

On February 26, 2014, the SEF trading mandate for CDS comes into effect with the beginning of the MAT rule implementation. This will dramatically change the way credit default swaps (CDS) indices are traded. The SEC has jurisdiction over single-name CDS and is expected to finalize rules governing the single-name CDS market later this year.

Below we have attempted to answer some of the most frequently asked questions about how these rules are likely to impact trading of derivatives and what you should do to prepare.

1. What do the Dodd-Frank SEF rules mean for the trading and clearing of swaps?

Within its final rules under Dodd-Frank, the CFTC has defined specific requirements relating to the trading and clearing of swap indices. In summary these are:

- All swaps that have been 'made available to trade' (MAT) by any swap execution facility (SEF) or board of trade designated as a contract market (DCM) must be traded on a SEF or DCM. These swaps are a sub-set of those subject to the CFTC's clearing mandate;
- Mandatory clearing through regulated derivatives clearing organizations (DCOs) of all 'clearable swaps' as designated by the CFTC; and
- Reporting of swap information to swap data repositories (SDRs).

The SEC has jurisdiction over single-names and is expected to finalize its rules governing the operation of security-based SEFs in 2014.

2. When will the CFTC's new rules for the trading of CDS indices take effect in the U.S.?

The rules governing the execution of swap indices on SEFs were finalized on May 16, 2013. The key dates relating to these rules are:

Trading:

- **October 2, 2013:** SEF Compliance date
 - MarketAxess begins operating as a SEF following the CFTC's mandatory compliance deadline. Participants are not required to trade on SEFs at this time;
 - Any many-to-many platform allowing for trading in swap indices must be registered as a SEF by this date.
- **February 26, 2014:** Made Available to Trade (MAT) Rule, signals the beginning of Mandatory CDS SEF Trading
 - CDS transactions involving certain 'made available to trade' (MAT) CDS contracts not subject to a block trade exemption must be executed on a SEF or DCM in compliance with the trade execution requirement. **This is the beginning of mandatory CDS SEF trading for market participants.**

Clearing:

- **In effect:** OTC Clearing Mandate

The final phase of the OTC clearing mandate required under the Dodd-Frank legislation came into effect on October 23, 2013. This means that firms that fall within the three categories below are now required to clear eligible CDS products that fall under the CFTC's jurisdiction.

- Category I (*Swap dealers, major swap participants, and active funds swaps*),
- Category II (*Commodity pools, private funds, and non third-party sub account*),and
- Category III (*Accounts managed by third-party investment managers, ERISA pension plans, and entities that were not subject to the Commission's first two implementation deadlines*)

3. What is a SEF?

The CFTC has defined a SEF as a 'system in which multiple parties have the ability to execute or trade swaps by accepting bids or offers from multiple participants'.

1) The CFTC states that for 'Required Transactions' (see below) SEFs must offer the following functionality:

- As a minimum, the SEF must offer a centralized electronic trading screen on which any market participant can post both executable and non-executable bids and offers that are transparent to all other market participants of the SEF – otherwise known as an 'order book';
- A SEF may also offer a request-for-quote (RFQ) system that operates in conjunction with the order book. Participants using the RFQ system must send any RFQ to a minimum of 2 other market participants (this minimum increases to 3 participants after 1 year).

2) 'Permitted Transactions' (see below) may trade via any means of execution as long as the SEF offers an order book as a minimum functionality.

3) The CFTC has also laid out a series of 15 core principles with which SEFs must comply.

4. What is the difference between a 'Required Transaction' and a 'Permitted Transaction'?

Required Transactions are certain 'Made Available to Trade' (MAT) CDS transactions not subject to a block trade exemption that comply with the trade execution mandate under Dodd-Frank. These swaps must be executed on a SEF or DCM using one of the minimum execution methods.

Permitted Transactions are not subject to the trade execution mandate under Dodd-Frank though they may be executed on a SEF or DCM, if the market participant chooses. These transactions are illiquid or bespoke in nature. Permitted Transactions may trade via any method of execution as long as the SEF offers an order book.

Block Trade thresholds for swaps vary by instrument and are based on the tenor and spread of the swap. Block trades are exempt from the minimum execution methods of Required Transactions but must be processed on a SEF or DCM.

- For the CDX IG with 5 yr tenor, the block threshold is \$110 million and up
- For the CDX HY with 5 yr tenor, the block threshold is \$32 million and up
- Block trade thresholds will be reviewed later this year and re-calculated as appropriated based on the previous year's trading data.

5. What is meant by 'Made Available to Trade' (MAT)?

MAT is the process by which a SEF or DCM designates the swaps that must be traded on a SEF/DCM using qualitative criteria defined by the CFTC.

These swaps are a sub-set of those subject to the CFTC's clearing mandate and are part of the Required Transactions that will be traded on a SEF or DCM starting February 26, 2014.

The CFTC has certified the following swaps as 'made available to trade' and, as of February 26, 2014, these swaps will be required to trade through MarketAxess SEF or any other SEFs or DCMs:

Index	Index Series	Index Tenor
CDX.NA.IG	On-The-Run	5Y
CDX.NA.IG	Most Recent Off-The-Run	5Y
CDX.NA.HY	On-The-Run	5Y
CDX.NA.HY	Most Recent Off-The-Run	5Y
iTRAXX Europe	On-The-Run	5Y
iTRAXX Europe	Most Recent Off	5Y
iTRAXX Europe Crossover	On-The-Run	5Y
iTRAXX Europe Crossover	Most Recent Off	5Y

6. What steps has MarketAxess taken to prepare for the implementation of the Dodd-Frank Act?

MarketAxess was granted temporary approval by the CFTC and has been operating as a SEF since October 2nd, 2013. We have developed extensive functionality in order to comply with the rules governing how swaps must be traded on a SEF, including:

- For Required Transactions – the development of an order book where all market participants can interact with all other market participants; and a request for quote (RFQ) system on which participants can go to a minimum of two other market participants;
- Connectivity to derivatives clearing organizations (DCOs), swap data repositories (SDRs) and credit hubs;
- Pre-trade credit checking to ensure certainty of clearing.

MarketAxess SEF was the first SEF to be connected with Traiana's CreditLink hub to verify pre-trade credit limits.

7. What are the requirements for market participants to report data to swap data repositories (SDRs)? What role does the SEF play in this process?

The CFTC requires real-time reporting of all transactions on a SEF to the SDR. MarketAxess SEF will be responsible for real-time reporting to the DTCC on behalf of its participants.

All reported SDR data is also available via the MarketAxess BondTicker™ data service at www.bondticker.com.

8. What differentiates MarketAxess' CDS trading capabilities?

As the only electronic trading platform focused on credit, MarketAxess offers market participants the ability to trade U.S. indices (CDX), European indices (iTraxx), CDS single-names and CDS options, using a broad range of trading protocols and functionality designed specifically for the credit markets.

MarketAxess SEF offers the following trading protocols for Required Transactions:

- **Order Book:** As mandated by Dodd-Frank, MarketAxess SEF offers an order book on which all market participants have the ability to execute or trade swaps by accepting bids or offers from multiple participants;
- **Request-for-Quote (RFQ):** MarketAxess offers a fully disclosed auction-style protocol which market participants can request either a bid or an offer from a minimum of 2 other market participants.

In addition, MarketAxess offers the following trading protocols and functionality for Permitted Transactions, CDS single-names and CDS index options:

- **Request for Market (RFM):** A fully disclosed auction-style protocol by which a market participant requests BOTH sides – Bid *and* Offer – from other market participants;
- **Streaming Markets/Click-to-Trade (CTT):** Over 10 dealers are today streaming live, executable CDS markets on MarketAxess, providing much greater pre-trade price transparency;
- **All-to-All Central Limit Order Book (CLOB) for single-name CDS :** MarketAxess launched the first, independent all-to-all central limit order book for CDS single-names with Barclays acting as the primary market maker;
- **List Trading:** Fully disclosed auction-style protocol – clients can trade baskets of CDS single-names using our patented list trading protocol;
- **Roll and switch trading:** Available alongside cash credit trading on MarketAxess, with basis trading support to come.

Our straight-through processing, post-trade feeds and reporting capabilities can deliver significant operational efficiencies to CDS market participants.

9. What should I be doing to prepare for CDS SEF trading mandate on February 26, 2014?

In order to continue trading the swaps made available to trade on a SEF or DCM on or after February 26, 2014, all market participants must sign the MarketAxess User Agreement prior to this date and review the MarketAxess SEF Rulebook.

Participants must also complete and return the MarketAxess CDS Clearing Account Activation Form to ensure clearing relationships have been established.

Please note: All transactions are Permitted Transactions until the MAT determination.

For more information or questions, contact Grigorios Reppas, CDS Product Manager, at +1 212 813 6342 or greppas@marketaxess.com, or your MarketAxess sales representative