Freddie Mac
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By Comments Online process at: http://comments.cftc.gov

April 23, 2014

David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Request for Public Comment on ICE Swap Trade, LLC's Self-Certification of Package Trade Rule; Release PR6890-14

Dear Mr. Stawick:

Freddie Mac is pleased to submit these comments in response to the request for public comment regarding ICE Swap Trade, LLC's (ICEST) Self-Certification of Package Trade Rule, released by the Commodity Futures Trading Commission (the Commission) on March 24, 2014 (the Request).[1] On February 11, 2014, ICEST submitted a notification to the Commission that it had amended its Rulebook (Amended Rulebook Submission).[2] On February 26, 2014, the Commission stayed ICEST's self-certification of the definition of "Packaged Transaction" and Rules 701(a) and (k) of its Amended Rulebook Submission.[3]

Freddie Mac was chartered by Congress in 1970 with a public mission to stabilize the nation's residential mortgage markets and expand opportunities for affordable homeownership and rental housing. Our statutory mission is to provide liquidity, stability and affordability to the U.S. housing market. Freddie Mac currently operates under the direction of the Federal Housing Finance Agency (FHFA) as our Conservator.

Summary and Recommendations

Freddie Mac supports ICEST's Amended Rulebook submission, which would treat "package transactions" as defined in proposed rule 701(k) of the rules as block trades and supports certification. While Freddie Mac supports ICEST's efforts to provide for the off-swap execution facility ("SEF") execution of certain package transactions within the current regulatory structure provided by the CFTC and its staff, we remain concerned that the absence of an explicit safe harbor for package transactions within that regulatory structure will create significant uncertainty and undue burdens on economically important commercial activities.

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[1] Commission Release PR6890-14 (Mar. 24, 2014).
[2] ICEST Submission 14-02 (Feb. 11, 2014);
https://www.theice.com/publicdocs/swap_trade/notices/New_Rulebook_Feb262014_02_12_2014.pdf
[3] Commission Division of Market Oversight Letter to ICEST (Feb. 26, 2014).

Consequently, Freddie Mac urges the Commission to provide relief from the mandatory trading requirement under Section 2(h)(8) of the Commodity Exchange Act for package transactions, which is parallel to the safe harbor that has been provided for block transactions and not dependent on the terms of the block transaction exception (including the minimum size requirement).[4] For these purposes, "package transaction" should be defined broadly to include transactions involving two or more instruments: (1) that are executed between two counterparties; (2) that are priced or quoted as one economic transaction with simultaneous execution of components; (3) that have at least one component that is a swap subject to a "made available to trade" determination; and (4) where the execution of each component is contingent upon the execution of all other components.

I. Economic and Business Rationales for Treatment of Package Transactions as Exempt from Mandatory Trading Requirements.

Package transactions are critical to Freddie Mac's ability to manage risk cost-effectively in connection with the fulfillment of our statutory mission. Mandatory SEF trading of these transactions would present various economic and business risks.

Freddie Mac typically enters into a variety of package transactions that require the simultaneous execution of multiple swaps and/or the execution of one or more swaps in coordination with another transaction. For example, while buying mortgage-backed securities ("MBS"), Freddie Mac and a particular dealer may enter into a series of interest rate swaps to transfer the interest rate risk that results from Freddie Mac's purchase of an MBS security. Hedging the interest rate risk from these MBS purchases requires simultaneously entering into a swap or several swaps with maturities at multiple points (or "key rate durations") on the interest rate yield curve. It is critical for these interest rate swap trades to be executed simultaneously with each other and the MBS purchase transaction to ensure that the best price is obtained, as the interest rate risk transfer could result in better execution for both parties involved. Mandatory SEF execution for the interest rate swap component of this transaction (which may fall below block-size thresholds) could result in inferior pricing with respect to the MBS transaction, as well as economic risk during the period in between the purchase and the execution of the interest rate swap. We estimate that for every $1 billion in the purchase or sale of MBS, hedged by $500 million in 10-year notional swaps, it may cost us an additional $250,000 (0.5 bps in yield).

Another example would be the purchase or sale of swaptions. We use forward starting swaps as "delta hedges" while purchasing or unwinding swaptions. Forward starting swaps could be made "made available to trade" on SEFs in the future. Typically, these trades, which only hedge the volatility portion of the interest rate risk of a swaption ("delta hedges") would fall below the block trade thresholds and, without Commission relief, could be subject to the risks of

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[4] In this regard, we note that the temporary relief provided for package transactions in Commission No-Action Letter 14-12 is due to expire on May 15, 2014. We recommend that the relief in No-Action Letter 14-12 be extended until such time as a permanent approach to the treatment of package transactions has been adopted.

either rejection or lack of simultaneous SEF execution. We believe this could lead to pricing inefficiencies for Freddie Mac and its dealer counterparty, particularly because the swaps market tends to be more volatile than the swaptions market.

In these "package transaction" circumstances, mandatory SEF trading could impose significant costs on Freddie Mac.

II. Legal Rationales for Treatment of Package Transactions as Blocks

As noted above, we urge the Commission or its staff to provide relief from the mandatory trading requirement for package transactions that is independent of the block exemption. In response to the CFTC's request for comment on the narrow question of a legal basis for treating such transactions as block transactions for purposes of CFTC rules, we believe that the definition of "block trade" as provided in Commission Regulation 43.2 is sufficiently broad to accommodate package transactions where the aggregate notional of the multiple legs of the transaction exceed minimum block sizes for the relevant category of swap. That said, while we support ICEST's use of the block trade exemption to provide relief from its mandatory execution requirements for package transactions, we also believe direct relief would be within the Commission's general rulemaking authority and is warranted because the policy rationale for such relief, as discussed in Part I of this letter, is largely independent from the aggregate size of the transaction.

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Freddie Mac appreciates the opportunity to provide its views in response to the Request. Please contact me if you have any questions or would like further information.

Sincerely,

Wendell J. Chambliss
Vice President and Deputy General Counsel
Mission, Legislative and Regulatory Affairs Department
Legal Division