

Request for No-action Letter - Commission Regulations Part 43 and Part 45

March 26, 2013

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

Re: Request for No-action Relief 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 time-limited no-action relief from the Commission regarding the reporting of certain “post-priced” equity 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.

Over the course of these preparations, however, we have identified issues with the reporting of equity swaps where certain Primary Economic Terms (“**PETs**”) may be unknown at the time at which the swap dealer (“**SD**”) accepts the client’s request to enter into the swap transaction. As

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.

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discussed in greater detail below, ISDA requests no-action relief regarding the reporting of such “post-priced” transactions.²

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 SD accepts a client request.

In a swap transaction that is not post-priced, a SD and its client will agree on all terms of the transaction, including price, funding, bid/offer, transaction costs and size, when the client’s order is accepted. 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 set and thus can be fully reported to the market with no risk to the client.

In contrast, post-priced swaps work differently. Here, the price (and often size) of a swap is not finalized until either the SD has completed its hedge to the swap or the agreed-upon observation period, which may be at an agreed-upon point in time or over a defined period of one or more days, has occurred. As described below, if a post-priced swap is publicly reported in accordance with reporting obligations under Part 43 before the SD’s hedge is completed or the agreed-upon observation period has occurred, as the case may be, then other market participants may be able to anticipate certain future trades in the SD’s hedge and use that publicly-reported information in its trading activity, and, as a result, the price received by the client (and perhaps the size) for the swap may be negatively impacted.

For equity swaps, the pricing typically involves two primary components: the funding leg (e.g., LIBOR +/- a spread) and the strike price on the underlying equity (the “equity delta”). Further, in the case of a “best efforts” order type (as described below), there is no agreement as to the size 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) “guaranteed” order³ with or without a set notional size, or (2) “best efforts” order based on the prices of the SD’s hedge executions with or without a benchmark whereby executions could be subject to a price or volume limit.

We describe these examples in detail below, along with the potential concerns related to disclosing the order to the market before the equity delta has been traded in the market:

² For purposes of this letter, we are assuming that absent relief, an equity swap may be considered by the Commission to be “executed” and “affirmed” and hence reportable prior to the time a numerical amount is known for one or more primary economic terms for which a numerical amount will be ultimately determined. ISDA separately plans to request an interpretative letter regarding the permanent requirements applicable to such transactions and, if temporary relief is granted, will use the period of relief to engage in further discussions on this issue. ISDA is also considering requesting no-action relief related to post-priced swaps involving other asset classes (e.g., rates).

³ E.g., Market-On-Open (“MOO”), Market-On-Close (“MOC”) or a market observable volume weighted average price (“VWAP”) or time weighted average price (“TWAP”) published on Bloomberg.

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Order Type	Funding Leg Price	Equity Delta Strike Price	Considerations
Guaranteed	Agreed up front either for the specific trade or based on prenegotiated defaults	Swap price determined after order placement (not known at the time of order); examples include: <ul style="list-style-type: none"> • Guaranteed VWAP • Guaranteed MOC • Guaranteed TWAP • Guaranteed MOO 	The underlying equity delta is traded in the cash market based on the order type. 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 would allow other market participants to trade in advance of the SD's hedge executions and could ultimately negatively impact the MOO, VWAP, TWAP or MOC price on the corresponding underlier with respect to the SD generating 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	Swap price determined by price SD achieves on equity delta (price and size not known at the time of the order). Client instructions can vary and often do change frequently throughout the day. Examples include : <ul style="list-style-type: none"> • 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 underlying 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 would allow other market participants to trade in advance of SD's hedge executions and could ultimately negatively impact the price on the corresponding underlier for the SD generating a worse fill price on the swap for the end user/client.

Separately, as explained in greater detail below, individual SDs have technological issues with reporting post-priced swaps to the SDR at the point in time that a client's order is accepted but the price and/or size of the swap are not known. As a result, we request relief from both Parts 43 and 45 to enable SDs and SDRs to develop the technology to allow for reporting of these trades in compliance with the rule.

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II. Request for No-action Relief

ISDA requests that, for the reasons discussed herein, the Commission's Division of Market Oversight issue a No-action Letter, for purposes of Parts 43 and 45, clarifying that post-priced equity swap transactions may be reported only when the numeric values of the price and size are known following the establishment of the SD's hedge or the relevant benchmark index value is available to the SD, as the case may be. ISDA requests this relief for purposes of Parts 43 and 45 until the earlier of:

- six months from Compliance Date 3 (“CD3”); and
- the date SDs/SDRs can develop the technology to allow for reporting of a post-priced swap when a client's order is accepted by the SD.

This relief request will be conditioned on (1) the SDs' compliance with their obligations to make and maintain records in accordance with the Commission's recordkeeping rules for swaps dealers,⁴ and, for guaranteed swap orders linked to a benchmark index, a record of the final benchmark index value, and (2) a prohibition on the SD entering proprietary trades for its own benefit based on actual knowledge of a client order for a post-priced swap, provided that the SD will be permitted to trade in the same underlier and/or components underlying the client swap order, as well as swaps and other instruments linked to such underlier and/or components, in order to hedge and risk manage the execution of the client's swap, any new swap order or request received by the SD, or the SD's existing book of positions.

The requested relief would expire not later than six months from CD3⁵ and – since the underlying markets that are the basis for pricing these transactions are completely transparent and thus reporting prior to finalization of pricing and/or size terms will not perform a price discovery function – the relief would not adversely affect overall market transparency. As the underlying equity delta is traded by the SD in the various cash markets (stocks, futures, etc.), those trades would already be transparently reported to the market in the ordinary course.

III. Conclusion

With respect to Part 43, as set forth above, if real-time public disclosure of post-priced swaps data were required before the underlying equity delta has been traded by the SD and the price and/or size have been established, displaying this information prematurely to the market would ultimately negatively impact the price (and sometimes the size) obtained by the client. The effect of this would be to add a material transaction cost to trading a post-priced swap as compared with trading in the cash, listed options or futures markets. This cost will not be offset by any benefit since there would be no additional transparency.

With respect to Part 45, individual SDs have technological issues with reporting to the SDR at the point in time that a post-priced swap order is accepted by the SD but the price and/or size of the swap are not known.

⁴ See, 17 CFR Part 23.200-206

⁵ April 10, 2013.

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SDs have developed reporting technology to report when all PET terms, including the numerical values of price and size, are known. This technology sits in a specific place in the life-cycle of a transaction and pulls certain information types from specific data sources, at which point the transaction is reported. To report post-priced swaps under Part 45 at the time a SD receives a client order but prior to the numerical values of price and size being known, SDs would have to make changes to capture different types of pricing information (i.e., "VWAP" rather than a specific price), as well as changes as to where in the life-cycle of a transaction the reporting technology needs to sit. These fundamental technology changes are needed to collect the different types of information and to access that information from systems which would not have been needed if the swap were only reportable after all PETs were known.

Specifically, SDs will need to make changes to systems relating to swap creation, order and execution management, allocations and reporting, as well as databases storing this information, and the gateway to and connectivity with SDRs. Not all firms will need to make the same changes, but all firms will need to make substantial changes. Further, while we understand that one SDR has indicated it can support the different information needed for this reporting, even if that is the case, other SDRs will need to alter their technology and SDs will need time to test with all SDRs before going live. Accordingly, we request time-limited relief to expire no later than six months from CD3 to allow SDs and SDRs time to plan, analyze, implement and test these systems and connectivity changes.

* * *

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

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 March 26, 2013 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.

