FIA Files Comment Letter on Re-Proposed Position Limits Rule

On Feb. 7 FIA filed a 48-page comment letter in response to the Commodity Futures Trading Commission's proposed position limits rule, warning that the proposal would have a "negative impact" on price discovery and liquidity and would "significantly restrict" the ability of market participants to rely on derivatives markets to hedge risk. FIA also said it is concerned that the proposed rule "will significantly restrict the ability of market participants to rely on the derivatives markets to hedge risk, which is one of the fundamental purposes of these markets."

The position limit proposal calls for CFTC-administered speculative position limits on 28 physical commodity contracts in agricultural, energy and metals markets and economically equivalent swaps. The CFTC redrafted the proposal after a federal court in 2012 struck down an earlier version of the position limit rules.

FIA noted that the court found that the Commodity Exchange Act expressly requires the CFTC to make a finding that speculative position limits are "necessary" to prevent excessive speculation prior to imposing them.

FIA urged the CFTC to defer imposing position limits until after it has collected and analyzed the data necessary to make an empirical finding that 1) speculative position limits are "necessary" to "diminish, eliminate or prevent" the burden on interstate commerce caused by excessive speculation, and 2) that the proposed limit levels are "appropriate."

If the CFTC decides to proceed with the proposed rule despite these issues, FIA recommended a number of specific changes regarding estimates of deliverable supply, the definition of the spot month, the use of hard limits on non-spot month positions, the treatment of commodity index contracts and trade options, and a number of other topics.

FIA Files Comment Letter on Proposed Aggregation Rule

On Feb. 6 FIA filed a 19-page comment letter in response to the Commodity Futures Trading Commission's proposed rule regarding the aggregation of positions, which was proposed jointly with the CFTC's position limits rule. The rule establishes standards for determining when positions held by two or more related entities should be aggregated for the purpose of compliance with position limits.

FIA said it generally supports the proposal because it incorporates or addresses many of the comments and recommendations made by FIA and other market participants concerning prior proposed amendments to the aggregation rules. In particular FIA said it supports the recognition that certain types of ownership structures are not proxies for control of positions and, therefore,should be exempted from aggregation.

FIA also urged the CFTC to provide a "reasonable transition period" after the rule is finalized and recommended a number of additional clarifications and amendments to address the practical impact of the proposed rule. These recommendations include:

- Permit disaggregation of majority-owned affiliates that demonstrate that their trading decisions and positions are subject to independent control and management regardless of whether they are required to consolidate their financial statements;
- Permit registered broker-dealers to disaggregate ownership or equity interest predicated on the ownership of securities acquired in the normal course of business as a dealer, absent actual knowledge of the trading decisions and positions of the owned entity;
- Permit disaggregation of transitory ownership of equity interests such as those acquired through foreclosure or similar credit event;
- Permit entities to aggregate the positions of an owned entity on a pro rata basis in proportion to their ownership of equity interest; and
- Provide a safe harbor period for notice filings received within 180 days after aggregation is required for entities otherwise qualifying for an exemption.

SEF Trading Mandate Takes Effect

The Commodity Futures Trading Commission's requirement that swaps be traded on swap execution facilities took effect on Feb. 15. Responding to concerns that key parts of the trading and clearing infrastructure are not ready yet, the CFTC has taken several steps to support the transition to the new market environment.

The CFTC announced several measures on Feb. 10 intended to ease certain rules that affect the trading of swaps on swap execution facilities or designated contract markets. The CFTC said the measures will promote trading on SEFs and support an "orderly transition" to mandatory trading.

"What we are trying to do here is maximize the amount of trading that is conducted on these facilities," said Mark Wetjen, acting chairman of the CFTC. "We want to take away the reasons or excuses some folks might have for keeping their trading away from these regulated platforms."

These measures include: an interim final rule clarifying that a party to an anonymous trade executed on a SEF or a DCM cannot access information in swap data repositories in order to obtain the identity of its counterparty; a no-action letter providing relief until May 15 from the CFTC's mandatory trading requirements for swaps executed as part of a "package transaction" such as butterflies, basis trades and invoice spreads; and guidance clarifying the process for SEFs to obtain consent from market participants trading on their platforms.

The relief came amid concerns from

participants that certain rules requiring pre-trade credit checks would not be feasible in particular for packaged transactions. Participants at a Feb 10 meeting of the CFTC's technology advisory committee and a later roundtable on Feb. 12 focusing solely on packaged transactions cautioned that the CFTC's pre-trade risk-related rules would not work for these transactions. Some panelists estimated this would impact as much as 60% of swaps volume in the interest rate markets alone.

"Not only are these transactions happening, they are happening very frequently and they are absolutely an integral part as to how people are managing risk," said Alex Evis, head of market structure strategy, global credit at Goldman Sachs.

The extension of time offered in the relief was welcomed by market participants speaking on the panel. Sunil Hirani, chief executive officer of trueEX, a designated contract market for trading swaps, explained that while trading technology exists for trading packaged transactions, many operational issues exist.

Supurna Vedbrat, co-head of electronic trading and market structure at BlackRock, added that if market participants are forced to break up packaged transactions and trade the components separately, it would harm the firm's ability to hedge.

Agency Model Takes Hold in Swaps Trading

Since the Commodity Futures Trading Commission's swap execution trading deadline hit on Feb. 15, many SEFs have begun to offer sponsored access for swaps trading.

Bloomberg SEF, for example, has introduced a sponsored access functionality that enables futures commission merchants to provide market access to their clients. In February the platform announced that NISA Investment Advisors, an investment manager based in St. Louis, was able to execute a trade on the platform with Credit Suisse providing the access.

Tradeweb announced a similar transaction on Feb. 13 in which an FCM executed a trade on behalf of a client. In this case, Credit Suisse executed a five-year high yield credit default index swap on behalf of an asset manager. "We've been working closely with SEFs like Tradeweb to offer our clients with flexible access to derivatives liquidity," said John Dabbs, managing director at Credit Suisse and U.S. head of listed derivatives and OTC clearing.

CFTC Meeting Spotlights Industry Views on Risk Controls for Automated Trading

On Feb. 10, the Commodity Futures Trading Commission's Technology Advisory Committee hosted a discussion with industry representatives and other experts on the risks of automated trading. The CFTC issued a concept release on this topic in September and is now asking what steps it should take, if any, to establish new regulatory standards in this area.

CFTC staffer Sebastian Pujol Schott said the responses to the concept release have provided the CFTC with a "better understanding" of the various types of risk controls and system safeguards currently in use at U.S. futures exchanges. He added that there appears to be broad support in the responses received so far for a "multi-layered" approach, meaning that risk controls and system safeguards should function throughout the execution process as orders move from traders through intermediaries to exchanges. On the other hand, he said the responses were split more or less evenly on whether the CFTC should attempt to define high-frequency trading and develop risk controls aimed specifically at HFT.

CFTC Commissioner Scott O'Malia, who chairs the TAC, asked if there are reasons why the CFTC should step in and establish risk control requirements at the federal level. Several members of the TAC said that CFTC requirements would promote accountability and consistency across the industry, but cautioned that these should call for compliance with general principles rather than implementation of specific types of risk controls.

Rob Creamer, president of Geneva Trading and chairman of FIA Principal Traders Group, briefed the TAC on the recommendations in the comment letter submitted by FIA, which was drafted in collaboration with members of FIA PTG. Creamer urged the CFTC to focus on addressing the risks of automated trading across all types of firms and automated trading strategies rather than limiting its focus to a particular class of market participant. Creamer also cautioned against attempting to draft a formal definition of high-frequency trading because of the difficulties in distinguishing between HFT and other forms of automated trading.

Richard Gorelick, chief executive officer of RGM Advisors and a member of FIA PTG's executive committee, expressed similar views and emphasized that the increasing automation of trading technology has improved futures markets by reducing trading costs and improving transparency. He decried the "fear-mongering" by HFT critics and urged the CFTC to provide more quantitative information about market microstructure to the public as the Securities and Exchange Commission has done with its "MIDAS" system.

"Criticizing HFT has become a "cottage industry" dedicated to putting forward frightening narratives that might make for good storytelling, but are not related to how markets actually work," Gorelick said. "I am confident that the CFTC Commissioners and staff will see through the fear-mongering and hype. However, I am afraid that many members of the general public might be unduly alarmed and manipulated. I urge the CFTC, with the detailed audit trails and other resources available to it, to act as an expert agency, to sanity-check the claims of commenters, and to report to the public what it actually sees happening in the markets."

FIA Requests Confirmation of Interpretation of CFTC Rule 1.73

On Jan. 31 FIA asked the Commodity Futures Trading Commission to confirm that Rule 1.73 does not apply to agency-executed transactions on swap execution facilities. The rule requires firms to establish risk-based limits and screen orders for compliance with those limits. FIA cautioned that in some cases the rule should not apply.

"Because the clearing FCM has the opportunity to screen the agency-executed swap transaction on a SEF for compliance with its limits before the transaction is executed and accepted for clearing, the executing agent has no need to screen swap orders for compliance with these limits," FIA wrote.

FIA also requested confirmation that bunched orders will not be subject to a provision in Rule 1.73 that applies to "give-ups" involving individual customers. FIA explained that because bunched orders involve multiple customers and do not identify at the time of execution the customers on whose behalf the order is executed or the amount of the order that is due to a particular customer, an initial clearing firm would not be able to apply and screen an individual customer limit.

CFTC and EU Announce Agreement on Swap Trading Platforms

The Commodity Futures Trading Commission and the European Commission jointly announced on Feb. 12 that they are making "significant progress" towards a harmonized regulatory framework for swap execution facilities in the U.S. and multilateral trading facilities in Europe.

The CFTC also announced several interim actions that will allow U.S. persons to continue trading swaps on European platforms on a temporary basis while European regulators and platforms finalize their rules.

"This is a temporary, practical solution," CFTC Acting Chairman Mark Wetjen said in a press conference in Washington. Wetjen added that the agreement builds on a key provision in the "Path Forward" agreement that Michel Barnier, European Commissioner for Internal Market and Services, reached with former CFTC Chairman Gary Gensler in July 2013.

"This is an important further step in implementing a joined up, consistent global approach to ensure that financial markets work for the benefit of the real economy," Barnier said in a statement issued jointly with the CFTC. "In particular this agreement shows how, as G20 commitments move from words to action, regulators can and should work together to ensure that their respective rules interact with each other in the most effective and efficient fashion."

In line with the progress in the negotiations, the CFTC issued a no-action letter that is aimed at preserving U.S. access to multilateral trading facilities after the CFTC's "made available for trading" execution requirements took effect. Under the terms of this relief, U.S. persons can fulfill the CFTC's trading mandate by trading on qualifying multilateral trading facilities and the MTFs do not need to register as SEFs in the U.S. as long as the MTFs meet certain requirements that apply to SEFs:

- non-discriminatory access;
- pre-trade transparency;
- comparable block sizes and market surveillance; and swaps involving U.S. persons must be reported by the MTF to a CFTC-regulated swap data repository.

The CFTC also announced that its division of market oversight is developing a rulemaking to set out a process for foreign-based swap trading platforms to seek appropriate regulatory treatment under U.S. law. That rulemaking is based on authority provided by Congress in the Dodd-Frank Act and builds on the relief provided in the no-action letter. Wetjen told reporters that he has directed staff to make this rulemaking a top priority, and said this rulemaking will be proposed in the near future.

This latest agreement came after high-level officials from the U.S. government and the European Commission met in Washington on Jan. 31 to discuss developments across a wide range of financial regulatory issues. The agenda included the implementation of derivatives reforms and in particular cross-border issues that have led to conflicts between the EU and the CFTC.

Nadia Calviño, the head of the EU delegation and the European Commission's deputy director general for financial services policy, said in a statement that financial market regulation has to "capture the international reality of modern-day finance" and added that this requires "compatibility and reliance on each other's systems."

The two sides agreed to "intensify discussions" on the scope for equivalence and comparability findings, including the recognition of central counterparties. The two sides also agreed on the importance of minimizing the divergences on margin requirements for uncleared derivatives.

In a related action, the CFTC announced on Jan. 3 that it is reconsidering a staff advisory issued in November that swap transactions between foreign counterparties are subject to CFTC requirements if U.S. personnel are involved in "arranging, negotiating or executing" the trade.

The CFTC acknowledged that concerns have been raised about the potential disruptive impact of this interpretation, which was described as the "elevator rule" by former CFTC Chairman Gary Gensler.

The CFTC therefore asked for public comment on this aspect of its cross-border policy and issued a no-action letter that provides foreign swap dealers with some relief from compliance with transaction-level rules until Sept. 15.

CFTC Reaches Accord with Singapore's MAS

On Dec. 27 the Commodity Futures Trading Commission signed a memorandum of understanding with the Monetary Authority of Singapore regarding cooperation and information-sharing in the supervision and oversight of entities that operate on a cross-border basis in the U.S. and Singapore.

The CFTC said the MOU covers markets and organized trading platforms, central counterparties, trade repositories, and intermediaries, dealers, and other market participants. On the same day, the CFTC issued an order registering Singapore Exchange's clearinghouse as a "designated clearing organization."

SGX commented that the order will allow it to provide clearing services for swaps to new and existing U.S. customers. SGX noted that the order provides a three-month period of time for clearing members to continue clearing swaps for U.S. customers while they seek registration as futures commission merchants in the U.S.

CFTC Allows ASX to Clear Swaps for U.S. Dealers

On Feb. 6 the CFTC's division of clearing and risk issued a no-action letter that temporarily allows ASX Clear (Futures), the derivatives clearinghouse operated by Australia's ASX, to provide clearing services for U.S. swap dealers without registering as a derivatives clearing organization in the U.S. The CFTC staff noted that the Australian branches of two U.S. swap dealers have expressed an interest in becoming direct members of ASX Clear (Futures) for the purpose of clearing swaps. The relief is limited to proprietary trades in Australian and New Zealand dollar-denominated interest rate swaps.

Problems with Swap Data Collection Draw Attention in Washington

Officials at the Treasury Department and the Commodity Futures Trading Commission are redoubling their efforts to address problems in the collection of swap transaction data that are preventing regulators from aggregating and analyzing the data.

On Jan. 23, Mary Miller, currently the second ranking official at Treasury, warned that Dodd-Frank reporting requirements are producing "fragmented" data that prevents regulators from getting a "holistic" view of threats to financial stability. She said it is time to "roll up our sleeves and address any obstacles to making these data useful," and mentioned in particular the need for standardized reporting formats.

In addition, Treasury Department's Office of Financial Research and the CFTC are working together to standardize reporting of swap transactions to swap data repositories, according to Richard Berner, who heads OFR.

In Jan. 29 testimony before the Senate Banking subcommittee, Berner said his office is working with the CFTC and highlighted the importance of collecting accurate and reliable data on swaps. "High-quality data are critical for good decision-making," he said.

Separately, the CFTC has stepped up its efforts to address data quality issues in swap reporting. On Jan. 21 the CFTC announced the formation of an interdivisional staff working group to review its reporting requirements and recommend ways to improve data quality. Acting CFTC Chairman Mark Wetjen directed the working group to publish a request for public comment on swap data issues by March 15.