



U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000

Division of
Market Oversight

Vincent McGonagle
Director

Re: No-Action Position to Facilitate the Migration of Credit Default Swaps from ICE Clear Europe

The Division of Market Oversight (“Division” or “DMO”) of the Commodity Futures Trading Commission (“CFTC” or “Commission”) is providing a no-action position regarding the requirements in section 2(h)(8) of the Commodity Exchange Act (“CEA” or “Act”) and Commission regulation 37.9, for credit default swaps (“CDS”) that are executed for the sole purpose of migrating open CDS positions from ICE Clear Europe Ltd. (“ICEU”) to a new central clearing counterparty (“CCP”) ahead of ICEU’s planned discontinuation of CDS clearing services in October 2023.¹

I. Background

On June 30, 2022, ICEU announced its decision to cease clearing all classes of CDS that it currently clears.² On September 26, 2022, ICEU announced that the cessation of its CDS clearing services would occur on October 27, 2023.³ The cessation of ICEU’s CDS clearing services means that market participants will need to migrate their open CDS positions from ICEU to other CCPs.

In order to facilitate an “orderly, uninterrupted, and risk-neutral” migration of CDS positions from ICEU to other CCPs, ISDA represents that market participants have identified two migration solutions, both of which “require a temporary exemption from the trade execution requirement and required methods of execution.”⁴

¹ This letter responds to a request received from the International Swaps and Derivatives Association (“ISDA”). See ISDA Letter, Re: Request for Temporary Exemption from the Trade Execution Requirement and Required Methods of Execution in order to Migrate Cleared CDS Trades (Feb. 21, 2023) (“ISDA Letter”).

² ICEU, Circular C22/076 Cessation of clearing of CDS Contracts, (Jun. 30, 2022), available at https://www.theice.com/publicdocs/clear_europe/circulars/C22076.pdf.

³ ICEU, Circular C22/109 Cessation of clearing of CDS Contracts: Postponement of Withdrawal Date, (Sept. 26, 2022), available at https://www.theice.com/publicdocs/clear_europe/circulars/C22109.pdf.

⁴ ISDA Letter at 1-2.

In the first solution, dealers will help clients migrate their open CDS positions from ICEU to a different CCP by “booking equal and opposite transactions at [ICEU] and the target CCP (“switch trades”).”⁵ In order to make the switch trades “market risk-neutral and profit-neutral,” ISDA represents that “both trades need to be executed at the same price.”⁶

The second solution involves the use of “a third party post-trade risk reduction service provider (“third party service provider”)....”⁷ In order to facilitate the migration of CDS positions for market participants that have a relationship with the relevant third party service provider, the third party service provider will use an algorithm⁸ to “analyze market participants’ open positions at ICEU, as well as information regarding market participants’ target CCP(s)” to “produce a set of execution instructions....”⁹ Pursuant to the execution instructions market participants will bilaterally execute transactions “at pre-determined prices in order to transfer their exposure efficiently and effectively from ICEU to their target CCP.”¹⁰ ISDA represents that “[i]t is essential that all trades are executed at the same price/spread for the same index series/tenor to prevent profits and losses from being generated; the trade executions must be non-price forming and market risk neutral for all participants and CCPs....”¹¹

Further, ISDA states that “[t]he difference between this approach and the aforementioned “switch trade” approach is scale.”¹² ISDA represents that use of “a third party service provider will reduce the overall number of transactions that need to be conducted, as opposed to if each individual dealer was tasked with developing switch trade strategies and operational processes for each of their clients’ CDS exposure to ICEU and their own CDS exposure to ICEU.”¹³ ISDA

⁵ *Id.* at 2.

⁶ *Id.* ISDA provides the following example to explain the mechanics of a switch trade:

“...Client A holds an existing long CDS index position at 98. Client A turns to its Dealer to arrange transfer of the position. Dealer would agree with Client A to offset its exposure to ICEU by selling index CDS at 98; the Dealer would take the other side of the transaction, clearing it with ICEU. The result is that Client A’s position at ICEU is flat, while the Dealer has a long exposure to ICEU. Next, the Dealer will enter into another transaction with the Client, at the same price, and clear it with the target CCP. The result is that the Dealer will now have two equal and opposite positions across ICEU and the target CCP, while Client A now holds a long CDS index position at 98 with the target CCP. This way, Client A’s position has been transferred to the target CCP.” *Id.*

⁷ *Id.* ISDA states that it “understand[s] that the majority of participants [that utilize the third party service provider approach] will be dealers, but clients may also avail themselves of such services if they have a relationship with the relevant third party service provider.” *See Id.* at FN 6.

⁸ ISDA represents that the algorithm will be similar but not the same “as those required for other risk-reducing exercises such as portfolio compression....” *Id.* at 3.

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.* Like other post-trade risk reduction exercises, such as compression, all participants involved in the exercise “must agree to book all of the proposed trades produced by the algorithm... (i.e., “all or nothing”).” *Id.*

¹² *Id.*

¹³ *Id.*

further states that “dealers will also likely use this process to lay off any open positions they acquired at ICEU by virtue of conducting any additional switch trades for their clients.”¹⁴

ISDA explains that certain of the transactions that must be executed to migrate open CDS positions to a different CCP, using the above-described methods of migration, are subject to the trade execution requirement under CEA section 2(h)(8) and the required methods of execution in Commission regulation 37.9.¹⁵ However, ISDA represents that “in order for [such] transactions to be migrated in a market risk-neutral manner, transactions must be executed between designated counterparties at a pre-determined price—which is not possible if market participants are required to execute their transactions on a SEF via the required methods of execution.”¹⁶

In particular, ISDA explains that if market participants are required to comply with the trade execution requirement and the associated required methods of execution they will have to “move to their target CCP by initiating two new trades: one to close out risk at ICEU and another to open the trade at a target CCP, potentially on multiple SEFs/venues.”¹⁷ ISDA represents that “[t]hese two trades will most likely be at different prices, causing unnecessary and unintended disruptions in the CDS market. Such a disorderly migration may introduce market risk, execution and operational risks, and replacement cost risks to market participants.”¹⁸

Therefore, ISDA requests DMO staff to provide a temporary no-action position regarding the trade execution requirement under CEA section 2(h)(8) and the required methods of execution under Commission regulation 37.9 “for market participants entering into CDS trades for the sole purpose of migrating their positions from ICEU to a target CCP.”¹⁹ Further, ISDA requests that such no-action position be provided “as soon as possible” and last “until the later of October 27, 2023 or such time when ICEU ceases its clearing service for CDS.”²⁰

II. Staff Position

Based upon the above representations and facts and in order to facilitate an orderly migration of open CDS positions from ICEU to other CCPs in a non-price forming, market risk

¹⁴ *Id.* at FN 9.

¹⁵ *Id.* See also 7 U.S.C. § 2(h)(8) and 17 C.F.R. 37.9.

¹⁶ *Id.*

¹⁷ *Id.* at 4.

¹⁸ *Id.*

¹⁹ *Id.* ISDA notes that it has requested the same position from the UK Financial Conduct Authority (“FCA”) and the European Securities and Markets Authority (“ESMA”). See *infra* note 21.

²⁰ *Id.*

neutral manner, DMO believes that a position of no-action is warranted.²¹ Accordingly, DMO will not recommend that the Commission commence an enforcement action against:

- any person for failure to comply with the trade execution requirement under section 2(h)(8) of the CEA with respect to any CDS transaction that is entered into for the sole purpose of migrating CDS positions from ICEU to another CCP; or
- any person, including but not limited to any SEF, for failure to comply with required methods of execution under Commission regulation 37.9 with respect to any CDS transaction that is entered into for the sole purpose of migrating CDS positions from ICEU to another CCP.

The no-action position taken in this letter will expire upon the later of either: (i) **October 27, 2023**; or (ii) **ICEU's cessation of its clearing services for CDS but no later than January 1, 2024**.

III. Conclusion

This letter, and the position taken herein, represent the views of DMO only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The no-action position taken in this letter does not excuse persons relying on it from compliance with any other applicable requirements contained in the CEA or in Commission regulations. Further, this letter, and the position taken herein, are based upon the facts and circumstances presented to DMO. Any different, changed, or omitted material facts or circumstances might render the no-action position taken in this letter void.

Finally, as with all staff letters, DMO retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action position taken herein, in its discretion.

If you have any questions concerning this correspondence, please contact Roger Smith, Associate Chief Counsel, DMO, at (202) 418-5344 or RSmith@CFTC.gov; or Nora Flood, Chief Counsel, DMO, at (202) 418-6059 or NFlood@CFTC.gov.

Sincerely,

Vincent McGonagle
Director
Division of Market Oversight

²¹ DMO staff and staff in the Office of International Affairs have engaged with FCA and ESMA staff in order to facilitate an orderly migration of CDS positions from ICEU to other CCPs.