



April 23, 2014

By electronic submission

Vincent A. McGonagle
Director, Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Comment Regarding Industry Filing IF 14-003; Request for Package Transactions to be Treated Independently for “Made Available to Trade” Determinations

Dear Mr. McGonagle:

The Securities Industry and Financial Markets Association (“**SIFMA**”)¹ appreciates the opportunity to provide the Commodity Futures Trading Commission (the “**Commission**”) with comments on Industry Filing IF 14-003 (the “**ICE SEF Filing**”) and related issues concerning the application of “made available to trade” (“**MAT**”) determinations to package transactions (as defined below). We also identify below certain issues that would be raised by requiring package transactions involving futures contracts or securities to be executed on a designated contract market (“**DCM**”) or swap execution facility (“**SEF**”), including issues raised by proposed revisions to Chicago Mercantile Exchange (“**CME**”) Rule 538. Finally, we express our support for permitting the execution of package transactions subject to the rules of a SEF, as proposed in the ICE SEF Filing, which would facilitate the orderly implementation of the mandatory trading requirement contained in the Commodity Exchange Act (the “**CEA**”), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank**”).

¹ 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, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

I. Background

Section 2(h)(8) of the CEA requires counterparties to “transactions involving swaps that are subject to the [CEA’s mandatory] clearing requirement” to execute such transactions on a DCM or a SEF, unless no DCM or SEF “makes the swap available to trade.” Commission Rule 37.9 requires that any “transaction involving a swap subject to the trade execution requirement in section 2(h)(8),” other than a block trade, be executed on a SEF’s Order Book or a Request for Quote System that operates in conjunction with an Order Book. Finally, Commission Rule 37.10 requires that a SEF, in order to make a swap “available to trade” for purposes of Section 2(h)(8), must consider specified factors that are intended to ensure that the swap has sufficient liquidity to enable counterparties to satisfy the mandatory trading requirement with respect to the swap.²

To date, five SEFs have made available to trade determinations.³ Of the five, four—Bloomberg SEF LLC, Javelin SEF LLC, trueEX LLC and TW SEF LLC—expressly excluded package transactions from consideration, with two of those four (Javelin SEF LLC and TW SEF LLC) amending their determinations in response to public comments in order clarify the exclusion of package transactions. MarketAxess did not expressly exclude package transactions from consideration, but its MAT determination does not reflect consideration of the liquidity or other characteristics of particular categories of package transactions.

On February 10, 2014, in order to support an orderly transition to mandatory trading, the Division of Market Oversight (“**DMO**”) granted no-action relief until May 15, 2014 with respect to the application of the mandatory trading requirement under Commission Rule 37.9 to “package transactions.” A “package transaction” is defined by the DMO for these purposes as a transaction involving two or more instruments: (1) that is executed between two counterparties; (2) that is priced or quoted as one economic transaction with simultaneous execution of all components; (3) that has at least one component that is a MAT swap and therefore is subject to the CEA section 2(h)(8) trade execution requirement; and (4) where the execution of each component is contingent upon the execution of all other components.⁴ We generally agree with this definition.⁵ On March 24, 2014, the Commission sought public comment on the ICE SEF

² Commission Rule 38.12 applies a similar requirement to a DCM. Under these rules, SEFs and DCMs must consider the following factors in making a MAT determination: (1) whether there are ready and willing buyers and sellers; (2) the frequency or size of transactions; (3) the trading volume; (4) the number and types of market participants; (5) the bid/ask spread; or (6) the usual number of resting firm or indicative bids and offers.

³ See <http://sirt.cftc.gov/sirt/sirt.aspx?Topic=%20SwapsMadeAvailableToTradeDetermination>.

⁴ CFTC Letter No. 14-12 (Feb. 10, 2014).

⁵ We note that, in connection with syndicated debt issuances, packaged transactions including MAT rate swaps are executed in transactions involving more than two parties. These transactions also require the Commission’s attention in order to avoid execution requirements that would create additional market risk for the parties to these transactions and increase the cost of raising debt. This adverse consequence could be prevented in a manner consistent with the overall “package transaction” definition by clarifying that the definition covers transactions that are executed between “two or more” counterparties. We would be pleased to discuss with, and provide further

Filing, which proposes rule amendments that would permit package transactions to be executed pursuant to the rules of ICE Swap Trade, LLC in a manner similar to block trades.

II. Discussion

a. Package Transactions Have Individual Characteristics and Should Be Subject to MAT Determinations Independent of their Component MAT Swap(s).

We understand that the Commission has preliminarily construed Section 2(h)(8) and Rule 37.9 to mean that a package transaction, at least one component of which is a MAT swap, is potentially subject to the CEA's mandatory trading requirement. This construction raises the question whether existing MAT determinations are applicable to swaps that are components of package transactions when they are executed as part of a package transaction.

Under DMO's definition of a package transaction (and consistent with market convention), a package transaction is not merely the execution of two or more contemporaneous transactions. It is a transaction in which the MAT swap component is entered into in consideration of and is contingent on the execution of the other components of the package transaction, which is priced and executed as an integrated transaction. As Commission staff have recognized in other contexts, a swap that includes a term making the swap contingent on other terms (such as clearing) is material⁶ and distinguishes the contingent swap from an otherwise equivalent swap lacking that contingency.

Moreover, a swap that is executed as part of a package transaction exhibits different trading and liquidity characteristics than an outright transaction in the underlying MAT swap. The fact that a package transaction involves one highly liquid swap component is not necessarily indicative that the package transaction is highly liquid. By way of example, a "swap curve" package transaction that involves a highly liquid swap, such as an on-the-run index credit default swap ("CDS") with a 5-year tenor, might also involve a much less liquid swap, such as an on-the-run index CDS with a 10-year tenor. Because of the 10-year CDS component, such a "swap curve" package transaction might only trade a handful of times a year, even though outright trades in its 5-year CDS component are very common.⁷ For this reason, the analysis conducted by SEFs in making MAT determinations for outright swaps has little to no bearing on the

background to, the DMO and the Commission with respect to package transactions executed in connection with syndicated debt issuances.

⁶ See Staff Guidance on Straight-Through Processing (Sept. 26, 2013) at p. 5.

⁷ While data on this type of package transaction is not readily available, we note that TW SEF LLC's MAT determination estimated that over 90% of trading in on-the-run index CDSs is in contracts with a 5-year tenor (*i.e.*, MAT CDS), and we would expect that only a very small percentage of the remaining 10% of trading composed of non-MAT CDS are executed as part of package transactions, such as swap curves.

analysis that one would need to conduct in order to evaluate the liquidity of package transactions that involve those swaps.

Accordingly, we believe the Commission should require SEFs to make MAT determinations with respect to package transactions they intend to make available for execution as integrated transactions. This requirement would comport with the Commission's policy of having SEFs determine, in the first instance, whether a particular transaction meets the 6 criteria required of a MAT swap, based on the SEF's experience and expertise. Requiring separate MAT determinations for package transactions would further congressional intent to avoid disruption in the execution of transactions whose liquidity is insufficient to warrant mandatory SEF/DCM execution. Significantly, such a requirement would not result in the exclusion of a significant volume of trading activity from SEFs because those package transactions that are traded in large volumes will have the requisite liquidity for SEFs to make MAT determinations with respect to them. In contrast, package transactions that do not exhibit sufficient liquidity will have correspondingly low trading volumes and little impact on SEF liquidity in the underlying MAT swap.⁸

b. Key Operational Issues Must be Addressed Before Package Transactions Can Become Subject to Mandatory SEF/DCM Execution.

In order for market participants to execute a package transaction through a SEF's Order Book or Request for Quote System, the relevant SEF trading protocol and quoting convention must permit participants on that SEF to quote the package transaction with a single, integrated price and to execute each component of the package transaction simultaneously. Accordingly, before a type of transaction is subjected to the mandatory trading requirement, the Commission should require that one or more SEFs offer these functionalities for that type of package transaction.⁹

In addition, futures commission merchants, their limit check service providers, and derivatives clearing organizations ("DCOs") do not currently have the ability to recognize, screen and accept for clearing a package transaction in an integrated manner. Instead, they must screen each component sequentially, which can result in complete or partial rejection of the package transaction or any of its components.¹⁰ Under the Commission staff's straight-through-

⁸ See the ensuing discussions regarding regulatory and other considerations in the context of package transactions involving non-swap components that bear on the need for an independent evaluation as to whether the swap component of a package transaction should be regarded, in the context of that package transaction, as MAT.

⁹ For example, the Commission could require a SEF to offer these functionalities for a package transaction before the SEF can make a MAT determination with respect to swaps that are components of that type of package transaction.

¹⁰ A partial rejection is made more likely by the fact that the risk presented by the individual components of a package transaction is almost always greater than the risk presented by the package transaction as a whole. Where that is not the case, there is less incentive to execute the transaction as a package.

processing guidance, a partial acceptance/rejection by a DCO would result in the rejected swap component(s) being deemed *void ab initio* and the parties potentially becoming exposed to unhedged risk on the accepted component(s), a very different result than the one contemplated by the terms of the package transaction.

While market participants and infrastructure providers are seeking to address these clearing-related operational issues in the context of package transactions each component of which is a cleared swap, those efforts are not yet complete. Until they are, the Commission should either defer the application of the mandatory trading requirement to package transactions, or it should provide temporary relief from pre-trade limit check and other straight-through-processing requirements (including the *void ab initio* guidance) for package transactions subject to the mandatory trading requirement.

Similar issues exist for package transactions involving components other than cleared swaps (such as securities or uncleared swaps). Yet, because these transactions involve components that exist outside the cleared swap infrastructure, efforts to enhance that infrastructure to address package transactions will not prevent the possibility that the cleared swap components of such transactions may be rejected, deemed *void ab initio*, and leave the parties exposed to unhedged risk on the non-cleared swap components. In order to facilitate SEF/DCM execution of these types of package transactions, the Commission should also provide relief from the *void ab initio* risk for such a transaction, consisting at a minimum of additional time to resolve the issues giving rise to a rejection and resubmit the rejected component(s), without jeopardizing the transaction as a whole.

c. Proposed CME Rule 538 Would Unfairly Restrict SEF-Execution of Package Trades With Futures Contract Components.

Proposed CME Rule 538, if it came into effect, would prohibit any SEF-executed swap from being exchanged by market participants as part of an exchange of futures for related position (“**EFRP**”) transaction. This result would directly preclude the execution, on a SEF, of a package transaction comprising a MAT swap and a futures contract. This aspect of Proposed CME Rule 538 would be inconsistent with Dodd-Frank’s goal of promoting trading on SEFs, and it would unfairly restrict market competition, transparency and innovation, unnecessarily segregate the marketplace and impose limits on the product and risk management choices available to market participants. In light of the relatively small volume of swap transactions that are executed on DCMs, such a result could significantly impair liquidity in the market for affected package transactions.

Indeed, the rule’s principal objectives appear to be to promote trading on DCMs, at the expense of SEFs, and limit the ability to trade futures and swaps in a more fungible manner. For these reasons, we are supportive of comments submitted in connection with Proposed CME Rule 538 by the Futures Industry Association¹¹ and Tradeweb.¹² We would encourage the

¹¹ Futures Industry Association Comment Letter to CME Proposed Rule 538, Dec. 6, 2013, available at: <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59431&SearchText=>.

Commission to weigh carefully the adverse consequences of allowing a DCM to prohibit the use of SEF-executed swaps in connection with an EFRP before permitting Proposed CME Rule 538 to come into effect.

d. Additional Time Will Be Required to Resolve Regulatory Challenges Associated With Package Transactions Involving Securities.

Package transactions comprised of swap and security components present a number of unique challenges due to the dual regulatory obligations under the federal securities laws and the CEA and Commission Rules thereunder that apply to such transactions. In particular, SEFs and the parties to package transactions involving MAT swaps executed on a SEF generally must consider whether the system executing the package transaction (or its securities component) must be registered with the Securities and Exchange Commission (“SEC”) as an alternative trading system,¹³ whether the securities component must otherwise be effected through a registered broker-dealer,¹⁴ and how such broker-dealer could comply with applicable customer-related obligations associated with the package transaction’s security component (e.g., know-your-customer obligations,¹⁵ anti-money laundering obligations,¹⁶ suitability requirements,¹⁷ confirmations¹⁸ and other documentation and onboarding requirements). Depending on the manner in which such transactions are executed, resolving these issues may require further clarification from the Commission regarding the application of some of its own requirements, such as the minimum trading functionality requirement and impartial access requirements, to package transactions involving securities. In addition, as noted in Part II.b above, the *void ab initio* guidance presents significant risks to the parties to package transactions involving securities.

¹² Tradeweb Comment Letter to CME Proposed Rule 538, Dec. 6, 2013, available at: <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59432&SearchText=>.

¹³ See SEC Rules 300-303.

¹⁴ See Section 15 of the Securities Exchange Act of 1934.

¹⁵ See FINRA Rule 2090.

¹⁶ See FINRA Rule 3310.

¹⁷ See FINRA Rule 2111.

¹⁸ See SEC Rule 10b-10.

e. Permitting Package Transactions to Be Executed Subject to the Rules of a SEF Would Facilitate Orderly Implementation of Mandatory SEF/DCM Execution.

We support the proposal in the ICE SEF Filing to permit package transactions to be executed subject to the rules of a SEF in a manner analogous to the execution of block trades.¹⁹ We believe that this approach would be desirable both before and after the package-specific MAT determination process described in Part II.a above. Before a SEF has determined a given package transaction to be MAT, permitting package transactions to be executed subject to the rules of a SEF would subject such transactions to SEF recordkeeping, reporting and surveillance requirements, thereby allowing SEFs to obtain additional data regarding some of the factors (such as frequency or size of transactions and number and types of market participants) that they must take into account in making MAT determinations. Once a given package transaction has been made available to trade, it may still be necessary to permit bilateral execution of the package transaction subject to the rules of a SEF, at least for a transition period, in order to address outstanding legal or operational issues.²⁰ For example, parties to package transactions involving securities may prefer to execute such transactions bilaterally because it would provide them with additional flexibility in addressing the securities law issues noted above until those issues are addressed more comprehensively.

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¹⁹ We do not believe that a package transaction (or any of its swap component(s)) should need to be above minimum block size in order to be executed in this manner, although we recognize that swap components below minimum block size would not benefit from a public reporting delay.

²⁰ During this period, it may also be necessary for the Commission to clarify the application of, or provide relief from, pre-trade limit check and other straight-through-processing requirements (including the *void ab initio* guidance) for package transactions executed in this manner.

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We would be pleased to provide further information or assistance at the request of the Commission. Please do not hesitate to contact the undersigned, or Edward J. Rosen (+1 212 225 2820) or Colin D. Lloyd (+1 212 225 2809) of Cleary Gottlieb Steen & Hamilton LLP, outside counsel to SIFMA, if you should have any questions with regard to the foregoing.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "K. Bentsen, Jr.", with a long horizontal flourish extending to the right.

Kenneth E. Bentsen, Jr.
President and Chief Executive Officer
SIFMA

cc: The Honorable Mark Wetjen, Acting Chairman
The Honorable Scott O'Malia, Commissioner