

Alert

Swaps Update: Mandatory Trading on SEFs Commences February 15 for Certain Interest Rate Swaps

January 28, 2014

The Commodity Futures Trading Commission (the “CFTC”) announced its first two “made available for trade” determinations (each, a “MAT Determination”), which mandate that fund managers trade certain benchmark interest rate swaps on behalf of their funds and managed accounts through a swap execution facility (a “SEF”) or a designated contract market (a “DCM”).¹ Once a product is subject to a MAT Determination, fund managers will not be permitted to trade such products over-the-counter.²

Fund managers must complete the onboarding process with an appropriate SEF or DCM if they intend to trade swaps subject to the MAT Determinations by Feb. 15 or 21, depending upon the particular interest rate swap. The MAT Determinations apply to funds that are “U.S. Persons,” which include: (1) funds that are incorporated or organized in the U.S.; (2) funds incorporated or organized inside or outside the U.S. that are managed by investment managers that have a “principal place of business” in the U.S.; and (3) funds with a “majority of U.S. investors.”

The interest rate products with an Effective Date of Feb. 15, 2014 on Exhibit A must be traded through a SEF or DCM on **Feb. 15**.³ Javelin SEF, LLC (“Javelin”) submitted the initial request for a MAT Determination for the interest rate swaps, which was followed by trueEX, LLC (“trueEX”)’s submission. Once the products are subject to the trade execution requirement, fund managers may trade such interest rate swaps on any SEF or DCM that offers such products (fund managers are not required to trade through Javelin’s or trueEX’s SEF platform). Because trueEX’s submission was a subset of the interest rate swaps submitted by Javelin, they are subject to the Feb. 15 deadline. However, trueEX also

¹ Press Release, Commodity Futures Trading Commission, Staff Announces Trade Execution Mandate for Certain Interest Rate Swaps (Jan. 16, 2014), <http://www.cftc.gov/PressRoom/PressReleases/pr6831-14>; Press Release, Commodity Futures Trading Commission, Division of Market Oversight Announces Trade Execution Mandate for Additional Interest Rate Swaps (Jan. 23, 2014), <http://www.cftc.gov/PressRoom/PressReleases/pr6838-14>.

² Swaps that are subject to MAT Determinations will become subject to the trade execution requirement under section 2(h) of the Commodity Exchange Act. To the extent that swaps subject to the trade execution requirement are executed on a SEF, they must be executed in accordance with the execution methods prescribed by CFTC regulation.

³ See Javelin MAT Determination Submission (Oct. 18, 2013, amended Jan. 8, 2014), *available at* <http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul010814javsef001.pdf>. We note that the related CFTC Press Release does not expressly include certain characteristics (indicated by asterisks in the chart below) that were specified in the Javelin MAT Determination Submission. However, because the CFTC Press Release did not include such specifications, it is unclear whether, for example, quarterly or monthly payment frequencies would be included in the MAT Determination (although not included in the Javelin MAT Determination as amended). CFTC clarification may be requested, especially in light of the more detailed trueEX MAT Determination.

submitted Market Agreed Coupon (“MAC”) contracts, which will be subject to the trade execution requirement on Feb. 21, 2014 (see the Effective Date for certain swaps of Feb. 21 on Exhibit A).⁴

Since the submissions by Javelin and trueEX, other SEFs, including Bloomberg SEF, Market Axess and Tradeweb, have submitted MAT Determination proposals. Additional products being considered include other interest rate swaps and CDS (CDX and iTraxx) products. Certain CDS products are expected to be subject to a trade execution requirement in the coming weeks.

In the Javelin CFTC press release, the CFTC stated that it will consider relief for certain “packaged transactions” based upon input to be received at a public roundtable that the CFTC will host Feb. 10, 2014.⁵ A “packaged transaction” is comprised of two transactions, with one transaction subject to the SEF trade execution requirement and the other transaction that does not trade on a SEF. The issue with splitting a “packaged transaction” such that one swap trades on a SEF and one off-SEF is that the cost may be significantly more expensive and it also may create a hedging mismatch due to the timing of execution. Several large trade organizations, including the Managed Funds Association, SIFMA Asset Management Group and the International Swaps and Derivatives Association, have requested relief.

SRZ will host a “Swap Execution Facilities: The Onboarding Process” webinar on Tuesday, Feb. 4, 2014 from 12:00 pm – 12:45 pm. If you would like to register for this webinar, please contact your SRZ attorney.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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⁴ A “MAC” contract is a fairly new interest rate swap product that has a pre-defined coupon rate that is set close to par, based on the three or six month forward curve, rounded to the nearest 25 basis point increment. By setting a fixed coupon, the product is expected to be more fungible and liquid.

⁵ Details regarding the public meeting may be found at: <http://www.cftc.gov/PressRoom/PressReleases/pr6840-14>.

Exhibit A

Fixed-to-Floating Interest Rate Swaps				
Effective Date	Feb. 15	Feb. 15	Feb. 21	Feb. 15
Currency	U.S. Dollar (USD)	U.S. Dollar (USD)	U.S. Dollar (USD)	Euro (EUR)
Floating Rate Indexes	USD LIBOR	USD LIBOR	USD LIBOR	EURIBOR
Trade Start Type	Spot Starting (T+2)	IMM ⁶ Start Date (next two quarterly IMM start dates)	IMM ⁷ Start Date (next two IMM start dates)	Spot Starting (T+2)
Optionality	No	No	No	No
Fixed Leg:*				
Payment Frequency*	Semi-Annual, Annual*	Semi-Annual, Annual*	Semi-Annual	Semi-Annual, Annual*
Day Count Convention*	30/360, ACT/360*	30/360, ACT/360*	30/360	30/360, ACT/360*
Floating Leg:*				
Reset Frequency*	Quarterly (3 month), Semi-Annual*	Quarterly (3 month), Semi-Annual*	Quarterly (3 month)	Quarterly (3 month), Semi-Annual*
Day Count Convention*	ACT/360*	ACT/360*	ACT/360	ACT/360*
Dual Currencies	No	No	No	No
Notional	Fixed Notional	Fixed Notional	Fixed Notional	Fixed Notional
Fixed Rate*	Par*	Par*	Standard Coupon**	Par*
Tenors	2, 3, 5, 7, 10, 12, 15, 20, 30 years	2, 3, 5, 7, 10, 12, 15, 20, 30 years	1, 2, 3, 5, 7, 10, 15, 20, 30 years	2, 3, 5, 7, 10, 15, 20, 30 years

* These characteristics were included in Javelin's MAT Determination, but were not expressly included in the related CFTC Press Release.

** Standard Coupon refers to the then-current fixed coupon rates for Market Agreed Coupon ("MAC") contracts.

⁶ IMM dates refer to the International Monetary Market calendar, which are the third Wednesday of March, June, September and December.

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