Summary of FIA Comment Letter

Processing, Clearing and Transfer of Customer Positions

The proposed rules would: (i) establish time frames for the submission of swap transactions to a derivatives clearing organization ("DCO"); (ii) require designated contract markets ("DCMs") and swap execution facilities ("SEFs") to coordinate with DCOs in the development of rules and procedures to facilitate clearing; (iii) set standards for cleared swaps; and (iv) require a DCO, upon a customer’s request, to transfer such customer’s positions and related collateral from one clearing member to another without requiring the close-out and re-booking of positions.

* General
  + The proposed rules fail to recognize the essential role that clearing members play in the transmission and submission of executed swaps for clearing or in assuming responsibility to DCOs for the financial obligations arising from such transactions.

* Treatment of Customer Funds
  + Failure to vest primary responsibility for the transfer of customer positions in the carrying clearing member is inconsistent with sound risk management.
  + Proposed Rule 39.15(d) requires a DCO to have rules providing that, upon request of a customer, and subject to the consent of the receiving clearing member, the DCO will promptly transfer all or a portion of a customer’s portfolio and funds from the carrying clearing member to the receiving clearing member without requiring the close-out and re-booking of the positions prior to the requested transfer.
  + A DCO interacts with its clearing members’ customers through its clearing members. If a customer wants to transfer all or a portion of its positions, the customer must direct its request to the clearing member carrying those positions.
  + The proposed rule does not permit any conditions precedent to a requested transfer being effected…..The Commission [must] revise the proposed rule to confirm that a clearing member is required to transfer customer positions only after the customer has met all contractual obligations (outstanding margin calls and any additional margin that may be required to support any remaining positions)
* Swap Processing and Clearing
* Clearing member acceptance is required before trades can be cleared:
* The proposed rules contemplate no role for clearing members before a trade is submitted for clearing and accepted by the DCO. (Rule only says that Swap dealers, major swap participants, SEFs and DCMs are required to coordinate with DCOs, and DCOs with them).
* A DCO deals directly only with its clearing members, which are the only entities that maintain accounts at the DCO and with which the DCO is in privity. Rather than requiring swap dealers and major swap participants to have the capacity to route orders to a DCO, therefore, it would be more appropriate to require such entities to assure that they have clearing arrangements in place with clearing members that, in turn, have the capacity to route orders to a DCO in a manner acceptable to it.
* The proposed rules do not allow for a clearing member to make a risk-based decision whether to accept a swap or reject it for breach of credit limits or other risk-related reasons.
* Timing requirements don’t reflect market practice
* Proposed Rule 23.506(b). would require a swap dealer to submit a swap for clearing "to a DCO as soon as technologically practicable after execution" but in any event "no later than the close of business on the day of execution."
* "as soon as technologically practicable after execution of the swap, but no later than the close of business on the day of execution," may not always be possible. DCOs have cut-off times prior to the end of their business day, beyond which time they will not accept a swap for clearing. The Commission [must] provide flexibility to submit a swap for clearing within a reasonable time as prescribed by the applicable DCO.
* For swaps that are not subject to mandatory clearing, but which the parties have agreed to clear, the proposed rules provide that a swap dealer must submit the swap for clearing "not later than the next business day after execution of the swap, or the agreement to clear, if later than execution." To encourage the voluntary use of clearing, the proposed rule [should] be revised to permit the parties to submit such trades for clearing on any date to which the parties and their respective clearing firms agree.
* Acceptance and Clearing
* Proposed Rule 39.12. provides that a DCO: (i) must provide that all swaps with the same terms and conditions as defined by templates established under the DCO’s rule, submitted for clearing are economically equivalent and may be offset with each other; and…… (iv) must select contract unit sizes and other terms and conditions of swaps that it will clear, which may include contract unit sizes that are smaller than the contract units in which trades submitted for clearing are executed, that maximize liquidity, facilitate transparency in pricing, promote open access and allow for effective risk management.
* The Commission does not define the term "templates." If it is meant to include the terms and conditions of a swap that a DCO will clear, Commission must confirm that "economically equivalent" swaps must have the same cash flows, identical values and liquidation dates. Other terms and conditions of such templates (e.g. events of default) must be consistent with market practice.
* Agree with Commission’s proposal that DCO’s select contract unit sizes that maximize liquidity, facilitate transparency in pricing, promote open access and allow for effective risk management. But cannot support the proposed rule at this time.
* Swaps trade without a smallest notional size, and their size can be arbitrary. Although swap contracts may evolve in such a way that it would be appropriate for a DCO to establish templates regarding the terms and conditions of standardized swaps eligible for clearing, we do not believe the market is at that point. Such templates are appropriate for exchange-traded futures. However, there are significant differences between swaps and futures, and the Commission should not force futures conventions on swaps. Requiring swaps to fit within artificial, prescribed templates would be disruptive to the market and would not benefit customers.
* Proposed Rule 39.12(b)(6), regarding novation of swaps accepted for clearing appears to provide that a clearing member would be deemed to be a principal with respect to each swap it clears, even those swaps cleared on behalf of customers. This position conflicts with the FCMs’ position that, with respect to customer positions, FCMs are acting as agent, and not as principal, for customers in executing and clearing swaps (and futures) on behalf of customers. FIA, therefore, reiterates its request that the proposed rule be revised to confirm that, in clearing swaps on behalf of customers, a clearing member shall be deemed a guarantor and agent of a cleared swap and not a principal.