

April 24, 2014

CFTC Issues Updated Relief for Cross-Border Trading of Swaps on Qualifying Multilateral Trading Facilities in the European Union

On April 9, 2014, the Division of Market Oversight (DMO) and Division of Swap Dealer and Intermediary Oversight (DSIO) (together, the Divisions) of the United States Commodity Futures Trading Commission (CFTC) issued no-action Letter 14-46 (Amended Qualifying MTF Letter)¹, which clarifies, modifies and supersedes the conditional relief offered to non-US multilateral trading facilities (each, an MTF) overseen by competent regulatory authorities designated by European Union member states (each, a Competent Authority) in CFTC Letter 14-16 (Prior Letter).² The Amended Qualifying MTF Letter generally tracks the terms of the Prior Letter, so it also provides three forms of conditional relief to MTFs and users of MTFs:

- an MTF meeting certain stated compliance requirements (each, a Qualifying MTF) may permit US persons or persons located in the United States the ability to trade or execute swaps on or through the MTF without requiring such MTF to register as a swap execution facility (SEF) pursuant to Section 5h(a)(1) of the United States Commodity Exchange Act (CEA) and CFTC Rule 37.3(a)(1);
- swap market participants executing swaps on a Qualifying MTF are relieved from any applicable trade execution mandate pursuant to Section 2(h)(8) of the CEA or any otherwise applicable obligations to report such swaps pursuant to Parts 43 and 45 of the CFTC Rules; and
- swap dealers and major swap participants (together, Swap Entities) executing swaps on Qualifying MTFs are relieved from certain conduct of business requirements under Part 23 of the CFTC Rules.

However, the Amended Qualifying MTF Letter adds several additional certifications and reporting requirements that increase the difficulty of meeting all the conditions necessary to obtain that relief. Despite these additional requirements, the Amended Qualifying MTF Letter does not extend the time limit on the available relief, which remains the earlier of 1) the date when DMO issues a letter acknowledging and granting an MTF's request to be treated as a Qualifying MTF or 2) 11:59 p.m. on May 14, 2014, so prompt action is necessary if an MTF wishes to qualify before the relief expires.³ Once an MTF becomes a Qualifying MTF, the relief lasts until such date, if ever, that the CFTC adopts final rules exempting MTFs from the SEF registration requirement of Section 5h(a)(1) of the Commodity Exchange Act (CEA).

¹ [CFTC Letter 14-46](#), Conditional No-Action Relief with respect to Swaps Trading on Certain Multilateral Trading Facilities Overseen by Competent Authorities Designated by European Union Member States (April 9, 2014).

² [CFTC Letter 14-16](#), Conditional No-Action Relief with respect to Swaps Trading on Certain Multilateral Trading Facilities Overseen by Competent Authorities Designated by European Union Member States (February 12, 2014).

³ [CFTC Letter 14-31](#), Extension of Time-Limited No-Action Relief with respect to Swaps Trading on Certain Multilateral Trading Facilities Overseen by Competent Authorities Designated by European Union Member States (March 21, 2014) (Extended Transition Period Letter).

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Terms of the Amended Conditional Relief

The Prior Letter set out a number of conditions an MTF must meet in order to become a Qualifying MTF, including obligations relating to: trading methodology, block trades, non-discriminatory access, oversight requirements, reporting requirements and clearing requirements.⁴ In addition, Qualifying MTFs were not allowed to permit access to any US person that is not an “eligible contract participant” as defined in CFTC Rule 1.3(m) to trade or execute on its trading platform. Applicants must also demonstrate that they are subject to regulations established by the relevant Competent Authority addressing the applicable compliance requirements; voluntary compliance with the terms of relief was not permitted.

The Amended Qualifying MTF Letter increases the compliance burden on applicants by requiring them to meet the following additional requirements in order to be designated as Qualifying MTFs.

Pre-Execution and Credit Check Requirements

The Divisions clarified in the Amended Qualifying MTF Letter that the “other applicable clearing requirements” set out in the CEA continue to apply, with a specific reference to pre-execution credit checks and straight-through processing obligations. Accordingly, Swap Entities and futures commission merchants trading on behalf of US customers must make the same pre-execution credit checks as if they were trading on a SEF. The Divisions’ statement also appears to subject a Qualifying MTF to the straight-through processing requirements of CFTC Rule 37.702(b), otherwise applicable only to registered SEFs.

Real-Time and Swap Data Reporting

An applicant must now also certify that it will report all real-time and swap data reports to a CFTC-registered (or provisionally registered) swap data repository (SDR) as if it was a registered SEF within 60 days of receiving a letter from DMO granting the applicant’s request to be treated as a Qualifying MTF.⁵ Until such time, swap counterparties would be subject to real-time and swap data reporting obligations as if the transactions were “off-facility” swaps for purposes of the CFTC’s Part 43 and Part 45 Rules. Once an applicant becomes a Qualifying MTF and begins to submit real-time and swap data reports, it must have rules in place prohibiting swap counterparties from submitting Part 43 creation data and initial Part 45 reports. A Qualifying MTF must also use the Acknowledgement ID (or AID) provided in DMO’s letter on all such reports for purposes of generating unique swap identifiers, and must notify each SDR of its AID prior to starting reporting. Although the language in the Amended Qualifying MTF Letter is not clear, it is likely that the Divisions intend these requirements only to apply to those trades executed pursuant to an applicant’s Qualifying MTF status.⁶

Additional Reporting Obligations

Qualifying MTFs must also submit monthly reports to the CFTC relating to levels of participation and volume by US persons, including the following:

- the percentage of the total notional value (expressed in US dollars) of completed swaps executed on the Qualifying MTF that are attributable to orders entered by US persons, and
- the percentage of the total number of completed swap transactions executed on or pursuant to the rules of the Qualifying MTF that are attributable to orders entered by US persons.

Although the terms of the relief are not clear, these calculations presumably will include all trades where at least one counterparty is a US person. These reporting requirements will continue until such time as the CFTC notifies Qualifying MTFs that it is able to obtain similar information through the reports submitted by Qualifying MTFs to SDRs.

⁴ For additional detail on the terms of the Qualifying MTF Letter, please see Katten’s earlier client advisory published on February 14, 2014 ([Katten MTF Advisory](#)).

⁵ This represents a loosening of the relief provided in the Qualifying MTF Letter, which would have required such reporting to be made as a condition precedent to obtaining relief.

⁶ For example, an MTF operator may elect to create a separate liquidity pool for “Qualifying MTF” transactions subject to the terms of the conditional relief in which US persons may transact with other US persons and non-US persons, while retaining its existing MTF liquidity pool for transactions solely between non-US persons. In this case, only the transactions in the former pool would appear to be subject to the terms of the Qualifying MTF Letter and the Amended Qualifying MTF Letter.

Adjusted Block Trade Obligations

An applicant must certify that it maintains appropriate minimum block sizes and requirements related to block trades that are in accordance with the requirements established by its Competent Authority where such requirements must be “in accordance with” the block trade rules set out in CFTC Rule 43.6.⁷

Submission to Jurisdiction

An applicant must certify that it is subject to and complies with regulations of its Competent Authority that require its participants’ consent to the applicant’s jurisdiction.

IOSCO MMOU

Finally, an applicant must certify that its Competent Authority is a signatory to the Multilateral Memorandum of Understanding (MMOU) Concerning Consultation and Cooperation and the Exchange of Information published by the International Organization of Securities Commissions (IOSCO).⁸

Even More Questions

As described above, the Amended Qualifying MTF Letter provides relief only in respect of a few of the conditions set out in the Prior Letter and primarily consists of further obligations that an applicant must meet in order to become a Qualifying MTF. These additional requirements are likely to increase the already substantial compliance challenges for applicants. The conditions in the Amended Qualifying MTF Letter also continue to leave a number of key questions unanswered.⁹

Compliance Costs for Qualifying MTFs

In the aftermath of the publication of the Prior Letter, MTF operators, particularly those regulated in the United Kingdom by the Financial Conduct Authority (FCA), studied the conditions to the relief carefully in weighing whether to pursue Qualifying MTF status. The FCA also established a mechanism, through a “variation of permission”, pursuant to which FCA-authorized MTF operators could demonstrate that they were subject to appropriate regulation by their Competent Authority. However, while a number of MTF operators saw some possible advantages to becoming a Qualifying MTF, the time frame provided to come into compliance with the terms of the Prior Letter (i.e., February 8 to March 24) was generally considered as inadequate for the required build-out of systems, procedures and rules. Therefore, while many MTF operators were willing to consider Qualifying MTF status, there appear to have been few, if any, that were able to meet the terms of the relief by the March 24 deadline. It is likely that the scale of the compliance challenges identified through this process induced DMO to issue the Extended Transition Period Letter to prolong such relief through May 14, 2014.

Given the difficulties encountered in meeting the terms of the Prior Letter, the addition of new compliance obligations in the Amended Qualifying MTF Letter may limit the appetite of MTF operators to apply for Qualifying MTF status.¹⁰ For example, the pre-execution credit check requirement has proven to be a complex undertaking for registered SEFs and MTF operators may not wish to go through a similar process to amend their systems to provide a similar functionality in respect of orders from US persons.

In addition, the requirement that an MTF operator obtain consent from its participants that they are subject to the operator’s “jurisdiction” may also pose challenges, as the notion of “jurisdiction” is highly specific to US regulation and the notion of exchanges and clearing organisations as self-regulatory organisations with quasi-public functions. This is not a concept that is easily translatable outside the United States and therefore may not be easily understood by MTF operators and their participants.

⁷ This represents a loosening of the relief provided in the Qualifying MTF Letter, which would have required an applicant to certify that its block trade arrangements complied directly with CFTC Rule 43.6.

⁸ Available [here](#).

⁹ See also the “Continuing Challenges” discussion in the [Katten MTF Advisory](#).

¹⁰ A similar concern was recently expressed in a *Risk* magazine article. See CFTC told EU platforms not to seek SEF equivalence (April 17, 2014) (“...the consensus among European MTFs in both the interdealer and dealer-to-client markets is that few, if any, trading platforms will seek [Qualifying MTF] status”).

Time Frame for Compliance

As noted above, the initial time frame for compliance set out in the Prior Letter was sufficiently challenging that many MTF operators determined they would be unable to meet the deadline of March 24. It is similarly unclear whether the extended relief to May 14 will be sufficient, and the Divisions may find that they are required to issue yet a further extension in order to give applicants sufficient time to meet the terms of the Amended Qualifying MTF Letter.

A separate issue relating to the time frame for compliance has arisen in respect of persons currently applying, or that in the future may apply, for authorisation as MTF operators. The plain terms of the current relief would *de facto* prevent such MTF operator applicants from becoming a Qualifying MTF to the extent they would not be authorised prior to May 24. It is unclear what the policy is behind imposing such a limited time frame for compliance, and there is nothing in the Amended Qualifying MTF Letter or the Extended Transition Period Letter clarifying the intended treatment of MTF operators authorised after May 24 that may wish to become Qualifying MTFs.

What Role for Qualifying MTFs?

In considering whether to apply for Qualifying MTF status, MTF operators have faced the challenge of how a Qualifying MTF fits within the existing universe of swaps trading venues. Qualifying MTFs offer an additional liquidity pool where US persons may transact in swaps with other US persons and willing non-US persons on an offshore platform which, as noted in the [Katten MTF Advisory](#), does little to promote the alignment of existing pools of US and European swaps liquidity in an organised and coherent fashion. Therefore, the advent of the Qualifying MTF may actually serve to further fragment, rather than unite, transatlantic swaps liquidity. The question also remains whether, due to the now-increased terms of the conditional relief described herein, there will be sufficient demand by non-US persons to transact with US persons on an offshore platform to make a Qualifying MTF commercially viable.

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