

Corporate & Financial Weekly Digest

Posted at 12:26 PM on January 7, 2011 by [Kenneth M. Rosenzweig](#)

CFTC Publishes Eighth Series of Dodd-Frank Rules

Co-authored by [Kevin M. Foley](#) and [Vanessa L. Colman](#)

The Commodity Futures Trading Commission has published its eighth series of rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The eighth series of CFTC rules and rule proposals relate to confirmation, portfolio reconciliation and portfolio compression requirements for swap dealers (SDs) and major swap participants (MSPs), registration obligations of derivatives clearing organizations (DCOs) and core principles and other requirements applicable to swap execution facilities (SEFs).

- **Confirmation, Portfolio Reconciliation And Portfolio Compression Requirements for Swap Dealers and Major Swap Participants:** Dodd-Frank directs the CFTC to “adopt rules governing documentation standards” for SDs and MSPs. Accordingly, the CFTC is proposing rules that would impose certain standards on SDs and MSPs regarding the confirmation of swap transactions and the reconciliation and compression of swap portfolios.

The CFTC’s stated objective with respect to the proposed confirmation standards is for parties to swap transactions to “have full written agreement on all terms as soon as practicable after execution and also upon any ownership event during the life of the swap.” The proposed rules would therefore be applicable to any event that would result in a new swap or a change in the terms of an existing swap, and would vary by transaction, depending on the counterparties. With respect to a swap transaction in which both parties are either an SD or MSP, each party must execute a confirmation of the transaction on the same calendar day as execution. With respect to a swap transaction entered into by an SD or MSP with a counterparty that is neither an SD nor an MSP, the SD or MSP would be obligated to send an acknowledgement of the transaction on the same day as execution and a confirmation of the transaction by the next business day (although if the counterparty is a financial entity, such confirmation must be effected the day of execution). An “acknowledgement” is defined as “a written or electronic record of all the terms of a swap signed and sent by one party to another.” A “confirmation” is an acknowledgement that has been verified and signed by the receiving counterparty. SDs and MSPs must also maintain certain records of such acknowledgements and confirmations.

The proposed reconciliation rule would require SDs and MSPs to undertake portfolio reconciliation with respect to a swap transaction entered into with another SD or MSP and not cleared by a DCO. Both counterparties to an uncleared swap must agree in writing to the terms of the reconciliation. SDs and MSPs must reconcile swap portfolios daily, weekly or quarterly, as determined by the size of the particular swap portfolio. SDs and MSPs would also be required to establish written policies and procedures to perform portfolio reconciliation with respect to swap portfolios involving a counterparty that is neither an SD nor an MSP. The proposed rules would also impose certain requirements on SDs and MSPs regarding the resolution of discrepancies in the material terms or valuation of swap transactions, and the maintenance of records concerning such transactions.

With respect to eligible swap transactions in which both parties are either an SD or MSP, the proposed rules would require SDs and MSPs to engage in (1) bilateral portfolio compression exercises annually, and (2) multilateral portfolio compression exercises as required by the CFTC or offered by an applicable DCO or self-regulatory organization. A swap would be excluded from these requirements if including it would be reasonably likely to significantly increase the risk profile of the SD or MSP. In a portfolio compression exercise, “swap market participants whose combined portfolios include outstanding transactions that contain substantially similar economic terms and/or that would result in redundant payments wholly or partially net their swaps by terminating the original swaps and replacing them with a smaller number of new transactions that have a lower gross notional value.” Additionally, SDs and MSPs would be required to bilaterally terminate, within one day, all fully offsetting swaps entered into with an SD or MSP counterparty. With respect to swaps entered into by an SD or MSP with a counterparty that is neither an SD nor an MSP, the SD or MSP would be required to maintain written policies and procedures for periodically (1) terminating any fully offsetting swaps and (2) participating in compression exercises, to the extent such swaps can be terminated by compression.

The CFTC has requested comment on various items, including the appropriate effective date for final rules. Comments must be submitted by February 28.

- **Registration Requirements for Derivatives Clearing Organizations:** The CFTC is proposing rules governing the registration process of DCOs. The proposals set forth criteria for compliance with Core Principles applicable to DCOs, including standards for participant and product eligibility, risk management, settlement procedures, treatment of funds, default rules and procedures and system safeguards (such as risk analysis programs and business continuity and disaster recovery plans). The proposed rules would impose greater obligations with respect to such system safeguards on systematically important DCOs in connection with the recovery time objective and geographic diversity. The proposal would replace the current Appendix A to Part 39 of the CFTC rules, Application Guidance and Compliance with Core Principles, with a new application for DCO registration, Form DCO.

The CFTC is also proposing to supplement another recently proposed rule to require DCOs to make certain additional reports to the CFTC, including reporting clearing members' end-of-day customer positions for each beneficial owner.

The proposals have not yet been published in the *Federal Register*.

- **Core Principles and Other Requirements for Swap Execution Facilities:** Dodd-Frank established a regulatory framework for SEFs by (1) providing a definition of an SEF, (2) requiring that swaps that are required to be cleared under the Commodity Exchange Act (CEA) be executed on a designated contract market (DCM) or an SEF, to the extent a DCM or SEF makes the swap available for trading, and (3) creating registration and core principle requirements for SEFs.

The proposed rules will: (1) require SEFs to provide a basic functionality that gives all market participants the option to post both firm and indicative quotes to multiple parties, including all other parties participating in the SEF, and (2) provide that SEFs have the option to deploy any trading system or platform that provides this basic functionality, including request for quote systems or order books.

The CFTC is proposing to implement the execution requirement by allowing "Required Transactions" to be traded on "Request for Quote Systems" or "Order Books." "Required Transactions" include transactions that: (1) are subject to the clearing and execution requirements under the CEA, (2) are made available for trading, and (3) are not block trades.

A "Request for Quote System" would include (1) a trading system or platform in which a market participant must transmit a request for a quote to buy or sell a specific instrument to no fewer than five market participants, (2) a trading system or platform in which multiple market participants can both view real-time electronic streaming quotes from multiple potential counterparties on a centralized electronic screen and have the option to complete a transaction by either accepting a firm streaming quote or transmitting a request for quote to no fewer than five market participants, and (3) any other trading system or platform approved by the CFTC.

"Order Books" would include (1) electronic trading facilities as defined in the CEA, (2) trading facilities as defined in the CEA, (3) trading systems or platforms in which all market participants in the trading system or platform can enter multiple bids and offers, observe bids and offers entered by other market participants and choose to transact on such bids and offers, and (4) any other trading system or platform approved by the CFTC.

The CFTC is also proposing to adopt regulations and provide guidance and acceptable practices governing the obligations of SEFs to comply with the applicable provisions of the CEA, as amended by Dodd-Frank, including the registration requirements and the 15 core principles under Section 5h of the CEA. Specifically, the proposed regulations, guidance and acceptable practices govern the general obligations of SEFs, including (1) trading and product requirements, (2) compliance and audit-trail obligations, (3)

governance and disciplinary requirements, (4) operational capabilities, (5) surveillance obligations, and (6) financial information and resource requirements. The proposed rules further include a Form SEF, which would be used in the application for or amendment to registration as an SEF. The proposed Form SEF provides further guidance on compliance by SEFs with the 15 core principles contained in the CEA.

The proposed rules have not yet been published in the *Federal Register*. The comment period for these proposals will expire 60 days from the date of their publication in the *Federal Register*.

Information regarding all of the CFTC proposals, including the *Federal Register* releases or CFTC releases (as applicable), fact sheets and Q&As can be found [here](#).

Katten Muchin Rosenman LLP

Charlotte Chicago Irving London Los Angeles New York Washington, DC