



*Request for No-Action Relief from Trade Execution Requirement*

January 24, 2014

Mr. Vincent A. McGonagle  
Division of Market Oversight  
Commodity Futures Trading Commission  
Three Lafayette Center  
1155 21<sup>st</sup> Street, N.W.  
Washington, DC 20581

**Re: Request for Relief from the Trade Execution Requirement for Swaps Executed as Part of Package Transactions in the Interest Rate Asset Class**

Dear Mr. McGonagle,

Managed Funds Association (“**MFA**”)<sup>1</sup> respectfully requests the no-action relief described below with respect to swaps entered into as part of package transactions commonly executed in the interest rate swap markets and defined below (“**Package Transactions**”). As has been described to the Commodity Futures Trading Commission (the “**Commission**”) in a series of letters from market participants and industry associations in recent months (the “**Industry Submissions**”)<sup>2</sup>, Package Transactions involving one or more swaps subject to the trade execution requirement (each, a Made Available-to-Trade or “**MAT Swap**”) are commonplace in the interest rate asset class.

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<sup>1</sup> Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

<sup>2</sup> We refer the Commission’s Division of Market Oversight Staff (the “**Staff**” or the “**Division**”) to the series of comment letters located at, for example, <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1409>, which, in relevant part, discuss in detail the nature and business drivers for Package Transactions and the challenges with which market participants would be faced once (as is now the case) the trade execution requirement applies to MAT Swaps executed as part of Package Transactions. We refer the Staff, in particular, to the letter to the Commission from MFA, dated November 21, 2013, regarding Industry Filings IF 13-004, 13-005, and 13-007 (the “**MFA Letter**”) and the letter to the Commission from Citadel LLC, dated November 29, 2013 (the “**Citadel Letter**”). While we do not restate in this letter the points made in the letters submitted to the Commission on this subject, we respectfully request that the Division view the requests for relief set out in this letter in light of the comments in those letters concerning Package Transactions.

As a preliminary matter, we wish to emphasize both our support for the reforms to the OTC derivatives markets being implemented by the Commission and our position that mandatory central clearing and mandatory trading of standardized, liquid swaps on registered swap execution facilities (“SEFs”) and designated contract markets (“DCMs”)<sup>3</sup> are essential both to the development of a level, competitive playing field and to the reduction of systemic risk in the swaps markets. The requests for temporary relief set out in this letter are made in response to the Staff’s January 16, 2014 announcement of the trade execution mandate for certain interest rate swaps in connection with Javelin SEF, LLC’s Made-Available-to-Trade (“MAT”) determination and, in particular, the position taken by the Staff in that announcement in relation to Package Transactions.<sup>4</sup> We respectfully submit that granting the relief requested in this letter would promote the implementation of effective swaps market reforms by striking an essential balance between the desire to advance such reforms and the need to preserve orderly markets in the interest rate asset class. In the absence of the temporary relief requested in this letter, over the course of the next several months, the increase in expense and execution risk associated with the execution of Package Transactions would likely cause these products to become largely unavailable as an investment or risk management tool to a significant number of market participants.

## **I. Defining Package Transaction**

For purposes of this letter, “Package Transaction” means any transaction commonly entered into in the interest rate asset class that satisfies all of the following criteria:

- (a) it comprises two or more legs (each, a “**Component**”) that are priced as a package and executed at substantially the same point in time between the same two market participants;
- (b) at least one Component is a MAT Swap;
- (c) economically, the Components are a combination of “buys” and “sells” or “payers” and “receivers”;
- (d) there is a reasonable and readily quantifiable degree of correlation between the Components; and
- (e) the interest rate risk of the offsetting Components is reasonably equivalent.

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<sup>3</sup> All references to SEFs in this letter shall also refer to DCMs.

<sup>4</sup> See <http://www.cftc.gov/PressRoom/PressReleases/pr6831-14>. We also note the Division’s announcement on January 23, 2014, that trueEX, LLC’s MAT determination for certain interest rate swap contracts is deemed certified.

The following is a non-exclusive list of examples of the Package Transactions that are the subject of this letter:

- Swap Curves: packages of two swaps of differing tenors;
- Swap Butterflies: packages of three swaps of differing tenors;
- Swap Spreads: U.S. or non-U.S. government securities versus swaps typically with similar tenors;
- MBS Basis: TBAs (Agency MBS) versus swaps;
- Invoice Spreads: Treasury-note or Treasury-bond futures versus swaps;
- Cash/Futures Basis: Eurodollar futures bundles versus swaps;
- Delta-Neutral Option Packages: caps, floors, or swaptions versus swaps; and
- Unwind (or offset) Packages: Replacing legacy swaps with new swap instruments with an equivalent risk profile.

For the purposes of this letter, we group Package Transactions as follows:

- Package Transactions that involve only swaps that are cleared and listed on the same SEF and have at least one Component that is a MAT Swap, which group would encompass certain Swap Curves, Swap Butterflies and Unwind Packages (“**Same SEF Package Transactions**”);
- Package Transactions that involve at least one Component that is a MAT Swap and one Component that is either a security or a future, which group would encompass Swap Spreads, MBS Basis, Invoice Spreads and Cash/Futures Basis transactions (“**Swap plus Non-Swap Package Transactions**”); and
- Package Transactions that involve a MAT swap and any of: (i) one or more uncleared swaps<sup>5</sup>, (ii) one or more cleared swaps that are not listed on a SEF, or (iii) one or more swaps that are cleared and listed on a SEF, but are not listed on the same SEF as the MAT Swap, which group would encompass among others, for example, Delta-Neutral Option Packages (“**Other Swap Package Transactions**”).

## II. Requests for Relief

As was described in several of the Industry Submissions<sup>6</sup>, the impediments presented when a Component in a Package Transaction is a MAT Swap vary with the type of Package Transaction in question. As has been described to the Commission<sup>7</sup>, market participants are actively developing the infrastructure necessary to process certain Package Transactions as a whole through the execution-to-clearing workflow, but that infrastructure is not presently available. The complexity of the issues and the time needed to develop comprehensive solutions vary

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<sup>5</sup> Includes uncleared swaps that are listed on SEFs and uncleared swaps that are not listed on SEFs.

<sup>6</sup> See, e.g., the Citadel Letter.

<sup>7</sup> See, e.g., the MFA Letter and the Citadel Letter.

depending on the group of Package Transactions in question. Below we set forth our requests for temporary relief in relation to each of the three groups of Package Transactions that are the subject of this letter.

**(a) Same SEF Package Transactions**

The Industry Submissions set out the challenges faced by the industry in relation to multi-swap Package Transactions. They also described the solutions that the industry is pursuing in this regard. Certain electronic trading facilities already show bid and offer prices for standardized, liquid Swap Curves and Swap Butterflies. To us, it appears clear that, provided that SEFs offer the ability to quote and execute all of the swap Components of a Same SEF Package Transaction *as a package*, and the Futures Commission Merchants (“FCMs”) and Derivatives Clearing Organization (“DCO”) involved have the ability to recognize, credit check, and process the Same SEF Package Transaction as such, and not as a series of unrelated swaps, it should not be necessary to exempt a MAT Swap that is a Component of such a Same SEF Package Transaction from the trade execution requirement. As with other SEF-executed cleared swap trades, pre-execution credit checks by the FCM would apply, but importantly, to the Package Transaction *as a whole*. We anticipate that a comprehensive solution for this set of Package Transactions will likely be available in 2Q2014 or 3Q2014.

As such, we respectfully request no-action relief (subject to the conditions described in this letter) from the trade execution requirement for MAT Swaps that are Components of Same SEF Package Transactions until the earlier of:

(i) the first date on which:

- (a.) SEFs either list the relevant Same SEF Package Transaction or otherwise allow market participants to quote and execute against a single bid or offer for the net risk presented by all swap Components of the relevant Same SEF Package Transaction; and
- (b.) (1) the SEFs, FCMs, any relevant credit hubs, and DCOs involved in the clearing of all swap Components of the relevant Same SEF Package Transaction have in place standardized language and communication protocols that enable them to identify to each other a swap that is part of a Same SEF Package Transaction;
- (2) FCMs have the ability to assess the net credit risk of the Same SEF Package Transaction as a whole against the relevant client and FCM credit limits (as opposed to credit checking each Component individually) in accordance with applicable as-soon-as-technologically-practicable (“ASATP”) processing standards; and
- (3) DCOs have the ability to measure and manage the risk presented by the Same SEF Package Transaction as a whole (as opposed to conducting risk assessments

against individual Components) in accordance with applicable ASATP processing standards; and

- (ii) in the case of benchmark Swap Curves and Swap Butterflies, August 15, 2014 and, in the case of Unwind (or offset) Packages, November 15, 2014, in each case, based on our estimated time frames for the availability of industry solutions and our proposed phase-in periods.<sup>8</sup>

As a related matter, while FCMs should remain subject to the ASATP standard with respect to the acceptance or rejection of swaps entered into as part of a Package Transaction, it may be necessary for the Division to clarify that the relevant period for acceptance or rejection would start from the time all Components of the Package Transaction are received by the FCM for pre-trade credit checks and/or clearing acceptance. Further, based on available evidence, the Division may reasonably conclude that at present, the ASATP standard for Package Transactions could be a period of longer than 60 seconds, to allow FCMs a reasonable period of time to assess the net risk presented by the Same SEF Package Transaction as a whole. These considerations may apply equally with respect to the timeframe within which DCOs are required to accept or reject such transactions. Specifically, if the Division concludes that a DCO may reasonably require more than 10 seconds to assess the net risk presented by a Same SEF Package Transaction against the limits it applies to the relevant clearing FCM, the Division could provide that a longer period of time would satisfy the ASATP standard, if and where necessary.

#### **(b) Swap plus Non-Swap Package Transactions and Other Swap Package Transactions**

- (i) Benchmark Swap Spreads Involving U.S. Treasury Securities

For the Swap Spread market involving U.S. Treasuries to function properly, market participants need certainty that both the swap and the U.S. Treasury component of the transaction will clear/settle as expected. While solutions that afford this certainty are currently available on platforms in the inter-dealer market, in the dealer-to-customer market, settlement of the U.S. Treasury relies on bilateral relationships between dealers and customers, which will not readily translate into an all-to-all SEF market. While market participants are in the course of developing and/or vetting solutions that will be available to all market participants, to our knowledge, none is fully developed and/or vetted to date.<sup>9</sup> It appears to us that, once a broader solution is fully developed, it should not be necessary to exempt any swap Component in a benchmark Swap Spread Package Transaction involving U.S. Treasuries from the trade execution requirement.<sup>10</sup> We

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<sup>8</sup> See MFA Letter at p. 18.

<sup>9</sup> In this regard, please also refer to the discussion in Section III of the Citadel letter.

<sup>10</sup> We ask the Staff to note that additional challenges would be presented by Swap Spreads that involve U.S. Treasury securities in the event that non-benchmark tenor swaps become MAT certified. Such challenges may require different solutions. Since no non-benchmark tenor swaps have yet been MAT certified, the challenges and solutions with respect to Swap Spreads and other Package Transactions that include a hypothetical non-benchmark tenor MAT Swap are beyond the scope of this letter.

anticipate that it will take until the end of 2Q2014 for the regulatory and technological complexities associated with a broader solution to be adequately resolved.

Accordingly, we respectfully request no-action relief from the trade execution requirement for MAT Swaps that are Components of Swap Spreads involving U.S. Treasuries until August 15, 2014 (*i.e.*, shortly after 2Q2014), subject to the conditions described below in Section III of this letter.

(ii) MBS Basis and Other Swap Spreads

We believe that the points made immediately above with respect to the challenges and likely solutions applicable to Swap Spreads involving U.S. Treasury securities are, in principle, equally applicable to MBS Basis Package Transactions and to Swap Spreads that involve securities other than U.S. Treasuries. However, we anticipate that it will take the industry longer to develop a market-wide solution for these products, as benchmark Swap Spreads involving U.S. Treasuries are the priority. Accordingly, we respectfully request no-action relief from the trade execution requirement for MAT Swaps that are Components of MBS Basis Package Transactions or Swap Spreads that involve securities other than U.S. Treasuries until November 15, 2014, subject to the conditions described in Section III of this letter.

(iii) Other Swap Package Transactions; The Need for EFRP Mechanisms

We believe that the most comprehensive way to preserve liquidity in Package Transactions is to develop an Exchange for Related Position (“**EFRP**”) equivalent regime for Package Transactions. As we explained in the MFA Letter<sup>11</sup>, we believe that the EFRP model operated in the futures space is clear empirical evidence that such a regime can achieve an appropriate balance between regulatory oversight and orderly, liquid markets.<sup>12</sup> With respect to the Package Transactions that are the subject of this letter other than those described in sections II(a) and II(b)(i) and (ii), it is difficult to see how any other approach to the challenges at hand can be overcome without lengthy disruption in the market for Package Transactions. An EFRP-like solution should also help to resolve the issues that DCMs are facing in connection with EFRP transactions that involve SEF-executed swaps, which issues would otherwise be exacerbated over time as successive MAT determinations are issued.<sup>13</sup>

In this regard, we note the Commission’s comments in footnote 218 of the Commission’s final rule on Core Principles and Other Requirements for Swap Execution Facilities. We

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<sup>11</sup> See MFA Letter at pp. 16-17.

<sup>12</sup> For discussion of the EFRP solution, please see the Industry Submissions, including the MFA Letter and the Citadel Letter.

<sup>13</sup> See, *e.g.*, the letter from the Futures Industry Association to the Commission, dated December 6, 2013, regarding Amended Request from CME Group to (1) Amend Rule 538 (Exchange for Related Positions), and (2) Issue CME Group Market Regulation Advisory Notice RA1311-5.

refer the Division to the Industry Submissions and, in particular, to section II of the Citadel Letter. We are of the view that there is irrefutable empirical evidence to support the proposition that there is a *bona fide* business purpose underlying the use of Package Transactions.

Accordingly, we respectfully request that the Division, acting together with the Commission, approve a regime for these Package Transactions that closely approximates the EFRP regime that exists in the futures space. Any such regime should provide that the swap Components, once executed, are subject to the rules of the relevant SEF and must be cleared in accordance with Commission regulations. To allow sufficient time for such arrangements to be properly developed and implemented, we respectfully request that the Division also provide no-action relief from the trade execution requirement for MAT Swaps that are Components of these Package Transactions until November 15, 2014.

### **III. Proposed Conditions for Relief**

We believe it would be reasonable and appropriate for the Division to determine that, in order to rely on the relief requested in this letter, a market participant must:

- (a) in addition to satisfying the obligations to which it is subject under Commission Regulation 45.2, record completely and systematically the execution of all MAT Swaps that are entered into by it as Components of Package Transactions executed in reliance upon the relief requested in this letter;
- (b) keep all such records in electronic form, or in paper form if originally created and exclusively maintained in paper form, so long as they are retrievable as described herein;
- (c) keep all such records readily accessible via real-time electronic access throughout the life of the swap and for two years following the final termination of the swap; and
- (d) ensure that all such records are retrievable by such market participant in accordance with the requirements of Commission Regulation 45.2(e).

Please note that no request is made in this letter for relief from any reporting or recordkeeping requirements established by the Commission.

### **IV. Summary of Relief Requested**

In the table immediately below, we summarize the requests for relief set out in this letter.

<b>Package Transaction</b>	<b>Relief Requested</b>
Swap Curves, Swap Butterflies and Unwind Packages that involve only	Conditional no-action relief from the trade execution requirement for MAT Swap

<p>swaps that are cleared and listed on the same SEF and have at least one Component that is a MAT Swap:</p>	<p>Components until the earlier of:</p> <ul style="list-style-type: none"> <li>(i) the first date on which:           <ul style="list-style-type: none"> <li>(a.) SEFs list or otherwise allow market participants to quote and execute against a single bid or offer for the net risk presented by all swap Components; and</li> <li>(b.) (1) SEFs, FCMs, relevant credit hubs, and DCOs have in place standardized language and communication protocols that enable them to identify to each other a swap that is part of a Package Transaction;</li> <li>(2) FCMs have the ability to assess the net credit risk of the Package Transaction as a whole against limits in accordance with applicable ASATP processing standards; and</li> <li>(3) DCOs have the ability to measure and manage the risk presented by the Package Transaction as a whole in accordance with applicable ASATP processing standards; and</li> </ul> </li> <li>(ii) in the case of benchmark Swap Curves and Swap Butterflies, August 15, 2014 and, in the case of Unwind (or offset) Packages, November 15, 2014.</li> </ul>
<p>Swap Spreads that involve U.S. Treasury Securities:</p>	<p>Conditional no-action relief from the trade execution requirement for MAT Swap Components until August 15, 2014.</p>



MBS Basis transactions and Swap Spreads that involve securities other than U.S. Treasury Securities:	Conditional no-action relief from the trade execution requirement for MAT Swap Components until November 15, 2014.
All other Package Transactions:	The development of an Exchange for Related Position (“ <b>EFRP</b> ”)-equivalent regime for Package Transactions and conditional no-action relief from the trade execution requirement for MAT Swap Components until November 15, 2014.

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For the reasons given above, MFA requests that the Division issue the no-action relief described herein.

**Certification Pursuant to Commission Regulation 140.99(c)(3)**

As required by Commission Regulation 140.99(c)(3), we hereby (i) certify that the material facts set forth in this letter are true and complete to the best of our knowledge; and (ii) undertake to advise the Commission, prior to the issuance of a response hereto, if any material representation contained herein ceases to be true and complete.

We appreciate the Division’s consideration of the requests set forth in this letter. Please feel free to call Laura S. Harper, MFA’s Assistant General Counsel, or the undersigned at (202) 730-2600 with any questions regarding this letter.

Respectfully,

/s/ Stuart J. Kaswell

Stuart J. Kaswell  
Executive Vice President, Managing Director &  
General Counsel

cc:

The Hon. Mark P. Wetjen, Acting Chairman  
The Hon. Bart Chilton, Commissioner  
The Hon. Scott D. O’Malia, Commissioner