

**MEMO# 26005**

March 29, 2012

# **CFTC Adopts Final Rules on Customer Clearing Documentation for Swaps, Timing of Acceptance for Clearing, and Allocation of Bunched Orders**

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 14-12  
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 11-12  
SEC RULES MEMBERS No. 23-12 RE: CFTC ADOPTS FINAL RULES ON CUSTOMER CLEARING DOCUMENTATION FOR SWAPS, TIMING OF ACCEPTANCE FOR CLEARING, AND ALLOCATION OF BUNCHED ORDERS

Recently, the Commodity Futures Trading Commission (“CFTC”) adopted rules regarding the documentation between a customer and a futures commission merchant (“FCM”), the timing of acceptance or rejection of trades for clearing by derivatives clearing organizations (“DCOs”) and clearing members, the allocation of bunched orders, and the risk management procedures of FCMs, swap dealers (“SD”), and major swap participants (“MSP”) that are clearing members. [\[1\]](#) The Final Rules incorporate four separate CFTC rulemakings in these areas. [\[2\]](#) The Final Rules become effective on October 1, 2012 for FCMs, designated contract markets (“DCMs”), and DCOs. For SDs and MSPs, the rules become effective on the later of October 1, 2012 or the date that the registration rules become effective. [\[3\]](#); A summary of the Final Rules is provided below.

## **Customer Clearing Documentation**

In response to the development of a template by industry groups for use by swap market participants in negotiating execution-related agreements with counterparties to swaps that are intended to be cleared, [\[4\]](#) the CFTC adopted rules that would prohibit terms that could conflict with the concepts of open access to clearing and competitive execution of transactions. [\[5\]](#)

The voluntary template includes optional annexes that make the clearing member to one or

both of the executing parties a party to the agreement (i.e., trilateral agreement). The trilateral agreement contains provisions that would permit a customer's FCM, in consultation with the SD that is the customer's counterparty, to establish specific credit limits for the customer's swap transactions with the SD. The provisions of the template also specify that the FCM will only accept for clearing those transactions that fall within these limits, which may be less than the limit set for the customer for all trades cleared through the FCM.

To address concerns that certain of the provisions in the trilateral agreements may conflict with the goal of open access to clearing by market participants, the CFTC has adopted the Final Rules. These rules prohibit arrangements 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 credit 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.

In adopting these rules, the CFTC was of the view that disclosure of a customer's original executing counterparty could have potentially anticompetitive effects (e.g., lead to undue influence by FCMs on a customer's choice of counterparties or undue influence by SDs on a customer's choice of clearing member). Moreover, the CFTC was concerned that limiting the number of counterparties would hurt the customer's access to the best price as well as general market liquidity, restricting the size of trades with particular counterparties would impair the customer's access to the best price as well as general market liquidity, and restrictions on the number of counterparties and on the size of trades with them would slow down acceptance for clearing. The CFTC believed that the exposure of dealers, counterparties, and FCMs to risks of increased costs because of trades being rejected for clearing could be better addressed through processing rules and risk management rules adopted as part of the Final Rules, which are discussed below.

## **Time Frames for Acceptance into Clearing**

The Final Rules set forth time frames for submission of trades by SDs and MSPs and acceptance for clearing by clearing members and clearing organizations. These rules are intended to facilitate the timely processing of trades and to minimize risk stemming from a delay between the time of execution and acceptance into clearing. Specifically, an SD or MSP would be required to submit a swap that is not executed on a SEF and DCM but is subject to a clearing mandate as soon as technologically practicable following execution of the swap, but no later than the close of business on the day of execution. For swaps that are not executed on a SEF and DCM and not subject to a clearing mandate but for which both counterparties have elected to clear the swap, the SD or MSP would be required to submit the swap for clearing no later than the next business day after execution of the swap, or the agreement to clear, if later than execution.

With respect to acceptance for clearing by a clearing member and clearing organization,

the Final Rules would require each FCM, SD, and MSP that is a clearing member of a DCO to coordinate with each DCO on which it clears to establish systems that would enable the FCM, SD, and MSP, respectively, or DCO acting on its behalf, to accept or reject each trade submitted to the DCO for clearing as quickly as would be technologically practicable if fully automated systems were used. In response to comments, the CFTC has determined to permit DCOs to screen trades against applicable product and credit criteria before acceptance or rejection provided that the criteria are non-discriminatory with respect to trading venues and clearing participants.

The CFTC also modified the original proposal to require acceptance or rejection by the DCO of all trades not executed on a DCM or SEF as quickly after submission as would be technologically practicable if fully automated systems were used. The original proposal made a distinction between swaps subject to mandatory clearing and those not subject to mandatory clearing.

## **Post-Trade Allocation of Bunched Orders**

The CFTC adopted rules to apply the procedures for allocating bunched orders in the futures market to swaps. [6] Bunched orders are orders entered into by an account manager on behalf of multiple customers, which are executed as a block and later allocated among participating customer accounts. As adopted, the Final Rules require that bunched orders be allocated as soon as practicable after execution but no later than: (1) for cleared transactions, sufficiently before the end of the day the order is executed to ensure that clearing records identify the customer accounts, and (2) for uncleared transactions, no later than the end of the day the swap was executed.

## **Clearing Member Risk Management**

Finally, the Final Rules set forth risk management requirements for FCMs, SDs, and MSPs that are clearing members to require them to have procedures to limit the financial risks they incur as a result of clearing trades and to have liquid resources to meet the obligations that arise. The procedures must include, among others, establishing risk-based limits, screening order for compliance with risk-based limits, monitoring for adherence to the risk-based limits intra-day and overnight, conducting stress tests, and evaluating the ability to meet initial and variation margin requirements and to liquidate, and testing all lines of credit.

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### **endnotes**

[1] Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, RIN 3038-0092, -0094, available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister032012.pdf> (Mar. 20, 2012) (“Final Rules”).

[2] Customer Clearing Documentation and Timing of Acceptance for Clearing, 76 FR 45730 (Aug. 1, 2011); Clearing Member Risk Management, 76 FR 45724 (Aug. 1, 2011); Adaption of Regulations to Incorporate Swaps, 76 FR 33066 (June 7, 2011); Requirements for

Processing, Clearing, and Transfer of Customer Positions, 76 FR 13101 (Mar. 10, 2011).

[3] For swap execution facilities (“SEFs”), the rules become effective on the later of October 1, 2012 or the date that the rules implementing the core principles for SEFs become effective.

[4] See FIA-ISDA Cleared Derivatives Execution Agreement, available at <http://www.futuresindustry.org/fia-and-isda-publish-documentation-for-cleared-swaps.asp>. FIA is the Futures Industry Association and ISDA is the International Swaps and Derivatives Association.

[5] See ICI [Memorandum](#) No. 25526 (Sept. 30, 2011), available at [http://www.ici.org/my\\_ici/memorandum/memo25526](http://www.ici.org/my_ici/memorandum/memo25526) (ICI comment letter on customer clearing documentation for swaps); ICI [Memorandum](#) No. 25430 (Aug. 22, 2011), available at [http://www.ici.org/my\\_ici/memorandum/memo25430](http://www.ici.org/my_ici/memorandum/memo25430) (summary of proposal for customer clearing documentation and timing of acceptance of swaps for clearing).

[6] In the futures market, bunched orders are executed as a block for immediate acceptance into clearing and allocated into individual accounts later in the day. A “stand-by clearing member” guarantees the trades until they are allocated.