ISDA Safe, Efficient Markets

July 27, 2015

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CC:
Jeffrey Bandman
Special Counsel to the Chairman
Office of the Chairman
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Three Lafayette Centre
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Re: Straight Through Processing and Affirmation of SEF Cleared Swaps

Dear Ms. Markowitz and Mr. Remmler,

The International Swaps and Derivatives Association[1] ("**ISDA**"), on behalf of its members, is writing this letter jointly to the Divisions of Market Oversight (DMO) and Clearing and Risk ("DCR") to follow up on our call with the staff and Jeffrey Bandman, during which we agreed to submit a plan to the CFTC for reducing the current Straight Through Processing ("**STP**") timeframes of certain interest rate contracts resulting from execution on a Swap Execution Facility ("**SEF**") or Designated Contract Market ("**DCM**"), with the intention for the transaction to be cleared at a Derivatives Clearing Organization ("**DCO**"), through use of an "affirmation hub" ("**SEF Cleared Contracts**").

[1] Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 67 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, 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. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

Summary of Proposal:

1. Implement a phased plan for all SEF Cleared Contracts to be sent to a DCO within 10 minutes of execution by April 2016.

2. Market participants, SEFs, DCMs and DCOs will work together to design, develop and implement effective solutions that facilitate fully automated submission of all SEF Cleared Contracts to a DCO, including solutions for managing errors identified after a transaction has been cleared.

Background:

When assessing the challenges of improving **STP** for SEF Cleared Contracts it is important to consider the execution methods associated with the swap, and for which purpose there are two broad categories: i) pure electronically executed ("**Electronic**") where the order for a trade is electronically filled and submitted to a DCO, and ii) Voice executed ("**Voice**") where a SEF voice broker facilitates the trading process, after an order is placed by a counterparty and prior to it being accepted for clearing by a DCO. For Voice trades, the human intervention may be on one or both sides of the trade, and may relate to only a small part of the execution or processing.

We acknowledge that there are requirements for SEFs to have robust error trade policies and welcome continued efforts by SEFs to further enhance such policies. Equally, we recognise and welcome CFTC No-Action Relief 15-24 that provides for resubmission or replacement of trades that contain an operational or clerical error, and for which the trade is either rejected for clearing or cleared in an erroneous state. However, our members are concerned that there still remain some significant risks associated with trade execution and submission to clearing which require a trade verification step following execution and prior to submission to the DCO.

We note Staff Guidance on Straight-Through Processing issued on September 26, 2013, which acknowledges the use of "affirmation hubs" as an acceptable means for routing a swap transaction to a DCO, which provides an opportunity for swap counterparties to validate the accuracy of the trade. We also note that use of such affirmation hubs is only permitted on the basis that the trade is still routed to DCOs "as quickly after execution as would be technologically practicable if fully automated systems were used". We acknowledge CFTC concerns that the current timeframes for routing a swap transaction using an affirmation hub does not fully comply with their expectations regarding this provision and further acknowledge their requests for ISDA to assist the industry in addressing this issue. We believe that it is possible for the industry to make significant improvement in this regard. Therefore, we propose the following plan included herein as a mechanism for the industry to progress towards the regulatory expectations for STP.

Current Operating Models:

As noted above the method of execution of SEF trades can be broadly categorised as Electronic and Voice, with the benefit offered by a post execution validation mechanism, dependant on the risks inherent in the method of execution. It is generally acknowledged that in the Electronic environment the opportunity for operational or clerical error is significantly small, perhaps non existent, to the extent that appropriate controls exist to ensure real time communication of up to date information between market participants and infrastructures. As a result, there should not be any need for a post execution validation for transactions which are Electronic, as existing controls and checks should occur pre trade or at the point of trade for these transactions.

For Voice, post execution validation may be a prudent requirement to prevent errors persisting into the downstream environment, where costs or other implications may be incurred by one or more participants in the trade processing chain. Such implications could amount to direct financial impact to counterparties. This may occur through margin calls by a CCP, or indirectly, due to the costs associated with fixing erroneously cleared and reported trades. Additionally, market conditions may change while participants are in the process of fixing erroneous transactions. These concerns remain irrespective of the existence of SEF and/or DCO error correction policies. Furthermore, industry participants are concerned at potential reputational risks associated with erroneous trades, primarily caused through incorrect margin calls, which may result in a party having insufficient margin available to cover other transactions, which are therefore rejected.

Notwithstanding the above it is important that the industry considers the materiality effect of erroneously cleared transactions, and therefore the mechanisms that are suitable and proportional to mitigate those risks.

While it is not always possible to differentiate Electronic from Voice in the current workflow, market participants and SEFs will need to work together to address this as part of the strategy to improve STP.

For the Voice population in particular, it is inevitable that errors will occur from time to time. The current research suggests the rate of error for any manual input process can vary from anywhere between 1 and 4 %. In the case of SEF Cleared Contracts, observations from the current process reflect a population of around 1-3% of trades requiring resubmission, although not all of these will be economic in nature. Nevertheless, those that are economic in nature could have the negative consequences to market participants described herein. While the industry is making progress in reducing the number of errors there is more work to be done.

Notwithstanding this, there are a number of processing and behavioural adjustments that market participants can make to reduce current delays to STP. Such adjustments will take a period of time to implement and may also require coordinated industry efforts to design, develop and test.

Proposed Compliance Plan:

In recognition of the comments made above ISDA, on behalf of its members, would like to propose the plan, attached in Appendix 1, as a means to address the current CFTC concerns relating to STP delays for interest rate derivatives. The plan suggests a series of phases, each with industry targets aimed at reducing the number of trades that are delayed for clearing, as a result of post execution validation through an affirmation hub.

We would also note that the plan herein constitutes an interim step to the ultimate goal of implementing fully automated affirmation of all SEF Cleared Contracts. Such an approach will require more time for design, development, testing and implementation but should be the goal for a safe and efficient market.

Notwithstanding this, it is reasonable to expect that errors may occur from time to time in any STP regime (whether Electronic or Voice) and therefore a robust method of dealing with such errors is required. We are operating under the assumption that the CFTC will eventually codify into formal regulation the provisions of NAR 15-24. We would welcome the opportunity to discuss this further with staff. Our members would support the formal regulation allowing participants to correct errors, on the existing transaction, through a singular action, removing the requirement to resubmit an entirely new record (i.e. new trade / old terms).

Conclusion

For the reasons discussed above, ISDA's members believe that the industry can accomplish the above goals set forth in the plan of action, moving closer to compliance with the Commissions expectation of STP while retaining the risk mitigation requirements which are brought forth through use of affirmation hubs. We welcome an opportunity to further clarify the above plan with DMO staff.

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

Sincerely,

Steven Kennedy
Global Head of Public Policy
International Swaps and Derivatives Association, Inc.

Appendix 1

Industry STP/Affirmation Compliance Proposal

Phase	Objective	Category	Timing	Rationale for Timing
1	Auto processing or direct send to clearing to be applied as default by SEFs to all in scope transactions.	All Electronic transactions	November 2015	The ability for a SEF to apply the auto processing flag to Markitwire messages on a case by case basis already exists and SEFs are in the process of integrating this functionality within their rulebooks. However, it is rarely applied today as SEF users are not currently comfortable with this level of default. SEFs need to complete development of processes and controls to ensure that this default is only applied to an Electronic transaction and market participants need to test the controls and process flows. This will provide fully automated submission of trades to clearing.
2.1	Auto processing or direct send to clearing to be applied as default by SEFs to all in scope transactions.	Reset Runs	November 2015	Reset Runs are predominantly automated and therefore there is limited risk although the process often takes place out of hours. SEFs, Market Participants and DCOs need to test the process. In particular DCOs need to consider the impact of a significant number of trades hitting clearing in one go (i.e. upon DCO open).
2.2	All in scope transactions to be	All Voice traded	November 2015	Internal policy and behavioural changes can be

	affirmed and submitted to clearing within 45 Minutes of execution	vanilla IRS and package transactions containing only IRS legs and "spread over treasury" packages		implemented to accelerate the manual affirmation process.
2.3	Auto processing or direct send to clearing to be applied as default by SEFs to all in scope transactions where possible, commit to remainder being affirmed and submitted to clearing within 10 Minutes of execution	All Voice traded vanilla IRS and package transactions containing only IRS legs and "spread over treasury" packages	February 2016	In order to achieve shorter timeframes for sending to clearing this population needs to be analysed further. Sub categories of trades may be suitable for auto processing, however, market participants need some time to analyse the impact of these trades absent a post execution validation step, determine materiality and develop suitable mitigation techniques, including assessment of error fixing policies of SEFs and DCOs.
2.4	All in scope trades to be affirmed and submitted to clearing within 10 minutes of execution	All voice traded package transactions not included in phase 2.3	April 2016	Some package transactions are more difficult to process and require a longer testing time to ensure all risks are mitigated. Furthermore, robust controls are required to ensure individual legs of a package are not rejected due to a DCO submission sequencing issue. NAR 15-24 that provides for resolution of this expires on June 15, 2016.