



November 21, 2013

Via Electronic Submission: <http://comments.cftc.gov>

Ms. Melissa Jurgens
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

RE: Industry Filings IF 13-004, 13-005, and 13-007

Certification from Javelin SEF, LLC (“**Javelin**”) to Implement Available-to-Trade Determinations for Certain Interest Rate Swaps, as amended (IF 13-004)¹

Certification from trueEX, LLC (“**trueEX**”) to Implement Available-to-Trade Determinations for Certain Interest Rate Swaps (IF 13-005)²

Certification from TW SEF LLC (“**TW**”) to Implement Available-to-Trade Determinations for Certain Interest Rate and Credit Default Swaps (IF 13-007)³

Dear Ms. Jurgens:

Managed Funds Association (“**MFA**”)⁴ appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the “**Commission**”) on the certifications from each of Javelin, trueEX, and TW to implement “made available-to-trade” (“**MAT**”) determinations for certain interest rate swaps (“**IRS**”). MFA thanks the Commission for staying each rule certification in light of the novel and complex issues presented, and to provide the

¹ See <http://www.cftc.gov/stellent/groups/public/@otherif/documents/ifdocs/javelinsefsubmat1306r.pdf>

² See <http://www.cftc.gov/stellent/groups/public/@otherif/documents/ifdocs/trueexsub201314mat.pdf>

³ See <http://www.cftc.gov/stellent/groups/public/@otherif/documents/ifdocs/corpg5twmatdeter101813.pdf>

⁴ Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

opportunity for public comments. Our comments in this letter are specific to the rates asset class and the IRS market.⁵

I. Executive Summary

MFA has consistently supported reforms to the over-the-counter (“OTC”) derivatives markets that decrease systemic risk, increase transparency, and promote a more open, competitive, and level playing field. We welcome the market’s transition to central clearing that occurred over the course of this year, and look forward to the market’s upcoming transition to trading liquid, standardized, cleared swaps on registered swap execution facilities (“SEFs”) and designated contract markets (“DCMs”).

Drawing lessons from the implementation of the Commission’s clearing requirement, we note that the Commission’s phased approach, beginning only with those swaps that were already being cleared voluntarily by derivatives clearing organizations (“DCOs”), ensured a relatively smooth implementation of an otherwise profound market transformation. The transition to trading swaps on SEFs/DCMs is equally profound, and a phased implementation is likewise critical to ensuring a smooth transition with minimal market disruption. Our proposed phased implementation, set forth below in more detail in Sections II.G and IV.G., focuses initially on those swap instruments that are already listed and actively traded on SEFs/DCMs, which are reliable indicators of operational readiness and sufficient liquidity. We then propose a progressive/systematic phase-in of the product set required to trade on SEFs/DCMs. This phased-in approach will promote market confidence in these new trading platforms and provide the market with time to both adapt and correct any unforeseen glitches.

We believe that the wise decision of the Commission to begin the clearing mandate with those swap contracts that were already being cleared made it possible to implement mandatory central clearing for all relevant market participants in less than a year. A phased implementation of the Commission’s trade execution requirement will deliver similar benefits by ensuring that all market participants and the SEFs/DCMs get this critical paradigm shift right before expanding to less liquid swap contracts. As the industry prepares for mandatory trade execution on SEFs/DCMs, we strongly believe that the Commission’s optimal implementation approach is to authorize a phase-in of the trading mandate by product and transaction type in the rates asset class. The Commission has a number of procedural methods, including the issuance of staff no-

⁵ We will thus address the amended Javelin submission, the trueEX submission, and the IRS MAT determination portion of the TW submission.

action relief, to exercise its authority to effect such a phase-in.⁶ The merits of our recommended phase-in approach are detailed further in Sections II-IV below.

The logical starting point for such a phase-in approach is to apply the trading mandate in the fixed-to-floating interest rate swap class to outright, spot-starting, USD and EUR swaps at the benchmark tenors.⁷ This initial phase would be followed by a progressive, data-driven, phased expansion of the trading mandate to include additional currencies, tenors, and forward start dates in the fixed-to-floating swap class, as well as to other swap classes. Our detailed recommendations and supporting rationales for this approach are presented in Section II, coupled with an evaluation of how to reconcile the scope of each of the IRS MAT determinations of Javelin, trueEX and TW against such an approach.

We recommend a similar approach to “package transactions”⁸ (as opposed to outright swaps), beginning in the earlier phases with benchmark swap spreads as well as swap curves and swap butterflies that include exclusively MAT instruments. The initial phase-in would be followed by a progressive, data-driven, phased expansion to cover additional types of package transactions, as well as those that include both MAT and non-MAT instruments. Our detailed recommendations and supporting rationales for this approach are presented in Sections III and IV below.

II. Background and Proposed Treatment of Outright Swaps

A. Benchmark vs. Non-Benchmark Swaps

The most commonly traded IRS are outright spot-starting swaps traded on the benchmark points of the swap yield curve (“**Benchmark Swaps**”). In the U.S., these benchmark points are the 1-yr., 2-yr., 3-yr., 5-yr., 7-yr., 10-yr., 15-yr., 20-yr., and 30-yr. points. Swap trading data demonstrates that the vast majority of trading activity is concentrated at these benchmark points.⁹ In addition, buy-side market participants currently observe live indicative and/or firm quotes

⁶ In addition to time-limited no-action relief, other procedural options include: (i) phased, partial, staggered, or conditional approval of the MAT submissions, (ii) an interim final rule to amend the Swap Transaction Compliance and Implementation Schedule for the Trade Execution Requirement, and (iii) an exemptive order.

⁷ By “outright,” we mean swaps that are executed individually on a stand-alone basis (*i.e.*, not as part of a “package”). By “spot-starting,” we refer to swaps with an effective date that is two business days after the trade date (*i.e.*, as opposed to “forward starting”), also referred to as T+2 (though this convention does vary by currency).

⁸ These compound or “package” transactions involving the simultaneous and contingent execution of two or more instruments are defined, and their business purpose explained, in Section IV.A. herein.

⁹ The publicly available data at <https://rtdata.dtcc.com/gtr/dashboard.do> support this conclusion, as discussed further in Section II.E. below. The Commission has access to more detailed non-public data from registered swap data repositories (“**SDRs**”) which we believe will also demonstrate this fact. The trueEX MAT submission also includes a number of graphs showing that the preponderance of trading activity occurs at the benchmark points (*see supra* n. 2 at Exhibit 2, pp. 6-7).

from dealers (*e.g.*, BBTI page on BSEF) at these benchmark points. Thus, we expect to see ample streaming liquidity provided in SEF/DCM order books for Benchmark Swaps.

Drawing parallels to the U.S. government bond market and the corporate credit market, Benchmark Swaps share similar trading features to on-the-run Treasuries and current series index credit default swaps (“**CDS**”). Within their respective markets, such instruments are used by market participants as primary risk transfer instruments and are often the most liquid, offering consistently observable measures of market levels. In contrast, across all of these markets, the non-benchmark issues trade with significantly less frequency and liquidity than the benchmark issues. Thus, we do not expect, at least initially, to see streaming order book liquidity in non-benchmark whole tenors.

B. Relevance of MAC Swaps

IRS market participants have only recently begun trading Standard Coupon Standard Maturity Swaps (“**MAC Swaps**”). MAC Swaps are forward starting swaps (starting on IMM dates) with benchmark maturities and fixed coupons that trade on price (not yield). MAC Swaps are potentially a viable complement or an alternative to traditional Benchmark Swaps. However, as MAC Swaps are relatively new IRS products for market participants, we expect that the majority of trading activity will continue in traditional Benchmark Swaps. Thus, while MAC Swaps are not a substitute for traditional Benchmark Swaps, given their relatively high degree of standardization, we believe they are suitable for the initial phase of SEF/DCM trading.

C. Aged Swaps and Partial Tenors

Once a Benchmark Swap ages past its origination (even by one trading day), it becomes a more bespoke swap (an “**Aged Swap**”). It is functionally equivalent to a new swap being traded with a bespoke, non-benchmark tenor, also referred to as a partial tenor (a “**Partial Tenor Swap**”), as opposed to a whole year tenor swap. In either case, Aged Swaps and Partial Tenor Swaps are not readily quoted and typically trade with significantly less liquidity relative to Benchmark Swaps.

In the IRS market as well as in the U.S. government bond and corporate credit market, as a market participant’s trading activity moves from the benchmark instruments to instruments with customized or bespoke start and end dates in order to meet more specific hedging, unwind or risk-taking requirements, observable views of exact market levels are less uniform and liquidity in such instruments becomes significantly more fragmented. Such liquidity fragmentation results from the fact that more customized trading activities typically require principal risk-taking on both sides of such transactions, rather than one side merely performing a market-making or liquidity-providing function. Where there are liquid, readily observable, two-

sided markets, it is straightforward for liquidity providers/market-makers to quote prices on an automated basis. This type of quoting activity characterizes the benchmark tenors. However, at more bespoke tenors, quotes from liquidity providers are not nearly as readily or as quickly available, as a liquidity provider needs time to both price such transactions and develop a hedging strategy to lay off the principal risk they assume.

We believe that market participants often execute Aged Swaps or Partial Tenor Swaps to unwind or offset an existing position, either individually or as part of an unwind or offset package, a related topic we discuss further in Section III.

D. Spot-Starting vs. Forward-Starting Swaps

In contrast to spot-starting swaps, forward-starting swaps have an effective date at some point in the future beyond T+2. For example, a 5y5y is a 5-year fixed-to-floating rate swap with an effective date 5 years after the trade date. Based on the trading experience of MFA members, forward-starting swaps trade far less frequently than spot-starting swaps, and as with Partial Tenor Swaps, have more fragmented liquidity and no observable market prices.

E. Regulatory Factors for MAT Determinations

Commission Rule §37.10¹⁰ states that a SEF must meet the listing requirement and consider six factors as part of a MAT submission. Specifically, §37.10(b) states: “To make a swap available to trade, for purposes of section 2(h)(8) of the Act, a swap execution facility shall consider, as appropriate, the following factors with respect to such swap: (1) Whether there are ready and willing buyers and sellers; (2) The frequency or size of transactions; (3) The trading volume; (4) The number and types of market participants; (5) The bid/ask spread; or (6) The usual number of resting firm or indicative bids and offers.”

We believe that Benchmark Swaps satisfy each of these factors to a far greater extent than non-Benchmark Swaps. For Benchmark Swaps, available swap trading data show that: (1) there is a greater number of ready and willing buyers and sellers, (2) there is a higher frequency of transactions, (3) there are larger trading volumes, (4) there is a broader array and diversity of market participants, (5) there are tighter bid/ask spreads, and (6) there are more resting bids and offers, in each case, as compared to non-Benchmark Swaps.¹¹ Similarly, we believe that spot-starting swaps satisfy these factors to a far greater extent than forward-starting swaps.

¹⁰ See <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-12250a.pdf>

¹¹ See *supra* n. 9.

We have analyzed the data available from DTCC's real-time dissemination dashboard.¹² In the six-and-a-half weeks from the beginning of SEF trading on October 2th through November 15th, there were 11,831 new, cleared, spot-starting, USD fixed-to-floating swaps executed on SEFs/DCMs. Of these, 88.0% were Benchmark Swaps and a further 11.7% were whole tenor (*e.g.*, 4-yr., 9-yr., etc.) non-Benchmark Swaps. Only 0.3%, or 37 swaps, were Partial Tenor Swaps. Meanwhile, a further 245 forward-starting swaps were executed. Thus, out of a total of 12,076 new, cleared, USD fixed-to-floating swaps executed on SEFs, 98.0% were spot-starting swaps and only 2.0% were forward-starting swaps. We believe this data illustrate that there are starkly different trading characteristics for (i) Benchmark versus non-Benchmark Swaps and (ii) spot-starting versus forward-starting swaps.

With respect to the listing requirement in §37.10(a)(2), we question whether any SEF actually lists Aged Swaps or Partial Tenor Swaps today. Based on our experience with SEFs to date, while many SEFs are well-prepared to offer both order book and request for quote (“**RFQ**”) trading protocols for Benchmark Swaps, we do not believe that SEFs are ready to support trading in the non-benchmark tenors. It is unclear, for example, how Partial Tenor Swaps (*i.e.*, swaps with non-integer tenors) can trade on the SEF order books we have seen to date, given that there are over 10,000 unique partial tenors extending to 30 years. Meanwhile, while RFQ protocols could presumably accommodate free text fields that would allow a requester to define bespoke terms, this approach does not strike us as efficient, robust or scalable. Reported data demonstrates that virtually all trading that has occurred on SEFs to date has been in the benchmark tenors, while only a handful of transactions have been executed with partial tenors.

As noted above, as market participants diverge from the benchmark tenors to satisfy unique hedging or risk-taking requirements, relevant measures of liquidity are markedly lower. While at the present time, we do not believe that the requisite trading characteristics itemized above are manifested sufficiently at the non-benchmark tenors to warrant a MAT determination for non-Benchmark Swaps, we acknowledge that this will evolve over time. For example, while liquidity providers may today be prepared to seamlessly provide quotes – whether on order books or in response to RFQs – for Benchmark Swaps, we believe that as experience with SEFs/DCMs grows and volumes of on-SEF/DCM trading grow, that the ability to more readily and seamlessly provide quotes for more bespoke instruments, like Partial Tenor Swaps, will grow. We believe our phase-in approach will allow this evolution to occur in a smooth fashion.

¹² See <https://rtdata.dtcc.com/gtr/dashboard.do>

F. The Need for Appropriate Granularity in Applying the Statutory Considerations

The three MAT submissions for IRS raise an important question as to the appropriate level of granularity at which a SEF/DCM's MAT determination should be made, specifically with respect to swap tenors. While the trueEX and TW submissions itemize specific whole year tenors (generally the benchmark points), the Javelin submission applies to all tenors from 28 days to 31 years. When assessing whether the six MAT factors are satisfied for a given instrument, the trueEX and TW MAT submissions examine the trading characteristics of each relevant whole tenor swap. However, when conducting its analysis, Javelin broadly groups all swaps into one of three maturity buckets (0-5Y, 5-10Y, and 10-31Y). By conducting the MAT determination analysis at this low level of granularity, we are concerned that Javelin's approach inappropriately combines the trading characteristics of Benchmark Swaps with those of non-Benchmark Swaps, including a wide array of Partial Tenor Swaps. We believe that this approach obscures the actual trading characteristics of Partial Tenor Swaps, making them appear far more liquid than trading experience would support. In our experience, Partial Tenor Swaps considered on a stand-alone basis would be significantly less likely to satisfy any of the six MAT factors.

Javelin's justification for this approach is that there are price correlations among different tenors and that certain tenors can be used to hedge other tenors, and therefore Javelin concludes that the liquidity is "transitive" to all other swaps within the same maturity bucket. While we believe that this analysis is accurate at some level, important distinctions among tenors nonetheless remain, and the assumed "transitive" nature of the liquidity fails to account for these distinctions. In our consideration of the six MAT factors, informed by the trading experience of MFA's members, we reach the following different conclusions from the conclusions of Javelin:

- First, with respect to "ready and willing buyers and sellers" and the "number and types of market participants", there are large numbers of each at the benchmark tenors. For any given Partial Tenor Swap, there are far fewer ready and willing buyers, since a Partial Tenor Swap is used to satisfy a bespoke risk-transfer need. With respect to sellers, there are also few "ready and willing" sellers, especially as compared to the benchmark tenors. While liquidity providers are generally able to post resting bids and offers and provide automated responses to RFQs at the benchmark tenors, our experience is that they are not presently equipped or prepared to do so for Partial Tenor Swaps.
- Second, as we demonstrated above, DTCC data show a much lower frequency of transactions and much lower trading volumes at any partial tenor when compared to any benchmark tenor.

- Third, bid-ask spreads are wider for Partial Tenor Swaps. While Benchmark Swaps are used to indicatively price non-Benchmark Swaps, the pricing is not necessarily as efficient.
- Fourth, we are not aware of any resting bids or offers for Partial Tenor Swaps on any trading platform.

Given these different conclusions, we submit that it is inappropriate for a SEF/DCM to apply the six MAT factors to a given swap category without sufficient granularity to account for differences in the actual trading characteristics of particular tenors. Broadly categorizing all IRS into three broad buckets by tenor fails to accurately assess important differences along the curve.

If the Commission determines that these materially different conclusions with respect to the application of the six MAT factors are not sufficient grounds to justify a rejection of the Partial Tenor Swaps included in Javelin's MAT submission, we respectfully submit that such differences are at a minimum sufficient to justify a phased approach that would authorize the application of the trading mandate first to Benchmark Swaps, and then only to Partial Tenor Swaps in a subsequent phase.

G. Recommended Initial MAT Scope and Sequential Expansion for Outright Swaps

Based on the foregoing discussion, both outright spot-starting Benchmark Swaps and outright MAC Swaps are strong candidates for MAT eligibility on Day 1. Nevertheless, we believe that SEF/DCM functionality will continue to evolve, and that SEF/DCM trading of certain non-benchmark tenors may be warranted in time. Therefore, after Day 1, we respectfully urge the Commission to adopt a phased implementation of the MAT determinations for SEF trading, with the spot-starting, non-benchmark whole tenors in Phase 1, and, as warranted by a review of relevant data, forward-starting benchmark tenors in Phase 2, and partial tenors and forward-starting, non-benchmark tenors in Phase 3. The expansion of the trading mandate to Partial Tenor Swaps will necessarily be subject to the operational capability of SEFs/DCMs to develop efficient trading protocols for Partial Tenor Swaps.

In our recommended phase-in approach, Phase 1 would capture the majority of market activity, and, as Congress and the Commission intended, would bring greater pre- and post-trade transparency to widely traded instruments that are the standard reference points for related, but less frequently traded non-benchmark tenors. Thus, including the benchmark tenors in Phase 1 will advance a significant volume of the IRS market to SEF trading, while ensuring a more seamless and efficient transition in subsequent phases of SEF trading of non-Benchmark Swaps.

By contrast, we fear that prematurely applying the MAT determination to non-Benchmark Swaps will inhibit price discovery and impede the buy-side's ability to transact in these instruments if SEFs and liquidity providers are not ready to facilitate their trading. While non-Benchmark Swaps trade significantly less frequently, they nonetheless play an essential trading role in our investing and risk management activities.

In addition, we fear that prematurely moving the trading of Partial Tenor Swaps onto SEFs could lead to disadvantageous pricing, because SEF trading protocols cannot support nearly infinite combinations of such tenors. For example, at present, we do not believe any SEF has the operational functionality to have an order book exist alongside the RFQ for Partial Tenor Swaps. Thus, to best serve the regulatory goals of SEF trading -- to promote pre- and post-trade transparency and to promote liquidity on SEFs -- we believe the scope of the first phased MAT determination should include only Benchmark Swaps. Forcing a large population of thinly traded instruments to mandatory SEF trading on Day 1 will, in our view, distract from ensuring the smooth and robust trading of the most important, higher volume products on SEFs.

Drawing lessons from the implementation of the clearing requirement, we note that a phased approach ensured a relatively smooth and seamless implementation of an otherwise profound market transformation. The transition to trading swaps on SEFs is equally profound, and a phased implementation is likewise critical to ensuring a smooth transition with minimal market disruption. Further, the clearing requirement was initially applied only to those swaps that were already being cleared by DCOs. Similarly, our proposed phased implementation, set forth in the table below, would focus initially on those products already being listed and actively traded on SEFs, and then progressively expand the IRS product set within the proposed time frames to ensure operational readiness and sufficient liquidity to trade systematically such other IRS products on SEFs.

Proposed Phase-In for Outright IRS

Phases	Fixed-to-Floating Rate Swap Class	Basis Swaps , Overnight Index Swaps (OIS), and Forward Rate Agreements (FRAs)
Day 1 (T+0)	<ul style="list-style-type: none"> Spot-starting Benchmark USD and EUR Par-Coupon and MAC Swaps (1y, 2y, 3y, 5y, 7y, 10y, 15y, 20y, and 30y) 	<ul style="list-style-type: none"> None
Phase 1 (T+90)	<ul style="list-style-type: none"> Spot-starting non-Benchmark whole tenor USD and EUR Par-Coupon Swaps (<i>e.g.</i>, 11y, 17y) 	<ul style="list-style-type: none"> For basis swaps and OIS, benchmark tenors for USD and EUR
Phase 2 (T+180)	<ul style="list-style-type: none"> Benchmark forward-starting USD and EUR Par-Coupon Swaps¹³ Spot-starting Benchmark GBP Par-Coupon Swaps 	<ul style="list-style-type: none"> For basis swaps and OIS: <ul style="list-style-type: none"> Non-benchmark whole tenors for USD and EUR Benchmark tenors for GBP
Phase 3 (T+270)	<ul style="list-style-type: none"> Partial tenor USD and EUR Par-Coupon Swaps Non-benchmark forward-starting USD and EUR Par-Coupon Swaps Spot-starting and forward-starting non-Benchmark GBP Par-Coupon Swaps 	<ul style="list-style-type: none"> For basis swaps and OIS: <ul style="list-style-type: none"> Partial tenors for USD and EUR Non-benchmark tenors for GBP FRAs

H. Comments on the MAT Submissions

i. trueEX Submission

trueEX's MAT determination is limited to the fixed-to-floating rate swap category and includes outright, spot-starting USD Benchmark Par Coupon Swaps and outright USD Benchmark MAC Swaps. Without revision, the Commission's approval of the trueEX MAT submission would be entirely consistent with our proposed phase-in approach. We believe that all of the IRS covered by the trueEX submission would be suitably placed at Day 1 in our recommended phasing. Thus, trueEX's MAT determination should be approved as is.

¹³ The most commonly traded forward-starting swaps are 1y1y, 2y1y, 3y1y, 2y2y, 3y2y, 5y5y, 10y10y, and 10y20y.

ii. TW Submission

In the fixed-to-floating rate swap class, TW's MAT determination applies to outright, spot-starting USD, EUR, and GBP Benchmark Par Coupon Swaps and outright USD Benchmark MAC Swaps. With respect to the USD and EUR swaps, the Commission's approval of the TW's MAT submission is consistent with our proposed phase-in approach. We believe that these swaps would be suitably placed at Day 1 in our recommended phasing. However, we believe that the GBP swaps belong in Phase 2 (at T+180).

TW's MAT determination also applies to the basis swap and OIS swap classes. We believe that the basis swap and OIS swap classes would benefit from an additional 90-day phase-in period vis-à-vis the fixed-to-floating rate swap class, with the MAT determination applying to the benchmark tenors in these classes in Phase 1 (at T+90) and to the non-benchmark tenors in Phase 2 (at T+180).

iii. Javelin Submission

In the fixed-to-floating rate swap class, Javelin's MAT determination applies to the whole curve (benchmark and non-benchmark tenors, including partial tenors) in USD, EUR and GBP, as well as certain forward-starting swaps (those with an effective date of up to 10 months from the spot start date). For USD and EUR swaps, we believe that only the outright, spot-starting Benchmark Swaps should be included on Day 1, with spot-starting non-benchmark whole tenors in Phase 1 (at T+90) and spot-starting partial tenors as well as all forward-starting swaps in Phase 3 (at T+270). For GBP swaps, we believe that outright, spot-starting Benchmark Swaps belong in Phase 2 and all remaining GBP swaps, including forward-starting swaps, are more suitably placed in Phase 3 (at T+270).

Javelin's MAT determination also appears to cover the basis swap, OIS, and FRA swap classes in USD, EUR and GBP. We believe that for USD and EUR, the basis swap and OIS swap classes would benefit from an additional 90-day phase-in vis-à-vis the fixed-to-floating rate classes, with the MAT determination applying to the benchmark tenors in Phase 1 (at T+90), to non-benchmark tenors in Phase 2 (at T+180), and to partial tenors in Phase 3 (at T+270). For GBP swaps in the basis swap and OIS swap classes, we recommend staggering the phase-in a further 90 days beyond the respective USD and EUR dates. Finally, for all currencies, we believe that the FRA swap class belongs in Phase 3 (at T+270).

I. Will Trading Shift Away from Benchmark Swaps if the Commission Adopts a Phase-in Approach?

The Commission would be right to ask if our recommendation to initially limit the scope of the trading mandate to Benchmark Swaps will simply drive trading activity to non-Benchmark Swaps and/or Partial Tenor Swaps:

- For example, if the MAT determination applies only to the 10Y, would market participants simply trade a mix of 9Y and 11Y non-Benchmark Swaps?
- Alternatively, if the MAT determination applies only to the 10Y, would market participants simply trade a Partial Tenor Swap of 9 years and 364 days?

We believe the answer to both questions is “not likely”. Market participants value the liquidity, transparency, and tighter bid-ask spreads available at the benchmark tenors. It would thus be irrational for them to diverge from those points simply to avoid trading on a SEF/DCM. In the unlikely event that such divergence were to occur, it would be readily transparent both to the public and to the Commission in data reported to SDRs and disseminated in real-time to the public. As a remedial response, Commission could expand the scope of the MAT determination to apply to the “newly liquid” whole or partial tenors.

In the next section, we discuss how an approved MAT determination and a resulting trading mandate for outright IRS will have potentially profound implications for other closely related swap structures. These potential implications bear further examination and consideration to ensure that the initial MAT determinations do not create confusion and/or liquidity concerns in these closely related products.

III. Background and Proposed Treatment of Unwind or Offset Packages

One common type of compound or package transaction is an unwind, or offset, package. Over time, market participants may accumulate a number of open swap position that market participants executed at benchmark tenors, but are now “aged” and whose remaining tenors may thus become partial, rather than whole year. As part of sound portfolio management, market participants will typically execute an unwind package to offset the profusion of individual instruments, and replace them with new swap instruments with an equivalent risk profile.¹⁴ This trading practice has a number of important benefits, including reducing systemic risk on a market-wide basis and reducing firm-level operational risk.

¹⁴ Note, in the cleared world these offset packages are a mandatory first step to enable portfolio compression at a DCO.

However, unwind or offset packages only work when the component instruments of the package or “legs” can be executed on a simultaneous and contingent basis. Requiring one or more legs of such transactions to be executed independently on a SEF would substantially curtail this important unwind activity.

While we are aware of a few SEFs that are developing trading protocols to support unwind packages, none of them are market-ready. Further, we are not aware of any SEF that has developed the requisite execution-to-clearing workflow to support SEF trading of unwind packages. Specifically, while the overall risk of an unwind package may be flat, each individual leg may exhibit material directional risk. Unless the package can be processed in its entirety through the execution-to-clearing workflow, the risk characteristics of stand-alone legs may inadvertently cause breaches of credit limits depending on the timing and order in which they are processed. Such credit limit breaches could occur either at the futures commission merchant (“FCM”) or DCO level.

Therefore, we recommend a phased implementation of MAT determinations that accommodates unwind packages in a tertiary phase, based on an objective analysis of when SEFs, FCMs and DCOs can operationally support the contingent and simultaneous execution and clearing of the package’s component instruments.

IV. Background and Proposed Treatment of Package Transactions

A. Description of Package Transactions

There are many types of transactions in the rates asset class that involve the simultaneous and contingent execution of two or more instruments. We broadly refer to these as “Package Transactions”. The market in Package Transactions is substantial. For example, based on members’ conversations with the two major dealer-to-customer electronic swap trading platforms, we understand that of the roughly \$1.5 trillion notional in USD IRS executed year-to-date on these platforms, over 25% was in Package Transactions (comprised in large part by swap curve package transactions and to a lesser degree by swap butterfly and swap spread package transactions).

The universe of IRS products that comprise Package Transactions varies, but includes:

- Swap Curve: package of two swaps of differing tenors
- Swap Butterfly: package of three swaps of differing tenors
- Swap Spreads: government bonds vs. swaps typically within similar tenors
- MBS Basis: TBAs (Agency MBS) vs. swap spreads
- Invoice Spreads: T-note or T-bond futures vs. swaps

- Cash/Futures Basis: Eurodollar futures bundles vs. swaps
- Delta-Neutral Option Packages: caps, floors, or swaptions vs. swaps

The components or legs of a Package Transaction are priced or quoted together as a single economic transaction. For certain more common Package Transactions, there are liquid markets and existing on-screen/electronic trading capabilities. Markets for other Package Transactions that are either customized or involve non-benchmark products are more bespoke in nature and thus less liquid. For the purposes of our discussion and phase-in recommendation, we limit Package Transactions to those that meet the following three criteria (in line with rules applicable to exchange-for-related position transactions or “EFRPs”):

- The package legs are a combination of “buys” and “sells” (*i.e.*, payer/receiver)
- The package legs have a reasonable degree of correlation
- The risk of the related position (*i.e.*, the non-MAT swap leg) is reasonably equivalent to that of the MAT swap leg.

B. Utility of Package Transactions

By allowing market participants simultaneously to price and execute multiple instruments of a single overall economic transaction, Package Transactions improve pricing and decrease transaction costs for the following reasons:

- A single Package Transaction will have a significantly tighter bid-offer spread than each stand-alone instrument, reflecting the fact that the Package Transaction has significantly lower market risk than an outright swap transaction.
- Separately executing each stand-alone instrument (within a package) would require paying the bid-offer on each leg as though they are each outright transactions, resulting in a cumulative bid-offer that is a multiple of the bid-offer of a Package Transaction.
- There is more efficient risk transfer and hedging, because a market participant exchanges the net risk of the package with a single counterparty, rather than the outright risk on each instrument within the package with different counterparties.

- There is no “legging risk”¹⁵, which refers to the risk that the market moves between the time the first instrument and the time any subsequent instrument of a transaction are executed.

In particular, it is important to note that Package Transactions do not represent the “tying” or “bundling” of different products in a way that obfuscates the pricing of each. Rather, they are distinct products in their own right. While correlated to their component instruments, Package Transactions are more efficient mechanisms of risk-transfer, with resulting advantageous pricing.

C. Benefits of Package Transactions

Based on their demonstrated market utility, Package Transactions play a meaningful role in ensuring an efficient, deep and liquid market for IRS and credit products. Ensuring that market pricing of IRS products is efficient (versus inefficient or even distorted) provides a necessarily sound and fundamental basis that is crucial for sovereign and corporate bond issuance as well as the wide variety of consumer credit products that are linked to interest rates.

For example, one common type of Package Transaction is a “swap spread,” which involves an interest rate swap and a government bond. Swap spread trading is largely tied to corporate issuance. Certain types of companies are better suited to issue floating rate liabilities. However, because investors largely prefer fixed coupon debt, these companies will issue fixed coupon debt and then enter into IRS with dealers to convert their liabilities from fixed rate to floating rate. The dealer community will in turn often use Treasuries to hedge the resulting duration of these IRS, due to the ample liquidity in the Treasury market. The resulting hedging activity leaves the dealer community with a position in swaps versus Treasuries, known as a swap spread. Many buy-side participants trade swap spreads with dealers, which facilitates liquidity in both the credit and rates markets.

D. “Bona fide” nature

As described above, Package Transactions serve a bona fide business purpose, as they allow market participants to focus their hedging and/or investing activities on particular parts of the interest rate curve. Market participants that enter into Package Transactions do so because they desire the positive or negative exposure that each leg of the Package Transaction provides. Package Transactions are not used merely to facilitate the off-exchange execution of one leg of the Package Transaction (*i.e.*, they are not “transitory”).

¹⁵ “Legging risk” refers to the risk that the market moves between the time the first instrument and the time any subsequent instrument of a transaction are executed.

E. Parallels to the Futures Markets and Relevance of EFRPs

Package Transactions involving futures are relatively common, and come in a variety of forms generally referred to as exchanges for related positions or EFRPs¹⁶. Two forms of EFRP transactions include:

- Exchange for Physical (EFP) - A position in the underlying physical instrument for a corresponding futures position.
- Exchange for Risk (EFR) - A position in an OTC swap or other OTC derivative in the same or related instrument for a position in the corresponding futures contract.

CME has stated that fixed income instruments with risk characteristics and maturities that parallel the instrument underlying the exchange contract are acceptable for EFRP transactions. According to CME, such instruments include, but are not necessarily limited to, money market instruments, Treasuries, Agencies, investment grade corporates, forward rate agreements (FRAs), mortgage instruments, including collateralized mortgage obligations (CMOs), and IRS and swaptions.¹⁷ When market participants execute a Package Transaction involving a future, the future is executed off-exchange pursuant to, and then submitted for clearing in accordance with, the rules of the exchange and clearinghouse.

F. MFA's Previous Comments on an EFRP Process for Trade Execution

MFA previously asked the Commission to consider an EFRP process for swaps traded on SEFs.¹⁸ More specifically, MFA recommended that the Commission should consider exempting from the trade execution requirement certain EFRP transactions such as exchanges for physical, exchanges for swaps, and linked or packaged transactions that may include individual segments which, when independently considered, may be sufficiently liquid for the trade execution mandate on SEFs. However, when such segments are considered together in a single joint transaction, we pointed out that such a transaction as a whole may be illiquid, and thus not suitable for the trade execution mandate.¹⁹

¹⁶ See <http://www.cmegroup.com/clearing/trading-practices/efp-efr-efr-trades.html>.

¹⁷ See <http://www.cmegroup.com/clearing/trading-practices/files/efrp-resources.pdf>

¹⁸ See MFA's comments on the Commission's Notice of Proposed Rulemaking on "Core Principles and Other Requirements for Swap Execution Facilities", 76 Fed. Reg. 1214 (Jan. 7, 2011), available at: <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=31242>

¹⁹ *Id.* at p. 8.

The Commission responded directly to our comments on Package Transactions in footnote 218 of the final SEF rule, noting that we failed to offer a specific bona fide business purpose for any of our suggested off-exchange exceptions for such transactions. The Commission specifically noted that we did not explain why an exchange of swaps for swaps transaction, where each leg of the transaction can presumably be executed on a SEF, needs to be executed off-exchange. The Commission focused only on swaps based on physical commodities when it asserted that if such swaps should become subject to the Commission's trade execution mandate, there might be some bona fide business purpose for executing exchanges of swaps for physicals. At such time, the Commission stated that it could entertain requests to permit a trade execution requirement exception for swaps that are components of such exchanges of swaps for physicals transactions.²⁰

Based on our reading, the Commission's principal question in this response was whether there was a bona fide business purpose for executing financial swaps as part of Package Transactions. In the preceding sub-sections of Section IV, we believe we have answered that question by explaining their business utility and market benefits. In addition, the Commission asserted that a bona fide business purpose may only exist for physical commodity transactions. As we discussed above, we respectfully dispute the narrow scope within that assertion. On the contrary, the existing EFRP programs in the futures markets exist for a wide variety of financial instruments in the rates asset class, and all of them meet the Commission's bona fide business purpose standard. We believe the Commission should reconsider whether to allow SEFs to offer EFRP programs for swaps, and factor the development of such programs into a phase-in plan for SEF trading of Package Transactions. In the next section, we recommend such a phase-in plan for the Commission's consideration.

G. Recommended Treatment and Phase-in for Package Transactions

As a threshold matter, we respectfully urge the Commission to avoid breaking up the simultaneous and contingent execution of Package Transactions into individual executions of the component instruments within a package. We fear that hastily moving Package Transactions and/or their component instruments onto SEFs will do just that. The costs of breaking up the packaged execution – including forcing market participants to cross multiple, wider bid-ask spreads and exposing market participants to “legging risk” – far outweigh any benefits from enhanced pre- or post-trade transparency or heightened competition in the SEF landscape.

²⁰ See Commission's Final Rule on “Core Principles and Other Requirements for Swap Execution Facilities”, 78 Fed. Reg. 33476 (June 4, 2013) at fn. 218, 33493-33494, available at: <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-12242a.pdf>

In today's bilateral swaps market, there are no constraints on negotiating and executing Package Transactions. However, once certain instruments of a Package Transaction are listed and MAT-approved on a SEF, then potential complications regarding the execution of Package Transactions will arise. The challenges associated with moving Package Transactions and/or their component instruments onto SEFs are not insurmountable, provided the transition occurs in a phased manner. As we explained above, the optimal way to build the foundation for a smoother market transition to mandatory SEF trading is to begin first with the outright (*i.e.*, non-package) benchmark tenors, as they are the building blocks for a wide array of Package Transactions, followed by more complex Package Transactions, phased in as follows:

Phases	Package Transactions
Phase 1 (T+90)	<ul style="list-style-type: none"> • Benchmark Swap Spreads (provided U.S. Treasury issues are resolved) • Curves and Butterflies referencing exclusively Benchmark Swaps (provided credit processing issues are resolved)
Phase 2 (T+180)	<ul style="list-style-type: none"> • Non-Benchmark Swap Spreads • Curves and Butterflies referencing non-Benchmark Swaps
Phase 3 (T+270)	<ul style="list-style-type: none"> • Unwind/Offset Packages • Invoice Spreads • Implementation of an EFRP-style process for Package Transactions in which there is a non-SEF executable leg (provided SEFs have developed a functional EFRP process). Examples of such Package Transactions include: <ul style="list-style-type: none"> ○ Swaps vs. Swaptions ○ Swaps vs. Corporate Bonds, MBS, ABS

H. Comments on the MAT Submissions for Package Transactions

i. trueEX Submission

The trueEX submission is limited to outright swaps and specifically excludes Package Transactions.²¹ This scope is consistent with our recommendation to exclude Package Transactions in the initial phase-in of the MAT determinations. Notwithstanding this fact, we recommend that the Commission's phase-in plan make it explicit that

²¹ See trueEX MAT submission, Section D at page 5.

notwithstanding the inclusion of a swap that has been made MAT on an outright basis, a given Package Transaction is not MAT.

ii. TW Submission

The TW submission does not explicitly mention Package Transactions. We presume that by omitting Package Transactions, the TW submission does not cover Package Transactions, which is consistent with our recommendation to exclude Package Transactions in the initial phase-in of the MAT determinations. Again, notwithstanding this fact, we recommend that the Commission's phase-in plan make this exclusion explicit.

iii. Javelin Submission

Javelin's MAT submission states that it includes swap spreads,²² but does not reference or include any other types of Package Transactions. As outlined above and explained further in Section IV.I, we believe a phase-in approach is appropriate for swap spreads, with Benchmark Swap spreads included in Phase 1 (at T+90) and non-Benchmark Swap spreads included in Phase 2 (at T+180).

I. Justifications for a Phase-in of Package Transactions

Presently, there is limited operational ability at SEFs to accommodate trading and settlement of Package Transactions. For swap spreads, it remains uncertain how a SEF can facilitate and/or guarantee the settlement of the government bond leg of the transaction. For invoice spreads, the ability to execute the futures leg of the transaction off-DCM is grounded in the DCM's EFRP rules, which will need to be reconciled with the migration of swaps trading onto SEFs.

As we described with respect to unwind packages, FCMs and DCOs are currently unable to calculate the risk of the Package Transaction and apply credit limits appropriately. For example, while the overall risk of a Package Transaction may be flat, each individual leg may exhibit material directional risk. Unless SEFs, FCMs, and DCOs can process the Package Transaction in its entirety through the execution-to-clearing workflow, the risk characteristics of stand-alone legs may inadvertently cause credit limit breaches depending on the timing and order in which they are processed, either at the FCM or DCO level.

²² See Javelin MAT submission at page 5. Under *Trade Types*, it lists "Spreads"; *combination of interest rate swaps and US Treasury Bonds purchases or sales*.

There are adverse consequences of executing packages on a leg-by-leg basis and/or constraining trading activity in Package Transactions by forcing market participants to cross multiple, wider bid-ask spreads and exposing market participants to legging risk. In addition, since the ability to executed EFRP-like Package Transactions is still available at the block level, there would be effective discrimination against smaller market participants who do not trade in block size if SEFs cannot develop a more uniform process for the execution of Package Transactions.

At the November 5, 2013 meeting of the Treasury Borrowing Advisory Committee, the Committee was charged with presenting how technological advances have affected the way assets are traded in the fixed income markets, specifically in the U.S. Treasury market.²³ Among such Advisory Committee's observations were the following:

- Asynchronized mandates for central clearing and electronic trading are creating stresses on the tight linkages between the government bond (and repo), IRS, listed interest rate futures (Eurodollar and Treasury) and corporate credit (bond and CDS) markets.
- Forcing part of a Package Transaction (*e.g.*, an IRS) onto a SEF on a stand-alone basis could disrupt the liquidity of the whole package (*e.g.*, a swap spread or invoice spread package) absent a reliable mechanism for simultaneous execution (such as the exchange-for-risk (EFR) process in the futures market, which allows an IRS and a bond future to be traded together off-exchange).
- This liquidity disruption could have serious adverse effects, as the markets in Package Transactions greatly contribute to, and facilitate liquidity provisioning in, the markets for the individual component instruments of such packages.
- Treasury liquidity could be negatively impacted by a disruption to the IRS markets during SEF implementation.
- To avoid liquidity disruptions to the fixed income markets, we recommend that MAT determinations for the IRS and CDS markets should be done in a phased approach.

²³ See:

[http://www.treasury.gov/resource-center/data-chart-center/quarterly-refunding/Documents/Nov%202013%20QR%20-%20TBAC%20Charge%201%20\(Final\).pdf](http://www.treasury.gov/resource-center/data-chart-center/quarterly-refunding/Documents/Nov%202013%20QR%20-%20TBAC%20Charge%201%20(Final).pdf)

We thank the Commission for the opportunity to provide comments on the MAT certifications of Javelin, trueEX and TW for certain IRS products. We would welcome the opportunity to discuss our views in greater detail. Please do not hesitate to contact the undersigned or Laura Harper at (202) 730-2600 with any questions the Commission or its staff might have regarding this letter.

Respectfully submitted,
/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President, Managing Director &
General Counsel

cc:

The Hon. Gary Gensler, Chairman
The Hon. Bart Chilton, Commissioner
The Hon. Scott D. O'Malia, Commissioner
The Hon. Mark P. Wetjen, Commissioner