



April 23, 2014

Mr. Vincent A. McGonagle
Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, DC 20581

Re: Certain Rule Amendments Self-Certified by ICE Swap Trade, LLC Concerning the Treatment of “Package Transactions”

Dear Mr. McGonagle,

Managed Funds Association (“MFA”)¹ appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the “CFTC” or the “Commission”) in Section II of this letter on certain rule amendments self-certified by ICE Swap Trade, LLC (“ICE Swap Trade”) concerning the treatment of swaps entered into as part of defined package transactions (“Package Transactions”). MFA also appreciates that the Commission is working to address our concerns with the phased implementation of the trade execution requirement for Package Transactions. To facilitate an orderly implementation based on current market experience, Section I of this letter outlines MFA’s suggestions for phasing in the trade execution requirement for different groups of Package Transactions to provide a general context for MFA’s more specific comments in Section II. In our view, Package Transactions involving one or more swaps subject to the trade execution requirement (each, a Made Available-to-Trade (“MAT”) Swap or “MAT Swap”) are commonplace, particularly in the interest rate asset class, where they play an important role in ensuring an efficient, deep and liquid market for interest rate products.²

¹ 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.

² We refer the Commission’s Division of Market Oversight Staff (the “Staff” or the “Division”) to the series of comment letters from market participants and industry associations (the “Industry Submissions”) located at, for example, <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1409>, which, in relevant part, discuss in detail the nature and business drivers for Package Transactions. We also refer the Staff to MFA’s letter to the Division, dated January 24, 2014, requesting no-action relief for Package Transactions from the trade execution requirement (the “MFA No-Action Request Letter”), available at: <https://www.managedfunds.org/wp-content/uploads/2014/01/Packaged-Transactions-NAL-Final-MFA-Letter.pdf>. With respect to the submitted comment letters, we refer the Staff, in particular, to the letter to the Commission from MFA, dated November 21,

I. Current Prevailing Market Conventions Regarding the Execution of Package Transactions

In the MFA No-Action Request Letter, we suggested certain groupings of Package Transactions and provided non-exclusive examples of Package Transactions that fall within each group.³ Based on recent industry discussions, as well as our observations of the types of Package Transactions that are currently listed on SEFs,⁴ we would slightly revise our original groupings to recognize four distinct groups as follows:

- (a) Package Transactions where all legs (“Components”) are MAT Swaps (“**Group 1 Package Transactions**”);
- (b) Package Transactions where all Components are swaps, at least one Component is a MAT Swap, and all non-MAT Swap Components are subject to the Commission’s clearing mandate and listed on a SEF (“**Group 2 Package Transactions**”);
- (c) Package Transactions where all Components are swaps, at least one Component is a MAT Swap and at least one Component is a swap that is not a MAT Swap and is either not subject to the Commission’s clearing mandate or not listed on a SEF (“**Group 3 Package Transactions**”); and
- (d) Package Transactions that include a MAT Swap and a financial instrument that is not a swap (“**Group 4 Package Transactions**”).

As was described in detail in the Industry Submissions, the impediments presented when a component of a Package Transaction is a MAT Swap vary with the type of Package Transaction in question.⁵ While some registered Swap Execution Facilities⁶ (“SEFs”) already facilitate the trading of certain Package Transactions,⁷ many types of Package Transactions cannot be traded

2013, regarding Industry Filings IF 13-004, 13-005, and 13-007 (the “**MFA MAT Letter**”) and the letter to the Commission from Citadel LLC, dated November 29, 2013 (the “**Citadel Letter**”). While we do not restate in this letter all of the points made in the letters submitted to the Commission on this subject, we respectfully request that the Division view the comments set out in this letter in light of the comments in those letters concerning Package Transactions.

³ See Section I of the MFA No-Action Request Letter.

⁴ We wish to emphasize to the Commission that our groupings in this letter, and our proposed solutions for the respective groupings, are qualified by certain notable exceptions of particular Package Transactions within each grouping that are not listed by any SEF as of the date of this letter. For example, in Group 1 Package Transactions, multi-currency Package Transactions (*i.e.*, a Swap Curve where each leg is MAT, but one is USD and one is EUR) are not yet listed on any SEF. Nor are packages where the MAT Swap leg is a Market Agreed Coupon (MAC) swap. In Group 4 Package Transactions, for example, Package Transactions involving multiple Swap Spreads are also not listed on any SEF.

⁵ See, *e.g.*, the MFA MAT Letter and the Citadel Letter.

⁶ All references to SEFs in this letter shall also refer to DCMs.

⁷ For example, many SEFs facilitate the trading of certain USD Swap Spreads, Swap Curves, and Swap Butterflies that are comprised of benchmark tenor swaps that have been made MAT.

on any SEF.⁸ In addition, generally speaking, for those Package Transactions that are capable of being executed on a SEF, market participants are continuing to develop the infrastructure necessary to process Package Transactions as a whole through the execution-to-clearing workflow.⁹

Nonetheless, we believe that certain Package Transactions do not require further relief from the trade execution mandate, and realistic solutions to the challenges presented by other types of Package Transactions can be identified based on the current status of market infrastructure. Accordingly, we suggest that the Staff distinguish possible approaches to Package Transactions with the following categorizations in mind:¹⁰

- (i) Package Transactions that lend themselves to an infrastructure-driven solution that, despite the absence of optimal market infrastructure, can be traded in a reasonably efficient manner in the short term and, as such, do not require further relief from the Division (“**Solution 1 Package Transactions**”);
- (ii) Package Transactions that lend themselves to an infrastructure-driven solution that cannot be traded in a reasonably efficient manner in the absence of improved, generally accessible market infrastructure and, as such, merit an extension of the relief granted in CFTC Letter No. 14-12 until **August 15, 2014**¹¹ (“**Solution 2 Package Transactions**”); and
- (iii) Package Transactions that do not lend themselves to an infrastructure-driven solution alone and thus require a regulatory construct that permits each MAT Swap Component of the Package Transaction to be executed off-SEF (but subject to the rules of a SEF) and,

⁸ For example, to our knowledge, no SEF facilitates the trading of Invoice Spreads, MBS Basis Package Transactions, Delta-Neutral Option Package Transactions, MAC swap Package Transactions, non-USD Swap Spreads, or multi-currency Swap Curves/Swap Butterflies, among others. As a general regulatory principle, if no SEF lists these and other more bespoke Package Transactions, we believe that the Commission should not subject them to the trade execution requirement.

⁹ For example, while certain SEFs facilitate the trading of certain Swap Curves, the Futures Commission Merchants (“FCMs”) and Derivatives Clearing Organizations (“DCOs”) involved in the execution-to-clearing workflow do not yet have the ability to recognize, credit check and process these Package Transactions as packages, and instead treat them as a series of unrelated swaps.

¹⁰ See Appendix 1 for a chart summarizing the proposed approaches set out in this letter. An alternative approach would be for the Commission to interpret (or revise, if needed) Commission Regulation 37.9(a)(1) to make clear that, in the context of Package Transactions, the reference to “Required Transaction” is to the Package Transaction as a whole and that, therefore, only once the Package Transaction as a whole becomes MAT eligible and subject to the trade execution requirement would any Component swap entered into in connection with the Package Transaction be required to be executed on or subject to the rules of a SEF. Until such time, the relevant Package Transaction could be deemed a “Permitted Transaction” as an interim solution. This interim solution would authorize execution flexibility for Packaged Transactions that are also not listed by any SEF as of the date of this letter, and also provide a mechanism going forward for mandating the execution of Package Transactions that are listed on a SEF, where appropriate.

¹¹ Please note that, although we comment on the need for additional no-action relief in this letter, this letter is not itself a request for such relief, and MFA would submit separately to the Staff any further request for relief.

as such, merit an extension of the relief granted in CFTC Letter No. 14-12 until the later of **November 15, 2014** or such time as an appropriate regulatory construct has been advanced and implemented (“**Solution 3 Package Transactions**”).

Below we set forth our views as to which Package Transactions should be considered eligible for the different solutions outlined above:

Solution 1 Package Transactions should be limited to Swap Curves and Swap Butterflies referencing spot-starting benchmark MAT Swaps that are Group 1 Package Transactions.

We believe that Swap Curves and Swap Butterflies where all Components are spot-starting benchmark MAT Swaps in the same currency are the most common form of Group 1 Package Transactions, and can properly be considered Solution 1 Package Transactions. With regard to market infrastructure readiness for Solution 1 Package Transactions, while an extension of the relief granted in CFTC Letter No. 14-12 until optimal market infrastructure is fully available would be preferable, we acknowledge that there are less optimal means of solving the credit-checking complications for these Group 1 Package Transactions if the Commission determines that they must become MAT immediately after the current no-action relief expires on May 15, 2014.¹²

- **USD benchmark Swap Spreads should be Solution 2 Package Transactions.** Based on the inter-dealer market liquidity of U.S. dollar benchmark Swap Spreads (*i.e.*, a subset of Group 4 Package Transactions), some may argue that such Swap Spreads can also properly be considered Solution 1 Package Transactions. However, we have some reservations that the settlement mechanisms and liquidity that exist for U.S. dollar benchmark Swap Spreads in the inter-dealer market are readily transferable to the dealer-to-client SEF landscape that is currently accessible to MFA members. Given these reservations, we believe that U.S. dollar benchmark Swap Spreads should be considered Solution 2 Package Transactions.
- **Solution 2 Package Transactions should also include Group 2 Package Transactions.** Group 2 Package Transactions clearly are not Solution 1 Package Transactions¹³ and should be considered Solution 2 Package Transactions.
- **Solution 3 Package Transactions should include Group 3 Package Transactions.** Group 3 Package Transactions must currently be considered Solution 3 Package Transactions, although it is conceivable that an infrastructure-based solution will develop with respect

¹² For example, where a Group 1 Package Transaction contains not more than three swaps, current market experience suggests that FCMs can manually manage customer credit limits so that inadvertent breaches of credit limits do not occur. There will be resulting inefficiencies for Group 1 Package Transactions, however, because customer credit limits must be substantially increased to provide over-extensions of credit until optimal market infrastructure is fully available.

¹³ For example, Group 2 Package Transactions include both Unwind (or Offset) Packages and Package Transactions that include both swaps that are listed on a SEF and those that are not. Current market experience suggests that FCMs are currently unable to manually manage customer credit limits of such Group 2 Package Transactions to avoid inadvertent breaches of credit limits.

to certain transactions within that group in the future.¹⁴ Consequently, any further relief granted by the Division with respect to those Package Transactions should be expressed to expire upon the implementation of such a solution.

- Solution 3 Package Transactions should also include the majority of Group 4 Package Transactions. Except with respect to U.S. dollar benchmark Swap Spreads, all Group 4 Package Transactions are Solution 3 Package Transactions.

Finally, with respect to market conventions, and in response to the Commission's sixth question in relation to the proposed ICE Swap Trade amendments,¹⁵ the industry's clear understanding of a Package Transaction is a transaction with multiple Components that, in combination, are duration-neutral (that is, the resulting net position does not create material DV01 exposure).¹⁶ In our view, transactions with multiple Components that are not "sized" to achieve that outcome should not be considered Package Transactions.

II. Possible Approaches to Solution 3 Package Transactions

The regulatory construct needed for Solution 3 Package Transactions is one that permits each MAT Swap Component of the Package Transaction to be executed off-SEF but subject to the rules of a SEF. This execution flexibility would allow market participants to continue to quote and execute Package Transactions *as a package*, instead of treating them as a series of unrelated transactions. We believe that the following approaches would facilitate this regulatory construct in the shorter term and longer term, respectively:

- ICE Swap Trade's suggested block trade treatment of Package Transactions; and
- the Commission's establishing an EFRP-equivalent regime for Package Transactions.¹⁷

We discuss both of these suggestions in more detail below.

¹⁴ For example, Group 3 Package Transactions will contain products not currently cleared by any DCO. However, as the scope of products that are cleared by a DCO and subsequently listed by a SEF is expected to expand, this may change in the medium to long term.

¹⁵ In the Commission's release, dated March 24, 2014, seeking public comment on ICE Swap Trade rule amendments, the Commission's sixth question relates to the definition of "Package Transaction" in ICE Swap Trade Rule 701(k), and states as follows: "Rule 701(k) defines a 'Package Transaction' as a transaction that, among other things, consists of offsetting components that are approximately equivalent in size (measured by the amount of risk of fluctuation of a specified asset). Please provide comment on these criteria, in particular with respect to the degree of size equivalence that would be required between the components".

¹⁶ DV01 being the dollar value of a one basis point move in the underlying rate or yield.

¹⁷ As we most recently noted in the MFA No-Action Request Letter, we believe that the most comprehensive way to preserve liquidity in Package Transactions is to develop an Exchange for Related Position ("EFRP")-equivalent regime for Package Transactions. For discussion of the EFRP solution, please see the Industry Submissions, including the MFA MAT Letter and the Citadel Letter.

(a) Block Trades vs. Package Transactions

Block trades are, by definition, a function of notional size.¹⁸ Trades that have large notional sizes present certain execution challenges and, as such, entail different policy considerations. While, in certain respects, one might find the execution risks associated with block trades similar to those associated with Package Transactions, the challenges presented by Package Transactions arise not from size, but rather from the fact that the transactions are comprised of components that, absent an appropriate execution solution in respect of SEF-executed swaps, may not be readily recognizable as constituting a single transaction.

We believe that a shorter-term regulatory solution for Solution 3 Package Transactions could be constructed around rules originally designed to address block trades, such as those self-certified by ICE Swap Trade for the credit asset class. To ensure a more comprehensive solution, such an approach would likely require setting at zero (or some other nominal threshold) the block sizes applicable to Package Transactions for an initial period of time. In addition, it would be necessary to determine whether the real-time reporting delays permitted for block trades should apply equally in respect of Package Transactions.

(b) EFRP Approach and the *Bona Fide* Business Purpose of Package Transactions

As we noted in the MFA No-Action Request Letter, the MFA MAT Letter¹⁹ and above, we believe that the only comprehensive way to preserve liquidity in certain Package Transactions is to develop an EFRP-equivalent regime for those Package Transactions.²⁰ We remain of the view that the EFRP model operated in the futures space is clear empirical evidence that such a regime can provide orderly, liquid markets with appropriate regulatory oversight.²¹

In this regard we wish to revisit the Commission's comments in footnote 218 of its final rule on Core Principles and Other Requirements for Swap Execution Facilities. The Commission stated that "MFA does not offer a specific *bona fide* business purpose for any of its three suggested off-exchange exceptions, nor is the Commission aware of any."²² In light of ongoing industry discussions²³ and the evidence presented in the Industry Submissions (and, in particular, in Section II of the Citadel Letter and Section IV of the MFA MAT Letter), MFA believes that there is now ample empirical evidence to support the proposition that there is a *bona fide* business purpose underlying the use of Package Transactions. Specifically, the ability to execute

¹⁸ See 17 C.F.R. § 43.2.

¹⁹ See MFA No-Action Request Letter at pp. 6-7 and the MFA MAT Letter at p. 16.

²⁰ See MFA No-Action Request Letter; see also *supra* n. 17.

²¹ See *id.*

²² See "Core Principles and Other Requirements for Swap Execution Facilities", 78 Fed. Reg. 33476, 33493-4 (June 4, 2013).

²³ Such industry discussions also include the Division's Public Roundtable Regarding the Trade Execution Requirement and Package Transactions held on February 12, 2014, and the CFTC Technology Advisory Committee Meeting held on February 10, 2014.

and clear Package Transactions improves overall pricing and decreases transaction costs for the following reasons:

- (1) a single Package Transaction will have a significantly tighter bid-offer spread than each stand-alone instrument;
- (2) separately executing each stand-alone instrument (within a package) would require paying the bid-offer on each leg as though they were each outright transactions, resulting in a cumulative bid-offer that is a multiple of the bid-offer of a Package Transaction; and
- (3) there is more efficient risk transfer and hedging, because in a Package Transaction a market participant is able to exchange the *net* risk of the package with a single counterparty, rather than the outright risk on each instrument within the package on a gross basis with multiple counterparties.²⁴

Based on more recent empirical evidence facilitated in large part by the Commission's industry discussions, we wish to confirm our recommendation for the Commission's development of a regime for Package Transactions that closely approximates the EFRP regime in the futures space. We respectfully suggest that an EFRP regime would provide the Commission and industry participants with a longer-term, comprehensive solution for those Package Transactions that either cannot benefit, or are not likely to soon benefit, from less comprehensive SEF infrastructure-based execution solutions.

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²⁴ For further discussion of the utility of Package Transactions, please see the Industry Submissions, including the MFA MAT Letter and the Citadel Letter.

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We thank the Commission for the opportunity to provide comments on ICE Swap Trade's rule amendments and related recommendations concerning the treatment of Package Transactions and their phased implementation to the trade execution requirement. 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,

/s/ Stuart J. Kaswell

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

cc:

The Hon. Mark P. Wetjen, Acting Chairman
The Hon. Scott D. O'Malia, Commissioner

Appendix 1: Summary of Proposed Solutions

Solution Category	Package Transaction Group	Package Transaction Examples	Proposed Approach
Solution 1	<ul style="list-style-type: none"> Swap Curves and Swap Butterflies referencing spot-starting benchmark MAT Swaps that are Group 1 Package Transactions¹ 	<ul style="list-style-type: none"> 5yr/10yr USD Swap Curve 3yr/5yr/7yr USD Swap Butterfly 	No further relief from the trade execution requirement is necessary beyond what is provided in CFTC Letter No. 14-12 (which expires May 15, 2014), at least for those Package Transactions involving swaps in the same currency.
Solution 2	<ul style="list-style-type: none"> USD benchmark Swap Spreads that are Group 4 Package Transactions² Group 2 Package Transactions³ 	<ul style="list-style-type: none"> 10yr Swap Spread Unwind (or Offset) Packages 20yr/25yr/30yr/ Swap Butterfly 	The relief granted in CFTC Letter No. 14-12 should be extended until August 15, 2014.
Solution 3	<ul style="list-style-type: none"> Group 3 Package Transactions⁴ 	<ul style="list-style-type: none"> Delta-Neutral Option Packages: Caps, floors, or swaptions vs. swaps 	The relief granted in CFTC Letter No. 14-12 should be extended until such time as a regulatory construct has been implemented that permits each MAT Swap Component of the Package Transaction to be executed off-SEF (but subject to the rules of a SEF).
	<ul style="list-style-type: none"> Group 4 Package Transactions that are not USD benchmark Swap Spreads 	<ul style="list-style-type: none"> MBS Basis: TBAs (Agency MBS) vs. swaps Invoice Spreads: Treasury-note or Treasury-bond futures vs. swaps 	

¹ “Group 1 Package Transactions” are Package Transactions where all Components are MAT Swaps.

² “Group 4 Package Transactions” are Package Transactions that include a MAT Swap and a financial instrument that is not a swap.

³ “Group 2 Package Transactions” are Package Transactions where all Components are swaps, at least one Component is a MAT Swap, and all the non-MAT Swap Components are subject to the Commission’s clearing mandate.

⁴ “Group 3 Package Transactions” are Package Transactions where all Components are swaps, at least one Component is a MAT Swap and at least one Component is a swap that is not a MAT Swap and is not subject to the Commission’s clearing mandate.