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Package trade rules - can they do that?

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On Thursday May 1 the CFTC released an eagerly awaited clarifying document outlining when and how package trades would be required on SEF. Packaged transactions will be phased in by type from May 15th through November 15th, and to deal with the pre-trade credit checking issue (checking limits against each leg as opposed to the limit utilization of the total package) no-action relief has been provided until September 15th.

Photo Credit: Marc Falardeu

From an execution point of view, those SEFs that have historically provided execution for packaged transactions should have little issue putting in place the necessary controls to meet the deadlines. The September 15th credit check deadline will be a tougher one to meet, with the onus on the credit hubs (Markit and Traiana) and the clearinghouses, although not impossible. What leave's me still perplexed is not these operational issues but instead issues of jurisdiction and fair access

Jurisdiction

Per the rules, only swaps that are made available to trade must be traded on a SEF. If you want to trade non-MAT instruments on a many-to-many platform, that also must be done on a SEF - but in that case the single-dealer platform option still remains. But now, per the CFTC's package guidance, non-MAT instruments that are part of a MAT/non-MAT package must be traded on a SEF full stop.

Then we have the MAT/UST package trades. While many SEFs run parallel liquidity pools for trading US Treasury securities, trading in those instruments falls under the jurisdiction of the SEC and must be done through a registered broker dealer, not a SEF. And while we're we're on the jurisdiction issue, the final package category - CFTC jurisdiction swaps over non-CFTC jurisdiction swaps - raises the same question. How can the CFTC direct trading of either a UST or security-based swap when those products are under the jurisdiction of the SEC?

Don't get me wrong - these packaged transactions should and ultimately will be traded on SEF. Bringing them on the platforms will create more liquidity and transparency across the board which of course is the ultimate goal of this whole exercise. But even with the SEC still distracted by high frequency traders and kill-switches, I don't think the CFTC has the legal authority to step on their toes and start regulating their markets. Maybe they should, but that is a topic for another post.

Package CLOB

Under the current guidance it also seems unlikely that MAT/UST packages could ever trade in an order book. Participants in such an order book would need certainty that the counterparty on the other side had the ability to trade UST (via access to an FICC account, etc.). To gain that certainty, SEFs would have to require this of participants which either infringes on the fair access rule, or changes the definition of eligible contract participant (ECP).

Package transactions are a huge part of the market and need to move on SEF for the desired end-game to ever be reached, however the timelines set forth by the CFTC seem somewhat too aggressive. MAT/MAT on the 15th will work, but more time spent on defining the MAT/UST flow would be prudent.

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