

February 7, 2023

CFTC Revises No-Action Relief for Swaps Intended to Be Cleared

No-Action Letter Expands Relief From Swap Dealer External Business Conduct Standards and Related Documentation Requirements to a Broader Category of Swaps.

SUMMARY

On February 1, 2023, the Market Participants Division (“MPD”) of the Commodity Futures Trading Commission (the “Commission”) issued a no-action letter with respect to certain external business conduct standards and documentation requirements applicable to swap dealers (“SDs”) entering into swaps that are intended to be submitted for clearing contemporaneously with execution. The letter expands upon existing relief by, among other things and subject to certain conditions, applying to all “intended to be cleared” swaps (1) of a type accepted for clearing by a registered or exempt derivatives clearing organization (“DCO”) on the date of execution, and (2) that are executed on or pursuant to the rules of a registered or exempt swap execution facility (“SEF”). The revised no-action relief supersedes the prior relief and will expire on December 31, 2025, unless MPD or the Commission take further action prior to that date.

BACKGROUND

The Commission subjects SDs to various external business conduct standards (“External BCS”) that require SDs, among other things, to provide to, or obtain from, their counterparties certain information and representations, and to perform certain due diligence on counterparties.¹ Commission rules provide for safe harbors to allow SDs to rely on their counterparties’ written representations, and certain of the External BCS do not apply either (1) when the SD does not know the identity of its counterparty prior to execution, or (2) when the swap is initiated on a SEF or designated contract market (“DCM”) and the SD does not know the identity of its counterparty prior to execution. SDs are also required to execute swap trading

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relationship documentation with a counterparty prior to or contemporaneously with entering into a swap, but this requirement does not apply with respect to swaps executed on a DCM or anonymously on a SEF if such swaps are cleared by a DCO and the terms of the swaps conform to the applicable DCO and Commission rules.²

In response to a request from market participants, in 2013 the Commission's Division of Swap Dealer and Intermediary Oversight ("DSIO," now called MPD) issued no-action relief in Commission Letter 13-70 ("Letter 13-70").³ Letter 13-70 provided no-action relief with respect to certain External BCS and related documentation requirements for swaps that were intended to be submitted for clearing contemporaneously with execution. Reliance on Letter 13-70 was also subject to certain conditions and contingent upon certain aspects of the swap, including whether: (1) the SD knew the identity of the counterparty prior to execution, (2) the swap was executed on or subject to the rules of a SEF or DCM and (3) whether the swap was, as of the date of Letter 13-70, of a type accepted for clearing by a DCO or, as of the date of execution, subject to a mandatory clearing determination by the Commission.

REVISED NO-ACTION RELIEF

On February 1, 2023, and in light of the increase in the number of SEFs and DCOs that are exempt from registration ("Exempt SEFs" and "Exempt DCOs," respectively) and the general growth of the cleared swaps market since the issuance of Letter 13-70, MPD expanded the scope of its no-action relief by issuing Commission Letter 23-01 ("Letter 23-01").⁴ Subject to the conditions noted below, Letter 23-01 expands the scope of the swaps covered to encompass all swaps of a type accepted for clearing by a DCO or an Exempt DCO (each, an "Eligible DCO") on the date of execution and intended to be cleared contemporaneously with execution (each, an "ITBC Swap") and swaps that are executed on or pursuant to the rules of a DCM, a SEF or an Exempt SEF (each, an "Eligible Trading Venue").⁵

In this regard, MPD's no-action position no longer distinguishes between swaps of a type accepted for clearing as of the date of Letter 13-70 and those of a type accepted for clearing after that date, nor between swaps of a type accepted for clearing and swaps that are required to be cleared. Letter 23-01 also differs from Letter 13-70: (1) by eliminating the condition, with respect to swaps for which an SD does not know the identity of the counterparty prior to execution, that the swap must not be executed on or subject to the rules of a SEF or DCM; and (2) by eliminating the no-action position included in Letter 13-70 relating to Commission regulation 23.451 (regarding restrictions on political contributions) where the SD knows the identity of the counterparty prior to execution, which MPD stated is no longer warranted.⁶

Letter 23-01 accordingly provides that MPD will not recommend that the Commission commence an enforcement action against an SD or an MSP for:

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1. Failure to comply with the requirements of the External BCS specified in Table 1, below, or the trading documentation requirements of Commission regulation 23.504 with respect to an ITBC Swap where:
 - a. The SD or MSP does not know the identity of the counterparty prior to execution of the swap; and
 - b. If the ITBC Swap is not executed on or pursuant to the rules of an Eligible Trading Venue, the SD or MSP ensures that both parties submit the ITBC Swap for clearing on an Eligible DCO as quickly after execution as would be technologically practicable if fully automated systems were used;⁷ or
2. Failure to comply with the requirements of the External BCS specified in Table 1, below (excluding the political contribution restrictions in Commission regulation 23.451), or the trading documentation requirements of Commission regulation 23.504 with respect to an ITBC Swap where:
 - a. The SD or MSP knows the identity of the counterparty prior to execution of the swap; and
 - b. The ITBC Swap is executed on or pursuant to the rules of an Eligible Trading Venue; or
3. Failure to comply with the trading documentation requirements of Commission regulation 23.504 with respect to an ITBC Swap where:
 - a. The SD or MSP knows the identity of the counterparty prior to the execution of the swap; and
 - b. The ITBC Swap is not executed on or pursuant to the rules of an Eligible Trading Venue; and
 - c. The SD or MSP ensures that both parties submit the ITBC Swap for clearing on an Eligible DCO as quickly after execution as would be technologically practicable if fully automated systems were used.

Table 1	
Commission Regulation	Subject Matter
§ 23.402(b)-(f)	Know your counterparty, true name and owner, reasonable reliance on representations, manner of disclosure, and disclosures in a standard format
§ 23.430	Verification of counterparty eligibility
§ 23.431(a)	Material risks, characteristics, incentives, and conflicts of interest
§ 23.431(b)	Scenario analysis
§ 23.431(d)(1)	Notice of right to receive daily mark from DCO for cleared swaps
§ 23.432(a)	Notice of right to select DCO
§ 23.432(b)	Notice of right to clearing
§ 23.434	Recommendations to counterparties—institutional suitability
§ 23.440	Requirements for SDs acting as advisors to Special Entities
§ 23.450	Requirements for SDs and MSPs acting as counterparties to Special Entities
§23.451	Political contributions by certain SDs

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The no-action relief provided in Letter 23-01 continues to be subject to the following conditions:

1. If clearing on a DCO, the SD is either a clearing member of the DCO to which the ITBC Swap will be submitted or has entered into an agreement with a clearing member of such DCO for clearing of swaps of the same type as the ITBC Swap;
2. If clearing on an Exempt DCO, the SD is a clearing member of the Exempt DCO to which the ITBC Swap will be submitted or an affiliate of a clearing member of the Exempt DCO;
3. The SD does not require the counterparty or its clearing futures commission merchant (if any) to enter into a breakage agreement or similar agreement as a condition to executing the ITBC Swap; and
4. If the ITBC Swap is rejected from clearing, the ITBC Swap is void *ab initio*.

Letter 23-01 supersedes Letter 13-70 in its entirety and Letter 13-70 may no longer be relied upon. Unlike Letter 13-70, which did not have a specified expiration date, Letter 23-01 will expire on December 31, 2025, unless MPD or the Commission take further action prior to that date.

* * *

ENDNOTES

- 1 17 CFR 23.400-23.451. Major swap participants (“MSPs”) are also subject to the External BCS requirements, but there are currently no such entities registered with the Commission.
- 2 17 CFR 23.504.
- 3 CFTC Letter No. 13-70, *No-Action Relief: Swaps Intended to be Cleared* (Nov. 15, 2013).
- 4 CFTC Letter No. 23-01, *Revised No-Action Positions for Swaps Intended to be Cleared* (Feb. 1, 2023).
- 5 Letter 23-01 clarifies that these no-action positions apply with respect to existing Exempt DCOs and Exempt SEFs, as well as any Exempt DCOs and Exempt SEFs that the Commission may recognize prior to the expiration of Letter 23-01.
- 6 MPD provides the following explanation for the elimination of this aspect of the no-action relief: “DSIO established this no-action position in Letter 13-70 with the understanding that required execution of intended-to-be-cleared swaps on or subject to the rules of a SEF or DCM would adequately safeguard against the risk that a political contribution by an SD’s covered associates might color the decision of an official of a governmental Special Entity to enter into a swap with the SD. Upon further review, *MPD has concluded that only those ITBC Swaps in which the SD does not know the identity of the counterparty prior to execution adequately safeguard against this risk.*” (emphasis added) Therefore, and as described further in this memo, the no-action relief from this aspect of the External BCS does not extend to an ITBC Swap where the SD knows the identity of its counterparty prior to execution and the swap is executed on or pursuant to the rules of an Eligible Trading Venue.
- 7 Letter 23-01 notes that this condition sets forth a standard for submission of the ITBC Swap for clearing to an Eligible DCO. It is in addition to the obligations in Commission regulations 23.506, 17 CFR 23.506 (which requires the SD or MSP to coordinate prompt and efficient swap transaction processing with the DCO), and 23.610, 17 CFR 23.610 (which requires the SD or MSP to accept or reject each trade submitted to the DCO for clearing as quickly as would be technologically practicable if fully automated systems were used).

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