

December 20, 2013

## Mandatory Exchange Trading for Swaps is Coming

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the **Dodd-Frank Act**) mandates that swaps that (1) are subject to the Dodd-Frank Act's clearing requirement and (2) have been made "available to trade" be traded on either swap execution facilities (**SEFs**) or designated contract markets (**DCMs**, and such requirement, the **Mandatory Trading Requirement**).

As described below, the U.S. Commodity Futures Trading Commission (the **CFTC**) has developed a process for certifying determinations by SEFs and DCMs that swaps are "available to trade," and began receiving available-to-trade submissions from SEFs in the middle of October. While these submissions are currently under review by the CFTC, any approved requests will result in the obligation to trade certain interest rate and credit default swaps on SEFs or DCMs starting mid-February 2014, unless the CFTC provides for an extended implementation schedule.

### I. Swap Execution Facilities and Designated Contract Markets

SEFs are self-regulatory organizations that were created under the Dodd-Frank Act as trading platforms for swaps. SEFs allow market participants to execute swaps by accepting bids and offers made by multiple participants. To comply with the Mandatory Trading Requirement, SEFs must either provide a request-for-quote system (**RFQ**), which allows market participants to transmit requests for quote to buy or sell a specific swap, or an open access order book, which allows trades to be booked based on live quotes displayed on either a disclosed or anonymous basis.

SEFs are required to submit a detailed registration application to the CFTC and comply with "core principles" regarding their operation set by the Dodd-Frank Act and the CFTC's regulations. To date, 21 SEFs have registered with or submitted registration materials to the CFTC.

DCMs are boards of trade or exchanges for a variety of products regulated by the CFTC, including futures, options, and now swaps. To date, however, no DCM has submitted an available-to-trade determination for swaps.

### II. "Available-to-Trade Determinations"

#### How are swaps made available to trade?

An available-to-trade determination is initiated by a SEF or DCM as part of its self-regulatory rule-making. If a SEF or DCM lists a swap (or a group, category, type or class of swap) for trading and determines that such swap (or such group, category, type or class of swap) meets the liquidity factors

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prescribed by the CFTC, the SEF or DCM can submit its determination for the CFTC's approval under CFTC Rule 40.5 or, alternatively, self-certify its determination pursuant to CFTC Rule 40.6.

Under Rule 40.5, the CFTC has 45 days to review a SEF's or DCM's available-to-trade submission, and can extend the review period for another 45 days. Although it is not a requirement of Rule 40.5, the CFTC routinely solicits comments from the public regarding submissions made under Rule 40.5.

Under Rule 40.6, a SEF's or DCM's available-to-trade determination will be effective 10 business days after it is submitted to the CFTC, unless the CFTC decides during this time to stay the new rule for 90 days if, among other reasons, the rule presents novel or complex issues. The CFTC indicated that initial available-to-trade determination submissions by SEFs or DCMs may present novel or complex issues, and would therefore be subject to the 90 day stay, but that later submissions may not. Rule 40.6 also requires the CFTC to provide a 30 day public comment period (which may be extended) within the 90 day stay period.

#### **Have any swaps been made available to trade?**

Currently, no swaps have been made available to trade. However, available-to-trade determinations with respect to interest rate and credit default swaps were submitted by several SEFs to the CFTC starting in October 2013.<sup>1</sup> All of the determinations were submitted to the CFTC pursuant to the self-certification process under CFTC Rule 40.6, and the CFTC has stayed each of these submissions for 90 days to allow for review and public comment.

Several market participants have submitted comment letters regarding the pending available-to-trade submissions. Many comment letters raised operational concerns and urged the CFTC to adopt a phased-in implementation schedule with any positive determination being applicable initially to swap dealers only. Many letters also raised substantive concerns regarding the liquidity of some of the swaps included in such submissions, and suggested that the CFTC approve only benchmark swaps with standard tenors. Some commentators also stressed that the relevant SEF's terms and rulebook, which would govern any swaps executed on its platform, need to be carefully reviewed prior to any available-to-trade submission being approved.

For the determinations submitted in October, the CFTC's first stay will expire on January 16, 2014.

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<sup>1</sup> Bloomberg SEF LLC recently submitted its available-to-trade determinations for certain interest rate and credit default swap contracts on December 5, 2013.

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### **III. Consequence of Available to Trade Determination**

#### **What happens when a swap is made available to trade?**

Swaps included in an available-to-trade determination will be subject to the Mandatory Trading Requirement 30 days after the available-to-trade determination is deemed approved or certified. At such time, market participants will be required (absent an available exception) to execute relevant swaps on a DCM or SEF through either a RFQ or order book platform. To trade on a SEF or DCM, market participants must either have direct access to the SEF or DCM or place their trades through brokers who are members of the SEF or DCM.

#### **Which swaps are being made available to trade?**

The CFTC has determined that at this time, it will only review available-to-trade determinations for swaps that are subject to mandatory clearing. All of the available-to-trade determination submissions to date therefore relate to interest rate and credit default swaps already subject to mandatory clearing.

To assist market participants, the CFTC will publish on its website a list of swaps that have been made available to trade and all the SEFs and DCMs that list or offer those swaps.

#### **When will I be required to trade swaps?**

The CFTC's 90 day stay period with respect to the first available-to-trade determination submitted by a SEF expires on January 16, 2014. If the CFTC does not object to the submission or approve the determination prior to the end of the 90 day period relevant swaps will be subject to the Mandatory Trading Requirement starting on February 18, 2014. The CFTC may, however, impose an implementation schedule phasing in the Mandatory Trading Requirement over a longer time period, as requested by many commenters.

#### **Are there any exceptions to the Mandatory Trading Requirement?**

The Mandatory Trading Requirement does not apply to swaps that benefit from the clearing exceptions under Section 2(h)(7) of the CEA, which includes the end-user exception and the inter-affiliate exception. Therefore, entities such as corporate end-users will not be required to execute any swap on a SEF or DCM for which they elect the clearing exception, even if such swap has been made available for trading. In addition, certain block trades can be executed away from a SEF's or DCM's RFQ or order book system (e.g., as in a pre-arranged sale subject to the rules of the SEF or DCM).

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This memorandum represents a general discussion of the issues presented and is not intended to provide legal advice. No legal or business decision should be based on its content. We would be pleased to answer any questions concerning the issues addressed in this memorandum. If you wish to receive more information on the topics covered in this memorandum, you may contact:

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