

U.S. COMMODITY FUTURES TRADING COMMISSION

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CFTC Letter No. 14-108
No-Action
August 18, 2014
Division of Market Oversight

Re: Staff No-Action Position Regarding SEF Confirmations and Recordkeeping Requirements under Certain Provisions Included in Regulations 37.6(b) and 45.2

This letter responds to requests received from multiple parties¹ by the Division of Market Oversight (“DMO” or the “Division”) of the Commodity Futures Trading Commission (the “Commission”) for no-action relief from the confirmation provisions in Commission regulation 37.6(b)² and the portions of Part 37 of the Commission’s regulations that discuss the incorporation of terms by reference in these confirmations.³ As set forth below, the Division is granting conditional time-limited no-action relief.

Background

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”)⁴ amended the Commodity Exchange Act (“CEA”)⁵ to establish a comprehensive new regulatory framework for swaps. Among other responsibilities, CEA section 5h requires the Commission to promulgate rules for swap execution facilities (“SEFs”).⁶ Part 37 of the Commission’s regulations contains the general provisions governing SEFs, including the fifteen Core Principles.⁷

¹ This letter responds to no-action relief requested in, among others, the following: (1) Jointly-submitted Letter from Bloomberg SEF LLC, ICE Swap Trade, LLC, INFX SEF, Inc., MarketAxess SEF Corporation, SwapEx, LLC, TeraExchange, LLC, 360T Trading Networks Inc., Thomson Reuters (SEF) LLC, and Global FX Division of the Global Financial Markets Association (GFMA), Request for Time-Limited No-Action Relief Relating to Confirmations for Swaps Not Required or Intended to Clear (March 7, 2014); (2) Letter from the International Swaps and Derivatives Association, Inc. (ISDA), Request for Relief for Confirmation Requirements under Part 37 for Swaps Executed on Swap Execution Facilities (March 10, 2014); and (3) Letter from Wholesale Markets’ Brokers Association Americas, Request for Relief from Certain Requirements under Parts 37 and 45 Related to Trade Confirmations for Swaps Not Required or Intended to be Cleared (March 12, 2014). Notwithstanding the scope of relief sought in any of these particular requests, relief is limited to that provided herein.

² 17 C.F.R. § 37.6(b) (2013).

³ See Core Principles and Other Requirements for Swap Execution Facilities, 78 Fed. Reg. 33491-92 (June 4, 2013).

⁴ Pub. L. 111-203, 124 Stat. 1376 (2010).

⁵ 7 U.S.C. 1, *et seq.* (2012)

⁶ CEA § 5h; 7 U.S.C. 7b-3 (2012).

⁷ 17 C.F.R. part 37 (2013).

Among the requirements for a SEF is the duty under Commission regulation 37.6(b) to “provide each counterparty to a transaction that is entered into on or pursuant to the rules of the [SEF] with a written record of all of the terms of the transaction which shall legally supersede any previous agreement and serve as a confirmation of the transaction”⁸ (the “Confirmation”). Section 37.6(b) requires the Confirmation to take place at the same time as execution.⁹

The preamble to the Part 37 final rules (“Preamble”) discusses the reasoning behind the confirmation requirement in Section 37.6(b).¹⁰ The Commission requires, for uncleared transactions executed on or pursuant to the rules of a SEF, that the SEF “must have all terms, including possible long-term credit support arrangements, agreed to no later than execution, such that the SEF can provide a written confirmation inclusive of those terms at the time of execution and report complete, non-duplicative, and non-contradictory data to an SDR as soon as technologically practicable after execution.”¹¹ This requirement “is necessary to provide market participants who execute swap transactions on or pursuant to the rules of a SEF with legal certainty with respect to such transactions, and to promote the Commission’s policy goals of achieving ‘straight-through processing’ of swap transactions in order to facilitate orderly markets, whether bilateral or facility traded.”¹²

Footnote 195 in the Preamble¹³ (“Footnote 195”) observes that there is “no reason, under certain specified circumstances, why a SEF’s written confirmation agreement cannot incorporate by reference the privately negotiated terms from a freestanding master agreement.”¹⁴ Though Footnote 195 only cites the incorporation by reference of master agreements, staff notes that other previously-negotiated freestanding agreements and templates similarly may contain swap transaction terms relevant to the Confirmation. Therefore, staff anticipates that SEFs may incorporate swap transaction terms from these agreements. In order to incorporate by reference terms from these freestanding agreements, staff expects that the agreement containing the terms to be incorporated must be “submitted to the SEF ahead of execution” and that the counterparties ensure that nothing in the confirmation terms contradicts the standardized terms intended to be incorporated from the agreement, as provided in Footnote 195.¹⁵

Requested Relief

⁸ 17 C.F.R. §37.6(b).

⁹ Id.

¹⁰ 78 Fed. Reg. at 33491-92.

¹¹ Id. at 33491.

¹² Id. at 33491-92.

¹³ Id. at 33491, FN 195.

¹⁴ Id. (The relevant text of footnote 195 states “There is no reason why a SEF’s written confirmation terms cannot incorporate by reference the privately negotiated terms of a freestanding master agreement for these types of transactions, provided that the master agreement is submitted to the SEF ahead of execution and the counterparties ensure that nothing in the confirmation terms contradict the standardized terms intended to be incorporated from the master agreement.”).

¹⁵ Id.

The requesting parties raised questions regarding compliance obligations under Commission regulation 37.6(b) generally and the interaction of this regulation with other Commission regulations, including Part 45. Each requesting party proposed no-action relief suspending enforcement of Section 37.6 for various periods of time.

Requesting parties stated, for example, that not all SEFs are prepared to issue confirmations that include all terms of a swap transaction. Some participants stated that SEFs do not have access to the relevant non-economic terms of the transaction, and it is not clear how SEFs will be able to access the ISDA Master Agreements that contain terms that need to be included in the Confirmation, such as ISDA templates, definitions, and the terms negotiated by the counterparties with respect to the templates and definitions. Requestors also sought clarification as to which individual terms must be included in the Confirmation and requested time to standardize terms to be included in a Confirmation. Requesting parties were particularly concerned that the lack of certainty over what terms must be included in a Confirmation would lead to legal uncertainty over the terms of executed transactions, because the terms in the Confirmation legally supersede any contradictory terms.

The requesting parties therefore have requested no-action relief from the requirements of Commission regulation 37.6(b), as well as Commission regulation 45.2.

Discussion

Under Commission regulation 37.6(b), all terms of the swap transaction are required to be included in the Confirmation. Terms included in other documents governing the transaction are not superseded by the Confirmation if such terms do not conflict with the swap terms included in the Confirmation. However, if specific terms of the swap transaction conflict with specific terms from the previously-negotiated freestanding agreement(s), the swap terms will legally supersede the conflicting previously-negotiated terms incorporated by reference from such agreements. Further, all transaction terms included in previously-negotiated freestanding agreements existing at the time of execution of the swap transaction shall be superseded by the Confirmation unless they are not expressly included, or incorporated by reference in the Confirmation.

In regard to the interaction of Commission regulations 37.6(b) and 45.3, SEFs have an obligation to report swap confirmation data to an SDR under Part 45 of the Commission's regulations. Some market participants have asserted to the Commission that the Primary Economic Terms ("PET") of a swap transaction alone should be sufficient to satisfy the "all the terms of the transaction" requirement of Section 37.6(b).¹⁶ However, the terms that must be included in the Confirmation under Section 37.6, include terms that are not primary economic

¹⁶ 17 C.F.R. § 37.6(b) ("A swap execution facility shall provide each counterparty to a transaction that is entered into on or pursuant to the rules of the swap execution facility with a written record of all of the terms of the transaction which shall legally supersede any previous agreement and serve as a confirmation of the transaction.")

terms of the transaction. Examples of such terms include, but are not limited to, the date of the confirmation, the type of agreement (i.e., ISDA Master, CSA, etc.), additional information regarding settlement, additional payment details, options exercise, maturity and definitional terms.

For uncleared swaps executed on or pursuant to the rules of a SEF, Commission regulation 45.3(a)(1) requires that the SEF “report all required swap creation data, as soon as technologically practicable after execution of the swap. This report must include all confirmation data for the swap...and all primary economic terms data for the swap, as defined in § 45.1.” Section 45.1 defines “Required Swap Creation Data” (or “Creation Data”) to include all confirmation data for the swap...and all primary economic terms data for the swap.¹⁷ The same section also defines “Primary Economic Terms” as “all of the terms of a swap matched or affirmed by the counterparties in verifying the swap...”¹⁸ In addition, § 45.1 defines “Confirmation Data” as “all of the terms of a swap matched and agreed upon by the counterparties in confirming the swap.”¹⁹

Where a SEF has incorporated the swap’s governing documents by reference into the Confirmation under Commission regulation 37.6(b), the SEF must glean all confirmation data from the terms of the incorporated documents and report the confirmation data to an SDR. The specific individual terms contained in the referenced documents would be included in the confirmation data that the SEF must report. The Confirmation Data reporting requirement of Section 45.3(a)(1) resulting from creation of the Section 37.6(b) Confirmation includes additional terms that are not reportable to an SDR as PET. Further, the preamble to the Part 37 Notice of Final Rulemaking also indicates that the SEF’s Confirmation should contain *all* of the terms of the transaction, “including possible long-term credit support arrangements.”²⁰ The terms included in long-term credit support agreements, if not “matched and affirmed by the counterparties in verifying the swap,” are not required to be reported as PET data, but are required to be reported as confirmation data.

Conditional Time-Limited No-Action Relief

As described in more detail below, the Division will grant time-limited no-action relief to a SEF,²¹ in the context of uncleared swap transactions executed on or pursuant to the rules of the SEF, from the following requirements:

¹⁷ 17 C.F.R. § 45.1 (2013) (definition of “Required Swap Creation Data”).

¹⁸ 17 C.F.R. § 45.1 (2013) (definition of “Primary Economic Terms”).

¹⁹ 17 C.F.R. § 45.1 (2013) (definition of “Confirmation Data”).

²⁰ 78 Fed. Reg. at 33491.

²¹ An entity not registered with the Commission as a SEF, but reporting swap transaction data to an SDR in the time and manner as a SEF would report consistent with parts 43 and 45 of Commission regulations, as a condition of existing no-action relief, such as Qualifying Multilateral Trading Facilities under CFTC NAL 14-46, may rely on the relief with associated conditions provided in this Letter.

(1) Requirement that freestanding previously-negotiated agreements incorporated by reference into the Confirmation are submitted to the SEF prior to execution of the relevant swap transaction.²²

During the period of relief, the Division will not recommend that the Commission take enforcement action if a SEF incorporates terms from underlying previously-negotiated freestanding agreements of the counterparties by reference into the Confirmation generated and transmitted to the counterparties to a swap transaction as required under Commission regulation 37.6(b), without copies of the underlying previously-negotiated freestanding agreements being submitted to the SEF prior to execution of the swap transaction.²³ A SEF must still provide a Confirmation as required under Commission regulation 37.6(b). This relief is conditioned upon all previously-negotiated freestanding agreements incorporated by reference into the Confirmations being available to Commission staff upon request within a reasonable period of time. This relief only applies to uncleared swap transactions executed on or pursuant to the rules of the SEF. The relief provided in this paragraph shall **expire at midnight, Eastern Standard Time, on September 30, 2015.**

(2) Requirement that SEF keep a record of the documents incorporated by reference in the Confirmation pursuant to §§ 37.1000, 37.1001, and 45.2(a) of the Commission's regulations.

During the period of relief, the Division will not recommend that the Commission take enforcement action against a SEF for failure to receive or maintain a copy of the documents incorporated by reference in the SEF's Confirmation as a record currently required under Commission regulations 37.1000, 37.1001, and 45.2(a). This relief is conditioned upon the documentation being available to Commission staff upon request within a reasonable period of time. This relief only applies to uncleared transactions executed on or pursuant to the rules of the SEF. The relief provided in this paragraph shall **expire at midnight, Eastern Standard Time, on September 30, 2015.**²⁴

This letter, and the no-action positions taken herein, represent the views of the Division only, and do not necessarily represent the positions or views of the Commission or of any other division or office of the Commission's staff. The no-action positions taken herein do not excuse affected persons from compliance with any other applicable requirements of the Commodity Exchange Act or the Commission's regulations thereunder. As with all no-action letters, the Division retains the authority to further condition, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

If you have any questions concerning this correspondence, please contact Laurie Gussow, Special Counsel, Division of Market Oversight, at (202) 418-7623 or lgussow@cftc.gov; Ben

²² See 78 Fed. Reg. at 33491, FN 195.

²³ See *id.* (Currently, the agreements to be incorporated by reference must be submitted to the SEF prior to execution).

²⁴ Although broader relief was requested from the recordkeeping and reporting requirements of Part 45, the Division finds it appropriate, in this letter, to limit the relief solely to those specific matters addressed herein.

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Sincerely,

Vincent A. McGonagle
Director
Division of Market Oversight