

August 17, 2015

Request for Relief – CEA § 2(h)(8)

Via E-mail

Mr. Vincent McGonagle
Director
Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: **Comment on the Division of Market Oversight’s Public Roundtable
Regarding the Made Available to Trade; Request for Further Relief from
Trade Execution Requirements for Package Transactions**

Dear Mr. McGonagle:

The Asset Management Group (the “AMG”)¹ of the Securities Industry and Financial Markets Association (“SIFMA”) appreciates the Division of Market Oversight’s (“DMO”) hosting of the public roundtable regarding Made Available to Trade (“MAT”) determinations on July 15, 2015 and providing the opportunity to submit comments on this important topic.

Throughout the past year, Commissioner Giancarlo, the AMG and other market participants have consistently highlighted concerns regarding serious flaws in the MAT process that threaten trading liquidity in the affected swaps contracts and related package transactions.² While the DMO’s no-action relief has been helpful in delaying some

¹ The AMG’s members represent U.S. asset management firms whose combined assets under management exceed \$30 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds and private funds such as hedge funds and private equity funds.

² See, e.g., CFTC’s Division of Market Oversight to Host Public Roundtable Regarding the Trade Execution Requirement and Package Transactions (Jan. 31, 2014), available at: <http://www.cftc.gov/PressRoom/PressReleases/pr6845-14>; SIFMA, CFTC Comment Regarding Industry Filing IF 14-003; Request for Package Transactions to be Treated Independently for “Made Available to Trade” Determinations” (Apr. 23, 2014), available at: <http://www.sifma.org/issues/item.aspx?id=8589948877>; SIFMA AMG, Request for Further Relief from Trade Execution Requirement for Package Transactions (Oct. 21, 2014), available at:

disruptions to the swaps markets,³ the core problems with the MAT determination process have not been addressed. The AMG hopes that the Commodity Futures Trading Commission (the “**Commission**”) considers formal rulemaking to address these issues and the concerns underscored by participants at the MAT Roundtable and by the AMG in this letter, in which the AMG reiterates its recommendations to improve the MAT determination process.

The AMG continues to support the transition of swap trading to swap execution facilities (“**SEFs**”) but, as stated in prior submissions, thinks that amendments to the Commission’s existing regulations are required to reduce disruptions in liquidity and to counter increased operational risks, both of which our members have experienced as swaps have been mandated for SEF trading. In particular, the AMG believes that: (i) Commission Regulation 37.10 should be amended to require that all Six MAT Factors (as defined below) must be satisfied as part of any MAT submission; (ii) the Commission should consider certain additional factors in assessing any MAT applications; (iii) any new MAT application should be treated as novel and complex and accordingly, should be subject to a full 90-day review period by the Commission, a concurrent 30-day public comment period and feedback from a SEF advisory committee comprised of market participants; (iv) MAT determination should have phased-in compliance; and (v) package transactions should be reviewed for MAT consideration as a single, integrated unit rather than solely based on its swap component(s).

As discussed below and set forth in Appendix I, the AMG suggests specific changes to Commission Regulation 37.10 and the general MAT determination process and requests further no-action relief for package transactions. We hope that the Commission makes these changes now, in order to avoid further negative impacts upon swaps trading.

<http://www.sifma.org/comment-letters/2014/sifma-amg-submits-letter-to-cftc-requesting-further-relief-relating-to-the-execution-of-package-transactions>; Commissioner J. Christopher Giancarlo, *Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank* (Jan. 29, 2015), available at:

<http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf>; SIFMA AMG Submits Comments to the CFTC in Response to Commissioner Giancarlo's White Paper and in Regards to the SEF Regulatory Framework (May 11, 2015), available at: <http://www.sifma.org/issues/item.aspx?id=8589954630>.

³ Commission Staff No-Action Letter No. 14-137 (Nov. 10, 2014), available at: <http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-137.pdf>.

I. All Six MAT Factors Should be Demonstrated as Supporting the Determination

Under Commission Regulation 37.10, SEFs can submit a MAT application on the basis of six factors: (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 (collectively, the “**Six MAT Factors**”).⁴ Currently, Commission Regulation 37.10 only requires a SEF submission’s consideration of the Six MAT Factors “as appropriate,” and a SEF is not required to demonstrate that all six support the MAT determination.⁵

The AMG believes that **all** of the Six MAT Factors must be considered for every MAT determination. The aim of the Six MAT Factors is to measure trading liquidity, separate and apart from the Commission’s prerequisite determination that sufficient liquidity is present to impose mandatory clearing. As AMG stated in its May 11, 2015 letter to the Commission, “the analysis of whether there is sufficient liquidity to support a mandatory clearing determination should differ from the trading liquidity evaluation required to support a mandatory execution requirement.”⁶ The AMG views the Six MAT Factors and additional factors proposed in Section II below as critical to maintaining stable, liquid swaps markets as contracts move to SEF trading.

Additionally, to promote SEF trading and avoid any market disruptions, the AMG believes that the Commission should assess the Six MAT Factors on the basis of the current trading activity of the relevant swaps on SEFs and in the aggregate in order to consider whether there is proven liquidity on SEFs to support a MAT determination.

For these reasons, the AMG recommends revising Commission Regulation 37.10 as set forth in Appendix I.

II. MAT Determinations Should be Supported by Additional Factors

Based on the experiences of our members executing on SEFs, the AMG believes that the Commission should expand the MAT factors to also mandate evidence

⁴ 17 CFR § 37.10.

⁵ *Id.*

⁶ SIFMA AMG Submits Comments to the CFTC in Response to Commissioner Giancarlo's White Paper and in Regards to the SEF Regulatory Framework (May 11, 2015) at 3, *available at*: <http://www.sifma.org/issues/item.aspx?id=8589954630>.

demonstrating that the SEF submitting the MAT application has the requisite infrastructure to support mandatory SEF trading by: (a) adding an assessment of technological readiness, such as necessary trading protocols and quoting conventions; (b) requiring threshold numbers of SEFs and dealers transacting in the swap on SEFs prior to a MAT determination being made; and (c) evaluating the hit ratio and time-to-quote for the contract.

A. Technological Readiness

Technological readiness is a fundamental requirement for a MAT determination given that once the MAT determination is effective, the ability of market participants to trade bilaterally will be eliminated for that particular contract or set of contracts. When SEFs first went live, asset managers experienced significant trading issues resulting from problems with the SEF interfaces with dealers, middleware providers and clearinghouses. While many of these initial issues have since been addressed, the current connectivity between the dealers and SEFs is not sufficiently established for all contracts. For example, many dealers are currently responding to Requests for Quotes by manually pulling down trades to run through their own internal pricing models and re-loading their prices back into the SEF, resulting in a process that is anything but straight-through or efficient.

B. Threshold Numbers of SEFs and Dealers

Before any MAT determination is made, it is imperative that the Commission assess whether there is sufficient liquidity on SEFs. The AMG believes that there should be a minimum of five liquidity providers available on the relevant SEFs to provide options for Request for Quotes and to support best execution. Currently, a number of package transactions, including package transactions involving the Market Agreed Coupon (“MAC”) swap, lack sufficient market participants to trade on SEFs. Additionally, the AMG believes that there should be a minimum of two SEFs offering the particular swap in order to avoid any trading disruptions in the event of any technological or other issues with a single SEF and to thwart attempts by one SEF to garner a monopoly by being the first to make a MAT application for a contract.

C. Hit Ratios and Time-to-Quote

Assessment of hit ratios and time-to-quote would assist the Commission in considering the depth of liquidity present for on-facility execution of the swap contract for which the MAT application has been made. Hit ratios, by measuring the percentage of successful quotes provided by each dealer, and time-to-quote, by measuring the amount of time that passes before a quote is received in response to a request for quote, indicate dealers’ ability and willingness to provide liquidity for the contract. Likewise, time-to-quote may also provide insights into technological readiness, where manual pricing of

complex swaps or package transactions, requires significant time before a dealer can respond.

For these reasons, the AMG recommends adding factors measuring technological readiness, threshold numbers of SEFs and Dealers, hit ratios and time-to-quote to Section 37.10, as set forth in Appendix I.

III. MAT Determinations Should Require Commission Approval After Consideration of Public Comment and Advisory Committee Input

Commission Regulation 37.10 allows SEFs to submit a MAT determination to the Commission pursuant to Part 40 of the Commission's Regulations, which enables MAT determinations to be made through SEF certification or by Commission approval.⁷ Currently, there is no public comment period contemplated under Commission Regulation 40.5.

As a threshold matter, changes to the MAT approval process will have limited impact if the factors for making a MAT determination do not change. If the Six MAT Factors and the additional proposed factors are not all required, then the Commission's review of whether a swap "meets, initially or on a continuing basis, the requirements of the Act"⁸ will be incomplete. As a result, the Commission may be forced to allow the listing of a swap by a SEF that lacks the wherewithal to facilitate trading.

Given the market-wide impact that MAT designations have (as discussed herein and in prior AMG submissions), the AMG believes that MAT determinations should require Commission approval. Automatic self-certification pursuant to Commission Regulation 40.6 should not be available.

Further, the AMG believes that the Commission should have at least 90 days to assess the proposed MAT determination, during which time it should provide the public with a 30-day period for submitting comments. In addition, the AMG believes that the Commission would benefit from having a standing advisory committee consisting of swap market participants and registered entities to provide the Commission with product and trading expertise throughout the 90-day period. Given the novel and complex issues each

⁷ 17 CFR §§ 40.2, 40.5 and 40.6.

⁸ 17 CFR § 40.2.

MAT determination presents, this time period and input is necessary for the Commission to fully assess liquidity and technological readiness for executing the swap on SEF.

As such, the AMG recommends amending Section 37.10, as set forth in Appendix I, to reflect these process changes and creating a standing advisory committee of swap market participants and registered entities.

IV. MAT Determinations Should Have a Phased-In Compliance Schedule

Currently, a MAT determination results in mandating execution on SEFs within “[t]hirty days after the available-to-trade determination submission or certification for that swap is, respectively, deemed approved under §40.5 of this chapter or deemed certified under §40.6 of this chapter.”⁹ In order to allow orderly transition of trading on SEFs, the AMG recommends a longer, phased-in compliance schedule similar to the schedule used to phase-in clearing pursuant to Commission Regulation 50.25. This longer phase-in should help to mitigate connectivity issues experienced when prior MAT determinations were made and will generally allow better preparation for transitioning all trading in the MAT’ed contract to the SEFs.

V. MAT Determinations Should be Required for Package Transactions as Integrated Units

As the AMG and other market participants repeatedly warned,¹⁰ mandating on-SEF execution for package transactions without requiring satisfaction of the Six MAT Factors for the integrated unit itself has caused disruptions in trading and has exposed market participants to unnecessary risks.

With each expiration of DMO’s no-action relief for a category of package transactions,¹¹ liquidity in packages has dropped and some packages have ceased trading altogether. For example, when no-action relief expired on May 15, 2015 for MAT swap/Agency MBS package transactions, only spot-start MAT swap/ “To be Announced” (“TBA”) packages were available to trade on any SEFs. No other MAT swap/Agency MBS package transactions were supported by any SEFs and therefore, with one broad stroke, the liquidity in such other packages was eliminated. It was only recently that a

⁹ 17 CFR § 37.12.

¹⁰ See note 2 *supra*.

¹¹ Commission Staff No-Action Letter No. 14-137 (Nov. 10, 2014), *available at*: <http://www.cftc.gov/ucm/groups/public/@llettergeneral/documents/letter/14-137.pdf>.

SEF has begun supporting spot-start MAT swap/pool package transactions, but MAT swap/CMO packages still cannot be traded on SEFs. Further, the only MAT swap available to trade in the package is the spot starting swap. Should managers want to utilize the widely-accepted standardized MAC swap, they need to execute the package versus the spot starting swap, and then execute an at market trade that converts the spot starting swap to the MAC swap. This unnecessarily exposes the transaction to market risk and adds expense to our members' clients, thus undermining the benefits of original package transaction. These disruptions were caused by the absence of an assessment of the integrated package transactions' liquidity as measured by the Six MAT Factors and necessary market infrastructure to support trading on SEF, including trading protocol and quoting conventions.

The AMG has even graver concerns about the expiration of MAT swap/futures packages on November 14, 2015,¹² as these packages are frequently relied upon by its members to hedge risk for clients and are not currently traded on any SEF. The Six MAT Factors have not been established for each of the MAT swap/futures packages that market participants trade. Further, as the AMG explained to the Commission in its May 11, 2015 letter:

[F]or MAT/Futures Package Transactions, both CME and ICE have adopted rules that would disqualify package transactions containing futures from Exchange for Related Positions status on these exchanges if the MAT component is executed on or pursuant to the rules of a SEF or DCM. As a result, a future mandatory trade execution requirement for MAT /Futures Package Transactions would seemingly conflict with these exchange rules, force these packages to be broken into their component parts, and raise associated issues related to mandatory membership to certain DCMs and lack of competition or choice of venue (potentially fostering a monopoly on one product's trading) to execute these transactions.¹³

¹² *Id.* at 6.

¹³ SIFMA AMG Submits Comments to the CFTC in Response to Commissioner Giancarlo's White Paper and in Regards to the SEF Regulatory Framework (May 11, 2015) at 3, *available at*: <http://www.sifma.org/issues/item.aspx?id=8589954630>.

The CME and ICE rules referred to in the AMG’s May 11, 2015 letter remain unchanged.¹⁴ These rules result in a *de facto* prohibition of Exchange for Related Product Transactions for any MAT’ed contracts, which thwarts efficient pricing of markets trading the same asset, putting at risk price correlation between the futures contracts and the outright swaps trading on SEF. These rules also adversely impact impartial access to markets and market services in a manner inconsistent with Commission Regulation 37.202.¹⁵

As of the submission of this letter, with less than three months until the no-action relief expires, the AMG has identified no listing of these package transactions by the CME or ICE and, in discussions with dealers, have been unable to identify how these package transactions could be traded on-SEF. The AMG’s prior letters, as well as submissions by other market participants, chronicle the consequences of separately executing the components of the package trade, including higher costs and greater risks for the asset managers’ clients with no ascertainable benefit to the market or the Commission.¹⁶ Breaking package transactions into component transactions prior to execution would “eviscerate the rationale behind conducting a package transaction in the first place, namely to achieve better pricing and to minimize risk by more efficiently aligning hedging strategies.”¹⁷ The negative consequences of doing so include “worse pricing for clients of our members,” creating “risk by potentially exposing legs of trades that would have been hedged if executed as a package[,] ... volatility, wider bid-ask spreads and increased costs for each of the component parts, resulting in poorer overall execution for clients of asset managers.”¹⁸

Likewise, the expiration of no-action relief for MAT/Non-MAT Uncleared package transactions, which includes MAT/swaption packages, on February 12, 2016 will be disastrous for markets. Similar to MAT/Futures transactions, MAT/swaption packages are used to transfer exposure from one instrument to the other without exposing asset

¹⁴ See CME Rule 538, available at: <http://www.cmegroup.com/rulebook/files/ra1311-5r.pdf>; see also ICE Rule 4.06, available at: https://www.theice.com/publicdocs/rulebooks/futures_us/4_Trading.pdf.

¹⁵ 17 CFR § 37.202.

¹⁶ See note 2 *supra*.

¹⁷ See SIFMA AMG, Request for Further Relief from Trade Execution Requirement for Package Transactions (Oct. 21, 2014), available at: <http://www.sifma.org/comment-letters/2014/sifma-amg-submits-letter-to-cftc-requesting-further-relief-relating-to-the-execution-of-package-transactions>.

¹⁸ See *id.*

managers' clients to price risk and additional costs. The Six MAT Factors have not been established for each potential MAT/swaption package. In addition, SEFs and DCOs are not ready to support MAT/swaption trades. Based on information available to the AMG, these packages are not offered for trading on any SEF or DCM, and no facility has the trading protocols and quoting conventions to support on-facility execution. Further, the CME is the only clearinghouse actively investigating clearing these packages, and has not announced any means of doing so.

The AMG recommends that any MAT determination approved by the Commission should only cover package transactions for which liquidity, as assessed by the Six MAT Factors, and market infrastructure has been demonstrated. The AMG requests that the Commission clarify its interpretation of 37.10 as not applying to package transactions absent a determination of the package transaction itself and extend no-action relief for the upcoming deadline for MAT/futures packages, MAT/swaption packages and subsequent deadlines until the scope of MAT determinations can be adjusted to match the MAT designation requirements. The AMG further believes that no-action relief should be reinstated for MAT/Agency MBS packages.

In addition, the AMG recommends that the Commission coordinate with other regulators who have jurisdiction over other products “packaged” with swaps and priced and executed together as an integrated unit. Guidance and clarity is still needed on the appropriate trading protocols and requirements for packages involving, for example, securities, security-based swaps, options, and other non-swap products. These unresolved issues hinder market participants from trading package transactions and negatively impact the liquidity and pricing associated with these trades.

In adjusting the scope of the MAT determination, the result may be that some packages may never be capable of being traded on-SEF due to complexity in execution or low liquidity to support central execution. As Commissioner Wetjen noted, the Commission may need to make permanent some of the no-action relief “in order to provide more certainty and flexibility for [package] transactions.”¹⁹ While on SEF execution would be beneficial for certain package transactions once liquidity and market infrastructure is present, the AMG does not think that the market would be benefited by requiring every package transaction to trade on-facility.

¹⁹ Testimony of Commissioner Mark Wetjen before the U.S. House Committee on Agriculture Subcommittee on Commodity Exchanges, Energy, and Credit Subcommittee (April 14, 2015), available at: <http://www.cftc.gov/PressRoom/SpeechesTestimony/opawetjen-95cv>.

* * *

The AMG requests that the Commission amend Section 37.10 as set forth in Appendix I to strengthen the criteria and process, to clarify that package transactions must satisfy Section 37.10's requirements prior to being mandated for on-facility execution and to provide for phased-in compliance of MAT determinations.

The AMG further requests that the Division of Market Oversight extend unexpired relief and reinstate expired no-action relief set forth in No-Action Letter 14-137 dated November 10, 2014.

The AMG thanks the Division of Market Oversight for the opportunity to comment. Should you have any questions, please do not hesitate to contact Tim Cameron at 202-962-7447 or tcameron@sifma.org or Laura Martin at 212-313-1176 or lmartin@sifma.org.

Respectfully submitted,

A handwritten signature in black ink, appearing to be "Tim Cameron", written over a horizontal line.

Timothy W. Cameron, Esq.
Managing Director
Asset Management Group – Head
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Association

A handwritten signature in black ink, appearing to be "Laura Martin", written over a horizontal line.

Laura Martin
Managing Director and Associate General
Counsel
Asset Management Group
Securities Industry and Financial Markets
Association

cc: The Honorable Timothy Massad, Chairman
The Honorable Mark Wetjen, Commissioner
The Honorable Sharon Bowen, Commissioner
The Honorable J. Christopher Giancarlo, Commissioner
Mr. Christopher Kirkpatrick, Secretary

APPENDIX I

SIFMA AMG's Proposed Changes to Commission Regulation 37.10, 17 CFR §37.10

§37.10 Process for a swap execution facility to make a swap available to trade.

(a)(1)(i) *Required submission.* A swap execution facility that makes a swap available to trade in accordance with paragraph (b) of this section, shall submit to the Commission its determination with respect to such swap as a rule, as that term is defined by §40.1 of this chapter, pursuant to the procedures under part 40 of this chapter. **All such submissions shall be classified as raising novel or complex issues pursuant to § 40.5(d)(1) and, as such, trigger 45 days in addition to the initial 45 days provided by § 40.5(c), for a total of 90 days for the Commission to consider the submission.**

(ii) Public comment. The Commission shall provide a 30-day comment period within the 90-day period described in paragraph (a)(1)(i) of this section. The Commission shall publish a notice of the 30-day comment period on the Commission web site. Comments from the public shall be submitted as specified in that notice.

(iii) Commission approval. All determinations submitted for Commission approval under paragraph (a) of this section shall only be approved by order of the Commission.

(2) *Listing requirement.* A swap execution facility that makes a swap available to trade must demonstrate that it lists or offers that swap for trading on its trading system or platform.

(b) *Factors to consider.* To make a swap available to trade, for purposes of section 2(h)(8) of the Act, a swap execution facility shall consider, ~~as appropriate,~~ the following factors with respect to such swap:

(1) Whether **the contract has been trading on at least two swap execution facilities for at least six months;**

(2) Whether sufficient technological infrastructure is present for on-facility trading, including automated pricing and transaction connectivity (e.g., via application programming interfaces a/k/a APIs); sufficient messaging protocols amongst dealers, non-dealers and SEFs;

- ~~(1)~~(3) **Whether** there are ready and willing buyers and sellers, **including at least five dealers quoting two-way markets for the swap on at least two swap execution facilities**;
- ~~(2)~~(4) The frequency or size of transactions, **both on the swap execution facility and in the aggregate**;
- ~~(3)~~(5) The trading volume, **both on the swap execution facility and in the aggregate**;
- ~~(4)~~(6) The number and types of market participants, **both on the swap execution facility and in the aggregate**;
- ~~(5)~~(7) The bid/ask spread, **both on the swap execution facility and in the aggregate**; ~~or~~
- ~~(6)~~(8) The usual number of resting firm or indicative bids and offers, **both on the swap execution facility and in the aggregate**;
- (9) hit ratio; and**
- (10) time-to-quote.**

(c) *Applicability.* Upon a determination that a swap is available to trade on any swap execution facility or designated contract market pursuant to part 40 of this chapter, all other swap execution facilities and designated contract markets shall comply with the requirements of section 2(h)(8)(A) of the Act in listing or offering such swap for trading.

(d) *Removal—(1) Determination.* The Commission may issue a determination that a swap is no longer available to trade upon determining that no swap execution facility or designated contract market lists such swap for trading.

(2) *Delegation of Authority.* (i) The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, the authority to issue a determination that a swap is no longer available to trade.

(ii) The Director may submit to the Commission for its consideration any matter that has been delegated in this section. Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

APPENDIX II

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 the attached letter dated August 17, 2015 are true and complete to the best of our knowledge; and (ii) undertake to advise the Commission, prior to the issuance of a response thereto, if any material representation contained therein ceases to be true and complete.

Respectfully submitted,



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