

MEMO# 25430

August 22, 2011

CFTC Proposal For Customer Clearing Documentation and Timing of Acceptance of Swaps for Clearing; Conference Call

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 41-11
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 33-11
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 39-11
ETF ADVISORY COMMITTEE No. 60-11
EQUITY MARKETS ADVISORY COMMITTEE No. 56-11
SEC RULES COMMITTEE No. 72-11 RE: CFTC PROPOSAL FOR CUSTOMER CLEARING
DOCUMENTATION AND TIMING OF ACCEPTANCE OF SWAPS FOR CLEARING; CONFERENCE
CALL

The Commodity Futures Trading Commission ("CFTC") has proposed rules regarding documentation for customer clearing arrangements and the timing of acceptance or rejection for clearing by derivatives clearing organizations ("DCOs") and clearing members. [1] In part, the proposed rules are a product of the CFTC's concern regarding the recently issued FIA-ISDA Cleared Derivatives Execution Agreement ("Agreement") [2] to be used as a template by swap market participants in negotiating execution agreements with counterparties to swaps that are intended to be cleared. The proposed rules would attempt to limit any potential conflicts with concepts in the Dodd-Frank Act, including open access to clearing and execution of customer transactions, that might arise through use of the Agreement.

Comments on the proposed rules are due to the CFTC no later than September 30. We have scheduled a conference call for Friday, August 26, at 2:00 p.m. ET to discuss potential comments by the Institute on the proposed rules. If you would like to participate in the call, please contact Ruth Tadesse at rtadesse@ici.org or 202/326-5836.

Customer Clearing Documentation

The CFTC is proposing rules relating to futures commission merchants ("FCMs"), swap dealers ("SDs"), major swap participants ("MSPs") and derivatives clearing organizations

("DCOs") that would prohibit execution-related arrangements (i.e., contracts) between these parties from including certain restrictions.; Specifically, the proposed rules would prohibit contractual provisions that would:

- Disclose to an FCM, SD or MSP the identity of a customer's original executing counterparty;
- Limit the number of counterparties with whom a customer may enter into a trade;
- Restrict the size of the position a customer may take with any individual counterparty, apart from an overall limit for all positions held by the customer at the FCM;
- Impair a customer's access to execution of a trade on terms that have a reasonable relationship to the best terms available; or
- Prevent compliance with specified time frames for acceptance of trades into clearing.

The CFTC Release explains that the inclusion of these restrictions in an execution-related contract could increase customer and systemic risk by delaying or blocking access to clearing, increase costs and reduce market efficiency by limiting the number of counterparties available for trading, and restrict access to clearing by limiting the potential clearing members with which a customer could interact. The Release further explains that prohibiting these restrictions would decrease the likelihood that swap trades would be rejected from clearing and diminish the potential for loss in cases where rejection does occur.

The Release states that the proposed rules were drafted in response to the Agreement published by the FIA and ISDA regarding execution-related contracts with counterparties to swaps that are intended to be cleared.; The Release explains that the CFTC is concerned that the Agreement may not be consistent with certain principles in the Dodd-Frank Act, including open access to clearing and exchange trading on terms that have a "reasonable relationship to the best terms available" by market participants. [\[3\]](#) For example, the Release highlights provisions in the Agreement that would permit a customer's FCM to establish specific credit limits for the customer's swap transactions with a SD, and to declare that, with respect to trades with that SD, the FCM will accept for clearing only those transactions that fall within the specified limits (i.e., creating a sublimit for the customer for trades with that SD). Moreover, the identity of the customer's counterparty would need to be disclosed to the FCM to implement any such credit limits, which, in the case of affiliated FCMs and SDs, could inhibit a customer's choice of clearing member because of the greater information exchange between the FCM and SD. In addition, the compliance process for such credit limits could delay acceptance of trades into clearing.

Time Frames for Acceptance into Clearing

The CFTC has proposed rules (and modified previously proposed rules) to require prompt, efficient and accurate processing of trades as a means to minimize risk stemming from the time lapse between trade execution and acceptance into clearing. Specifically, FCMs, SDs or MSPs that are clearing members would be required to accept or reject each trade submitted for clearing as quickly as would be technologically practicable if fully automated systems were used. Similarly, DCOs would be required to accept all swaps the DCO is eligible to clear as quickly as would be technologically practicable if fully automated systems were used, provided that:

- The executing parties have clearing arrangements in place with clearing members of the DCO;
- The executing parties identify the DCO as the intended clearinghouse; and

- The trade satisfies the criteria of the DCO (provided that such criteria are non-discriminatory across trading venues, and are applied as quickly as would be technologically practicable if fully automated systems were used).

Over-the-counter swaps and other swaps executed non-competitively on or subject to the rules of a designated contract market or swap execution facility also would be required to be submitted to a DCO in the following time frames:

- No later than the close of business on the day of execution if the swap is required to be cleared; or
- No later than the next business day after execution of the swap, or the agreement to clear, if later than execution, if the swap is not subject to a mandatory clearing requirement but is accepted for clearing by any DCO and the SD or MSP and its counterparty agree that such swap will be submitted for clearing. (Proposed Rule 39.12(b)(7)(ii))

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endnotes

[1] See Customer Clearing Documentation and Timing of Acceptance for Clearing, 76 FR 45730 (August 1, 2011) (“Release”), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-19365a.pdf>.

[2] FIA is the Futures Industry Association and ISDA is the International Swaps and Derivatives Association. The Agreement is available at www.futuresindustry.org. See press release, “FIA and ISDA Publish Documentation for Cleared Swaps” (June 16, 2011).

[3] The Agreement is voluntary and, as noted in its related press release, may not be necessary and appropriate under all circumstances.