

CFTC Finalizes Dodd-Frank Rulemaking on Customer Clearing Documentation, Timing for Acceptance of Clearing, and Clearing Member Risk Management

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On Tuesday, March 20, 2012, the U.S. Commodity Futures Trading Commission (CFTC) approved a final rule (the "Final Rule") regarding customer clearing documentation, timing of acceptance of swaps for clearing, and clearing member risk management. Late last week, the CFTC published the [Final Rule](#) on its website, but the Final Rule has not yet appeared in the Federal Register. CFTC staff has also posted additional information about the Final Rule in a [Fact Sheet](#) and [Q&A](#) on its website.

The Final Rule is based on four separate proposed rules: (1) customer clearing documentation; (2) timing of acceptance of swaps for clearing; (3) allocation of bunched orders; and (4) clearing member risk management. Except for the addition of clarifying language in several instances, the Final Rule is substantially similar to the rules as they were initially proposed.

The effective date of the Final Rule will be 60 days after it is published in the Federal Register, and the dates for compliance are as follows:

- For derivatives clearing organizations (DCOs), designated contract markets (DCMs), and futures commission merchants (FCMs), October 1, 2012.
- For swap dealers (SDs) and major swap participants (MSPs), on the later of October 1, 2012, and the date on which SDs and MSPs are required to register as such under the CFTC's final registration rules.
- For swap execution facilities (SEFs), on the later of October 1, 2012, and the date on which the CFTC finalizes its rules implementing core principles for SEFs.

1. Customer Clearing Documentation

The Customer Clearing Documentation portion of the Final Rule prohibits SDs, MSPs, DCOs and FCMs from entering into agreements that:

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

The CFTC specifically cites the Futures Industry Association and International Swaps and Derivatives Association template for execution agreements between swap market participants, their counterparties

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and clearing members (the “FIA/ISDA Execution Agreement”) as “potentially [in] conflict with the concepts of open access to clearing and competitive execution of transactions.”¹ An annex to the FIA/ISDA Execution Agreement is designed to address the risks associated with trades that are executed, but fail to clear as a result of actions or inactions by one of the clearing members for one of the counterparties. In doing so, however, the FIA/ISDA Execution Agreement would force customers to disclose the identity of their executing counterparties to their clearing members and would force clearing members to establish limits on the positions that customers could take with each of their counterparties, both of which are prohibited by the Final Rule.

2. Timing of Acceptance of Swaps for Clearing

In keeping with the Dodd-Frank Act and ensuing regulations, swap counterparties will continue to execute certain cleared swaps bilaterally before they are submitted to a DCO for clearing, through their respective clearing members. Counterparties will execute certain other swaps on SEFs or DCMs and then submit those swaps to a DCO for clearing. The second portion of the Final Rule establishes timing requirements for submission of swaps to DCOs and for acceptance of such swaps by DCOs, and in doing so seeks to ensure compliance with mandatory clearing requirements and promote the mitigation of counterparty credit risk through the use of central clearing.

SDs and MSPs must submit for clearing swaps that are: (1) subject to a clearing mandate; (2) not executed on an SEF or a DCM; and (3) not electively excepted from mandatory clearing pursuant to the end-user exception, as soon as technologically practicable following execution of the swap, but no later than the close of business on the day of execution. SDs and MSPs must submit for clearing clearable swaps that are: (1) not subject to a clearing mandate; and (2) not executed on an SEF or a DCM and that the counterparties have elected to clear, no later than the next business day after execution of the swap (or after the agreement to clear, if this is later than execution).

DCOs will be obligated to accept or reject all trades as quickly as would be technologically practicable if fully automated systems were used. This allows DCOs to screen trades against applicable product and credit criteria before accepting or rejecting them. However, the criteria used to make this determination must be nondiscriminatory with respect to trading venues and clearing participants. The Final Rule requires that SDs, MSPs, SEFs and DCMs coordinate with each DCO to which they submit trades for clearing to develop rules and procedures that facilitate prompt and efficient transaction processing in accordance with the CFTC’s time frames for acceptance or rejection of swaps for clearing.

The CFTC stated that the timing requirements for acceptance or rejection of trades into clearing create performance standards, not a prescribed method of trade processing. The CFTC anticipates trades to be accepted for clearing in milliseconds or seconds, at most a few minutes, but not hours or days. The Commission expects some SDs, MSPs and FCMs to implement fully automated systems, while others will include manual steps in their processes.

¹ The FIA/ISDA Execution Agreement is available at:
http://www.futuresindustry.org/downloads/ClearedDerivativesExecutionAgreement_June142001.pdf.

3. Allocation of Bunched Orders

The Final Rule requires clearing members to immediately accept bunched orders for swaps executed as a block. An account manager would then allocate the block to individual customer accounts later in the day. These provisions are similar to rules that have been applicable to futures trading for years.

4. Clearing Member Risk Management

The Final Rule establishes risk management rules that require SDs, MSPs and FCMs that are clearing members to:

1. Establish credit and market risk-based limits;
2. Use automated means to screen orders for compliance with these limits and monitor adherence to these risk-based limits intra-day and overnight;
3. Conduct stress tests at least once a week of all positions in the clearing member's proprietary account and any customer account that may pose material risk to the clearing member;
4. Evaluate their ability to meet initial and variation margin requirements once a week;
5. Evaluate their ability to liquidate positions they clear in an orderly manner and estimate the cost of liquidation at least once a month; and
6. Test all lines of credit at least once a year.

The Final Rule does not prescribe a process to implement these risk management requirements but leaves it up to clearing members to use their judgment in deciding the processes that work best for them. In most instances, DCOs, in their capacity as self-regulatory organizations, already impose similar requirements on their clearing members.



If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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