

Corporate & Financial Weekly Digest

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CFTC Publishes Rule Proposals and Approves Final Rules Under Dodd-Frank

At a July 19 meeting, the Commodity Futures Trading Commission approved three final rulemakings and two rule proposals under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), as described below.

- Final Rule Implementing Procedures for Review of Swaps for Mandatory Clearing: The CFTC unanimously adopted new CFTC Regulation 39.5 to establish processes for (1) determining the eligibility of derivatives clearing organizations (DCOs) to clear swaps; (2) the submission of swaps by DCOs to the CFTC for mandatory clearing determinations; (3) reviews of swaps initiated by the CFTC; and (4) stays of the clearing requirement.
 1. Rule 39.5(a) provides that, subject to CFTC review, a DCO would be presumed eligible to accept for clearing any swap within a group, category, type or class of swaps that the DCO already clears. A DCO would be required to request a CFTC determination as to its eligibility to clear any swap that does not meet this criterion. The CFTC noted that while a DCO's authority to clear particular swaps transactions would not be conditioned on its ability to clear the entire market volume of such swaps transactions, its inability to do so would be taken into account in the CFTC's determination of whether the swap must be cleared.
 2. Rule 39.5(b) sets forth the process by which a DCO may submit a swap to the CFTC and the information that must be included in such a submission. For example, the DCO must include a "description of the manner in which the [DCO] has provided notice of the submission to its members and a summary of any views on the submission expressed by the members." The CFTC has eliminated additional proposed submission requirements for DCOs previously set forth in Regulation 40.2. Upon receipt of a DCO's swap submission, the CFTC will publish the submission in the Federal Register and on its website for a 30-day public comment period, as required under the Dodd-Frank Act, and conduct a 90-day review, taking into account certain factors specified by CFTC Rule 39.5(b)(3)(ii).
 3. Rule 39.5(c) requires the CFTC, on an ongoing basis, to review swaps not accepted for clearing by a DCO to determine whether such swaps should be required to be cleared. In conducting such CFTC-initiated reviews, the CFTC would use the same criteria as for DCO-submitted reviews set forth in Rule 39.5(b)(3)(ii). Upon a determination that any swap or group, category, type or class of swaps that no DCO has accepted for clearing

should be subject to mandatory clearing, the CFTC may take such actions as it “determines to be necessary and in the public interest, which may include requiring the retaining of adequate margin or capital by parties to the swap, group, category, type, or class of [uncleared] swaps.” The CFTC noted that it does not anticipate imposing margin or capital requirements under this rule on any swap counterparty otherwise permitted by CFTC regulations to exercise the end-user exception to mandatory clearing.

4. Under Rule 39.5(d), after determining that a swap or group, category, type or class of swaps is required to be cleared, the CFTC may stay the clearing requirement until after it has reviewed the terms of the swap and the clearing arrangement. After such a review, the CFTC could either impose mandatory clearing requirements or choose to not apply the clearing requirement, but allow clearing to continue on a non-mandatory basis (subject to any terms or conditions it deems appropriate). The CFTC has declined to specify what factors it will consider in determining whether to stay a clearing requirement or to adopt a deadline by which it must respond to a request for a stay.
- Final Rule Regarding Provisions Common to Registered Entities: The CFTC also unanimously approved rules implementing a new procedural framework for certifying and approving new products, rules and rule amendments submitted by designated contract markets, DCOs, swap execution facilities and swap data repositories.
 - Final Rule Removing References to Credit Ratings from CFTC Regulations: The CFTC also unanimously adopted a final rulemaking to carry out the Dodd-Frank Act mandate to remove certain credit ratings references from agency regulations and substitute such references with alternative standards.
 - Proposed Rule on Customer Clearing Documentation and Timing of Acceptance for Clearing: By a vote of 3-2, the CFTC approved the publication of proposed rules that would prohibit certain arrangements involving clearing customers and establish regulatory timeframes for the acceptance or rejection of trades for clearing by DCOs and their clearing members. The proposed rulemaking would prohibit futures commission merchants (FCMs), swap dealers (SDs), major swap participants (MSPs) or DCOs from entering into arrangements with customers that would (1) disclose to an FCM, SD or MSP the identity of a customer’s original executing counterparty; (2) limit the number of counterparties with whom a customer may enter into a trade; (3) restrict the size of the position a customer may take with any individual counterparty (apart from an overall credit limit across all of the customer’s positions); (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. With respect to the acceptance or rejection of trades for clearing, the proposed rules would require DCOs and their clearing members to accept or reject trades submitted for clearing as quickly as would be technologically practicable if fully automated systems were used. DCOs and their FCM, SD and MSP clearing members would be required to coordinate in establishing systems for prompt processing of trades.
 - Proposed Rule on Clearing Member Risk Management: Finally, also by a vote of 3-2, the CFTC approved the publication of proposed rules governing risk management by FCMs, SDs and MSPs that are clearing members. The proposed rulemaking would require such entities to: (1) establish credit and market risk-based limits based on factors including position size, order size and margin requirements; (2) use automated means to screen

orders for compliance with the risk-based limits; (3) monitor for adherence to the risk-based limits intra-day and overnight; (4) conduct stress tests of all positions in their proprietary accounts and all positions in any customer account (in the case of an FCM) that could pose material risk to the entity at least once per week; (5) evaluate their ability to meet initial margin requirements at least once per week; (6) evaluate their ability to meet variation margin requirements in cash at least once per week; (7) evaluate their ability to liquidate positions they clear in an orderly manner, and estimate the cost of the liquidation at least once per month; and (viii) test all lines of credit at least once per quarter.

Each of the final rules adopted at the meeting will take effect 60 days from the date the respective rulemaking notice is published in the *Federal Register*; the comment period for each of the proposed rules will close 60 days from the date of the proposal's publication in the Federal Register.

Information regarding the final and proposed rules, including the releases, CFTC fact sheets and Q&As, is available [here](#).

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