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January 30, 2014

## **Mandatory Exchange Trading for Swaps to Begin February 18, 2014**

### **I. Mandatory Exchange Trading**

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 in our previous client alert, SEFs and DCMs are self-regulatory exchanges which serve as trading platforms for swaps.<sup>1</sup> The Commodity Futures Trading Commission (the **CFTC**) has established 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 2013. Over the past week, the CFTC has begun certifying these submissions.

### **II. Product-Level Certifications**

On January 16, 2014, the CFTC announced that Javelin, SEF, LLC's available-to-trade determination, the first of the available-to-trade determinations submitted, was deemed certified. Similarly, on January 23, 2014, the CFTC announced that trueEx, LLC's available-to-trade determination was deemed certified, and on January 28, 2014, the CFTC announced that TW SEF LLC's (Tradeweb) available-to-trade determination was deemed certified. As a result of these certifications, certain interest rate and credit default swaps listed below will be subject to the Mandatory Trading Requirement and must be executed through either a SEF or DCM starting on February 18, 2014,<sup>2</sup> February 21, 2014, and February 26, 2014, respectively. Available-to-trade determinations are product-level determinations, and market participants may execute swaps subject to the Mandatory Trading Requirement on any SEF or DCM that offers the relevant swaps, not just the SEF or DCM that submitted the relevant available-to-trade

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<sup>1</sup> For additional information regarding the Mandatory Trading Requirement, SEFs and DCMs, and available to trade determinations, please refer to our Client Memorandum of December 20, 2013 ("Mandatory Exchange Trading for Swaps is Coming"), available at: <http://www.paulweiss.com/media/2250829/20dec13memo.pdf>.

<sup>2</sup> While the CFTC specifies that the Mandatory Trading Requirement will apply to these interest rate swaps starting on February 15, 2014, as this is the Saturday of a holiday weekend, the requirement will become effective on the following business day, Tuesday, February 18, 2014.

determination.<sup>3</sup> The CFTC publishes 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.<sup>4</sup>

Some uncertainty remains regarding "package transactions" that involve more than one swap or financial instrument and at least one swap subject to the Mandatory Trading Requirement. The CFTC stated that the inclusion of such a swap in a multi-legged transaction "would not per se relieve market participants of the obligation to trade such swap through a SEF or DCM," and has reserved the matter for discussion at a public roundtable scheduled for February 10, 2014. On January 24, 2014, the Managed Funds Association submitted a request for no-action relief from the Mandatory Trading Requirement for swaps executed as part of package transactions.<sup>5</sup>

### III. Which Swaps Must Be Exchange Traded?

Transactions involving the following USD interest rate swaps will be subject to the Mandatory Trading Requirement as of February 18, 2014, with transactions involving the interest rate swaps highlighted in blue and bold subject to the Mandatory Trading Requirement as of February 21, 2014 and transactions involving the interest rate swaps highlighted in red and underlined subject to the Mandatory Trading Requirement as of February 26, 2014.

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<sup>3</sup> The CFTC publishes a list of registered SEFs on its website, available at: <http://sirt.cftc.gov/SIRT/SIRT.aspx?Topic=SwapExecutionFacilities>.

<sup>4</sup> Available at: <http://sirt.cftc.gov/sirt/sirt.aspx?Topic=+SwapsMadeAvailableToTrade>.

<sup>5</sup> Available at: <https://www.managedfunds.org/wp-content/uploads/2014/01/Packaged-Transactions-NAL-Final-MFA-Letter.pdf>.

| Specification                | Fixed-to-Floating Interest Rate Swap (USD)                         |  |  |
|------------------------------|--|--|--|
| Mandatory Trading Start Date | February 18 or <u>February 26, 2014</u>                            | February 18 or <u>February 26, 2014</u>                            | <u>February 21</u> or <u>February 26, 2014</u> |
| Currency                     | U.S. Dollar (USD)  | U.S. Dollar (USD)  | <u>U.S. Dollar (USD)</u>                       |
| Floating Rate Indexes        | USD LIBOR  | USD LIBOR  | <u>USD LIBOR</u>                               |
| Trade Start Type             | Spot Starting (T+2)  | IMM Start Date (next two IMM dates)                                | <u>IMM Start Date (next two IMM dates)</u>     |
| Optionality                  | No   | No   | <u>No</u>                                      |
| Fixed Leg                    |  |  |  |
| Payment Frequency            | Semi-Annual, Annual  | Semi-Annual, Annual  | <u>Semi-Annual</u>                             |
| Day Count Convention         | 30/360, Actual/360   | 30/360, Actual/360   | <u>30/360</u>                                  |
| Floating Leg                 |  |  |  |
| Reset Frequency              | Quarterly, Semi-Annual   | Quarterly, Semi-Annual   | <u>Quarterly</u>                               |
| Day Count Convention         | Actual/360   | Actual/360   | <u>Actual/360</u>                              |
| Dual Currencies              | No   | No   | <u>No</u>                                      |
| Notional                     | Fixed Notional   | Fixed Notional   | <u>Fixed Notional</u>                          |
| Fixed Rate                   | Par  | Par  | <u>Standard Coupon</u> <sup>6</sup>            |
| Tenors <sup>7</sup>          | 2, 3, <u>4</u> , <u>5</u> , <u>6</u> , 7, 10, 12, 15, 20, 30 years | 2, 3, <u>4</u> , <u>5</u> , <u>6</u> , 7, 10, 12, 15, 20, 30 years | <u>1, 2, 3, 4, 5, 7, 10, 15, 20, 30 years</u>  |

Transactions involving the following Non-USD interest rate swaps will be subject to the Mandatory Trading Requirement as of February 18, 2014, with transactions involving the interest rate swaps highlighted in red and underlined subject to the Mandatory Trading Requirement as of February 26, 2014:

<sup>6</sup> Standard Coupon refers to the then-current fixed coupon rates for Market Agreed Coupon (“MAC”) contracts.

<sup>7</sup> Par coupon swaps with a tenor of 4 or 6 years that are made available to trade are limited to the 3M USD LIBOR floating rate index; Quarterly Reset Frequency; and the following fixed leg conventions: (1) Semi-Annual and 30/360; or (2) Annual and Actual/360.

| Specification                | Fixed-to-Floating Interest Rate Swap (Non-USD)                 |   |
|------------------------------|--|---|
| Mandatory Trading Start Date | February 18 or <u>February 26, 2014</u>                        | <u>February 26, 2014</u>                      |
| Currency                     | Euro (EUR)   | <u>Sterling (GBP)</u>                         |
| Floating Rate Indexes        | EURIBOR  | <u>GBP LIBOR</u>                              |
| Trade Start Type             | Spot Starting (T+2)  | <u>Spot Starting (T+0)</u>                    |
| Optionality                  | No   | <u>No</u>                                     |
| <b>Fixed Leg</b>             |  |   |
| Payment Frequency            | Semi-Annual, Annual  | <u>Quarterly, Semi-Annual</u>                 |
| Day Count Convention         | 30/360, Actual/360   | <u>Actual/365F</u>                            |
| <b>Floating Leg</b>          |  |   |
| Reset Frequency              | Quarterly, Semi-Annual   | <u>Quarterly, Semi-Annual</u>                 |
| Day Count Convention         | Actual/360   | <u>Actual/365F</u>                            |
| Dual Currencies              | No   | <u>No</u>                                     |
| Notional                     | Fixed Notional   | <u>Fixed Notional</u>                         |
| Fixed Rate                   | Par  | <u>Par</u>                                    |
| Tenors <sup>8</sup>          | 2, 3, <del>4</del> , 5, <del>6</del> , 7, 10, 15, 20, 30 years | <u>2, 3, 4, 5, 6, 7, 10, 15, 20, 30 years</u> |

Transactions involving the following credit default swaps will be subject to the Mandatory Trading Requirement as of February 26, 2014:

| Specification                | Untranching Credit Default Swap Indices  |  |
|------------------------------|--|--|
| Mandatory Trading Start Date | <u>February 26, 2014</u>   | <u>February 26, 2014</u>                                     |
| Reference Entities           | <u>Corporate</u>   | <u>Corporate</u>   |
| Region                       | <u>North America</u>   | <u>Europe</u>  |
| Indices                      | <u>CDX.NA.IG</u><br><u>CDX.NA.HY</u>   | <u>iTraxx Europe</u><br><u>iTraxx Europe Crossover</u>       |
| Tenor                        | <u>CDX.NA.IG 5Y</u><br><u>CDX.NA.HY 5Y</u>   | <u>iTraxx Europe 5Y</u><br><u>iTraxx Europe Crossover 5Y</u> |
| Applicable Series            | <u>At any time, the then-current on-the-run series and the preceding series that was replaced by the current one</u> |  |

<sup>8</sup> Euro (EUR)-denominated par coupon swaps with a tenor of 4 or 6 years that are made available to trade are limited to the following fixed leg conventions: Annual and 30/360.

On January 30, 2014, MarketAxess SEF's available-to-trade determination for certain credit default swaps was deemed certified. In addition, Bloomberg SEF has submitted an available-to-trade determination that the CFTC has not yet deemed certified. However, neither of these available-to-trade determinations addresses any swap other than those listed above, so the certification of MarketAxess SEF's available-to-trade determination did not and the certification of Bloomberg SEF's available-to-trade determination will not cause any additional swaps to be subject to the Mandatory Trading Requirement.

#### **IV. Are any Exceptions Available?**

The Mandatory Trading Requirement does not apply to swaps that benefit from the clearing exceptions under Section 2(h)(7) of the Commodity Exchange Act, which include 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).

#### **V. What Do I Have to Do to Trade on a SEF or DCM?**

Market participants who trade in the interest rate and credit default swaps listed above and for whom an exception from the Mandatory Trading Requirement is not available (or who do not elect such an exception) should ensure that they are set up to trade on a DCM or SEF by the applicable compliance start date. Leading up to the available-to-trade determinations, two alternatives for executing trades on a SEF or DCM have emerged: direct principal trades or trades through a broker.

- (1) Trading directly on a SEF requires market participants to become a member of the SEF by entering into the SEF's participation agreement and submitting to its rules and jurisdiction. In addition, members of a DCM or SEF must comply with applicable CFTC rules, including the oral and written recordkeeping requirements under CFTC Rule 1.35(a), subject to certain exceptions.<sup>9</sup>
- (2) Trading on a SEF through a broker requires market participants to enter into an execution services agreement with a broker that is a member of the SEF. This product is currently being developed by many brokers and will permit either "direct/sponsored access" or "agency access" to a SEF. Under a direct or sponsored access model, market participants will trade directly on the

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<sup>9</sup> Exceptions from the oral recordkeeping requirement are available for registered commodity pool operators and members of a DCM or SEF that are not registered or required to be registered with the CFTC in any capacity. CFTC Rule 1.35(a)(1)(v) and (viii). Although the recordkeeping requirements of CFTC Rule 1.35(a) have traditionally applied to intermediaries such as futures commission merchants and introducing brokers, the CFTC broadly extended these requirements in December 2012 to all members of DCMs and SEFs.

SEF through a broker interface. Under an agency model, the broker will execute trades on the SEF on behalf of the client.

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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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