

Joint Audit Committee

REGULATORY UPDATE

TO: Chief Financial Officers
Chief Compliance Officers

#11-01

DATE: August 12, 2011

SUBJECT: Proposed CFTC Regulations 1.72, 1.73, and 1.74

The CFTC has recently published for comment proposed Regulation 1.72 regarding restrictions on customer clearing arrangements, Regulation 1.73 regarding clearing futures commission merchant ("FCM") risk management, and Regulation 1.74 regarding FCM acceptance of trades for clearing.

Proposed Regulation 1.72 Restrictions on Customer Clearing Arrangements

Proposed Regulation 1.72, among other things, prohibits an FCM providing clearing services from entering into an arrangement that:

- Discloses to the FCM or any swap dealer or major swap participant the identity of a customer's original executing counterparty;
- Limits the number of counterparties with whom a customer may enter into a trade;
- Restricts the size of the position a customer may take with any individual counterparty, apart from an overall limit for all positions held by the customer at the FCM;
- Impairs a customer's access to execution of a trade on terms that have a reasonable relationship to the best terms available; or
- Prevents compliance with specified time frames for acceptance of trades into clearing.

The proposal was published in the attached Federal Register (August 1, 2011, Vol. 76, No. 147, at page 45730) and can be found on the CFTC's Web site at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-19365a.pdf>.

Proposed Regulation 1.73 Clearing Futures Commission Merchant Risk Management

Proposed Regulation 1.73, among other things, requires a clearing member FCM to establish risk management requirements that:

- Establish risk-based limits in the proprietary account and in each customer account;
- Use automated means to screen orders for compliance with risk-based limits;
- Monitor adherence to the risk-based limits intra-day and overnight;
- Conduct stress tests of all positions in the proprietary account and all positions in any customer account that could pose material risk to the FCM at least once per week;

The Joint Audit Committee is a representative committee of U.S. futures exchanges and regulatory organizations including the: CBOT, CCFE, CFE, CME, COMEX, ELX, KCBOT, MGEX, NFA, ICE Futures U.S., Inc., INET, NADEX, NFX, NYMEX, NYSE Liffe US, and OCX.

- Evaluate its ability to meet initial margin requirements at least once per week;
- Evaluate its ability to meet variation margin requirements in cash at least once per week;
- Evaluate its ability to liquidate positions, in an orderly manner, and estimate the cost of the liquidation at least once per month;
- Test all lines of credit at least once per quarter; and
- Establish written procedures to comply with Regulation 1.73; and keep full, complete, and systematic records documenting its compliance with this regulation.

The proposal was published in the attached Federal Register (August 1, 2011, Vol. 76, No. 147, at page 45724) and can be found on the CFTC's Web site at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-19362a.pdf>.

Proposed Regulation 1.74 Futures Commission Merchant Acceptance for Clearing

Proposed Regulation 1.74, among other things, requires a clearing member FCM to establish procedures for acceptance of trades for clearing that include:

- FCM's requirement to coordinate with each derivatives clearing organization on which it clears to establish systems that enable the FCM, or the derivatives clearing organization acting on its behalf, to accept or reject each trade submitted for clearing by or for the FCM or a customer of the FCM as quickly as technologically practicable if fully automated systems were used; and
- FCM's requirement to accept or reject each trade submitted for clearing as quickly as technologically practicable if fully automated systems were used and evidenced by:
 - Establishing systems to pre-screen orders for compliance with criteria specified by the FCM;
 - Establishing systems that authorize a derivatives clearing organization to accept or reject on its behalf trades that meet, or fail to meet, FCM criteria; or
 - Establishing systems that enable the clearing FCM to communicate to the derivatives clearing organization acceptance or rejection as quickly as technologically practicable if fully automated systems were used.

When considering a standard for action to be taken "as quickly as would be technologically practicable if fully automated systems were used" the CFTC anticipates the standard would require action in a matter of milliseconds or seconds or, at most, a few minutes, not hours or days.

The proposal was published in the attached Federal Register (August 1, 2011, Vol. 76, No. 147, at page 45730) and can be found on the CFTC's Web site at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-19365a.pdf>.

The proposed changes are significant; therefore, we encourage you to carefully review the proposals for their impact to your business, and to provide the CFTC with your comments which are due by September 30, 2011.

If you have any questions, please contact your DSRO.

§ 23.609 Clearing member risk management.

(a) With respect to clearing activities in futures, security futures products, swaps, agreements, contracts, or transactions described in section 2(c)(2)(C)(i) or section 2(c)(2)(D)(i) of the Act, commodity options authorized under section 4c of the Act, or leveraged transactions authorized under section 19 of the Act, each swap dealer or major swap participant that is a clearing member of a derivatives clearing organization shall:

(1) Establish risk-based limits based on position size, order size, margin requirements, or similar factors;

(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 at least once per week;

(5) Evaluate its ability to meet initial margin requirements at least once per week;

(6) Evaluate its ability to meet variation margin requirements in cash at least once per week;

(7) Test all lines of credit at least once per quarter; and

(8) Evaluate its ability to liquidate the positions it clears in an orderly manner, and estimate the cost of the liquidation.

(b) Each swap dealer or major swap participant that is a clearing member of a derivatives clearing organization shall:

(1) Establish written procedures to comply with this regulation; and

(2) Keep full, complete, and systematic records documenting its compliance with this regulation.

Issued in Washington, DC, on July 19, 2011, by the Commission.

David A. Stawick,

Secretary of the Commission.

Appendices to Clearing Member Risk Management—Commission Voting Summary and Statements of Commissioners

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendix 1—Commission Voting Summary

On this matter, Chairman Gensler and Commissioners Dunn and Chilton voted in the affirmative; Commissioners O'Malia and Sommers voted in the negative.

Appendix 2—Statement of Chairman Gary Gensler

I support the proposed rulemaking for enhanced risk management for clearing members. One of the primary goals of the Dodd-Frank Wall Street Reform and

Consumer Protection Act was to reduce the risk that swaps pose to the economy. The proposed rule would require clearing members, including swap dealers, major swap participants and futures commission merchants to establish risk-based limits on their house and customer accounts. The proposed rule also would require clearing members to establish procedures to, amongst other provisions, evaluate their ability to meet margin requirements, as well as liquidate positions as needed. These risk filters and procedures would help secure the financial integrity of the markets and the clearing system and protect customer funds.

[FR Doc. 2011-19362 Filed 7-29-11; 8:45 am]

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COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 23, and 39

RIN 3038-AD51

Customer Clearing Documentation and Timing of Acceptance for Clearing

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (Commission or CFTC) is proposing rules to implement new statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. These proposed rules address: The documentation between a customer and a futures commission merchant that clears on behalf of the customer, and the timing of acceptance or rejection of trades for clearing by derivatives clearing organizations and clearing members.

DATES: Submit comments on or before September 30, 2011.

ADDRESSES: You may submit comments, identified by RIN number 3038-AD51, by any of the following methods:

- *Agency Web site, via its Comments Online process:* <http://comments.cftc.gov>. Follow the instructions for submitting comments through the Web site.

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.

- *Mail:* David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

- *Courier:* Same as mail above.

Please submit your comments using only one method. RIN number, 3038-AD51, must be in the subject field of responses submitted via e-mail, and

clearly indicated on written submissions. All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <http://www.cftc.gov>. You should submit only information that you wish to make available publicly. If you wish the CFTC to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the CFTC's regulations.¹

The CFTC reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from <http://www.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of this action will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

FOR FURTHER INFORMATION CONTACT: John C. Lawton, Deputy Director and Chief Counsel, 202-418-5480, jlawton@cftc.gov, or Christopher A. Hower, Attorney-Advisor, 202-418-6703, chower@cftc.gov, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Background

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).² Title VII of the Dodd-Frank Act amended the Commodity Exchange Act (CEA or Act)³ to establish a comprehensive new regulatory framework for swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating rigorous recordkeeping and real-time reporting

¹ 17 CFR 145.9.

² See Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).

³ 7 U.S.C. 1 *et seq.*

regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission's oversight. Title VII also includes amendments to the federal securities laws to establish a similar regulatory framework for security-based swaps under the authority of the Securities and Exchange Commission (SEC).

II. Proposed Regulations

A. Introduction

A fundamental premise of the Dodd-Frank Act is that the use of properly regulated central clearing can reduce systemic risk. Another tenet of the Dodd-Frank Act is that open access to clearing by market participants will increase market transparency and promote market efficiency by enabling market participants to reduce counterparty risk and by facilitating offset of open positions. The Commission has proposed extensive regulations addressing open access at the derivatives clearing organization (DCO) level.⁴

Clearing members provide the portals through which market participants gain access to DCOs as well as the first line of risk management. Accordingly, the Commission is proposing regulations to facilitate customer access to clearing and to bolster risk management through timely processing. The proposals address: (i) The documentation between a customer and a futures commission merchant (FCM) that clears on behalf of the customer; and (ii) the timing of acceptance or rejection of trades for clearing by DCOs and clearing members.

B. Customer Clearing Documentation

Section 4d(c) of the CEA, as amended by the Dodd-Frank Act, directs the Commission to require FCMs to implement conflict of interest procedures that address such issues the Commission determines to be appropriate. Similarly, section 4s(j)(5), as added by the Dodd-Frank Act, requires SDs and MSPs to implement conflict of interest procedures that address such issues the Commission determines to be appropriate. Section 4s(j)(5) also requires SDs and MSPs to ensure that any persons providing clearing activities or making determinations as to accepting clearing customers are separated by appropriate informational partitions from persons whose involvement in pricing, trading,

or clearing activities might bias their judgment or contravene the core principle of open access.

Pursuant to these provisions, the Commission has proposed § 1.71(d)(1) relating to FCMs and § 23.605(d)(1) relating to SDs and MSPs.⁵ These regulations would prohibit SDs and MSPs from interfering or attempting to influence the decisions of affiliated FCMs with regard to the provision of clearing services and activities and would prohibit FCMs from permitting them to do so.

Section 4s(j)(6) of the CEA prohibits an SD or MSP from adopting any process or taking any action that results in any unreasonable restraint on trade or imposes any material anticompetitive burden on trading or clearing, unless necessary or appropriate to achieve the purposes of the Act. The Commission has proposed § 23.607 to implement this provision.⁶

Section 2(h)(1)(B)(ii) of the CEA requires that DCO rules provide for the non-discriminatory clearing of swaps executed bilaterally or through an unaffiliated designated contract market (DCM) or swap execution facility (SEF). The Commission has proposed § 39.12(b)(2) to implement this provision.⁷

On June 16, 2011, the Futures Industry Association (FIA) and the International Swap and Derivatives Association (ISDA), published an FIA-ISDA Cleared Derivatives Execution Agreement (Agreement) as a template for use by swap market participants in negotiating execution-related agreements with counterparties to swaps that are intended to be cleared.⁸ The Agreement was developed with the assistance of a committee comprised of representatives of certain FIA and ISDA member firms which included both swap dealers and buy-side firms. More than 60 organizations provided input during the development of the document.⁹

⁵ 75 FR 70152 (Nov. 17, 2010) (Implementation of Conflicts of Interest Policies and Procedures by Futures Commission Merchants and Introducing Brokers); 75 FR 71391 (Nov. 23, 2010) (Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants).

⁶ 75 FR 91397 (Nov. 23, 2010) (Regulations Establishing Duties of Swap Dealers and Major Swap Participants).

⁷ 76 FR 3698 (Jan. 20, 2011) (Risk Management Requirements for Derivatives Clearing Organizations); 76 FR 13101 (March 10, 2011) (Requirements for Processing, Clearing, and Transfer of Customer Positions).

⁸ See press release, "FIA and ISDA Publish Documentation for Cleared Swaps" (June 16, 2011) at <http://www.futuresindustry.org>.

⁹ *Id.*

FIA and ISDA emphasized that the use of the agreement is voluntary and may not be necessary and appropriate under all circumstances.¹⁰ FIA and ISDA recognized that many of the provisions in the Agreement will be superseded by new regulatory requirements and the rules of swap execution venues and clearing organizations.¹¹

The Agreement includes optional annexes that make the clearing member to one or both of the executing parties a party to the Agreement (the Tri-party annexes). Some of the participants in the process, as well as some market participants that were not included, have expressed concern to the Commission that aspects of the Tri-party annexes may be inconsistent with certain principles of the Dodd-Frank Act.¹²

Specifically, concerns arise in connection with certain provisions that would permit a customer's FCM, in consultation with the SD, to establish specific credit limits for the customer's swap transactions with the SD, and to declare that with regard to trades with that SD, the FCM will only accept for clearing those transactions that fall within these specific limits.¹³ The limits set for trades with the SD might be less than the overall limits set for the customer for all trades cleared through the FCM. The result would be to create a "sublimit" for the customer for trades with that SD. Some market participants have stated that the setting of such "sublimits" would result in restrictions of customer counterparties because, without such "sublimits," the customer may enter into transactions with whomever it chooses, up to its overall limit with the FCM.¹⁴

Generally, in cleared markets, an FCM does not know the identity of its customer's executing counterparty. Another effect of such sublimits would be to disclose the identity of the customer's counterparty to the FCM. In many instances, the FCM and the customer's counterparty—the SD—might be affiliated entities. Some market participants have stated that such disclosure may lead to "greater information exchange" between the FCM and the affiliated SD, which would

¹⁰ *Id.*

¹¹ *Id.*

¹² See, e.g., letter dated April 11, 2011 from Stuart J. Kaswell, Executive Vice President, Managing Director, and General Counsel, Managed Funds Association; letter dated April 19, 2011 from James Cawley, Swaps & Derivatives Market Association. These letters can be found in the Commission's comment file for 76 FR 13101.

¹³ See Kaswell letter at 9.

¹⁴ *Id.* at 10.

⁴ See, e.g., 76 FR 3698 (Jan. 20, 2011) (Risk Management Requirements for Derivatives Clearing Organizations).

“force the customer to execute with the clearing member’s trading desk affiliate.”¹⁵ A third effect of such sublimits could be to delay acceptance of the trades into clearing while the FCM verifies compliance with the sublimits.

Arrangements with these effects potentially conflict with the concepts of open access to clearing and execution of customer transactions on a DCM or SEF on terms that have a reasonable relationship to the best terms available. More specifically, they potentially conflict with proposed §§ 1.71(d)(1), 23.605(d)(1), 23.608, and 39.12. As certain market participants have stated, tri-party agreements of the type described above could lead to undue influence by FCMs on a customer’s choice of counterparties (or, conversely, undue influence by SDs on a customer’s choice of clearing member). Therefore, they could constrain a customer’s opportunity to obtain execution of the trade on the terms that have a reasonable relationship to the best terms available by limiting the number of potential counterparties.¹⁶

To address these concerns and to provide further clarity in this area, the Commission is now proposing § 1.72 relating to FCMs, § 23.608 relating to SDs and MSPs, and § 39.12(a)(1)(vi) relating to DCOs. These new regulations would prohibit arrangements involving FCMs, SDs, MSPs, or DCOs that would (a) disclose to an FCM, SD, or MSP the identity of a customer’s original executing counterparty; (b) limit the number of counterparties with whom a customer may enter into a trade; (c) 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; (d) impair a customer’s access to execution of a trade on terms that have a reasonable relationship to the best terms available; or (e) prevent compliance with specified time frames for acceptance of trades into clearing.

The Commission believes that implementation of the proposal would reduce risk and foster open access to clearing, as well as execution of customer trades on terms that have a reasonable relationship to the best terms

available. Restrictions of the sort prohibited by the proposed rules could increase risk by delaying or blocking access to clearing. They could increase costs and reduce market efficiency by limiting the number of counterparties available for trading. They could restrict access to clearing by limiting the potential clearing members with which a customer could deal.

The Commission is not proposing to dictate here what happens to a trade that is rejected for clearing by an FCM or a DCO. Three outcomes are possible: (i) The parties could try to clear the trade through another DCO or FCM; (ii) the trade could revert to a bilateral transaction; or (iii) the parties could break the trade. The parties should agree in advance, subject to applicable law, which alternative will apply and how to measure and apportion any resulting losses. The Commission believes that the proposals herein will decrease the likelihood that trades will be rejected and diminish the potential for loss in cases where rejection does occur.

The Commission requests comment on whether the proposals will achieve the intended goals and on the costs and benefits of the proposed means of achieving those goals. In particular, the Commission requests comment on:

- Whether the proposal would increase open access to clearing and execution of customer transactions on a DCM or SEF on terms that have a reasonable relationship to the best terms available;
- Whether the proposal could decrease open access to clearing in any way; and
- Whether the proposals would increase risk to DCOs, FCMs, SDs, or MSPs in any way.

C. Time Frames for Acceptance Into Clearing

As noted above, a goal of the Dodd-Frank Act is to reduce risk by increasing the use of central clearing. Minimizing the time between trade execution and acceptance into clearing is an important risk mitigant. The Commission recently proposed § 39.12(b)(7) regarding time frames for clearing.¹⁷ Upon review of the comments received, the Commission is now proposing a revised version of that provision.¹⁸

As previously proposed, § 39.12(b)(7)(i) required DCOs to coordinate with designated contract markets (DCMs) and swap execution

facilities (SEFs) to facilitate prompt and efficient processing of trades. In response to a comment, the Commission now proposes to require prompt, efficient, and accurate processing of trades.¹⁹

Recognizing the key role clearing members play in trade processing and the submission of trades to central clearing, the Commission is also now proposing parallel provisions for coordination among DCOs and clearing members. Proposed § 39.12(b)(7)(i)(B) would require DCOs to coordinate with clearing members to establish systems for prompt processing of trades. Proposed §§ 1.74(a) and 23.610(a) would require reciprocal coordination with DCOs by FCMs, SDs, and MSPs that are clearing members.

As previously proposed, § 39.12(b)(7)(ii) required DCOs to accept immediately upon execution all transactions executed on a DCM or SEF. A number of DCOs and other commenters expressed concern that this requirement could expose DCOs to unwarranted risk because DCOs need to be able to screen trades for compliance with applicable clearinghouse rules related to product and credit filters.²⁰ The Commission recognizes that while immediate acceptance for clearing upon execution currently occurs in some futures markets, it might not be feasible for all cleared markets at this time. For example, where the same cleared product is traded on multiple execution venues, a DCO needs to be able to aggregate the risk of trades coming in to ensure that a clearing member or customer has not exceeded its credit limits. Accordingly, the Commission is proposing to modify § 39.12(b)(7)(ii) to permit DCOs to screen trades against applicable product and credit criteria before accepting or rejecting them. Consistent with principles of open access, the proposal would require that such criteria be non-discriminatory with respect to trading venues and clearing participants.

The Commission continues to believe that acceptance or rejection for clearing in close to real time is crucial both for effective risk management and for the

¹⁹ See letter from Robert Pickel, Executive Vice Chairman, International Swaps and Derivatives Association, dated April 8, 2011.

²⁰ See letter from Craig S. Donohue, Chief Executive Officer, CME Group, dated April 11, 2011; letter from R. Trabue Bland, Vice President and Assistant General Counsel, ICE, dated April 11, 2011; letter from Iona J. Levine, Group General Counsel and Managing Director, LCH.Clearnet, dated April 11, 2011; letter from William H. Navin, Executive Vice President and General Counsel, Options Clearing Corporation, dated April 11, 2011; letter from John M. Damgard, President, Futures Industry Association, dated April 14, 2011.

¹⁵ *Id.*

¹⁶ The Commission previously proposed § 155.7, an execution standard that would apply to swaps available for trading on a DCM or SEF to ensure fair dealing and protect against fraud and other abusive practices. 75 FR 80638, 80648 (Dec. 22, 2010). The proposed rule would require Commission registrants to execute swaps available for trading on a DCM or SEF on terms that have a reasonable relationship to the best terms available.

¹⁷ 76 FR 13101 (March 10, 2011) (Requirements for Processing, Clearing, and Transfer of Customer Positions).

¹⁸ The Commission continues to review comments on other aspects of the March 10 proposal and they will be addressed separately.

efficient operation of trading venues.²¹ Rather than prescribe a specific length of time, the Commission is proposing as a standard that action be taken “as quickly as would be technologically practicable if fully automated systems were used.” The Commission anticipates that this standard would require action in a matter of milliseconds or seconds or, at most, a few minutes, not hours or days.²²

This is intended to be a performance standard, not the prescription of a particular method of trade processing. The Commission expects that fully automated systems will be in place at some DCOs, FCMs, SDs, and MSPs. Others might have systems with some manual steps. This would be permitted so long as the process could operate within the same time frame as the automated systems.

The Commission recognizes that some trades on a DCM or SEF are executed non-competitively. Examples include block trades and exchanges of futures for physicals (EFPs). A DCO may not be notified immediately upon execution of these trades. Accordingly, as discussed below, they will be treated in the same manner as trades that are not executed on a DCM or SEF.

As previously proposed, §§ 39.12(b)(7)(iii) and 39.12(b)(7)(iv) distinguished between swaps subject to mandatory clearing and swaps not subject to mandatory clearing. Upon review of the comments, the Commission believes that this distinction is unnecessary with regard to processing time frames. If a DCO lists a product for clearing, it should be able to process it regardless of whether clearing is mandatory or voluntary. Therefore, newly proposed § 39.12(b)(7)(iii) would cover all trades not executed on a DCM or SEF. It would require acceptance or rejection by the DCO as quickly after submission as would be technologically practicable if fully automated systems were used.

Proposed § 1.74(b) would set up a parallel requirement for clearing FCMs; proposed § 23.610(b) would set up a parallel requirement for SDs and MSPs that are clearing members. These rules, again, would apply a performance standard, not a prescribed method for achieving it.

The Commission notes that from both a timing perspective and a risk perspective, the most efficient method would be to screen all orders using

predetermined criteria established by the rules of the DCO and the provisions of the clearing documentation between the customer and its clearing member. In such a case all trades would be accepted for clearing upon execution because the clearing member and DCO would have already applied their credit and product filters.

A less efficient means would be for the clearing member to authorize the DCO to screen trades on its behalf and to accept or reject according to criteria set by the clearing member. The least efficient would be for the DCO to send a message to the clearing member for each trade requesting acceptance or rejection.

The Commission requests comment on the costs and benefits of the proposal. In particular, the Commission requests comment on whether the performance standard is appropriate and workable.

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires that agencies consider whether the regulations they propose will have a significant economic impact on a substantial number of small entities.²³ The Commission previously has established certain definitions of “small entities” to be used in evaluating the impact of its regulations on small entities in accordance with the RFA.²⁴ The proposed regulations would affect FCMs, DCOs, SDs, and MSPs.

The Commission previously has determined, however, that FCMs should not be considered to be small entities for purposes of the RFA.²⁵ The Commission’s determination was based, in part, upon the obligation of FCMs to meet the minimum financial requirements established by the Commission to enhance the protection of customers’ segregated funds and protect the financial condition of FCMs generally.²⁶ The Commission also has previously determined that DCOs are not small entities for the purpose of the RFA.²⁷

SDs and MSPs are new categories of registrants. Accordingly, the Commission has not previously addressed the question of whether such persons are, in fact, small entities for purposes of the RFA. Like FCMs, SDs will be subject to minimum capital and margin requirements and are expected to comprise the largest global financial

firms. The Commission is required to exempt from SD registration any entities that engage in a de minimis level of swap dealing in connection with transactions with or on behalf of customers. The Commission anticipates that this exemption would tend to exclude small entities from registration. Accordingly, for purposes of the RFA for this rulemaking, the Commission is hereby proposing that SDs not be considered “small entities” for essentially the same reasons that FCMs have previously been determined not to be small entities and in light of the exemption from the definition of SD for those engaging in a de minimis level of swap dealing.

The Commission also has previously determined that large traders are not “small entities” for RFA purposes.²⁸ In that determination, the Commission considered that a large trading position was indicative of the size of the business. MSPs, by statutory definition, maintain substantial positions in swaps or maintain outstanding swap positions that create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets. Accordingly, for purposes of the RFA for this rulemaking, the Commission is hereby proposing that MSPs not be considered “small entities” for essentially the same reasons that large traders have previously been determined not to be small entities.

Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed regulations will not have a significant economic impact on a substantial number of small entities. The Commission invites the public to comment on whether SDs and MSPs should be considered small entities for purposes of the RFA.

B. Paperwork Reduction Act

The Paperwork Reduction Act (PRA)²⁹ imposes certain requirements on Federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the PRA. This proposed rulemaking would result in new collection of information requirements within the meaning of the PRA. The Commission therefore is submitting this proposal to the Office of Management and Budget (OMB) for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for this collection of information is

²¹ See letter from James Cawley, Swaps and Derivatives Market Association, dated April 19, 2011.

²² The Commission notes that processing times may vary by market or product.

²³ 5 U.S.C. 601 *et seq.*

²⁴ 47 FR 18618, Apr. 30, 1982.

²⁵ *Id.* at 18619.

²⁶ *Id.*

²⁷ See 66 FR 45605, 45609, Aug. 29, 2001.

²⁸ *Id.* at 18620.

²⁹ 44 U.S.C. 3501 *et seq.*

“Customer Clearing Documentation and Timing of Acceptance for Clearing.” An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The OMB has not yet assigned this collection a control number.

The collection of information under these proposed regulations is necessary to implement certain provisions of the CEA, as amended by the Dodd-Frank Act. Specifically, it is essential to reducing risk and fostering open access to clearing and execution of customer transactions on a DCM or SEF on terms that have a reasonable relationship to the best terms available by prohibiting restrictions in customer clearing documentation of SDs, MSPs, FCMs, or DCOs that could delay or block access to clearing, increase costs, and reduce market efficiency by limiting the number of counterparties available for trading. The proposed regulations are also crucial both for effective risk management and for the efficient operation of trading venues among SDs, MSPs, FCMs, and DCOs.

If the proposed regulations are adopted, responses to this collection of information would be mandatory. The Commission will protect proprietary information according to the Freedom of Information Act and 17 CFR part 145, “Commission Records and Information.” In addition, section 8(a)(1) of the CEA strictly prohibits the Commission, unless specifically authorized by the CEA, from making public “data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers.” The Commission is also required to protect certain information contained in a government system of records according to the Privacy Act of 1974, 5 U.S.C. 552a.

1. Information Provided by Reporting Entities/Persons

SDs, MSPs, FCMs, and DCOs would be required to develop and maintain written customer clearing documentation in compliance with proposed regulations 1.72, 23.608, and 39.12. Proposed regulation 39.12(b)(7)(i)(B) would require DCOs to coordinate with clearing members to establish systems for prompt processing of trades. Proposed regulations 1.74(a) and 23.610(a) require reciprocal coordination with DCOs by FCMs, SDs, and MSPs that are clearing members.

The annual burden associated with these proposed regulations is estimated to be 16 hours, at an annual cost of \$1,600 for each FCM, SD, and MSP.

Burden means the total time, effort, or financial resources expended by persons to generate, maintain, retain, disclose, or provide information to or for a federal agency. The Commission has characterized the annual costs as initial costs because the Commission anticipates that the cost burdens will be reduced dramatically over time as the documentation and procedures required by the proposed regulations become increasingly standardized within the industry.

Proposed §§ 1.72 and 23.608 would require each FCM, SD, and MSP to ensure compliance with the proposed regulations. Maintenance of contracts is prudent business practice and the Commission anticipates that SDs and MSPs already maintain some form of this documentation. Additionally, the Commission believes that much of the existing customer clearing documentation already complies with the proposed rules, and therefore that compliance will require a minimal burden.

In addition to the above, the Commission anticipates that FCMs, SDs, and MSPs will spend an average of 16 hours per year drafting and, as needed, updating customer clearing documentation to ensure compliance required by proposed §§ 1.72 and 23.608.

For each DCO, the annual burden associated with these proposed regulations is estimated to be 40 hours, at an annual cost of \$4,000. Burden means the total time, effort, or financial resources expended by persons to generate, maintain, retain, disclose, or provide information to or for a federal agency. The Commission has characterized the annual costs as initial costs as the Commission anticipates that the cost burdens will be reduced dramatically over time as once the documentation and procedures required by the proposed regulations are implemented, any additional expenditure related to § 39.12 likely would be limited to the time required to review and, as needed, amend, existing documentation and procedures.

Proposed 39.12(b)(7) would require each DCO to coordinate with clearing members to establish systems for prompt processing of trades. The Commission believes that this is currently a practice of DCOs. Accordingly, any additional expenditure related to § 39.12(b)(7) likely would be limited to the time initially required to review and, as needed, amend, existing trade processing procedures to ensure that they conform to all of the required elements and to coordinate with FCMs,

SDs, and MSPs to establish reciprocal procedures.

The Commission anticipates that DCOs will spend an average of 20 hours per year drafting and, as needed, updating the written policies and procedures to ensure compliance required by proposed § 39.12, and 20 hours per year coordinating with FCMs, SDs, and MSPs on reciprocal procedures.

The hour burden calculations below are based upon a number of variables such as the number of FCMs, SDs, MSPs, and DCOs in the marketplace and the average hourly wage of the employees of these registrants that would be responsible for satisfying the obligations established by the proposed regulation.

There are currently 134 FCMs and 14 DCOs based on industry data. SDs and MSPs are new categories of registrants. Accordingly, it is not currently known how many SD and MSPs will become subject to these rules, and this will not be known to the Commission until the registration requirements for these entities become effective after July 16, 2011, the date on which the Dodd-Frank Act becomes effective. While the Commission believes there will be approximately 200 SD and 50 MSPs, it has taken a conservative approach, for PRA purposes, in estimating that there will be a combined number of 300 SDs and MSPs who will be required to comply with the recordkeeping requirements of the proposed rules. The Commission estimated the number of affected entities based on industry data.

According to recent Bureau of Labor Statistics, the mean hourly wage of an employee under occupation code 11–3031, “Financial Managers,” (which includes operations managers) that is employed by the “Securities and Commodity Contracts Intermediation and Brokerage” industry is \$74.41.³⁰ Because SDs, MSPs, FCMs, and DCOs include large financial institutions whose operations management employees’ salaries may exceed the mean wage, the Commission has estimated the cost burden of these proposed regulations based upon an average salary of \$100 per hour.

Accordingly, the estimated hour burden was calculated as follows:

Developing Written Procedures for Compliance, and Maintaining Records Documenting Compliance for SDs and MSPs. This hourly burden arises from the proposed requirement that SDs and MSPs make and maintain records documenting compliance related to client clearing documentation.

³⁰ <http://www.bls.gov/oes/current/oes113031.htm>.

Number of registrants: 300.
Frequency of collection: as needed.
Estimated number of annual responses per registrant: 1.

Estimated aggregate number of annual responses: 300.
Estimated annual hour burden per registrant: 16 hours.

Estimated aggregate annual hour burden: 4,800 burden hours [300 registrants × 16 hours per registrant].

Developing Written Procedures for Compliance, and Maintaining Records Documenting Compliance for FCMs. This hourly burden arises from the proposed requirement that FCMs make and maintain records documenting compliance related to client clearing documentation.

Number of registrants: 134.
Frequency of collection: as needed.
Estimated number of annual responses per registrant: 1.

Estimated aggregate number of annual responses: 134.
Estimated annual hour burden per registrant: 16 hours.

Estimated aggregate annual hour burden: 2,144 burden hours [134 registrants × 16 hours per registrant].

Drafting and Updating Trade Processing Procedures for DCOs. This hour burden arises from the time necessary to develop and periodically update the trade processing procedures required by the proposed regulations.

Number of registrants: 14.
Frequency of collection: Initial drafting, updating as needed.
Estimated number of annual responses per registrant: 1.

Estimated aggregate number of annual responses: 14.
Estimated annual hour burden per registrant: 40 hours.

Estimated aggregate annual hour burden: 560 burden hours [14 registrants × 40 hours per registrant].

Based upon the above, the aggregate hour burden cost for all registrants is 7,504 burden hours and \$750,400 [7,504 × \$100 per hour].

2. Information Collection Comments

The Commission invites the public and other federal agencies to comment on any aspect of the recordkeeping burdens discussed above. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (iii) determine whether

there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Comments may be submitted directly to the Office of Information and Regulatory Affairs, by fax at (202) 395-6566 or by e-mail at OIRASubmissions@omb.eop.gov. Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rule preamble. Refer to the Addresses section of this notice of proposed rulemaking for comment submission instructions to the Commission. A copy of the supporting statements for the collections of information discussed above may be obtained by visiting RegInfo.gov. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, a comment is best assured of having its full effect if OMB receives it within 30 days of publication.

C. Consideration of Costs and Benefits Under Section 15(a) of the CEA

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its action before promulgating a regulation under the CEA. Section 15(a) of the CEA specifies that costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular order is necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the CEA.

The proposed rules have two major components: (i) The documentation between a customer and a futures commission merchant that clears on behalf of the customer; and (ii) the timing of acceptance or rejection of trades for clearing by derivatives clearing organizations and clearing members. The discussion below will

consider each component in light of the section 15(a) concerns.

A. Documentation Between a Customer and Futures Commission Merchant That Clears on Behalf of the Customer

The Commission is proposing regulations that would prohibit arrangements involving FCMs, SDs, MSPs, or DCOs that would (a) disclose to an FCM, SD, or MSP the identity of a customer's counterparty; (b) limit the number of counterparties with whom a customer may enter into swaps; (c) restrict the size of the position a customer may take with any individual counterparty, apart from an overall limit for all positions held by the customer at the FCM; (d) impair a customer's access to execution of trades on a DCM or SEF on terms that have a reasonable relationship to the best terms available; or (e) prevent compliance with specified time frames for acceptance of trades into clearing.

1. Protection of Market Participants and the Public

This measure protects the customer from any discriminatory behavior by potential clearing members or counterparties and helps ensure that customers have open access to the markets and an opportunity to obtain execution on competitive terms. The proposal would also promote financial integrity by removing potential obstacles such as more documentation requirements imposed by dealers or unnecessary restrictions on trading by a third-party, and by accelerating the timeframe for acceptance or rejection of a trade for clearing thereby reducing risk of delay or uncertainty as to whether a swap will be accepted or rejected for clearing. For example, by contrast, under a tri-party agreement, an FCM might have to evaluate each customer transaction not only against the customer's overall credit limit but also against a sub-limit for each counterparty which can delay acceptance.

As far as costs are concerned, the possibility of "breakage" remains for SDs and other counterparties. However, this concern is mitigated by the timelines required in the second section of this rule, which reduce the likelihood that a SD would have time to enter into other transactions before the one in view is accepted or rejected for clearing. Similarly, if a SD has to enter into a replacement trade, the costs will be mitigated by the tight timeline, because the SD would know quickly whether the trade was accepted or rejected for clearing. As noted above, the process of evaluating individual transactions against counterparty sub-limits could

delay notification of acceptance or rejection for clearing. In the absence of this rule, the cost to trade will have to account for these factors and additional market risk during that time.

2. Efficiency, Competitiveness, and Financial Integrity of Futures Markets

This rule helps prevent the disclosure, to the FCM, of the identity of the counterparty of its customer. Such lack of disclosure promotes integrity in the market by ensuring that all participants who meet certain qualifying criteria for trading have open access to all available counterparties because intermediaries will be unable to set sub-limits by counterparty. Moreover, in the absence of this rule, tri-party agreements or other similar arrangements among FCMs, SDs or MSPs and customers could result in matching processes that have the potential to be time intensive. Preventing these agreements will promote faster matching which may increase liquidity through lower transaction costs.

This rule also prevents customers from being penalized (or having distorted commercial incentives) in their choice of FCM due to previous transactions with a given FCM or SD. As a consequence, this rule also has the potential to promote competition among FCMs to deliver services efficiently. Lastly, this rule would reduce duplicative risk management because DCOs and their members already have access to information necessary to perform credit analysis on individual customers and counterparties. SDs would be unnecessarily duplicating work that has already been done.

3. Price Discovery

By not forcing a customer to transact with counterparties who may be offering less attractive terms, this rule may improve pricing. In addition, adhering to time frames specified for acceptance of trades into clearing helps to prevent stale prices.

4. Sound Risk Management Practices

The rule does not affect the risk management structure of FCMs. Moreover, by preventing customers from learning their counterparty's identity, the responsibility for risk management remains clear. The FCM must be responsible for evaluating each customer's credit risk. It cannot rely on a counterparty to conduct due diligence. Moreover, preserving anonymity in the market increases the number of available counterparties, which leads to a more liquid market, thereby reducing risk.

As mentioned before, to the extent that the SD experiences "breakage," it exposes a SD to counterparty risk which is a potential cost. However, by facilitating quicker acceptance or rejection into clearing, the proposal would mitigate such costs by compressing the time within which the counterparty exposure would exist.

B. Timing of Acceptance or Rejection of Trades for Clearing by Derivatives Clearing Organizations and Clearing Members

The Commission is proposing regulations that would require prompt, efficient, and accurate processing of trades, and require DCOs to coordinate with clearing members to establish systems for prompt processing of trades.

1. Protection of Market Participants

Rapid processing protects market participants from acting on bad information by making additional trades under the presumption that an initial trade has gone through if that trade may, in fact, not clear. As mentioned, compressing the time for acceptance or rejection for clearing also reduces the time within exposures can accumulate if a trade is rejected.

As far as costs are concerned, coordination among the DCOs, FCMs, SDs and MSPs in order to design and implement a system to clear transactions "as quickly as would be technologically practicable if fully automated systems were used" will likely require capital investment and personnel hours in some instances. The Commission believes, however, that DCOs and clearing members may already be using procedures that comply with the standard. To the extent that participants do not currently have automated systems, they made need to install or upgrade existing systems to comply.

2. Efficiency, Competitiveness, and Financial Integrity of Futures Markets

Rapid clearing helps ensure that eligible counterparties will not be tied up in transactions that do not clear. They will be available to other eligible customers. This increases both competitiveness and efficiency of the market. In addition, extensive coordination among the DCOs, FCMs, SDs, and MSPs has the potential to standardize processes and technologies to support this rule. That reduces switching costs for customers and increases competitiveness.

Costs will be incurred in developing systems and procedures for those products and participants where the proposed standards are not currently

being met. The Commission anticipates, however, that eventually such costs would be compensated for by increased efficiency and market integrity. The Commission does not know at this time, and requests comment on, how many parties will need to upgrade their systems, if any. Additionally, the Commission requests comment from the public as to what the costs might be to upgrade existing systems or install new systems to comply with the proposed regulation.

3. Price Discovery

Requiring rapid clearing encourages screening for credit worthiness of customers. That helps ensure that only bids and offers of qualified parties are contained in the limit order book which helps protect its informational value. Moreover, pricing feedback from cleared transactions will reach the market more quickly.

4. Sound Risk Management Practices

Timely clearing allows each party to the transaction to act more quickly if they need to implement a hedge or other transactions related to the swap. This reduces the risk associated with potential adverse movements of the market while waiting for clearing to occur. However, if some of the processes are manual, the mandate for greater speed increases the possibility of errors.

5. Other Public Interest Considerations

Rapid clearing makes U.S. based DCOs, FCMs, SDs, and MSPs more attractive as service providers for global swap business. Furthermore, the proposal would facilitate achievement of the overarching Dodd-Frank Act mandate to promote clearing.

List of Subjects

17 CFR Part 1

Conflicts of interest, Futures commission merchants, Major swap participants, Swap dealers.

17 CFR Part 23

Conflicts of interests, Futures commission merchants, Major swap participants, Swap dealers.

17 CFR Part 39

Derivatives clearing organizations, Risk management, Swaps.

In light of the foregoing, the Commission hereby proposes to amend part 1; part 23, as proposed to be added at 75 FR 71390, November 23, 2010, and further amended at 75 FR 81530, December 28, 2010; and part 39, as proposed to be amended at 76 FR 13101, March 10, 2011, of Title 17 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for part 1 is revised to read as follows:

Authority: 7 U.S.C. 1a, 2, 2a, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6l, 6m, 6n, 6o, 6p, 6r, 6s, 7, 7a–1, 7a–2, 7b, 7b–3, 8, 9, 10a, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, and 24, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).

2. Add § 1.72 to part 1 to read as follows:

§ 1.72 Restrictions on customer clearing arrangements.

No futures commission merchant providing clearing services to customers shall enter into an arrangement that:

- (a) Discloses to the futures commission merchant or any swap dealer or major swap participant the identity of a customer's original executing counterparty;
 - (b) Limits the number of counterparties with whom a customer may enter into a trade;
 - (c) Restricts the size of the position a customer may take with any individual counterparty, apart from an overall limit for all positions held by the customer at the futures commission merchant;
 - (d) Impairs a customer's access to execution of a trade on terms that have a reasonable relationship to the best terms available; or
 - (e) Prevents compliance with the time frames set forth in § 1.73(a)(9)(ii), § 23.609(a)(9)(ii), or § 39.12(b)(7) of this chapter.
3. Add § 1.74 to part 1 to read as follows:

§ 1.74 Futures commission merchant acceptance for clearing.

- (a) Each futures commission merchant that is a clearing member of a derivatives clearing organization shall coordinate with each derivatives clearing organization on which it clears to establish systems that enable the futures commission merchant, or the derivatives clearing organization acting on its behalf, to accept or reject each trade submitted to the derivatives clearing organization for clearing by or for the futures commission merchant or a customer of the futures commission merchant as quickly as would be technologically practicable if fully automated systems were used; and
- (b) Each futures commission merchant that is a clearing member of a derivatives clearing organization shall accept or reject each trade submitted by or for it or its customers as quickly as would be technologically practicable if

fully automated systems were used; a clearing futures commission merchant may meet this requirement by:

- (1) Establishing systems to pre-screen orders for compliance with criteria specified by the clearing futures commission merchant;
- (2) Establishing systems that authorize a derivatives clearing organization to accept or reject on its behalf trades that meet, or fail to meet, criteria specified by the clearing futures commission merchant; or
- (3) Establishing systems that enable the clearing futures commission merchant to communicate to the derivatives clearing organization acceptance or rejection of each trade as quickly as would be technologically practicable if fully automated systems were used.

PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

4. The authority citation for part 23 is revised to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b–1, 6c, 6p, 6r, 6s, 6t, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21.

5. Add § 23.608 to part 23, subpart J, to read as follows:

§ 23.608 Restrictions on counterparty clearing relationships.

No swap dealer or major swap participant entering into a cleared swap with a counterparty that is a customer of a futures commission merchant shall enter into an arrangement that:

- (a) Discloses to the futures commission merchant or any swap dealer or major swap participant the identity of a customer's original executing counterparty;
- (b) Limits the number of counterparties with whom a customer may enter into a trade;
- (c) Restricts the size of the position a customer may take with any individual counterparty, apart from an overall limit for all positions held by the customer at the futures commission merchant;
- (d) Impairs a customer's access to execution of a trade on terms that have a reasonable relationship to the best terms available; or
- (e) Prevents compliance with the time frames set forth in § 1.73(a)(9)(ii), § 23.609(a)(9)(ii), or § 39.12(b)(7) of this chapter.

6. Add § 23.610 to part 23, subpart J, to read as follows:

§ 23.610 Clearing member acceptance for clearing.

- (a) Each swap dealer or major swap participant that is a clearing member of a derivatives clearing organization shall

coordinate with each derivatives clearing organization on which it clears to establish systems that enable the clearing member, or the derivatives clearing organization acting on its behalf, to accept or reject each trade submitted to the derivatives clearing organization for clearing by or for the clearing member as quickly as would be technologically practicable if fully automated systems were used; and

(b) Each swap dealer or major swap participant that is a clearing member of a derivatives clearing organization shall accept or reject each trade submitted by or for it as quickly as would be technologically practicable if fully automated systems were used; a clearing member may meet this requirement by:

- (1) Establishing systems to pre-screen orders for compliance with criteria specified by the clearing member;
- (2) Establishing systems that authorize a derivatives clearing organization to accept or reject on its behalf trades that meet, or fail to meet, criteria specified by the clearing member; or
- (3) Establishing systems that enable the clearing member to communicate to the derivatives clearing organization acceptance or rejection of each trade as quickly as would be technologically practicable if fully automated systems were used.

PART 39—DERIVATIVES CLEARING ORGANIZATIONS

7. Revise the authority citation for part 39 to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6d, 7a–1, 7a–2, and 7b as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376.

Subpart B—Compliance With Core Principles

8. In § 39.12, add paragraph (a)(1)(vi) to read as follows:

- (a) * * *
- (1) * * *
- (vi) No derivatives clearing organization shall require as a condition of accepting a swap for clearing that a futures commission merchant enter into an arrangement with a customer that:
 - (A) Discloses to the futures commission merchant or any swap dealer or major swap participant the identity of a customer's original executing counterparty;
 - (B) Limits the number of counterparties with whom a customer may enter into trades;
 - (C) Restricts the size of the position a customer may take with any individual counterparty, apart from an overall limit for all positions held by the customer at the futures commission merchant;

(D) Impairs a customer's access to execution of a trade on terms that have a reasonable relationship to the best terms available; or

(E) Prevents compliance with the time frames set forth in § 1.73(a)(9)(ii), § 23.609(a)(9)(ii), or § 39.12(b)(7) of this chapter.

9. Amend § 39.12 by:

a. Redesignating paragraph (b)(7)(v) as paragraph (b)(8); and

b. Revising § 39.12(b)(7) to read as follows:

(i) *Coordination with markets and clearing members*

(A) Each derivatives clearing organization shall coordinate with each designated contract market and swap execution facility that lists for trading a product that is cleared by the derivatives clearing organization in developing rules and procedures to facilitate prompt, efficient, and accurate processing of all transactions submitted to the derivatives clearing organization for clearing.

(B) Each derivatives clearing organization shall coordinate with each clearing member that is a futures commission merchant, swap dealer, or major swap participant to establish systems that enable the clearing member, or the derivatives clearing organization acting on its behalf, to accept or reject each trade submitted to the derivatives clearing organization for clearing by or for the clearing member or a customer of the clearing member as quickly as would be technologically practicable if fully automated systems were used.

(ii) *Transactions executed competitively on or subject to the rules of a designated contract market or swap execution facility.* A derivatives clearing organization shall have rules that provide that the derivatives clearing organization will accept or reject for clearing as quickly after execution as would be technologically practicable if fully automated systems were used, all contracts that are listed for clearing by the derivatives clearing organization and are executed competitively on a designated contract market or a swap execution facility. The derivatives clearing organization shall accept all trades:

(A) For which the executing parties have clearing arrangements in place with clearing members of the derivatives clearing organization;

(B) For which the executing parties identify the derivatives clearing organization as the intended clearinghouse; and

(C) That satisfy the criteria of the derivatives clearing organization, including but not limited to applicable

risk filters; provided that such criteria are non-discriminatory across trading venues and are applied as quickly as would be technologically practicable if fully automated systems were used.

(iii) *Swaps not executed on or subject to the rules of a designated contract market or a swap execution facility or executed non-competitively on or subject to the rules of a designated contract market or a swap execution facility.* A derivatives clearing organization shall have rules that provide that the derivatives clearing organization will accept or reject for clearing as quickly after submission to the derivatives clearing organization as would be technologically practicable if fully automated systems were used, all swaps that are listed for clearing by the derivatives clearing organization and are not executed on a designated contract market or a swap execution facility. The derivatives clearing organization shall accept all trades:

(A) That are submitted by the parties to the derivatives clearing organization, in accordance with § 23.506 of this chapter;

(B) For which the executing parties have clearing arrangements in place with clearing members of the derivatives clearing organization;

(C) For which the executing parties identify the derivatives clearing organization as the intended clearinghouse; and

(D) That satisfy the criteria of the derivatives clearing organization, including but not limited to applicable risk filters; provided that such criteria are non-discriminatory across trading venues and are applied as quickly as would be technologically practicable if fully automated systems were used.

Issued in Washington, DC, on July 19, 2011, by the Commission.

David A. Stawick,

Secretary of the Commission.

Appendices to Customer Clearing Documentation and Timing of Acceptance for Clearing—Commission Voting Summary and Statements of Commissioners

Note: The following appendices will not appear in the Code of Federal Regulations

Appendix 1—Commission Voting Summary

On this matter, Chairman Gensler and Commissioners Dunn and Chilton voted in the affirmative; Commissioners O'Malia and Sommers voted in the negative.

Appendix 2—Statement of Chairman Gary Gensler

I support the proposed rulemaking for customer clearing documentation and timing of acceptance for clearing. The proposed rule promotes market participants' access to central clearing, increases market transparency and supports market efficiency. This proposal will foster bilateral clearing arrangements between customers and their futures commission merchants. This proposal also re-proposes certain time-frame provisions of the Commission's proposed rule in February related to straight-through processing.

[FR Doc. 2011-19365 Filed 7-29-11; 8:45 am]

BILLING CODE P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 165

[Docket No. USCG-2010-1145]

RIN 1625-AA11

Regulated Navigation Area; Pacific Sound Resources and Lockheed Shipyard EPA Superfund Cleanup Sites, Elliott Bay, Seattle, WA

AGENCY: Coast Guard, DHS.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Coast Guard proposes to establish a permanent regulated navigation area (RNA) on a portion of Elliott Bay in Seattle, Washington. The RNA would protect the seabed in portions of the bay that are subject to the U.S. Environmental Protection Agency (EPA)'s Pacific Sound Resources (PSR) and Lockheed Shipyard superfund cleanup remediation efforts. This RNA would prohibit activities that would disturb the seabed, such as anchoring, dragging, trawling, spudding or other activities that involve disrupting the integrity of the sediment caps that cover the superfund sites. It will not affect transit or navigation of the area.

DATES: Comments and related material must be received by the Coast Guard on or before October 31, 2011. Requests for public meetings must be received by the Coast Guard on or before September 15, 2011.

ADDRESSES: You may submit comments identified by docket number USCG-2010-1145 using any one of the following methods:

(1) *Federal eRulemaking Portal:*

<http://www.regulations.gov>.

(2) *Fax:* 202-493-2251.

(3) *Mail:* Docket Management Facility (M-30), U.S. Department of

applicable standard established by section 325 of the Act, possess and rely upon a reasonable basis consisting of competent and reliable scientific tests substantiating the representation. For

representations of the light output and life ratings of any covered product that is a general service lamp, unless otherwise provided by paragraph (a), the Commission will accept as a reasonable

basis scientific tests conducted according to the following applicable IES test protocols that substantiate the representations:

For measuring light output (in lumens):	
General Service Fluorescent	IES LM 9.
Compact Fluorescent	IES LM 66.
General Service Incandescent (Other than Reflector Lamps)	IES LM 45.
General Service Incandescent (Reflector Lamps)	IES LM 20.
For measuring laboratory life (in hours):	
General Service Fluorescent	IES LM 40.
Compact Fluorescent	IES LM 65.
General Service Incandescent (Other than Reflector Lamps)	IES LM 49.
General Service Incandescent (Reflector Lamps)	IES LM 49.

4. In § 305.15(d)(4) is revised to read as follows:

§ 305.15 Labeling for lighting products.

* * * * *

(d) * * *

(4) For any covered product that is a general service lamp and operates at discrete, multiple light levels (e.g., 800, 1600, and 2500 lumens), the light output, energy cost, and wattage disclosures required by this section must be provided at each of the lamp's levels of light output and the lamp's life provided on the basis of the shortest lived operating mode. The multiple numbers shall be separated by a "/" (e.g., 800/1600/2500 lumens) if they appear on the same line on the label.

* * * * *

By direction of the Commission.

Donald S. Clark,

Secretary.

[FR Doc. 2011-19041 Filed 7-29-11; 8:45 am]

BILLING CODE 6750-01-P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1 and 23

RIN 3038-AD51

Clearing Member Risk Management

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (Commission or CFTC) is proposing rules to implement new statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. These proposed rules address risk management for cleared trades by futures commission merchants, swap dealers, and major swap participants that are clearing members.

DATES: Submit comments on or before September 30, 2011.

ADDRESSES: You may submit comments, identified by RIN number 3038-AD51, by any of the following methods:

- *Agency Web site, via its Comments Online process:* <http://comments.cftc.gov>. Follow the instructions for submitting comments through the Web site.
- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.
- *Mail:* David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.
- *Courier:* Same as mail above.

Please submit your comments using only one method. RIN number, 3038-AD51, must be in the subject field of responses submitted via e-mail, and clearly indicated on written submissions. All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <http://www.cftc.gov>. You should submit only information that you wish to make available publicly. If you wish the CFTC to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the CFTC's regulations.¹

The CFTC reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from <http://www.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of this action will be retained in the public

comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

FOR FURTHER INFORMATION CONTACT: John C. Lawton, Deputy Director and Chief Counsel, 202-418-5480, jlawton@cftc.gov, or Christopher A. Hower, Attorney-Advisor, 202-418-6703, chower@cftc.gov, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Background

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).² Title VII of the Dodd-Frank Act amended the Commodity Exchange Act (CEA or Act)³ to establish a comprehensive new regulatory framework for swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating rigorous recordkeeping and real-time reporting regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission's oversight. Title VII also includes amendments to the federal securities laws to establish a similar

² See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

³ 7 U.S.C. 1 *et seq.*

¹ 17 CFR 145.9.

regulatory framework for security-based swaps under the authority of the Securities and Exchange Commission (SEC).

II. Proposed Regulations

A. Introduction

A fundamental premise of the Dodd-Frank Act is that the use of properly regulated central clearing can reduce systemic risk. The Commission has proposed extensive regulations addressing open access and risk management at the derivatives clearing organization (DCO) level.⁴ The Commission also has proposed regulations addressing risk management for swap dealers (SDs) and major swap participants (MSPs).⁵

Clearing members provide the portals through which market participants gain access to DCOs as well as the first line of risk management. Accordingly, the Commission is proposing regulations to facilitate customer access to clearing and to bolster risk management at the clearing member level. The proposal addresses risk management for cleared trades by FCMs and SDs and MSPs that are clearing members.

B. Clearing Member Risk Management

Section 3(b) provides that one of the purposes of the Act is to ensure the financial integrity of all transactions subject to the Act and to avoid systemic risk. Section 8a(5) authorizes the Commission to promulgate such regulations that it believes are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of the Act. Risk management systems are critical to the avoidance of systemic risks.

Section 4s(j)(2) requires each SD and MSP to have risk management systems adequate for managing its business. Section 4s(j)(4) requires each SD and MSP to have internal systems and procedures to perform any of the functions set forth in Section 4s.

Section 4d requires FCMs to register with the Commission. It further requires FCMs to segregate customer funds. Section 4f requires FCMs to maintain certain levels of capital. Section 4g establishes reporting and recordkeeping requirements for FCMs.

These provisions of law and Commission regulations promulgated

pursuant to these provisions create a web of obligations designed to secure the financial integrity of the markets and the clearing system, to avoid systemic risk, and to protect customer funds. Effective risk management by FCMs is essential to achieving these goals. For example, a poorly managed position in the customer account can cause an FCM to become undersegregated. A poorly managed position in the proprietary account can cause an FCM to fall out of compliance with capital requirements.

Even more significantly, a failure of risk management can cause an FCM to become insolvent and default to a DCO. This can disrupt the markets and the clearing system and harm customers. Such failures have been predominately attributable to failures in risk management.⁶

As noted previously, the Dodd-Frank Act requires the increased use of central clearing. In particular, Section 2(h) establishes procedures for the mandatory clearing of certain swaps. As stated in the Senate Committee report: "Increasing the use of central clearinghouses * * * will provide safeguards for American taxpayers and the financial system as a whole."⁷

The Commission has proposed extensive risk management standards at the DCO level. Given the increased importance of clearing and the expected entrance of new products and new participants into the clearing system, the Commission believes that enhancing the safeguards at the clearing member level is necessary as well.

Bringing swaps into clearing will increase the magnitude of the risks faced by clearing members. In many cases, it will change the nature of those risks as well. Many types of swaps have their own unique set of risk characteristics. The Commission believes that the increased concentration of risk in the clearing system combined with the changing configuration of the risk warrant additional vigilance not only by DCOs but by clearing members as well.

FCMs generally have extensive experience managing the risk of futures. They generally have less experience managing the risks of swaps. The Commission believes that it is a reasonable precaution to require that certain safeguards be in place. It would ensure that FCMs, who clear on behalf

of customers, are subject to standards at least as stringent as those applicable to SDs and MSPs, who clear only for themselves. Failure to require SDs, MSPs, and FCMs that are clearing members to maintain such safeguards would frustrate the regulatory regime established in the CEA, as amended by the Dodd-Frank Act. Accordingly, the Commission believes that applying the risk-management requirements in the proposed rules to SDs, MSPs, and FCMs that are clearing members are reasonably necessary to effectuate the provisions and to accomplish the purposes of the CEA.

Proposed § 1.73 would apply to clearing members that are FCMs; proposed § 23.609 would apply to clearing members that are SDs or MSPs. These provisions would require these clearing members to have procedures to limit the financial risks they incur as a result of clearing trades and liquid resources to meet the obligations that arise. The proposal would require clearing members to:

- (1) Establish credit and market risk-based limits based on position size, order size, margin requirements, or similar factors;
- (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 the proprietary account and all positions in any customer account that could pose material risk to the futures commission merchant at least once per week;
- (5) Evaluate its ability to meet initial margin requirements at least once per week;
- (6) Evaluate its ability to meet variation margin requirements in cash at least once per week;
- (7) Evaluate its ability to liquidate the positions it clears in an orderly manner, and estimate the cost of the liquidation at least once per month; and
- (8) Test all lines of credit at least once per quarter.

Each of these items has been observed by Commission staff as an element of an existing sound risk management program at a DCO or an FCM.

The Commission does not intend to prescribe the particular means of fulfilling these obligations. As is the case with DCOs, clearing members will have flexibility in developing procedures that meet their needs. For example, items (1) and (2) could be addressed through simple numerical limits on order or position size or through more complex margin-based limits. Further examples could include

⁴ See, e.g., 76 FR 3698 (Jan. 20, 2011) (Risk Management Requirements for Derivatives Clearing Organizations). These proposed regulations include a requirement that a DCO adopt rules addressing each clearing member's risk management policies and procedures. See proposed § 39.13(h)(5).

⁵ See, e.g., 75 FR 91397 (Nov. 23, 2010) (Regulations Establishing Duties of Swap Dealers and Major Swap Participants).

⁶ See, e.g., the failure of Volume Investors Corporation in 1986, the failure of Griffin Trading Company in 1998, and the failure of Klein & Company Futures, Inc. in 2000.

⁷ S. Rep. No. 111-176, at 32 (2010) (report of the Senate Committee on Banking, Housing, and Urban Affairs).

price limits to reject orders that are too far away from the market, or limits on the number of orders that could be placed in a short time.

The following are examples of tools that could be used to monitor for risk and to mitigate it:

- The ability to see all working and filled orders for intraday risk management;
- A “kill button” that cancels all open orders for an account and disconnects electronic access.

The Commission believes that these proposals are consistent with international standards. In August 2010, the International Organization of Securities Commissions issued a report entitled “Direct Electronic Access to Markets.”⁸ The report set out a number of principles to guide markets, regulators, and intermediaries. Principle 6 states that:

A market should not permit DEA [direct electronic access] unless there are in place effective systems and controls reasonably designed to enable the management of risk with regard to fair and orderly trading including, in particular, automated pre-trade controls that enable intermediaries to implement appropriate trading limits.

Principle 7 states that:

Intermediaries (including, as appropriate, clearing firms) should use controls, including automated pre-trade controls, which can limit or prevent a DEA Customer from placing an order that exceeds a relevant intermediary’s existing position or credit limits.

Stress tests are an essential risk management tool. The purpose in conducting stress tests is to determine the potential for significant losses in the event of extreme market events and the ability of traders and clearing members to absorb the losses. As was the case with the DCO risk management proposal, the Commission does not intend to prescribe the manner in which clearing members conduct stress tests. Rather, the Commission would monitor to determine whether clearing members were routinely conducting stress tests reasonably designed for the types of risk the clearing members and their customers face.

The proposal also would require clearing members to evaluate their ability to meet calls for initial and variation margin. This includes testing for liquidity of financial resources available to cover exposures due to market events. Routine testing of this sort diminishes the chance of a default based on liquidity problems.

Each clearing member also would be required to evaluate periodically its

ability to liquidate, in an orderly manner, the positions in the proprietary and customer accounts and estimate the cost of the liquidation. In recent years, Commission staff has observed instances where a trader was unable to meet its financial obligations and the FCM had to assume responsibility for the trader’s portfolio. Under these conditions, an FCM would normally liquidate the portfolio promptly. In some instances, however, where the portfolio contained large and complex options positions, the FCM found that it was not easy to liquidate. The Commission believes that clearing members should periodically review portfolios to ensure that they have the ability to liquidate them and to estimate the cost of such liquidation. The exercise should also address the ability of the FCM to put on appropriate hedges to mitigate risk pending liquidation. Such an exercise would take into account the size of the positions, the concentration of the positions in particular markets, and the liquidity of the markets.

Finally, the proposal would require each clearing member to establish written procedures to comply with this regulation and to keep records documenting its compliance. The Commission believes that these are important elements of a good risk management program.

The Commission requests comments on all aspects of the risk management proposal. In particular the Commission requests comment on:

- The extent to which each DCO already (i) Requires clearing member FCMs, SDs, and MSPs to have each component, and (ii) audits compliance with such requirement;
- The extent to which each component has otherwise been incorporated into existing risk management systems of clearing member FCMs, SDs, and MSPs; and
- The potential costs and benefits of each component.

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires that agencies consider whether the regulations they propose will have a significant economic impact on a substantial number of small entities.⁹ The Commission previously has established certain definitions of “small entities” to be used in evaluating the impact of its regulations on small entities in accordance with the RFA.¹⁰

The proposed regulations would affect FCMs, DCOs, SDs, and MSPs.

The Commission previously has determined, however, that FCMs should not be considered to be small entities for purposes of the RFA.¹¹ The Commission’s determination was based, in part, upon the obligation of FCMs to meet the minimum financial requirements established by the Commission to enhance the protection of customers’ segregated funds and protect the financial condition of FCMs generally.¹² The Commission also has previously determined that DCOs are not small entities for the purpose of the RFA.¹³

SDs and MSPs are new categories of registrants. Accordingly, the Commission has not previously addressed the question of whether such persons are, in fact, small entities for purposes of the RFA. Like FCMs, SDs will be subject to minimum capital and margin requirements and are expected to comprise the largest global financial firms. The Commission is required to exempt from SD registration any entities that engage in a de minimis level of swap dealing in connection with transactions with or on behalf of customers. The Commission anticipates that this exemption would tend to exclude small entities from registration. Accordingly, for purposes of the RFA for this rulemaking, the Commission is hereby proposing that SDs not be considered “small entities” for essentially the same reasons that FCMs have previously been determined not to be small entities and in light of the exemption from the definition of SD for those engaging in a de minimis level of swap dealing.

The Commission also has previously determined that large traders are not “small entities” for RFA purposes.¹⁴ In that determination, the Commission considered that a large trading position was indicative of the size of the business. MSPs, by statutory definition, maintain substantial positions in swaps or maintain outstanding swap positions that create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets. Accordingly, for purposes of the RFA for this rulemaking, the Commission is hereby proposing that MSPs not be considered “small entities” for essentially the same reasons that large traders have

¹¹ *Id.* at 18619.

¹² *Id.*

¹³ See 66 FR 45605, 45609, Aug. 29, 2001.

¹⁴ *Id.* at 18620.

⁸ The report can be found at <http://www.iosco.org>.

⁹ 5 U.S.C. 601 *et seq.*

¹⁰ 47 FR 18618, Apr. 30, 1982.

previously been determined not to be small entities.

Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed regulations will not have a significant economic impact on a substantial number of small entities. The Commission invites the public to comment on whether SDs and MSPs should be considered small entities for purposes of the RFA.

B. Paperwork Reduction Act

The Paperwork Reduction Act (PRA)¹⁵ imposes certain requirements on Federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the PRA. This proposed rulemaking would result in new collection of information requirements within the meaning of the PRA. The Commission therefore is submitting this proposal to the Office of Management and Budget (OMB) for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for this collection of information is "Clearing Member Position Risk Management." An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The OMB has not yet assigned this collection a control number.

The collection of information under these proposed regulations is necessary to implement certain provisions of the CEA, as amended by the Dodd-Frank Act. Specifically, it is essential both for effective risk management and for the efficient operation of trading venues among swap dealers, major swap participants, and futures commission merchants. The position risk management requirement established by the proposed rules diminishes the chance for a default, thus ensuring the financial integrity of markets as well as customer protection.

If the proposed regulations are adopted, responses to this collection of information would be mandatory. The Commission will protect proprietary information according to the Freedom of Information Act and 17 CFR part 145, "Commission Records and Information." In addition, section 8(a)(1) of the CEA strictly prohibits the Commission, unless specifically authorized by the CEA, from making public "data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of

customers." The Commission is also required to protect certain information contained in a government system of records according to the Privacy Act of 1974, 5 U.S.C. 552a.

1. Information Provided by Reporting Entities/Persons

Swap dealers, major swap participants, and futures commission merchants would be required to develop and monitor procedures for position risk management in accordance with proposed rules 1.73 and 23.609.

The annual burden associated with these proposed regulations is estimated to be 524 hours, at an annual cost of \$52,400 for each futures commission merchant, swap dealer, and major swap participant. Burden means the total time, effort, or financial resources expended by persons to generate, maintain, retain, disclose, or provide information to or for a federal agency. The Commission has characterized the annual costs as initial costs because the Commission anticipates that the cost burdens will be reduced dramatically over time as the documentation and procedures required by the proposed regulations become increasingly standardized within the industry.

This hourly burden primarily results from the position risk management obligations that would be imposed by proposed regulations 1.73 and 23.609. Proposed 1.73 and 23.609 would require each futures commission merchant, swap dealer, and major swap participant to establish and enforce procedures to establish risk-based limits, conduct stress testing, evaluate the ability to meet initial and variation margin, test lines of credit, and evaluate the ability to liquidate, in an orderly manner, the positions in the proprietary and customer accounts and estimate the cost of the liquidation. The Commission believes that each of these items is currently an element of existing risk management programs at a DCO or an FCM. Accordingly, any additional expenditure related to §§ 1.73 and 23.609 likely would be limited to the time initially required to review and, as needed, amend, existing risk management procedures to ensure that they encompass all of the required elements and to develop a system for performing these functions as often as required.

In addition, proposed §§ 1.73 and 23.609 would require each futures commission merchant, swap dealer, and major swap participant to establish written procedures to comply, and maintain records documenting compliance. Maintenance of compliance procedures and records of compliance is

prudent business practice and the Commission anticipates that swap dealers and major swap participants already maintain some form of this documentation.

With respect to the required position risk management, the Commission estimates that futures commission merchants, swap dealers, and major swap participants will spend an average of 2 hours per trading day, or 504 hours per year, performing the required tests. The Commission notes that the specific information required for these tests is of the type that would be performed in a prudent market participant's ordinary course of business.

In addition to the above, the Commission anticipates that futures commission merchants, swap dealers, and major swap participants will spend an average of 16 hours per year drafting and, as needed, updating the written policies and procedures to ensure compliance required by proposed §§ 1.73 and 23.609, and 4 hours per year maintaining records of the compliance.

The hour burden calculations below are based upon a number of variables such as the number of futures commission merchants, swap dealers, and major swap participants in the marketplace and the average hourly wage of the employees of these registrants that would be responsible for satisfying the obligations established by the proposed regulation.

There are currently 134 futures commission merchants based on industry data. Swap dealers and major swap participants are new categories of registrants. Accordingly, it is not currently known how many swap dealers and major swap participants will become subject to these rules, and this will not be known to the Commission until the registration requirements for these entities become effective after July 16, 2011, the date on which the Dodd-Frank Act becomes effective. While the Commission believes there will be approximately 200 swap dealers and 50 major swap participants, it has taken a conservative approach, for PRA purposes, in estimating that there will be a combined number of 300 swap dealers and major swap participants who will be required to comply with the recordkeeping requirements of the proposed rules. The Commission estimated the number of affected entities based on industry data.

According to recent Bureau of Labor Statistics, the mean hourly wage of an employee under occupation code 11-3031, "Financial Managers," (which includes operations managers) that is employed by the "Securities and Commodity Contracts Intermediation

¹⁵ 44 U.S.C. 3501 *et seq.*

and Brokerage" industry is \$74.41.¹⁶ Because swap dealers, major swap participants, and futures commission merchants include large financial institutions whose operations management employees' salaries may exceed the mean wage, the Commission has estimated the cost burden of these proposed regulations based upon an average salary of \$100 per hour.

Accordingly, the estimated hour burden was calculated as follows: *Developing and Conducting Position Risk Management Procedures for Swap Dealers and Major Swap Participants.* This hourly burden arises from the proposed requirement that swap dealers and major swap participants establish and perform testing of clearing member risk management procedures.

Number of registrants: 300.

Frequency of collection: Daily.

Estimated number of responses per registrant: 252 [252 trading days].

Estimated aggregate number of responses: 75,600 [300 registrants × 252 trading days].

Estimated annual burden per registrant: 504 hours [252 trading days × 2 hours per record].

Estimated aggregate annual hour burden: 151,200 hours [300 registrants × 252 trading days × 2 hours per record].

Developing Written Procedures for Compliance, and Maintaining Records Documenting Compliance for Swap Dealers and Major Swap Participants. This hourly burden arises from the proposed requirement that swap dealers and major swap participants make and maintain records documenting compliance related to clearing member risk management.

Number of registrants: 300.

Frequency of collection: As needed.

Estimated number of annual responses per registrant: 1.

Estimated aggregate number of annual responses: 300.

Estimated annual hour burden per registrant: 20 hours.

Estimated aggregate annual hour burden: 6,000 burden hours [300 registrants × 20 hours per registrant].

Developing and Conducting Position Risk Management Procedures for Futures Commission Merchants: This hourly burden arises from the proposed requirement that futures commission merchants establish and perform testing of clearing member risk management procedures.

Number of registrants: 134.

Frequency of collection: Daily.

Estimated number of responses per registrant: 252 [252 trading days].

Estimated aggregate number of responses: 33,768 [134 registrants × 252 trading days].

Estimated annual burden per registrant: 504 hours [252 trading days × 2 hours per record].

Estimated aggregate annual hour burden: 67,536 hours [134 registrants × 252 trading days × 2 hours per record].

Developing Written Procedures for Compliance, and Maintaining Records Documenting Compliance for Futures Commission Merchants. This hourly burden arises from the proposed requirement that futures commission merchants make and maintain records documenting compliance related to clearing member risk management.

Number of registrants: 134.

Frequency of collection: As needed.

Estimated number of annual responses per registrant: 1.

Estimated aggregate number of annual responses: 134.

Estimated annual hour burden per registrant: 20 hours.

Estimated aggregate annual hour burden: 2,680 burden hours [134 registrants × 20 hours per registrant].

Based upon the above, the aggregate hour burden cost for all registrants is 227,416 burden hours and \$22,741,600 [227,416 × \$100 per hour].

In addition to the per hour burden discussed above, the Commission anticipates that swap dealers, major swap participants, and futures commission merchants may incur certain start-up costs in connection with the proposed recordkeeping obligations. Such costs would include the expenditures related to re-programming or updating existing recordkeeping technology and systems to enable the swap dealer, major swap participant, or futures commission merchant to collect, capture, process, maintain, and re-produce any newly required records. The Commission believes that swap dealers, major swap participants, and futures commission merchants generally could adapt their current infrastructure to accommodate the new or amended technology and thus no significant infrastructure expenditures would be needed. The Commission estimates the programming burden hours associated with technology improvements to be 60 hours.

According to recent Bureau of Labor Statistics, the mean hourly wages of computer programmers under occupation code 15–1021 and computer software engineers under program codes 15–1031 and 1032 are between \$34.10 and \$44.94.¹⁷ Because swap dealers, major swap participants, and futures

commission merchants generally will be large entities that may engage employees with wages above the mean, the Commission has conservatively chosen to use a mean hourly programming wage of \$60 per hour. Accordingly, the start-up burden associated with the required technological improvements would be \$3,600 [\$60 × 60 hours] per affected registrant or \$1,562,400 [\$3,600 × 434 registrants] in the aggregate.

2. Information Collection Comments

The Commission invites the public and other federal agencies to comment on any aspect of the recordkeeping burdens discussed above. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Comments may be submitted directly to the Office of Information and Regulatory Affairs, by fax at (202) 395–6566 or by e-mail at OIRASubmissions@omb.eop.gov. Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rule preamble. Refer to the **ADDRESSES** section of this notice of proposed rulemaking for comment submission instructions to the Commission. A copy of the supporting statements for the collection of information discussed above may be obtained by visiting <http://www.RegInfo.gov>. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, a comment is best assured of having its full effect if OMB receives it within 30 days of publication.

C. Consideration of Costs and Benefits Under Section 15(a) of the CEA

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its action before promulgating a regulation under the CEA. Section 15(a) of the CEA specifies

¹⁶ <http://www.bls.gov/oes/current/oes113031.htm>.

¹⁷ <http://www.bls.gov/oes/current/oes113031.htm>.

that costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular order is necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the CEA.

The proposed rules involve risk management for cleared trades by futures commission merchants, swap dealers, and major swap participants that are clearing members. The discussion below will consider the proposed rule in light of each section 15(a) concern.

Position Risk Management for Cleared Trades by Futures Commission Merchants, Swap Dealers, and Major Swap Participants That Are Clearing Members

The Commission is proposing regulations that would require FCMs, SDs, and MSPs to put into place certain risk management procedures.

1. Protection of Market Participants

Good risk management practices among FCMs, SDs, and MSPs help insulate DCOs from financial distress. Moreover, while the rule calls for standard risk mitigation measures, it allows FCMs, SDs, and MSPs to use diverse techniques to implement those measures. This makes it less likely that multiple FCMs, SDs, and MSPs would be exposed to identical blind spots during unexpected market developments.

As far as costs are concerned, regular testing of various systems and financial positions requires significant personnel hours and potentially the services of external vendors. The requirement that records be created and maintained may impose costs on FCMs, SDs, and MSPs. The Commission believes that some costs might only be incremental because it believes that well-managed firms would generally already create and maintain records of this type.

2. Efficiency, Competitiveness, and Financial Integrity of Futures Markets

The integrity of the markets is enhanced with the certainty that the customer's counterparties (*i.e.*, FCMs,

SDs, and MSPs, as well as DCOs) are more likely to remain solvent during strenuous financial conditions.

As for the costs related to this rule, rigorous stress tests may encourage conservative margin requirements that reduce customers' ability to leverage their positions. Also, higher costs associated with maintaining more stringent risk management practices will ultimately be passed along to customers, likely in the form of larger spreads, which may reduce the liquidity and efficiency of the market. However, more conservative margin requirements and stringent risk management practices will also help reduce systemic risk thereby protecting the integrity of the financial system as a whole.

3. Sound Risk Management Practices

The rule extends the range of parties responsible for rigorous risk management practices which promotes further stability of the entire financial system. However, as mentioned previously, risk management systems can be costly to implement. The Commission does not know at this time, and requests comment on, how many parties will need to upgrade their systems, if any. Additionally, the Commission requests comment from the public as to what the costs might be to upgrade existing systems or install new systems to comply with the proposed regulation.

4. Other Public Interest Considerations

Requiring a significant investment in risk mitigation structures and procedures by all FCMs, SDs, and MSPs increases the number of entities committing time and resources to development of new techniques that have the potential to advance the practice across the entire industry. Such measures contribute to the overall stability of our global financial system.

List of Subjects

17 CFR Part 1

Conflicts of interest, Futures commission merchants, Major swap participants, Swap dealers.

17 CFR Part 23

Conflicts of interests, Futures commission merchants, Major swap participants, Swap dealers.

In light of the foregoing, the Commission hereby proposes to amend Part 1, and Part 23, as proposed to be added at 75 FR 71390, November 23, 2010, and further amended at 75 FR 81530, December 28, 2010, of Title 17 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for part 1 is revised to read as follows:

Authority: 7 U.S.C. 1a, 2, 2a, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6l, 6m, 6n, 6o, 6p, 6r, 6s, 7, 7a-1, 7a-2, 7b, 7b-3, 8, 9, 10a, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23, and 24, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

2. Add § 1.73 to part 1 to read as follows:

§ 1.73 Clearing futures commission merchant risk management.

(a) Each futures commission merchant that is a clearing member of a derivatives clearing organization shall:

(1) Establish risk-based limits in the proprietary account and in each customer account based on position size, order size, margin requirements, or similar factors;

(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 the proprietary account and in each customer account that could pose material risk to the futures commission merchant at least once per week;

(5) Evaluate its ability to meet initial margin requirements at least once per week;

(6) Evaluate its ability to meet variation margin requirements in cash at least once per week;

(7) Evaluate its ability to liquidate, in an orderly manner, the positions in the proprietary and customer accounts and estimate the cost of the liquidation at least once per month; and

(8) Test all lines of credit at least once per quarter.

(b) Each futures commission merchant that is a clearing member of a derivatives clearing organization shall:

(1) Establish written procedures to comply with this regulation; and

(2) Keep full, complete, and systematic records documenting its compliance with this regulation.

PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

3. The authority citation for part 23 is revised to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b-1, 6c, 6p, 6r, 6s, 6t, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21.

4. Add § 23.609 to part 23, subpart J, to read as follows:

§ 23.609 Clearing member risk management.

(a) With respect to clearing activities in futures, security futures products, swaps, agreements, contracts, or transactions described in section 2(c)(2)(C)(i) or section 2(c)(2)(D)(i) of the Act, commodity options authorized under section 4c of the Act, or leveraged transactions authorized under section 19 of the Act, each swap dealer or major swap participant that is a clearing member of a derivatives clearing organization shall:

(1) Establish risk-based limits based on position size, order size, margin requirements, or similar factors;

(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 at least once per week;

(5) Evaluate its ability to meet initial margin requirements at least once per week;

(6) Evaluate its ability to meet variation margin requirements in cash at least once per week;

(7) Test all lines of credit at least once per quarter; and

(8) Evaluate its ability to liquidate the positions it clears in an orderly manner, and estimate the cost of the liquidation.

(b) Each swap dealer or major swap participant that is a clearing member of a derivatives clearing organization shall:

(1) Establish written procedures to comply with this regulation; and

(2) Keep full, complete, and systematic records documenting its compliance with this regulation.

Issued in Washington, DC, on July 19, 2011, by the Commission.

David A. Stawick,

Secretary of the Commission.

Appendices to Clearing Member Risk Management—Commission Voting Summary and Statements of Commissioners

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendix 1—Commission Voting Summary

On this matter, Chairman Gensler and Commissioners Dunn and Chilton voted in the affirmative; Commissioners O'Malia and Sommers voted in the negative.

Appendix 2—Statement of Chairman Gary Gensler

I support the proposed rulemaking for enhanced risk management for clearing members. One of the primary goals of the Dodd-Frank Wall Street Reform and

Consumer Protection Act was to reduce the risk that swaps pose to the economy. The proposed rule would require clearing members, including swap dealers, major swap participants and futures commission merchants to establish risk-based limits on their house and customer accounts. The proposed rule also would require clearing members to establish procedures to, amongst other provisions, evaluate their ability to meet margin requirements, as well as liquidate positions as needed. These risk filters and procedures would help secure the financial integrity of the markets and the clearing system and protect customer funds.

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COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 23, and 39

RIN 3038-AD51

Customer Clearing Documentation and Timing of Acceptance for Clearing

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (Commission or CFTC) is proposing rules to implement new statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. These proposed rules address: The documentation between a customer and a futures commission merchant that clears on behalf of the customer, and the timing of acceptance or rejection of trades for clearing by derivatives clearing organizations and clearing members.

DATES: Submit comments on or before September 30, 2011.

ADDRESSES: You may submit comments, identified by RIN number 3038-AD51, by any of the following methods:

- *Agency Web site, via its Comments Online process:* <http://comments.cftc.gov>. Follow the instructions for submitting comments through the Web site.

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.

- *Mail:* David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

- *Courier:* Same as mail above.

Please submit your comments using only one method. RIN number, 3038-AD51, must be in the subject field of responses submitted via e-mail, and

clearly indicated on written submissions. All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <http://www.cftc.gov>. You should submit only information that you wish to make available publicly. If you wish the CFTC to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the CFTC's regulations.¹

The CFTC reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from <http://www.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of this action will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

FOR FURTHER INFORMATION CONTACT: John C. Lawton, Deputy Director and Chief Counsel, 202-418-5480, jlawton@cftc.gov, or Christopher A. Hower, Attorney-Advisor, 202-418-6703, chower@cftc.gov, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Background

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).² Title VII of the Dodd-Frank Act amended the Commodity Exchange Act (CEA or Act)³ to establish a comprehensive new regulatory framework for swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating rigorous recordkeeping and real-time reporting

¹ 17 CFR 145.9.

² See Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).

³ 7 U.S.C. 1 *et seq.*