

CFTC Proposes Risk Management and Operational Rules for Derivatives Clearinghouses under Dodd-Frank USA (National/Federal)

Related Content

An update on CFTC-proposed risk management and operational rules for derivatives clearing organizations (DCOs) under the Dodd-Frank Act.

On December 16, 2010, the CFTC proposed new [rules](#) under the Dodd-Frank Act for non-security-based-swap clearinghouses, referred to under Dodd-Frank as derivatives clearing organizations (DCOs). The rules establish regulatory standards for compliance with DCO core principles including risk-management matters, transaction settlement procedures, treatment of customer funds, rule and procedures for transaction default and DCO system safeguards. The rules also propose heightened system-safeguard standards on systemically important DCOs.

The proposed rules would address the following areas:

- **Participant and product eligibility.** The rules address eligibility matters including:
 - fair and open access to the DCO by market participants;
 - DCO financial resources and operational requirements;
 - monitoring, reporting and enforcement matters; and
 - product clearing eligibility standards.
- **Risk management.** The rules set out requirements for a DCO's:
 - written risk management framework (subject to internal audit);
 - appointment of a chief risk officer;
 - measurement of mark-to-market credit exposure;
 - margining, including methodology and coverage, independent validation, spread margins, price data, daily review and periodic back tests, and customer margin; and
 - other risk-control mechanisms including risk limits, review of large trader reports, stress tests, portfolio compression and review of clearing members' risk management policies and procedures.
- **Settlement procedures.** The rules address requirements and standards for:
 - daily settlements and other settlement matters;
 - recordkeeping;
 - netting arrangements; and
 - physical delivery.

- **Treatment of funds.** The rules address:
 - requirements for segregation of customer funds and assets;
 - standards for acceptable types of margin collateral and eligible collateral haircuts;
 - standards and requirements for asset valuation;
 - required concentration limits; and
 - permissible investment of customer funds.
- **Default rules and procedures.** The rules detail default management plans and procedures for a clearing member insolvency.
- **System safeguards.** The rules detail standards and requirements for:
 - risk analysis programs;
 - business continuity and disaster recovery plans (including coordination with clearing members' plans);
 - recordkeeping and testing;
 - outsourcing and resource location; and
 - CFTC notification procedures.

The new rules also propose:

- Heightened standards for safeguard of systemically important DCOs (referred to as SIDCOs), including requirements for SIDCO business continuity and disaster recovery plans that account for recovery time and geographic diversity. The rules would allow the CFTC "special enforcement authority" over SIDCOs.
- A requirement to file a Form DCO with the CFTC for all entities looking to register with the CFTC as a DCO (required of any entity operating as a DCO).
- The amendment of proposed Rule 39.19, which sets out core reporting principles for DCOs (for further information on this and related proposals, see [Legal Update, CFTC Proposes Rules on Reporting and Recordkeeping Requirements for Derivatives Clearing Organizations](#)). The amendment would require:
 - a DCO to report to the CFTC its clearing members' end-of-day mark-to-market customer positions for each beneficial owner; and
 - each DCO to submit certain reports in accordance with proposed rules.

The CFTC swap-related rules proposed and implemented under Dodd-Frank, including this one, relate only to non-security-based swaps. The SEC is separately proposing and implementing rules under Dodd-Frank covering security-based swaps.

For more information on the proposed rules, see the CFTC's [fact sheet](#) and [Q&A](#).

For details on additional Dodd-Frank rulemaking relating to non-security-based swap clearing, DCOs and other swaps and derivatives issues, see [Practice Note, Road Map to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010: Swaps and Derivatives](#). For a summary of the swaps and derivatives provisions of the Dodd-Frank Act, see [Article, Summary of the Dodd-Frank Act: Swaps and Derivatives](#).

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