaction as defined in new § 1.3(www) of this chapter if the leg is either rejected from clearing due to an operational or clerical error or omission made by the swap execution facility, either or both of the counterparties, or an agent of either or both of the counterparties or requires correction or replacement due to errors or omissions for operational or clerical reasons. (iii) A swap execution facility shall adopt rules describing the conditions, if any, under which it will determine that an error or omission has occurred and the procedures it will follow to execute a transaction. The requirements contained in §§ 1.74, 23.610, 39.12(b)(7), 43.3(e) and 45.14 of this chapter apply to these transactions.

Add new § 37.9(d):

A swap execution facility may submit a request to the Commission to approve additional execution methods to execute Required Transactions as defined in § 37.9(a)(1), pursuant to the procedures under § 40.5 of this chapter.

Revise § 37.10(a)(1) to read as follows:

(a)(1) *Required submission.* A swap execution facility that intends to make a swap available to trade shall submit to the Commission its initial determination with respect to such swap as a rule, as that term is defined by § 40.1 of this chapter, pursuant to the procedures under § 40.5 of this chapter.

(i) The Commission shall issue an order that a swap is made available to trade.

(ii) The requirements contained in §§ 40.1, 40.7, 40.8, 40.11 and 40.12 shall apply to all submissions made pursuant to this section.

(iii) *Public Comment.* The Commission shall provide a 30-day public comment period. The Commission shall publish a notice of the public comment period on the Commission website. Comments from the public shall be submitted as specified in that notice.

Revise § 37.10(b) to read as follows:

(b) *Criteria to consider.* In making its initial determination under paragraph (a) of this section, a swap execution facility shall consider with sufficient particularity each of the following criteria:

(1) Whether there are ready and willing buyers and sellers;

- (2) Frequency and size of the transactions;
- (3) The trading volume;
- (4) The number and types of counterparties executing trades in each swap listed in (a)(2), including the presence of consistent liquidity providers and market makers that are actively involved in making markets considered in (b)(2) of this section;
- (5) The bid/ask spread;
- (6) The usual number of resting firm bids and offers; and
- (7) Whether such swap has a high degree of standardization.

Revise 37.10(c) to read as follows:

(c) *Applicability.* Upon a Commission order that a swap is made available to trade, all swap execution facilities and designated contract markets shall comply with the requirements of section 2(h)(8) of the Act in listing such swap for trading.

Revise § 37.10 (d)(1) to read as follows:

(d) *Removal - (1) Determination.* The Commission shall issue an order that a swap is no longer required to be traded pursuant to the requirements of § 37.9(a)(2) upon a request made by either a swap execution facility or a swap execution facility's participant. In making such a request, the swap execution facility or the swap execution facility's participant shall consider each of the criteria described in paragraph (b) of this section.

Add new § 37.10(d)(1)(i) to read as follows:

*Public Comment.* The Commission shall provide a 30-day public comment period. The Commission shall publish a notice of the public comment period on the Commission website. Comments from the public shall be submitted as specified in that notice.

Add new § 37.10(f) to read as follows:

Prior to offering a package transaction as defined in new § 1.3(www) of this chapter, a swap execution facility shall certify to the Commission that: (1) the swap execution facility has the technological ability to arrange for the execution of such package transaction through the execution methods described in § 37.9(a)(2) and (2) the settlement of

any non-swap leg is not adversely affected by execution of such package transaction through the execution methods described in § 37.9(a)(2). Such certification shall be submitted as a rule, as that term is defined by § 40.1 of this chapter, pursuant to the procedures under § 40.6 of this chapter.

Revise § 37.12 to read as follows:

- (a) A swap transaction shall be subject to the trade execution requirements of section 2(h)(8) of the Act upon the later of:
  - (1) Sixty days after the applicable deadline established under the clearing requirement compliance schedule provided under § 50.25(b) of this chapter; or
  - (2) Thirty days after the Commission issues an order pursuant to § 37.10(a)(1)(ii).
  - (3) Nothing in this section shall prohibit any counterparty from complying voluntarily with the requirements of section 2(h)(8) of the Act sooner than as provided in paragraph (a) of this section.

Revise § 37.1301(c) to read as follows:

#### § 37.1301 (c) General requirements

Financial resources shall be considered sufficient if their value is at least equal to a total amount that would enable the swap execution facility to conduct an orderly wind down of its operations. Financial resources shall not include any compensation or benefits of swap execution facility employees that receive commission-based compensation.

Revise § 37.1305 to read as follows:

#### § 37.1305 Liquidity of financial resources

The financial resources allocated by the swap execution facility to meet the requirements of § 37.1301 shall include unencumbered, liquid financial assets (i.e., cash and/or highly liquid securities) equal to at least three months' operating costs. If any portion of such financial resources is not sufficiently liquid, the swap execution facility may take into account a committed line of credit or similar facility for the purpose of meeting this requirement.

### Part 43 — Real Time Public Reporting

Revise § 43.2 to read as follows:

Block trade means a publicly reportable swap transaction that:

(1) Involves a swap that is listed on a registered swap execution facility or designated contract market and that is either:

(i) Executed away from the designated contract market's trading system or platform and is executed pursuant to the designate contract market's rules and procedures; or

(ii) Executed on or away from the swap execution facility's trading system or platform and is executed pursuant to the swap execution facility's rules and procedures. Such transaction may be executed by any means of interstate commerce in accordance with the requirements described in § 37.9(c)(2) for Permitted Transactions as they are defined in § 37.9(c)(1) .

\*\* (3) and (4) remain unchanged

## Part 1 General Regulations under the Commodity Exchange Act

### § 1.3 Definitions

\*\* (nnn)—(vvv)

Add new § 1.3(www):

A "package transaction" is a transaction involving two or more components: (1) that is executed between two or more counterparties; (2) that is priced or quoted as one economic transaction with simultaneous or near simultaneous execution of all components; (3) that has at least one component that is a swap that is made available to trade and therefore is subject to the CEA section 2(h)(8) trade execution requirement; and (4) where the execution of each component is contingent upon the execution of all other components.

## II. Nature of ISDA's Interest

ISDA has over 800 member institutions from 67 countries. These members include a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities end-users, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Our members rely on derivatives to manage efficiently the risks inherent in their core economic activities. ISDA advocates for stable, competitive and sustainable financial markets that support economic growth and benefit society.

ISDA has previously highlighted in its comment letters to the Commission the importance of maintaining a flexible approach in adopting and implementing a new regulatory framework, focusing on overall risk reduction and increased transparency and market integrity - rather than imposing stringent requirements - to allow for a smoother transition toward effective cross-border regulation of derivatives trading.

The Commission faces some challenges in implementing the Swap Execution Facilities (SEF) rules. In his testimony before the U.S. Senate Committee on Agriculture, Nutrition and Forestry, Chairman Massad recognized that the Commission should “fine-tune the rules or make other changes as appropriate.” Chairman Massad also noted that “there is substantial work to be done to harmonize rules across national borders.”<sup>1</sup> We appreciate the Commission’s intent to engage with market participants and to make appropriate changes to the SEF rules “based on participant feedback and observing the new rules in practice.”<sup>2</sup>

ISDA members would like to provide their feedback by offering specific solutions to some trading challenges that have been observed by our members. We believe that utilizing a petition process is an effective way of proposing concrete fixes, while keeping the regulatory structure intact.

In ISDA’s Path Forward for Centralized Execution of Swaps published in April,<sup>3</sup> we pointed out that due to the restrictive nature of the Commission’s execution rules, a clear split in trading liquidity has emerged. For instance, European dealers have opted to trade euro interest rate swaps with other European dealers rather than be subjected to U.S. rules. By December last year, 85% of euro IRS transactions were traded between European entities, up from 71% in September 2013 before the SEF rules came into force.

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<sup>1</sup> Chairman Timothy Massad’s Testimony before the U.S. Senate Committee on Agriculture, Nutrition and Forestry (May 14, 2015) is available at: <http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-10>

<sup>2</sup> Remarks of Chairman Timothy Massad before the FIA International Derivatives Conference (June 9, 2015) available at: [www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-25](http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-25)

<sup>3</sup> Path Forward For Centralized Execution of Swaps (April 1, 2015) available at: <http://www2.isda.org/functional-areas/public-policy/united-states/>

In that document, we also suggested ways to reduce the undesirable regulatory outcomes that threaten the efficient functioning of the derivatives markets, reduce barriers to market access, and minimize roadblocks to an effective cross-border regulatory regime, while preserving increased transparency and market integrity.

We believe that the targeted amendments outlined in this Petition will allow SEFs to offer trading flexibility, as intended under the Dodd-Frank Act, and will ensure that SEFs can successfully compete in the global execution space. In sum, we hope that our suggestions may help the Commission achieve its goal of “creat[ing] a framework that not only promotes transparency and integrity but also enables markets to thrive.”<sup>4</sup>

### **III. Supporting Arguments**

#### Confirmation Requirements for Uncleared Swaps

The requirement imposed on SEFs to obtain, prior to the time of execution, paper copies of the privately negotiated ISDA master agreements between counterparties to a trade in uncleared swaps does not have any legal basis, does not meet any regulatory objectives and carries high compliance costs as SEFs will have to request, store, manage and consult numerous complex bilateral agreements.

This requirement is in direct contravention of normal market practice in which the vast majority of swaps are confirmed electronically. In addition, this requirement discourages trading of swaps on SEFs. The Commission seems to acknowledge this issue by continuing to extend no-action relief from compliance with this requirement. However, uncertainty regarding whether the relief is going to be extended in the future requires SEFs to continue to spend resources in search of a compliance solution. We urge the Commission to make targeted amendments to its rules to relieve SEFs from this unnecessary obligation.

#### Void ab Initio

ISDA believes that an appropriate balance should be struck between the Commission’s policy objectives of encouraging certainty of clearing while allowing counterparties to resubmit trades that were rejected from clearing because of operational or clerical errors. ISDA welcomes the issuance of recent no-action relief allowing a SEF, after a trade has been cleared and an error is discovered, to resubmit the original terms of the trade, without the trade having been executed pursuant to the execution methods set out in § 37.9(a)(2).

ISDA notes, however, that the relief is a temporary solution to resolving this issue. ISDA would like to offer a permanent fix in the SEF rules.

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<sup>4</sup> Supra fn.2, Remarks of Timothy Massad before the FIA International Derivatives Conference.

## Allowing Flexible Execution Methods on a SEF

Despite a broad definition of a SEF in the Dodd-Frank Act, the SEF rules contain unnecessary restrictions on swap execution mechanisms. The Dodd-Frank Act does not require that SEFs only execute transactions by means of an Order Book or an RFQ to 3. Such a restrictive interpretation contradicts Congressional intent to allow swaps to be traded by “any means of interstate commerce,”<sup>5</sup> discourages trading of swaps on SEFs and hurts pre-trade price transparency. We agree with Commissioner Giancarlo that “[a] better way to promote price transparency is through a balanced focus on promoting swaps trading and market liquidity as Congress intended.”<sup>6</sup>

Moreover, such a restrictive interpretation makes it difficult to achieve the broad goal of global swaps trading envisioned by the G-20 member countries. As we noted in the Path Forward document, ESMA intends to allow derivative contracts that are subject to the trading obligation to be traded on a number of centralized venues, including Regulated Markets (RMs), Multilateral Trading Facilities (MTFs), and Organized Trading Facilities (OTFs). OTFs offer the least restrictive methods of execution and are designed to include much of the inter-dealer market and offer voice brokering services. Thus, to avoid further market fragmentation and maintain robust liquidity in swaps contracts, it is advisable to provide flexibility in execution methods on a SEF platform.

In this regard, we suggest that the Commission amend its rules to allow the Commission, under certain circumstances, to approve additional methods of execution for swaps that are made available to trade. Adjusting SEFs’ execution models could clear a path toward achieving a substituted compliance regime for derivatives trading.<sup>7</sup>

## Made Available to Trade Determination

We believe that the made available to trade (MAT) process should require SEFs to provide a more granular explanation as to why a particular swap contains the requisite trading liquidity for mandatory trading. We also believe the Commission and not SEFs should make the final decision as to when a swap should be considered to be “MATed.”

In addition, the Commission should view a swap’s availability for mandatory trading as a fluid determination. The SEF rules do not provide sufficient flexibility to both SEFs and SEF users to remove a certain swap from a MAT determination if the trading characteristics of the swap change such that it is no longer suited for trading on an Order Book or an RFQ to 3. We believe our proposed fixes address the above mentioned concerns.

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<sup>5</sup> CEA section 1a(50).

<sup>6</sup> J. Christopher Giancarlo, Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank (White Paper) (Jan. 29, 2015) at 75.

<sup>7</sup> Supra fn. 3.

## Package Transactions

As stated in the Path Forward document, unreasonably restrictive regulations have decreased the ability of market participants to execute package transactions that contain a “MATed” swap.<sup>8</sup> There have been two principal concerns expressed with respect to executing package trades on a SEF. First, if one leg of a package trade is subject to a mandatory trade execution requirement, then all legs of the package trade must be executed on a SEF by means of an Order Book or an RFQ to 3. While this may be possible for some package trades, not all package trades have the liquidity to be executed on a SEF via these restrictive execution methods.<sup>9</sup>

In addition to ensuring that the pricing and execution of these packages can be handled on a SEF, it is important to ensure that derivatives clearing organizations (DCOs) are able to net the risk of both legs of these packages at the time of execution. Because package transactions are currently cleared on a leg-by-leg basis, a DCO may reject an individual leg due to its risk exceeding its credit limit even though the net risk of the package may not exceed the limit.

Our proposed targeted fixes to the SEF rules address these concerns and ensure that SEFs, Futures Commission Merchants (FCMs) and DCOs have structural workflows to execute and clear these trades in a straight through processing regime.<sup>10</sup>

## SEFs’ Financial Resources

We note that one SEF’s failure will not lead to a liquidity crisis because swaps trade on various trading platforms with various liquidity pools. Therefore, SEFs should only be required to hold adequate resources to be able to wind down their operations in one year. We note that some SEFs have their brokers inside the SEF, while others have their brokers outside the SEF. We believe that the financial resources requirements should exclude the compensation and benefits for brokers inside the SEF to even the playing field between the two different business models. Our proposed amendments reflect our views.

## Execution of Block Trades

The Commission’s regulatory objective behind requiring block trades to be executed away from the SEF’s trading platform is unclear.<sup>11</sup> As Commissioner Giancarlo points out “[t]he “occurs

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<sup>8</sup> Separately, ISDA continues to believe that if a price determined leg of a package trade is not made available to trade, then the entire package trade should not be made available to trade.

<sup>9</sup> Currently, these transactions are subject to phased-in no-action relief, CFTC NAL 14-137, Extension of No-Action Relief from Commodity Exchange Act Sections 2(h)(8) and 5(d)(9) and from Commission Regulation § 37.9 and Additional No-Action Relief for Swap Execution Facilities from Commission Regulation § 37.3(a)(2) for Swaps Executed as Part of Certain Package Transactions (Nov. 10, 2014).

<sup>10</sup> Although not addressed in this petition, we would like the Commission to amend the regulations to set forth with the requisite degree of particularity the appropriate execution methodology for package transactions that include at least one component leg that is a security and not within the jurisdiction of the Commission so that SEFs executing such packages are able to do so without running afoul of other regulatory requirements with respect to the execution of the security.

away” requirement creates an arbitrary and confusing segmentation between non-block trades “on-SEF” and block trades “off-SEF,” especially given that a SEF may offer any method of execution for *Permitted Transactions*. The “off-SEF” requirement also undermines the legislative goal of encouraging swaps trading on SEFs.”<sup>12</sup>

To complicate things further, in its clearing member risk management regulations,<sup>13</sup> the Commission requires, among other things, an FCM that is a clearing member (Clearing FCM) of a registered DCO to establish risk-based limits and to screen orders for compliance with those limits.<sup>14</sup> Commission § 37.702(b) requires a SEF to 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 § 39.12(b)(7).<sup>15</sup> Staff guidance on straight through processing<sup>16</sup> specifies that this requirement applies to orders for execution on or subject to the rules of a SEF or DCM, regardless of the method of execution (i.e., this requirement applies to block trades).

Market participants have expressed numerous concerns that adherence to the “occurs away” requirement under the current definition of a block trade in § 43.2 makes it very difficult to perform pre-execution credit screening against FCM risk-based limits. This is due to the fact that an FCM may have no involvement in a block transaction occurring away from a SEF’s trading system or platform; thus, it is unable to implement a credit screening of the trade prior to the counterparties’ execution of the block.

We believe, our proposed fixes allow blocks to be executed on a SEF, while preserving the Commission’s straight through processing requirements.

ISDA respectfully petitions the Commission to amend Parts, 1, 37 and 43 as described above.

Sincerely,



David Geen  
General Counsel

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<sup>11</sup> Currently, these transactions are subject to no-action relief that expires on December 15, 2015, CFTC NAL 14-118, No-Action Relief for Swap Execution Facilities from Certain “Block Trade” Requirements in Commission Regulation 43.2 (Sept. 19, 2014).

<sup>12</sup> *Supra* fn. 6, White Paper at 27.

<sup>13</sup> Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21,278 (Apr. 9, 2012).

<sup>14</sup> 17 C.F.R. § 1.73.

<sup>15</sup> 17 C.F.R. § 39.12(b)(7) (DCOs must accept or reject all trades executed on a SEF or DCM as quickly as technologically practicable after execution).

<sup>16</sup> CFCT Staff Guidance on Swaps Straight Through Processing (Sept. 26, 2013).