Request for Relief – CEA § 2(h)(8)

October 21, 2014

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: Request for Further Relief from Trade Execution Requirement for Package Transactions

Dear Mr. McGonagle:

The Asset Management Group (the "**AMG**")[1] of the Securities Industry and Financial Markets Association ("**SIFMA**") is writing to request further relief relating to the execution of package transactions.[2] In a no-action letter dated May 1, 2014, the Division of Market Oversight (the "**Division**") of the Commodity Futures Trading Commission (the "**Commission**") provided relief from the requirement to mandatorily execute certain package transactions on swap execution facilities ("**SEFs**") or designated contract markets ("**DCMs**") on a phased basis.[3] The last phase of that relief is currently set to roll off on November 15, 2014 (the "**Package Relief Expiration Date**"). We are hereby requesting deferral of the Package Relief Expiration Date for an indefinite period until a sufficient showing of liquidity can be made for the integrated package transaction, or at least for a period of no less than six months, for the MAT (as hereinafter defined) component of all package transactions that would otherwise be mandated for SEF or DCM execution on November 15, 2014 ("**Exempt Package Transactions**"); at a minimum, we are requesting that the Division provide this relief for the specific categories of Exempt Package

[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] A "package transaction" is defined 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 Commodity Exchange Act section 2(h)(8) trade execution requirement; and (4) where the execution of each component is contingent upon the execution of all other components. See CFTC Letter No. 14-12 (Feb. 10, 2014).

[3] CFTC No Action Letter No. 14-62 (May 1, 2014).

Transactions set forth herein. In any event, once an Exempt Package Transaction is subject to the trade execution mandate, we request that the Division permit execution of the MAT components of these transactions to occur off of SEFs, but subject to SEF rules, as described further below.

Package Transactions Should Not Be Subject to the Trade Execution Requirement Without a Sufficient Demonstration of the Made Available to Trade Factors on an Integrated Basis

As the Division knows from our previous discussions and correspondence, we have had concerns about mandatory execution of all package transactions, including those that have already become subject to the SEF execution mandate. As a baseline principal, we believe that all package transactions should be considered for potential made available to trade ("**MAT**") determinations on an integrated basis, looking at the package transaction as a whole rather than at its individual component parts. Package transactions are priced and traded together as an integrated unit. No SEF has included package transactions in a MAT determination made to date.[4] In submitting any package transactions for MAT consideration, we believe each SEF must consider the 6 criteria required for MAT determinations as outlined by the Commission.[5] In other words, we believe that each unique package transaction should be examined for its individual liquidity characteristics at the package level. While we are appreciative of the previous no-action relief relating to package transactions issued by the Division, we think a review of the trade execution mandate for all packages not yet subject to the mandate is warranted. We believe that if most, if not all, Exempt Package Transactions were examined at the package level, they would not have sufficient liquidity to justify MAT treatment. Automatically subjecting a MAT component of a package transaction to SEF execution just because that component on its own would be subject to a MAT determination ignores the status of a package transaction as unique from its component parts and obviates the entire MAT process under Commission Rule 37.9 by bringing in other transactions where a sufficient showing of the MAT Factors has not been made.

The Market Can Not Currently Support SEF Execution of Exempt Package Transactions

In any event, adequate functionality has not yet been developed to mandate SEF execution of the Exempt Package Transactions. We continue to believe that no MAT component of a package transaction should be subject to mandatory SEF execution until the relevant trading, messaging and quoting protocols are in place for such transactions. In particular, the market is not yet able to support pricing of the Exempt Package Transactions. Before asset managers can

[4] Two SEFs, Javelin SEF LLC and TW SEF LLC, amended their determinations to expressly remove package transactions.

[5] Commission Rule 37.10 requires that, in order to MAT a swap, a SEF must consider specified factors that are intended to ensure that the swap has sufficient liquidity. These factors are (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; and (6) the usual number of resting firm or indicative bids and offers (collectively, the "**MAT Factors**").

effectively execute MAT components of package transactions on SEFs for their clients, conventions on how to quote pricing information have to be fully established. This requires swap dealers to have adjusted their internal pricing systems to generate a package price, which is dependent upon SEFs finalizing their coding and connectivity. The dealers' and SEFs' coding also needs to synch up with gateways and middleware providers. Asset managers will then need to map out their workflows, as well as needing adequate time to test the package transaction execution functionality, which has not been provided to date. Each of these steps takes ample time to test and deploy and requires reliance on other participants in the process. To date, the timeframes for building this connectivity for package transactions has not been sufficient and the deficiencies will only be amplified for the Exempt Package Transactions as they are significantly more complex and bespoke than package transactions that have already been subjected to the trading mandate.

As there is a very large number of possible package transaction permutations, and pricing functionality needs to be built for each, swap dealers have been forced to prioritize certain transactions over others, leaving solutions for many package transaction variations unresolved. A large number of these Exempt Package Transactions will either have no swap dealers or very few prepared to execute on a SEF on November 15, 2014. As the vast majority of Exempt Package Transactions will be unsupported or under-supported, there will not be sufficient liquidity and scale to execute the MAT components of these products on SEFs. Moreover, the parties with which asset managers will be able to transact will be limited, raising concerns around counterparty concentration, best execution and meeting the request-for-quote (RFQ) minimum provider requirements.

Regulatory Considerations for Exempt Package Transactions Remain Unaddressed

Mandatory trade execution of the MAT components of Exempt Package Transactions also raises a variety of regulatory concerns that have been raised, but remain unanswered. For example, for MAT swap-futures package transactions, both CME and ICE have adopted rules that would disqualify package transactions containing futures from Exchange for Related Positions ("**EFRP**") status on these exchanges if the MAT component is executed on or pursuant to the rules of a SEF or DCM.[6] As a result if the Commission was to implement a mandatory SEF execution requirement for MAT swap-futures transactions, it would seemingly conflict with exchange rules and force these packages to be broken into their component parts.[7] Similarly, for Exempt Package Transactions that include securities, the Securities and Exchange Commission

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[6] See CME Rule 538 (see http://www.cmegroup.com/rulebook/files/ra1311-5r.pdf); ICE Rule 4.06. (see https://www.theice.com/publicdocs/rulebooks/futures_us/4_Trading.pdf).

[7] Although this issue has been raised with the Commission in the past, the conflict has not yet been resolved. See, e.g., SIFMA letter to Commodity Futures Trading Commission Regarding "Comment Regarding Industry Filing IF 14-003; Request for Package Transactions to be Treated Independently for "Made Available to Trade" Determinations" (April 23, 2014), available at http://www.sifma.org/issues/item.aspx?id=8589948877.

("**SEC**") has jurisdiction over the securities components and mandating them for execution on a SEF raises unresolved questions about a SEF's ability to execute these trades under SEC rules.[8]

With respect to Exempt Package Transactions that include uncleared swaps, some of the SEF rules, and indeed even some of the Commission's own rules, raise unanswered questions. For example, uncleared swaps may be subject to the CFTC's swap trading relationship documentation requirements and SEF rulebooks may require participants to put on trades only with counterparties with which they have documentation.[9] However, SEF platforms often only identify dealer counterparties by family name, so if an RFQ is put out to a given dealer family, it is possible that the particular counterparty that executes the trade may be one with which the client does not have documentation, resulting in a violation of the SEF rulebook.[10] There is no streamlined mechanism to collect the necessary information for the uncleared swap components of these transactions, and the necessary operational changes will not be able to be formalized and implemented by November 15, 2014. In addition, this SEF requirement may raise "enablement mechanism" and impartial access concerns,[11] as well as issues with confirmations.[12]

Subjecting the MAT Components of Exempt Package Transactions to Mandatory Trade Execution Will Not Further the Statutory Objectives and Policy Goals of SEF Rulemaking

We do not believe that mandating the MAT components of Exempt Package Transactions for mandatory trade execution will promote SEF trading or pre-trade price transparency. The disclosure of pricing of a MAT swap component of a package transaction is not all too enlightening and could be misleading as it is priced as part of the package transaction and not as a stand alone trade. The market would essentially be receiving false signals about the component parts of the trade. The same would hold true if a transaction priced as a package were to be broken up for execution. Similarly, if MAT components of Exempt Package Transactions are required to be executed on a SEF, market participants may cease trading these transactions, in some cases, and look to alternative products. Accordingly, subjecting Exempt Package Transactions to the trade execution mandate may not result in enhanced liquidity on SEFs.

[8] For example, it is not clear whether a SEF would have to register with the SEC as an exchange if it serves as an execution platform for a transaction including a security. The same issue exists for Exempt Package Transactions including security-based-swaps.

[9] See Commission Rule 23.504.

[10] See Request for Relief: Trade Execution Requirement – Implementation Phase-In Recommendation, SIFMA AMG, Feb. 14, 2014, available at http://www.sifma.org/issues/item.aspx?id=8589947579 ("**AMG February 2014 Letter**").

[11] See Request for Relief from the Trade Execution Requirement for Categories of Package Transactions under CFTC Staff No-Action Letter 14-62, Managed Funds Association, October 15, 2014.

[12] See, e.g., id and AMG February 2014 Letter.

Impact on Market if MAT Components of Exempt Package Transactions are Subjected to Trade Execution Requirement on November 15, 2014

If the trade execution mandate is not deferred beyond November 15, 2014 for MAT components of Exempt Package Transactions, we expect substantial disruption in the trading of these transactions. Due to the lack of market readiness and unresolved regulatory considerations described above, liquidity for trading these instruments will likely be significantly impaired. One potential market response is to break package transactions into its component parts prior to execution. However, doing so, 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. Breaking up a package transaction would result in worse pricing for clients of our members and would create risk by potentially exposing legs of trades that would have been hedged if executed as a package. Moreover, split trades would result in volatility, wider bid-ask spreads and increased costs for each of the component parts, resulting in poorer overall execution for clients of asset managers. Lower quality trade execution due to breaking up package transactions would run counter to asset managers' duties to their clients. There does not appear to be sufficient regulatory justification or a sound policy reason for encouraging package transactions to be broken up for execution.

Requested Relief

In light of the forgoing, we hereby request that the Division extend the Package Relief Expiration Date for all Exempt Package Transactions for an indefinite period until a sufficient showing of liquidity consistent with the MAT Factors can be demonstrated for the applicable package transaction taken in its entirety. If the Division is unwilling to do so, we request that the Division extend the Package Relief Expiration Date for all Exempt Package Transactions for a period of at least six months.

If the Division is unwilling to extend the Package Relief Expiration Date for all Exempt Package Transactions, we request that an extension be provided for at least the categories of package transactions enumerated below, each of which has significant hurdles to mandatory SEF execution on November 15, 2014:

- *MAT Swap-Swaption Package Transactions*. Swaptions are not currently subject to the Commission's clearing mandate. As the Commission recognized in its final SEF rulemaking, uncleared swaps should not be subjected to mandatory trade execution on a SEF. By definition, as swaptions are uncleared, an adequate liquidity determination has not yet been made to support clearing or exchange trading of these instruments. The pricing of these transactions is often counterparty-specific. Similarly, for swap-swaption package transactions, pricing is not robust enough to support mandatory SEF execution at this time. As these transactions include uncleared swaps, they also raise the documentation concerns with SEF and Commission rules identified above. Very importantly, it is our understanding that no SEF yet supports the ability to execute swap-swaption packages. This is highly problematic with less than a month to go before the Package Relief Expiration Date. Under no circumstances will adequate time be available to test pricing and SEF connectivity for these products before November 15, 2014.

- *Other MAT Swap-Option Package Transactions*. The same considerations also exist for other package transactions involving MAT swaps and options. Packages including CDX options together with a delta-neutralizing underlying swap are another good example of common package transactions including MAT swaps and options that will not be ready for the trade execution mandate on the Package Relief Expiration Date.

- *Invoice Spreads and Other MAT Swaps-Futures Package Transactions.* Jurisdictional issues and conflicting regulatory requirements create a unique issue for MAT swap-futures package transactions, including invoice spreads (which include Treasury futures), as described above. MAT swap-future package transactions are an important part of the market for asset managers and without the ability to hedge through the use of these transactions, further risk and volatility will be introduced to the market. Accordingly, unless and until the conflict with CME and ICE rules is resolved, these transactions should not be subjected to mandatory execution on a SEF.

- *MAT Swap-MBS-Related Package Transactions*. MAT swap-mortgage-backed security ("**MBS**")-related package transactions represent another important part of the market and an instrument that asset managers often use to hedge mortgage-related risks in an investment portfolio. These transactions may include "to-be-announced" or "TBA" MBS, as well as mortgage index swaps, such as IOSX and MBSX. In the case of package transactions including MBS, SEC jurisdictional issues are raised for these transactions as MBS are securities, as described above. SEFs have not completed their systems for these transactions and liquidity providers are not able to price these transactions for SEF execution at this time. As with MAT swap-swaption package transactions, there will not be sufficient time to connect to and test these systems prior to the Package Relief Expiration Date.

- *MAT Swap-Corporate Bond Package Transactions.* Pricing and structuring package transactions including corporate bonds is complex and often requires individualized discussion specific to the transaction given the bespoke nature of bond issuances. As corporate bonds of the same issuer may not be fungible, there is relatively less liquidity for package transactions that contain these bonds. These conditions are magnified for package transactions involving new issuance corporate bonds. In addition, corporate bonds are securities, raising the SEC jurisdictional issues referenced above.

- *Other MAT Swap-Securities Package Transactions*. Given uncertainty around the jurisdictional issues with the SEC discussed above and the lack of market readiness, Exempt Package Transactions that contain securities or securitiesbased-swaps should not be subject to the trade execution mandate prior on November 15, 2014.

In any event, once an Exempt Package Transaction is subject to the trade execution mandate, we request that the Division permit execution of the MAT components of these transactions to occur off of SEFs, but subject to their rules, similar to block trades.[13] This solution would subject the MAT components of the package transaction to transparency and oversight, including reporting, recordkeeping and surveillance obligations. This approach could provide the Commission with an opportunity to collect data to assess liquidity and volume. The proposal also would ensure that all legs within a package transaction are priced together and executed simultaneously between the same counterparties as contemplated under the package transaction definition.[14] In turn, this process would avoid fragmentation of the legs of the package transaction and prevent potential market disruptions if the MAT components of a package transaction were forced to be executed on a SEF before there is sufficient liquidity for the package transaction.

For all of the above-stated reasons, AMG requests that the Division provide the relief described herein.

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[13] A package transaction (or any of its swap component(s)) should not need to be above minimum block size in order to be executed in this manner and the swap components below minimum block size would not benefit from a public reporting delay. The real time reporting delay and cap size limits applicable to block trades, however, would apply to a MAT swap component of the package transaction if it meets the minimum block size threshold for that component.

[14] We note that to the extent the Division is concerned about market participants abusing the system by creating package transactions to avoid execution on a SEF or DCM, it could put guardrails in place for these transactions, such as ordinary course of business requirements, to protect against evasion. In any case, we believe that the Commission would be able to utilize its anti-evasion authority to avoid abuse.

We appreciate the Division's consideration of our request, and stand ready to provide any additional information or assistance that the Division might find useful. Should you have any questions, please do not hesitate to contact Matt Nevins at 212-313-1176.

Sincerely,

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group - Head
Securities Industry and Financial Markets Association

Matthew J. Nevins, Esq.
Managing Director and Associate General Counsel, Asset Management Group
Securities Industry and Financial Markets Association

cc: Hon. Timothy G. Massad, Chairman
Hon. Sharon Y. Bowen, Commissioner
Hon. J. Christopher Giancarlo, Commissioner
Hon. Mark Wetjen, Commissioner
Nancy Markowitz, Deputy Director, Division of Market Oversight

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 October 21, 2014 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.

Sincerely,

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Timothy W. Cameron, Esq.
Managing Director, Asset Management Group - Head
Securities Industry and Financial Markets Association

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