

November 20, 2013

Ms. Melissa Jurgens  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Center  
1155 21<sup>st</sup> Street, N.W.  
Washington, DC 20581

**Re: Comment on Javelin Submission for a Made Available to Trade Submission for Certain Interest Rate Swaps (Submission No. 13-06R)**

Dear Ms. Jurgens:

The International Swaps and Derivatives Association, Inc.<sup>1</sup> ("**ISDA**") and the Securities and Financial Markets Association ("**SIFMA**")<sup>2</sup> (hereinafter referred to as the "**Associations**") appreciate this opportunity to provide comments to the Commodity Futures Trading Commission (the "**Commission**") regarding the Made Available to Trade ("**MAT**") submission by Javelin SEF, LLC ("**Javelin**") for certain Interest Rate Swaps (the "**Submission Swaps**") to the Commission pursuant to Section 5(c) of the Commodity Exchange Act ("**CEA**") and Section 40.6(a) of the Commission's Regulations.<sup>3</sup>

**Executive Summary**

**Conclusion:** We believe the Javelin submission, in its current form, is not ready for action by the Commission because it lacks the specificity needed to determine whether it meets the six

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<sup>1</sup> 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. For more information, please visit: [www.isda.org](http://www.isda.org).

<sup>2</sup> SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, DC, is the U.S. regional member of the Global Financial Markets Association. For more information, visit [www.sifma.org](http://www.sifma.org).

<sup>3</sup> Letter from Javelin SEF, LLC to CFTC, Javelin Determination of Made Available to Trade of Certain Interest Rate Swaps Made Pursuant to Parts 37 of the Rules of the Commodity Futures Trading Commission (Submission No. 13-06R) dated Oct. 18, 2013 (hereinafter, "**Javelin Letter**").

Ms. Melissa Jurgens  
November 20, 2013

factors set out in Sec. 37.10(b) (the "**Six Factors**") and the listing requirement set out in Sec. 37.10(a)(2) (the "**Listing Requirement**").

**Six Factors:** Javelin fails to meet the Six Factors because its submission fails to describe the trading activity for individual swaps contracts.

**Listing Requirement:** Javelin fails to demonstrate that it meets the listing requirement because it does not describe how it supports trading of the Submission Swaps or how it will provide the minimum trading functionality described in Sec. 37.3(a) for those swaps.

**Phase In:** We suggest that to the extent that the Commission believes that the Javelin submission is ready for action, the Commission act cautiously during a transitional period as to the specific contracts that it believes most clearly have sufficient liquidity to meet the Six Factors.

**Cross-Border and Packaged Trades:** In addition, we request that the Commission address the cross-border and packaged swap issues that will become even more important as a result of a MAT determination.

**I. Javelin does not address the required factors (Sec. 37.10(b)) on a contract-by-contract basis.**

Section 37.10(b) requires a SEF to consider the Six Factors in determining whether a swap is available to trade. Javelin argues that it can group together swaps by currency and by maturity bucket for purposes of the Six Factors. We strongly disagree. The critical issue addressed by the Six Factors is trading activity and whether there is sufficient liquidity to justify a MAT determination. Swaps with particular contractual specifications, including maturity, rate source and currency will not trade directly against other swaps that do not have these contractual characteristics. As a result, the Six Factors must be applied on a contract-by-contract basis to give a meaningful indication of trading activity. While we recognize that two swaps with different contractual specifications may hedge each other, in whole or in part, the trading of these two swaps does not create a single liquid market for purposes of readily observable prices and meaningful market volumes. Other MAT submissions request certification for swaps which are defined on a contract-by-contract basis by, among other factors, currency and whole year maturity.

The MAT determination adopting release <sup>4</sup> provides that a SEF "must address, in its submission, the applicable determination factor or factors [that] apply to all of the swaps within that group, category, type or class (emphasis added)<sup>5</sup>". In addition, the language of Sec. 37.10 requires the Six Factors to be considered with respect to a swap, not a class or type of swaps. Thus both the

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<sup>4</sup> Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade, 78 Fed. Reg. 33613 (June 4, 2013) (the, "**MAT Release**").

<sup>5</sup> MAT Release at 33611.

Ms. Melissa Jurgens  
November 20, 2013

MAT Release and the rule itself require that Javelin must consider the Six Factors on a contract-by-contract basis. As further discussed below, the Javelin submission potentially applies to a vast number of swaps due to all the possible permutations of trade dates, maturities, currencies, indices, payment and reset dates, and other factors. In order to meet the requirements set forth by the Commission in the MAT Release, Javelin must show how the Six Factors apply to each Submission Swap.

The need to analyze swaps on a contract-by-contract basis is supported by a review of recent trading data. For example, data collected from the SDR over September 2013 shows that 75%<sup>6</sup> of interest rate swap trades were spot starting (*i.e.* the effective date was no later than T+2). Javelin asserts that since spot and forward starting swaps are 'mathematically related' then, as a result, consideration of the factors for spot starting swaps should be sufficient evidence of consideration of the factors for forward starting swaps and no separate analysis for forward-starting swaps is needed. We respectfully disagree that a mathematical relationship is a sufficient basis to assert equivalence for the purposes of MAT certification. This is an extraordinarily low bar to clear, particularly in the context of fixed income swaps, virtually all of which can be connected by some mathematical relationship. Spot and forward starting swaps are economically distinct and not necessarily fungible. Therefore, the Six Factors must be applied to spot and forward starting swaps separately.

The above argument is even more relevant in the context of termination dates. Javelin's submission bundles 10.01-30 year maturities into one category for analysis. The same SDR data demonstrates that 78% of interest rate swaps have "benchmark" maturities of 1 year, 2 years, 5 years, 7 years, 10 years, 15 years, 20 years or 30 years<sup>7</sup>. A swap with a 17 or 25 year maturity is economically different from a swap with a 10, 15 or 30 year maturity.

Further factors that Javelin does not address with specificity, such as business day conventions, must be considered as part of a satisfactory submission. Certain swaps, such as asset swaps and issuance hedges, use Following and Unadjusted business day conventions. These are unique and specific features of such swaps, and the fact that nominally similar swaps are generally executed on a SEF is insufficient to demonstrate that such swaps should be subject to a MAT determination. In addition, Javelin's overly broad submission would permit a swap with literally any permutation of its factors to be considered available to trade. For instance, a swap that uses the TARGET business day convention on a USD swap would be considered to be available for trade by the Javelin submission, although such a swap would clearly not meet the Six Factors because there is essentially no trading activity in such a swap.

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<sup>6</sup> This information is for euro, dollar and sterling denominated fixed-floating swaps and was obtained from the DTCC Real-Time Dissemination Dashboard, <https://rtdata.dtcc.com/gtr/dashboard.do>

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Ms. Melissa Jurgens  
November 20, 2013

The need for contract-by-contract analysis is further supported by an analysis of the interest rate swap market by the Federal Reserve Bank of New York staff report (the "**FRBNY Staff Report**"). This report found that "[interest rate derivatives] activity in major currencies and products is clustered around a select group of instruments; though even within this group, we found trade frequency in individual instruments to be low."<sup>8</sup> The FRBNY Staff Report gives specific examples of this clustering around certain contracts: for example, 98% of USD LIBOR interest rate swaps have a 3 month floating rate reset, while 91% have a 6 month fixed rate payment date<sup>9</sup>. Another example is that 64% of USD LIBOR interest rate swaps have one of five maturities (2 year, 3 year, 5 year, 10 year and 30 year)<sup>10</sup>. Thus, the report clearly indicates that trading activity is focused in contracts with specific contract specifications rather than evenly spread across the spectrum of interest rate swaps.

Therefore, Javelin needs to address the Six Factors for each contract with specifications as to effective date relative to trade date, maturity (defined narrowly to the specific day), currency, floating rate index, floating rate payment and reset dates, payment frequencies, day count conventions, trade type and other relevant characteristics that could cause two contracts to have different liquidity characteristics.

## **II. Listing Requirement.**

### **A. Javelin does not show that it can support the trading of each contract and therefore does not meet the Listing Requirement.**

Javelin's current application does not show how it will support trading for each Submission Swap. The listing requirement should not be satisfied simply because a SEF has completed the relevant certification requirements. If, as a consequence of a MAT determination, certain swaps are forced onto a SEF that has not demonstrated the practical ability to handle the necessary volumes, liquidity would be restricted, transparency would be limited and trading hampered. Since neither Javelin nor any other registered SEF currently trades many of the Submission Swaps, the market would be severely harmed if swaps were required to trade on a SEF that could not yet support trading of such swaps.

There are several elements to a SEF's ability to support trading of a Submission Swap. In order to show that Javelin can support trading, Javelin must demonstrate to the Commission that it has the operational ability to arrange for the clearing on a timely basis of Submission Swaps that are being traded. Javelin must show that it can provide swap participants uninterrupted real-time access to the system. SEFs are new institutions that present significant operational challenges for

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<sup>8</sup> An analysis of OTC Interest Rate Derivatives Transactions: Implications for Public Reporting, Federal Reserve Bank of New York, Staff Report No. 557, Fleming, Jackson, et. al., pg 14 (March 2012, revised October 2012).

<sup>9</sup> Supra note 7, at page 12

<sup>10</sup> Supra note 7, at page 14.

Ms. Melissa Jurgens  
November 20, 2013

all market participants; these challenges include establishing basic connectivity between SEFs and their users, linkages to clearing, and arranging for pre-trade screening. These operational issues would be significantly exacerbated by a MAT determination that forces Submission Swaps to be executed on a SEF that does not have appropriate (or appropriately scaled) operational capabilities.

Our argument that the Listing Requirement includes an ability to support trading is grounded firmly in the MAT Release. In the MAT Release, the Commission explained that, because of the adoption of the Listing Requirement, the Commission was removing a factor that required consideration of whether a SEF's trading platform would support trading in the swap. The MAT Release explained that "in light of the listing requirement, this factor is redundant."<sup>11</sup> The clear implication is that the Listing Requirement will only be met if a SEF can support trading of the relevant swaps.

Moreover, for the reasons discussed above, the market should be assessed separately for each contract. Each relevant swap market should be broken down into fixed contract specifications, including specified maturity, rate source, currency, etc. Instead, Javelin's submission cites the SEF's website as evidence that Javelin currently lists each relevant swap for trading. It does not, however, demonstrate the technical capacity to provide adequate or even minimal liquidity in each swap category. Ignoring business day conventions and holiday calendars, the submission covers 3 currencies, 3 floating rate indices, 4 fixed rate payment frequencies, 4 floating rate payment frequencies and resets, 5 fixed rate day count conventions, 4 floating rate day count conventions, 372 possible termination date months (11,323 days), approximately 300 possible start dates (from T+0 to T+10 months) and four trade types. While respecting that many of the resulting combinations are closely related, a conservative estimate of the number of economically distinct swaps covered in Javelin's application is almost 134,000.<sup>12</sup>

We believe that neither Javelin nor any other SEF has the capacity to list or offer such a large number of swaps for trading. A more sensible approach would be to certify a discrete set of products that are *actually* listed for trading on SEFs (and actually traded by the SEF making the submission) as MAT rather than broad categories that only theoretically could be listed or offered for trading in the future. Pending submissions from other SEFs take this approach.

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<sup>11</sup> 78 FR at 33613.

<sup>12</sup> 3 currencies x 3 indices x 372 termination date months x 10 start date months \* 4 trade types = 133,920 possible contract specifications

Our calculation method divides possible termination dates into months and ignores day count and payment/reset frequencies (in addition to ignoring holiday and business day conventions). A more granular approach (using weekly termination and effective date buckets and including day count and payment frequencies) yields nearly 39 million combinations (3 currencies x 3 indices x 4 fixed rate payment frequencies x 4 floating rate reset dates x 1,612 termination date weeks x 43 start weeks x 4 trade types = 39.9mm possible contract specifications).

Ms. Melissa Jurgens  
November 20, 2013

Therefore, for the reasons discussed above, since Javelin is unable to classify its Submission Swaps with sufficient specificity, it fails to meet the Listing Requirement.

**B. Javelin does not indicate that it has an Order Book available for each contract for which a MAT determination is requested.**

A SEF is required to support execution of Required Transactions on an Order Book or by a Request for Quote System ("RFQ") operated in conjunction with an Order Book.<sup>13</sup> The SEF release has several requirements that demonstrate the Order Book's central importance to achieving the Commission's view of the policy purposes behind Dodd-Frank's SEF trading requirement. For example, if an RFQ is used, the SEF must communicate resting orders from the Order Book to the requester. It is self-evident that any SEF that lists Required Transactions must be able to support execution of the Required Transaction on an Order Book. However, unlike other MAT submissions, Javelin's submission makes no mention of its ability to list and transact Required Transactions on an Order Book.

**III. Phase In**

For the reasons set forth above, we do not believe the Javelin MAT submission is ready for action by the Commission. However, if the Commission is prepared to act, we strongly urge it to approve the MAT Submission only in part. Due to the possible permutations of the characteristics listed in the Javelin MAT submission (such as maturity dates, currencies and indices), a large number of swaps would be required to be traded on SEFs if the Commission approves the submission. However, as discussed and substantiated above, the bulk of trading and liquidity is in a subset of Submission Swaps having standardized characteristics. Therefore, if the Commission approves the Javelin MAT submission, it should do so initially only with respect to those specific contracts that it believes most clearly have sufficient liquidity to meet the Six Factors. As the market for Submission Swaps not approved by the Commission develops and more data becomes available, the Commission can then consider whether other contracts included within the Submission Swaps have become appropriate for a MAT determination. This would be the most measured approach since it would prioritize the transition of "Permitted Transactions" to "Required Transactions" based on which contracts have sufficient liquidity.

The Commission has already indicated that it could take this approach in the MAT Release, stating that it "may approve or deem only part or some of the swaps within that group, category, type or class as available to trade, based on its review."<sup>14</sup> Thus, if the Commission were to permit the Javelin submission to proceed, it should do so only with respect to specific contracts

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<sup>13</sup> Core Principles and Other Requirements for Swap Execution Facilities, 78 Fed. Reg. 34496 (June 4, 2013) (the "SEF Release").

<sup>14</sup> MAT Release at 33611.

Ms. Melissa Jurgens  
November 20, 2013

with sufficient trading volume to meet the Six Factors, with the possibility of phasing in a MAT determination for other contracts over time.

**IV. The Commission should address the extraterritorial issues that arise in connection with MAT determinations.**

**A. Any MAT determination must consider operational ability to support execution of contracts on a twenty-four hour basis.**

Numerous parties outside the United States are, or depending on the facts may be, subject to the SEF trade execution requirement. Many of these parties and their counterparties have business days and hours that have partial, and in some case minimal, overlap with standard U.S. business days and trading hours. These parties would be unable to trade the Submission Swaps if they are subject to an effective MAT determination (and are thus Required Transactions) and Javelin is closed. For any interest rate swap subject to the trade execution requirement, there should be a requirement that at least one SEF that supports trading of such swap must be open twenty-four hours a day. Otherwise, parties subject to Dodd-Frank will not be able to trade swaps subject to a MAT Determination at times when no SEFs are open. Therefore, if a MAT determination is made for any Submission Swap, Javelin should be required to show that it or another SEF has the operational capacity to be open and to support trading of the relevant swap twenty-four hours a day.

**B. Approving a MAT determination without resolving cross-border SEF issues will fragment liquidity in the relevant swap market.**

A MAT determination with respect to the Submission Swaps will require all customers of U.S. Swap Dealers, including non-U.S. customers, to execute such trades on a SEF. However, many jurisdictions prohibit local customers from trading on a SEF unless that SEF is registered with and/or licensed by local regulators as an exchange or regulated trading facility. This is a potentially cumbersome and lengthy process, and considering the very recent establishment of SEFs generally, not one that SEFs applying for MAT determinations have completed. If the SEFs are not registered with foreign jurisdictions, and the MAT determination requires the Submission Swaps to be executed on a SEF, this will effectively prohibit many foreign customers from executing such swaps with U.S. Swap Dealers. In addition, many foreign trading platforms do not intend to decide whether to register with the CFTC as a SEF until the extraterritorial application of the SEF registration requirement becomes clearer. Some foreign trading platforms have already prohibited persons with a U.S. nexus from executing on such platforms.

The combination of these two factors is likely to fragment international liquidity for trading in the swaps subject to a MAT determination. Many foreign customers will not be permitted to execute on SEFs, so will not have access to the liquidity provided by U.S. Swap Dealers, while U.S. persons will effectively be shut out of foreign trading platforms that have not yet

Ms. Melissa Jurgens  
November 20, 2013

determined whether they are required to register with the Commission. A MAT determination at this time would prevent the parties from resolving the uncertainties themselves by executing transactions on a bilateral basis. The consequence is by no means trivial; the foreseeable result will be a greatly fragmented market in which Submission Swaps will only be executed on-SEF between two U.S. counterparties or off-SEF outside the U.S. between two non-U.S. counterparties. We strongly urge the Commission to consider and address the cross-border application of the SEF rules in the context of reviewing MAT submissions such as Javelin's.

**V. Transactions that are not swaps or that are packaged trades should not be subject to a MAT determination.**

Javelin requests a MAT determination for "Spreads", which are defined as a "combination of interest rate swaps and U.S. Treasury Bonds purchases or sales."<sup>15</sup> This definition is too broad and includes purchases and sales of U.S. Treasury Bonds, which are not swaps and therefore cannot be executed on SEFs.

Also, for packaged trades with two components in which one component is subject to a MAT determination, the overall packaged trade should not be subject to the trade execution requirement. Packaged trades and the components of packaged trades should not be Required Transactions. ISDA will prepare a submission to the Commission to address this issue further.

**VI. Conclusion**

For the reasons set out above, we believe the Javelin submission, in its current form, is not ready for action by the Commission.

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The Associations appreciate the opportunity to comment on the Javelin submission. Please feel free to contact the undersigned at your convenience.

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<sup>15</sup> Letter from Javelin SEF, LLC to CFTC at 4.



Ms. Melissa Jurgens  
November 20, 2013

Sincerely,



Robert Pickel  
Chief Executive Officer  
ISDA



Kenneth E. Bentsen, Jr.  
President  
SIFMA

cc: The Honorable Gary Gensler  
The Honorable Bart Chilton  
The Honorable Scott D. O'Malia  
The Honorable Mark P. Wetjen