CADWALADER

CABINET NEWS

Research and commentary on regulatory and other financial services topics

A Decade-Long Death of Footnote 195

May 2, 2024

By Peter Y. Malyshev
Partner | Financial Regulation

Sometimes a small footnote (which technically is not even a part of the official Federal rule) may have an outsize impact on the rule itself. In 2013, subsequent to the enactment of the Dodd Frank Act of 2010, the Commodity Futures Trading Commission ("CFTC") had implemented its rules and guiding principles for swap execution facilities ("SEFs") – i.e., the platforms where swaps must be traded if they are available for execution between multiple trading participants. If a platform qualifies as a SEF, it must register with the CFTC and must meet a number of requirements, such as (i) limiting participation on SEFs to only eligible contract participants ("ECPs"), as defined in the Commodity Exchange Act, (ii) ensuring competitive execution of transaction either through a request for quote ("RFQ") or central limit order book ("CLOB") functionality, (iii) preventing fraud and manipulation on the SEFs, and (iv) facilitating clearing and reporting of transactions executed on the SEFs to swap data repositories ("SDRs").

If a SEF-executed transaction is subsequently cleared through a derivatives clearing organization ("DCO"), the DCO would typically generate a record and that record would supersede previous agreements and confirmations because the transactions would be settled with the DCO. However, if a SEF-executed transaction is not cleared through a DCO, it would have to settle between the counterparties, and some form of a bilateral swap agreement (such as an ISDA master agreement) would be essential in addition to a confirmation generated by a SEF.

Understanding the importance of properly documenting swap transactions, the CFTC required in its § 37.6(b) rule (and further explained in its Footnote 195 to SEF rule's adoption release) that all uncleared swap transactions be properly documented and in the event there are ISDAs or any other swap agreements between the parties, the terms of such previously negotiated agreements could be incorporated in the SEF confirmations if these agreements were provided to the SEFs. In other words, the SEFs will have to collect and maintain the libraries of thousands upon thousands of bilaterally negotiated agreements when these agreements are provided to a SEF by its trading participants. From the moment the SEF rule was adopted in 2013, it became clear that the requirements in Footnote 195 were a burden that neither the SEFs nor the trading participants were able to comply with; as a result, the CFTC issued a series of no-action letters (such as CFTC Letter 17-17) where the staff of the CFTC agreed not to enforce the requirements of Footnote 195.

Eventually, acknowledging the impracticality of obtaining and storing previously negotiated master agreements, the CFTC **amended** its Part 37 rules, which now provide that:

- SEFs are permitted to incorporate in an uncleared swap confirmation by reference terms of previously negotiated master agreements between counterparties without being required to obtain a copy of such agreements;
- confirmation of all terms of a swap transaction executed on a SEF must be done “as soon as technologically practicable” after the execution of the swap transaction;
- the confirmation provided by the SEF after the execution of a swap transaction legally supersedes only the conflicting terms of the previous agreement (rather than the entire agreement), such as the ISDA master agreement, while both the SEF and the CFTC can obtain a copy of such agreement; and
- additional technical amendments of the SEF rules and swap dealer rules in Part 23.

Rule amendments will become effective on May 31, 2024 and CFTC Letter 17-17 will expire.