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CFTC Publishes Twelfth Series of Dodd-Frank Rules

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The Commodity Futures Trading Commission has published its twelfth series of proposed rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act as well as a proposed interpretive order to give effect to the Dodd-Frank Act provisions relating to "disruptive" trading practices. The proposals relate to technical amendments to regulations governing commodity pool operator (CPO) and commodity trading advisor (CTA) registration; requirements for processing, clearing and transferring customer positions; and the intermediary registration requirements as they relate to swap dealers, major swap participants (MSPs) and swap execution facilities (SEFs).

- **Amendments to Regulations Regarding CPOs and CTAs:** The CFTC has proposed amendments to its existing Part 4 regulations, relating to CPOs and CTAs, in order to harmonize the provisions of Part 4 with the Dodd-Frank Act. The proposed rules would, among other things, define the term "commodity interest" to include, among other instruments, a swap and modify CTA and CPO disclosure, reporting, and recordkeeping requirements to include swap transactions and interaction with swap dealers.
- **Processing, Submission, Acceptance of Swaps, and Customer Position Transfers:** The CFTC has proposed regulations that would establish uniform standards for the prompt processing, submission and acceptance of swaps eligible for clearing by a derivatives clearing organization (DCO) and establish certain product standards for DCOs. The proposed regulations are additionally intended to facilitate the transfer of customer positions from one clearing member to another.

  SEFs and designated contract markets (DCMs) would be required to submit swaps for clearing immediately upon execution. The proposed regulations further require (1) with respect to swaps that are not executed on a SEF or DCM but that are subject to mandatory clearing, that a swap dealer or MSP submit such swaps for clearing as soon as technologically practicable following execution, but not later than the close of business on the day of execution and (2) with respect to swaps not subject to mandatory clearing but which the parties agree to have cleared, that a swap dealer or MSP submit the swap for clearing not later than the next business day after execution.

The proposed regulations would also include timing requirements for the processing of swaps submitted to a DCO for clearing.

- If a swap is executed on a SEF or DCM, a DCO must accept the swap immediately upon execution.
- If a swap is not executed on a SEF or DCM, but is subject to mandatory clearing, the DCO must accept the swap upon its submission to the DCO.
- If a swap is not executed on a SEF or DCM, is not subject to mandatory clearing but is being submitted for clearing, the DCO must accept the swap no later than the close of the business day of submission to the DCO.

The proposed regulations would also require a DCO to establish templates for the terms and conditions of swaps that it will clear; to select contract unit sizes for swaps that maximize liquidity, open access and risk management; and to have rules stating that upon acceptance of a swap by the DCO for clearing, (1) the original swap is extinguished and (2) is replaced by equal and opposite swaps between clearing members and the DCO, (3) terms of the cleared swaps must conform to templates established under DCO rules, and (4) where a swap is cleared by a clearing member on behalf of a customer, all terms of the swap, as carried in the customer account on the books of the clearing member, must conform to the terms of the cleared swap established under the DCO's rules.

The CFTC is also proposing regulations that would require all swap dealers, MSPs, DCOs, SEFs and DCMs to coordinate with each other in developing rules and procedures that facilitate prompt and efficient swap processing.

The CFTC has further proposed to prohibit the DCOs from refusing to clear a swap if neither party to the transaction is a clearing member. The CFTC indicated that, in its view, a restriction of this nature serves no apparent risk management purpose and operates to keep certain trades out of the clearing process and to constrain liquidity for cleared trades.

Finally, the proposed regulations would require DCOs to establish rules for prompt transfers of all or a portion of a customer's portfolio of positions and related funds from one clearing member to another, upon the request of the customer and subject to the consent of the receiving clearing member, without requiring the close-out and re-booking of the positions prior to the requested transfer.

- **Registration of Intermediaries:** The CFTC has proposed to amend Part 3 of its regulations, which set forth registration requirements for intermediaries, to eliminate obsolete references to derivatives transaction execution facilities and to add references to swap dealers, MSPs and SEFs where appropriate. The CFTC proposal would also exempt an associated person of a swap dealer or MSP from individually having to register as a swap dealer or MSP.

The proposed rules also would expand an existing exemption from the definition of "principal" to include foreign banks that are otherwise regulated and would create an exemption from registration as a futures commission merchant for foreign brokers and other foreign intermediaries that execute a transaction on a SEF on behalf of non-U.S. persons.

- **Antidisruptive Trading Authority:** The Dodd-Frank Act amended the Commodity Exchange Act to include a new Section 4c(a)(5), which prohibits any trading, practice or conduct on or subject to the rules of a registered entity that:

    - violates bids or offers;
    - demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or
    - is of the character of, or is commonly known to the trade as, "spoofing" (bidding or offering with the intent to cancel the bid or offer before execution).

  The CFTC has released a proposed interpretive order to provide further clarity as to the scope and interpretation of the Section 4c(a)(5) prohibitions.

  With respect to the first prohibited activity, the proposed interpretive order would establish that violating bids or offers involves buying a contract at a price that is higher than the lowest available offer price and/or selling a contract at a price that is lower than the highest available bid price, regardless of intent. This prohibition would operate in any trading environment where a person exercises some control over the selection of the bids or offers against which they transact, including in an automated trading system which operates without pre-determined matching algorithms, but not in any automated trading system with a pre-determined matching algorithm (where it would be impossible to violate a bid or offer).

  With respect to the second prohibited activity, the proposed interpretive order would establish that the scienter requirement included in the statute ("intentional or reckless") would preclude violations based on accidental or negligent trading conduct and practices. Furthermore, the proposed interpretation would provide for this purpose that the "closing period" is the period when the daily settlement price is determined under the rules of that trading facility.

  Finally, the proposed order would interpret the prohibition as requiring that a person intend to cancel a bid or offer before execution (a scienter requirement). In the CFTC's view, the "spoofing" prohibition would not be implicated by reckless trading, conduct or practices or in the event of orders, modifications or cancellations submitted as part of a legitimate, good-faith attempt to consummate a trade. "Spoofing" would be interpreted, however, to include: (1) submitting or cancelling bids or offers to overload the quotation system of a registered entity; (2) submitting or cancelling bids or offers to delay another person's execution of trades; and (3) submitting or cancelling multiple bids or offers to create an appearance of false market depth.

Comments on the proposals are generally due within 60 days from the dates of their publication in the *Federal Register*. However, comments on the proposed rules regarding Processing, Submission, Acceptance of Swaps, and Customer Position Transfers are due 30 days from the date of their publication.

The proposed rules and interpretive order can be found here.
Further information regarding the proposals, including fact sheets and Q&As, is available here.

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