



## U.S. COMMODITY FUTURES TRADING COMMISSION

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CFTC Letter No. 12-53  
No-Action  
December 17, 2012  
Division of Market Oversight

Jeff Lillien  
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Robert Pickel  
Chief Executive Officer  
International Swaps and Derivatives Association, Inc.  
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Washington, DC 20004

**Re: Time-Limited No-Action Relief from (i) Parts 43 and 45 Reporting for Prime Brokerage Transactions, and (ii) Reporting Unique Swap Identifiers in Related Trades under Part 45 by Prime Brokers.**

Dear Messrs. Lillien and Pickel,

This letter responds to the Financial Markets Lawyers Group's ("FMLG") request, dated December 11, 2012 (originally submitted on November 21, 2012, but revised and resubmitted on December 11, 2012) and the International Swaps and Derivatives Association, Inc.'s ("ISDA") request, dated December 6, 2012 (collectively, the "Letters") for No Action Relief from the Division of Market Oversight ("DMO" or "Division") of the Commodity Futures Trading Commission ("Commission") regarding the application of the Commission's regulations for real-time reporting of swap transactions under Parts 43<sup>1</sup> ("Real-Time Reporting") and 45<sup>2</sup> reporting ("SDR Reporting," and together with Real-Time Reporting, "Swap Reporting") in the context of prime brokerage arrangements ("Prime Brokerage") relating to any uncleared, over-the-counter transaction that is a "swap" as defined in Section 1a(47) of the Commodity Exchange Act<sup>3</sup> ("CEA" or the "Act") and related Commission regulations.<sup>4</sup> FMLG and ISDA requested No Action Relief for swap dealers that, in the context of Prime Brokerage transactions, enter into

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<sup>1</sup> Real-Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1182 (January 9, 2012).

<sup>2</sup> Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2136 (January 13, 2012).

<sup>3</sup> 7 U.S.C. 1, *et seq.*

<sup>4</sup> FMLG limited its request to foreign exchange prime brokerage transactions in its December 11, 2012 letter. ISDA requested that any relief granted be extended to all prime brokerage arrangements related to uncleared, over-the-counter swap transactions in its December 6, 2012 letter.

agreements that allocate Swap Reporting responsibilities between prime brokers<sup>5</sup> and executing dealers.<sup>6</sup>

## Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”)<sup>7</sup> added to the CEA provisions requiring the retention and reporting of data relating to swap transactions. Section 727 of the Dodd-Frank Act added CEA Section 2(a)(13), which establishes requirements for the real-time reporting and public availability of swap transaction data, and requires that all swaps, both cleared and uncleared, be reported to a registered swap data repository (“SDR”). Section 728 of the Dodd-Frank Act added CEA Section 21(b), which directs the Commission to prescribe standards for swap data recordkeeping and reporting. Section 729 of the Dodd-Frank Act added CEA Section 4r, which, among other things, establishes reporting requirements for swaps not accepted for clearing by any derivatives clearing organization (“DCO”).

Pursuant to these newly added provisions of the CEA, the Commission added to its regulations Part 43, which sets forth rules for the real-time public reporting of swap transaction data, and Part 45, which establishes swap data recordkeeping and SDR reporting requirements. Part 43, among other requirements, sets forth the method and timing for how swap reporting parties must report swap data to SDRs to meet their real-time public reporting obligations. Part 45, among other requirements, sets forth obligations on swap counterparties to report swap creation data, including primary economic term (“PET”) data and confirmation data, to SDRs. Part 43 became effective on March 9, 2012; Part 45 became effective on March 13, 2012. Parts 43 and 45 do not specifically address Prime Brokerage transactions.

For purposes of this letter and by way of background, FMLG represented that a Prime Brokerage transaction begins with a counterparty opening an account with a prime broker. By opening this account, the prime broker grants limited agency powers to the counterparty, enabling the counterparty, as an agent for the prime broker, to enter into swap transactions with approved executing dealers, subject to specific limits and parameters, such as credit limits and collateral requirements. The prime broker also enters into “give-up” arrangements with approved executing dealers. In those give-up arrangements, the executing dealers agree to negotiate swap transactions with the counterparty, who is acting as an agent for the prime broker, within the specified parameters and to face the prime broker as counterparty for the resulting executing dealer-prime broker (“ED-PB”) Swap.

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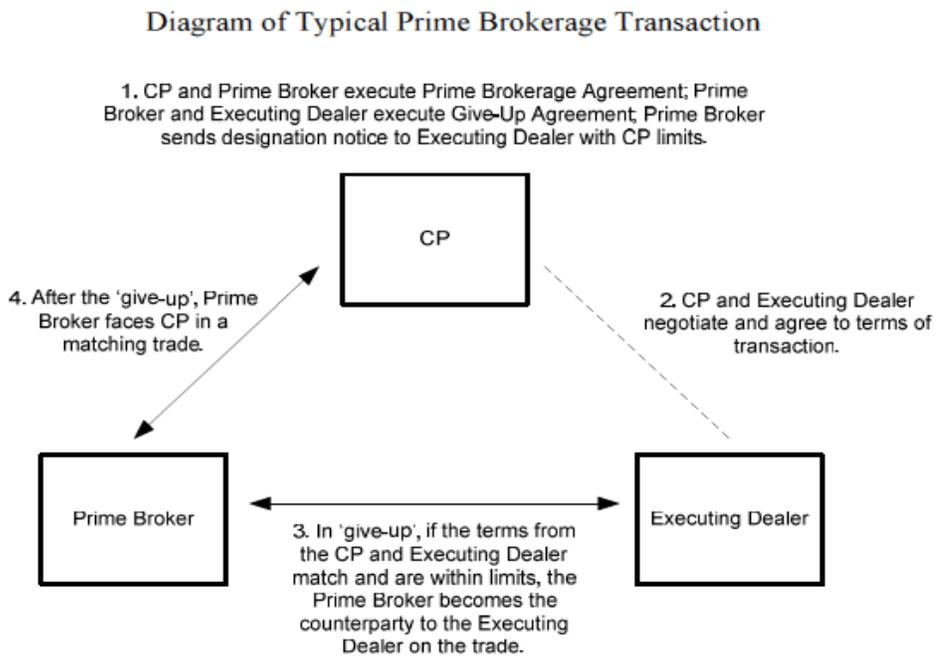
<sup>5</sup> FMLG represented that a prime broker is a party that acts as the credit intermediary for transactions whose terms and conditions are agreed to by a customer and an executing dealer, provided that the terms and conditions of the proposed transaction fall within the limits previously specified by the prime broker for the customer.

<sup>6</sup> FMLG represented that an executing dealer is a dealer selected by the customer (and that has previously executed a give-up agreement with the prime broker) that offers terms and conditions of transactions to the customer that, if and when the customer accepts them, are given up to the customer's prime broker (which steps into the middle of the terms and conditions as credit intermediary, becoming the counterparty to a pair of mirror image transactions with the customer and the executing dealer).

<sup>7</sup> Pub. L. 111-203, 124 Stat. 1376 (2010).

As represented by FMLG, in a Prime Brokerage transaction, the counterparty seeks bids for the desired swap from one or more of the approved executing dealers, within the parameters established by the prime broker for the counterparty and executing dealer. Once the counterparty and executing dealer agree on the terms, both the counterparty and executing dealer provide a notice of the terms to the prime broker, and those terms constitute the ED-PB Swap. The prime broker must accept the ED-PB Swap if the swap is with an approved executing dealer, the counterparty and executing dealer have committed to the material terms, and the terms are within the parameters established by the prime broker. Once the ED-PB Swap is accepted by the prime broker, the prime broker enters into an identical counterparty Mirror Swap (“Mirror Swap”) with the counterparty.<sup>8</sup>

The diagram below sets forth an illustration of the Prime Brokerage transactions as represented in the FMLG Letter.



As the regulations do not specifically address the reporting treatment of Prime Brokerage transactions, it is arguable that the regulations could be read to require Real Time and Swap Reporting by both the executing dealer for the ED-PB Swap and by the Prime Broker for the Mirror Swap.

<sup>8</sup> If the prime broker determines that the terms of the proposed ED-PB Swap are not within the established parameters, it may reject the transaction. The rejected transaction is then cancelled and, unless otherwise agreed by the parties, would generally not be rebooked as a new trade between the executing dealer and the Counterparty. In this instance, there is no Mirror Swap and the ED-PB Swap may be executed as a new trade between the counterparty and the executing dealer or the executing dealer may report a cancellation for the ED-PB Swap.

## **No-Action Relief for Reporting Prime Brokerage Transactions.**

The FMLG contends that the nature of Prime Brokerage arrangements necessitates the splitting of reporting responsibilities between the prime broker and the executing dealer because the terms and pricing of the ED-PB Swap and the Mirror Swap are the same and if, instead, the Commission requires Swap Reporting both by the executing dealer for the ED-PB Swap and by prime broker for the Mirror Swap, the result would falsely indicate the occurrence of two pricing events and incorrectly suggest the presence of more trading activity and price discovery in the market than actually exists.

Further, the FMLG represented that Real-Time Reporting of the Mirror Swap would not accurately reflect pricing changes that may have occurred in the interim between the execution of the ED-PB Swap and the Mirror Swap. FMLG representatives represented to Commission staff that many hours may pass between the two swap transactions.

As a result FMLG requested that the Division issue a no-action letter stating that:

- (i) the CFTC will not take enforcement action<sup>9</sup> if the executing dealer reports the ED-PB Swap under both the SDR Reporting and the Real-Time Reporting rules, including any required post-trade event reporting;
- (ii) the CFTC will not take enforcement action<sup>10</sup> against a prime broker if (i) the prime broker complies only with SDR Reporting for a Counterparty Mirror Swap (and not the ED-PB Swap) and as part of such compliance for the Counterparty Mirror Swap, the prime broker treats the time of “acceptance” by the prime broker of the ED-PB Swap associated with the Counterparty Mirror Swap as the time of execution of the Counterparty Mirror Swap<sup>11</sup> and (ii) the prime broker does not engage in Real-Time Reporting for a Counterparty Mirror Swap or the ED-PB Swap, unless there is a modification to the economic terms of the ED-PB swap<sup>12</sup>. For purposes of this letter only, the term “acceptance”<sup>13</sup> refers to the process by which a prime broker has been notified in a timely manner that the terms of the transaction agreed by the executing dealer and the Counterparty match and fall within the pre-agreed parameters specified in applicable agreements (it being understood, as described in more detail in Section III below, that the prime broker does not have an ability to reject, or not accept, a transaction upon such notification).

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<sup>9</sup> This letter, and the no-action positions taken herein, represents the views of the Division only, and do not necessarily represent the position or views of the Commission or of any other division or office of the Commission’s staff. This no-action position only assures the beneficiaries of this letter that the Division will not recommend an enforcement action to the Commission for failure to comply with a specific provision of the Act of a Commission rule, regulation or order if a proposed transaction is completed or a proposed activity is conducted by the beneficiary.

<sup>10</sup> Id.

<sup>11</sup> As provided in § 45.3 the swap must be reported “as soon as technologically practicable” after execution of the swap. This requirement applies to both the ED-PB Swap and the Mirror Swap.

<sup>12</sup> The Division notes that if there is a modification to the economic terms of the ED-PB swap, there would be real-time reporting obligations for the ED-PB swap as well as the Mirror Swap.

<sup>13</sup> This term is used in the standard Prime Brokerage Agreement executed between the Prime Broker and client/agent and the Master Give-Up Agreement between the Prime Broker and Executing Dealer.

Based on the FMLG's representations, the Division will grant time-limited no-action relief from parts 43 and 45 for swap dealers, or similarly situated persons, entering into agreements that allow the allocation of Swap Reporting Responsibilities between prime brokers and executing dealers in prime brokerage transactions, as noted above, and applicable to all asset classes<sup>14</sup>. The Division will not recommend that the Commission commence an enforcement action against a swap dealer provided that:

- (i) the allocation of responsibilities is agreed upon between the parties;
- (ii) the prime broker and the executing dealer are each registered with the Commission as swap dealers; and
- (iii) the ED-PB Swap and the Mirror Swap have identical economic terms and pricing, subject to adjustment in the case of the Mirror Swap as a result of the prime brokerage servicing fee.<sup>15</sup>

Staff believes that no-action relief is appropriate to provide staff with the necessary time to further evaluate the relationships and reporting obligations among market participants involved in Prime Brokerage swap transactions. Therefore, this relief is time-limited, and ends in all respects on or before **June 30, 2013**. The relief the staff is granting allows swap dealers to enter into agreements that allocate the Real-Time Reporting and SDR Reporting responsibilities for the two swap transactions, between the parties to the Prime Brokerage transaction, as noted in fulfillment of the requirements of Parts 43 and 45. However, staff notes that there may be other reporting methodology for the parties to a Prime Brokerage Transaction to fulfill their regulatory reporting requirements, depending on the facts and circumstances to a particular transaction, but are not subject to this no-action letter.

Further, based on FMLG's representations, the Division will grant time-limited no-action relief from parts 43 and 45 for a reporting counterparty, that for the purpose of reporting a Mirror Swap, treats the time of acceptance by the prime broker for the ED-PB Swap associated with the Mirror Swap as the time of execution of the Mirror Swap. This relief is time-limited, and ends in all respects on or before **June 30, 2013**.

### **No-Action Relief for Reporting of the ED-PB USI in the Mirror Swap**

Pursuant to the FMLG's representations, the functionality currently does not exist for the prime broker to reference the ED-PB Swap USI in the initial SDR Reporting for the Mirror Swap. Prime brokers also may not even know the ED-PB Swap USI at the time the prime broker initially reports the Mirror Swap. As a result, FMLG and ISDA request that prime brokers be allowed to amend the SDR Reporting submission after Mirror Swap execution to include the ED-PB Swap USI.

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<sup>14</sup> ISDA requested that any relief granted to FMLG's request be extended to prime brokerage transactions related to any uncleared, over-the-counter transaction that is a "swap" as defined in Section 1a(47) of the Act and related Commission Regulations. This no action relief contained herein encompasses that request.

<sup>15</sup> If the adjustment process involves modification of the economic terms of the ED-PB Swap, the Mirror Swap may also be reportable under part 43 (Real-Time Reporting).

The Prime Brokerage transactions are swaps wherein the prime broker must include the USI of the ED-PB Swap in the initial SDR Reporting for the Mirror Swap along with the USI for the Mirror Swap in order to link the transactions.

Based upon FMLG's representations, the Division will grant time-limited no-action relief for the prime brokers' Part 45 ED-PB Swap USI reporting obligations. For prime broker SDR Reporting, the Division will not recommend that the Commission commence an enforcement action against a prime broker for failure to include the ED-PB Swap USI in the initial SDR Reporting of the Mirror Swap until the earlier of such time that functionality is built to include the ED-PB USI into the prime brokers' SDR Reporting for the Mirror Swap, or **June 30, 2013**. Such no action relief is subject to the following conditions:

- (i) The prime broker shall amend any necessary reporting for the Mirror Swap as soon as technologically practicable after the prime broker receives the ED-PB Swap USI; and
- (ii) The prime broker must require the executing dealers to disclose the ED-PB Swap USI as soon technologically practicable after the executing dealer creates the ED-PB Swap USI.

This relief is time-limited, and ends in all respects on or before **June 30, 2013**. It applies only to prime broker reporting of the Mirror Swap and only to the inclusion of the ED-PB Swap USI in the initial Mirror Swap reporting.

This letter, and the no-action positions taken herein, which is based on FMLG's representations, represents the views of DMO only, and does not necessarily represent the position or views of the Commission or of any other division or office of the Commission's staff.<sup>16</sup> The no-action position taken herein does not excuse affected persons from compliance with any other applicable requirements of the CEA or the regulations thereunder. As with all no-action letters, DMO retains the authority to, in its discretion, further condition, modify, suspend, terminate or otherwise restrict the terms of the no-action relief provided herein.

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<sup>16</sup> Should the Commission promulgate additional swap data reporting rules applicable to the subject matter covered herein during the pendency of this no-action relief period, such rules could supersede the no-action relief granted herein.

If you have any questions concerning the content of this staff no-action letter, please contact Roger Smith, Attorney Advisor, at [rsmith@cftc.gov](mailto:rsmith@cftc.gov) or (202) 418-5344; or Ben DeMaria, Attorney Advisor, at [bdemaria@cftc.gov](mailto:bdemaria@cftc.gov) or (202) 418-5988.

Sincerely,

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Division of Market Oversight