



FEDERAL REGISTER

Vol. 77

Thursday,

No. 240

December 13, 2012

Part II

Commodity Futures Trading Commission

17 CFR Parts 39 and 50

Clearing Requirement Determination Under Section 2(h) of the CEA;
Final Rule

COMMODITY FUTURES TRADING COMMISSION**17 CFR Parts 39 and 50**

RIN 3038-AD86

Clearing Requirement Determination Under Section 2(h) of the CEA**AGENCY:** Commodity Futures Trading Commission.**ACTION:** Final rule.

SUMMARY: The Commodity Futures Trading Commission (Commission or CFTC) is adopting regulations to establish a clearing requirement under new section 2(h)(1)(A) of the Commodity Exchange Act (CEA or Act), enacted under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The regulations require that certain classes of credit default swaps (CDS) and interest rate swaps, described herein, be cleared by a derivatives clearing organization (DCO) registered with the Commission. The Commission also is adopting regulations to prevent evasion of the clearing requirement and related provisions.

DATES: The rules will become effective February 11, 2013. Specific compliance dates are discussed in the supplementary information.

FOR FURTHER INFORMATION CONTACT: Sarah E. Josephson, Deputy Director, 202-418-5684, sjosephson@cftc.gov; Brian O'Keefe, Associate Director, 202-418-5658, bokeefe@cftc.gov; or Erik Remmler, Associate Director, 202-418-7630, eremmler@cftc.gov, Division of Clearing and Risk, Camden Nunery, Economist, 202-418-5723, cnunery@cftc.gov, Office of the Chief Economist, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:**Table of Contents**

- I. Background
 - A. Clearing Requirement Proposal
 - B. Financial Crisis
 - C. Central Role of Clearing in the Dodd-Frank Act
 - D. G-20 and International Commitments on Clearing
 - E. Overview of Section 2(h) and § 39.5
 - F. Submissions From DCOs
- II. Comments on the Notice of Proposed Rulemaking
 - A. Overview of Comments Received
 - B. Generally Applicable Comments
 - C. Credit Default Swaps
 - D. Determination Analysis for Credit Default Swaps
 - E. Interest Rate Swaps
 - F. Determination Analysis for Interest Rate Swaps

- III. Final Rule
 - A. Regulation 50.1: Definitions
 - B. Regulation 50.2: Treatment of Swaps Subject to a Clearing Requirement
 - C. Regulation 50.3: Notice to the Public
 - D. Regulation 50.4: Classes of Swaps Required To Be Cleared
 - E. Regulation 50.5: Clearing Transition Rules
 - F. Regulation 50.6: Delegation of Authority
 - G. Regulation 50.10: Prevention of Evasion of the Clearing Requirement and Abuse of an Exception or Exemption to the Clearing Requirement
- IV. Implementation
- V. Cost Benefit Considerations
 - A. Statutory and Regulatory Background
 - B. Overview of Swap Clearing
 - C. Consideration of the Costs and Benefits of the Commission's Action
 - D. Consideration of Alternative Swap Classes for Clearing Determination
 - E. Section 15(a) Factors
- VI. Related Matters
 - A. Regulatory Flexibility Act
 - B. Paperwork Reduction Act

I. Background**A. Clearing Requirement Proposal**

On August 7, 2012, the Commission published a notice of proposed rulemaking (NPRM) to establish a clearing requirement under new section 2(h)(1)(A) of the CEA, as provided for under section 723 of Title VII of the Dodd-Frank Act.¹ The Commission proposed that swaps meeting the specifications identified in two classes of CDS and four classes of interest rate swaps, and available for clearing by an eligible DCO, would be required to be cleared. The Commission also proposed rules related to the prevention of evasion of the clearing requirement and prevention of abuse of an exception or exemption to the clearing requirement. The Commission is hereby adopting §§ 50.1–50.6 and § 50.10, subject to the changes discussed below.

B. Financial Crisis

In the fall of 2008, a series of large financial institution failures triggered a financial and economic crisis that threatened to freeze U.S. and global credit markets. As a result of these failures, unprecedented governmental intervention was required to ensure the stability of the U.S. financial system.²

¹ Clearing Requirement Determination Under Section 2(h) of the CEA; Proposed Rule, 77 FR 47170 (Aug. 7, 2012).

² On October 3, 2008, President Bush signed the Emergency Economic Stabilization Act of 2008, which was principally designed to allow the U.S. Department of the Treasury and other government agencies to take action to restore liquidity and stability to the U.S. financial system (e.g., the Troubled Asset Relief Program—also known as TARP—under which the U.S. Department of the Treasury was authorized to purchase up to \$700 billion of troubled assets that weighed down the

These failures revealed the vulnerability of the U.S. financial system and economy to widespread systemic risk resulting from, among other things, poor risk management practices of financial firms and the lack of supervisory oversight for a financial institution as a whole.³

The financial crisis also illustrated the significant risks that an uncleared, over-the-counter (OTC) derivatives market can pose to the financial system. As the Financial Crisis Inquiry Commission explained:

The scale and nature of the [OTC] derivatives market created significant systemic risk throughout the financial system and helped fuel the panic in the fall of 2008: millions of contracts in this opaque and deregulated market created interconnections among a vast web of financial institutions through counterparty credit risk, thus exposing the system to a contagion of spreading losses and defaults.⁴

Certain OTC derivatives, such as CDS, played a prominent role during the crisis. According to a white paper by the U.S. Department of the Treasury, “the sheer volume of these [CDS] contracts overwhelmed some firms that had promised to provide payment of the CDS and left institutions with losses that they believed they had been protected against.”⁵ In particular, AIG reportedly issued uncleared CDS transactions covering more than \$440 billion in bonds, leaving it with obligations that it could not cover as a result of changed market conditions.⁶ As a result of AIG's CDS exposure, the Federal government bailed out the firm with over \$180 billion of taxpayer money in order to prevent AIG's failure and a possible contagion event in the broader economy.⁷

More broadly, the President's Working Group (PWG) on Financial Markets noted shortcomings in the OTC

balance sheets of U.S. financial institutions). See Public Law 110-343, 122 Stat. 3765 (2008).

³ See Financial Crisis Inquiry Commission, “The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States,” Jan. 2011, at xxviii, available at <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>.

⁴ See *id.* at 386.

⁵ *Financial Regulatory Reform: A New Foundation*, June 2009, available at http://www.treasury.gov/initiatives/Documents/Final_Report_web.pdf and cited in S. Rep. 111-176 at 29-30 (Apr. 30, 2010).

⁶ Adam Davidson, “How AIG fell apart,” Reuters, Sept. 18, 2008, available at <http://www.reuters.com/article/2008/09/18/us-how-aig-fell-apart-idUSMAR85972720080918>.

⁷ Hugh Son, “AIG's Trustees Shun ‘Shadow Board,’ Seek Directors,” Bloomberg, May 13, 2009, available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aaog3i4yUopo&refer=us>.

derivative markets as a whole during the crisis. The PWG identified the need for an improved integrated operational structure supporting OTC derivatives, specifically highlighting the need for an enhanced ability to manage counterparty risk through “netting and collateral agreements by promoting portfolio reconciliation and accurate valuation of trades.”⁸ These issues were exposed in part by the surge in collateral required between counterparties during 2008, when the International Swaps and Derivatives Association (ISDA) reported an 86% increase in the collateral in use for OTC derivatives, indicating not only the increase in risk, but also circumstances in which positions may not have been collateralized.⁹

With only limited checks on the amount of risk that a market participant could incur, great uncertainty was created among market participants. A market participant did not know the extent of its counterparty’s exposure, whether its counterparty was appropriately hedged, or if its counterparty was dangerously exposed to adverse market movements. Without central clearing, a market participant bore the risk that its counterparty would not fulfill its payment obligations pursuant to a swap’s terms (counterparty credit risk). As the financial crisis deepened, this risk made market participants wary of trading with each other. As a result, markets quickly became illiquid and trading volumes plummeted. The dramatic increase in “TED spreads” evidenced this mistrust.¹⁰ These spreads increased from a long-term average of approximately 30 basis points to 464 basis points.¹¹

The failure to adequately collateralize the risk exposures posed by OTC derivatives, along with the contagion effects of the vast web of counterparty credit risk, led many to conclude that

OTC derivatives should be centrally cleared. For instance, in 2008, the Federal Reserve Bank of New York (FRBNY) began encouraging market participants to establish a central counterparty to clear CDS.¹² For several years prior, the FRBNY had led a targeted effort to enhance operational efficiency and performance in the OTC derivatives market by increasing automation in processing and by promoting sound back office practices, such as timely confirmation of trades and portfolio reconciliation. Beginning with CDS in 2008, the FRBNY and other primary supervisors of OTC derivatives dealers increasingly focused on central clearing as a means of mitigating counterparty credit risk and lowering systemic risk to the markets as a whole. Both regulators and market participants alike recognized that risk exposures would have been monitored, measured, and collateralized through the process of central clearing.

C. Central Role of Clearing in the Dodd-Frank Act

Recognizing the peril that the U.S. financial system faced during the financial crisis, Congress and the President came together to pass the Dodd-Frank Act in 2010. Title VII of the Dodd-Frank Act establishes a comprehensive new regulatory framework for swaps, and the requirement that swaps be cleared by DCOs is one of the cornerstones of that reform. The CEA, as amended by Title VII, now requires a swap: (1) To be cleared through a DCO if the Commission has determined that the swap, or group, category, type, or class of swap, is required to be cleared, unless an exception to the clearing requirement applies; (2) to be reported to a swap data repository (SDR) or the Commission; and (3) if the swap is subject to a clearing requirement, to be executed on a designated contract market (DCM) or swap execution facility (SEF), unless no DCM or SEF has made the swap available to trade.¹³

¹² See Federal Reserve Bank of New York, Press Release, “New York Fed Welcomes Further Industry Commitments on Over-the-Counter Derivatives,” Oct. 31, 2008, available at <http://www.newyorkfed.org/newsevents/news/markets/2008/an081031.html>, which references documents prepared by market participants describing the importance of clearing. See also Ciara Linnane and Karen Brettell, “NY Federal Reserve pushes for central CDS counterparty,” Reuters, Oct. 6, 2008, available at <http://www.reuters.com/article/2008/10/06/cds-regulation-idUSN0655208920081006>.

¹³ The Commission has proposed rules that would establish a separate process for determining whether a swap has been made “available to trade” by a DCM or SEF. Those rules, and any determinations made under those rules, will be finalized separately from the clearing requirements

Clearing is at the heart of the Dodd-Frank financial reform. According to the Senate Report:¹⁴

As a key element of reducing systemic risk and protecting taxpayers in the future, protections must include comprehensive regulation and rules for how the OTC derivatives market operates. Increasing the use of central clearinghouses, exchanges, appropriate margining, capital requirements, and reporting will provide safeguards for American taxpayers and the financial system as a whole.

The Commission believes that a clearing requirement will reduce counterparty credit risk and provide an organized mechanism for collateralizing the risk exposures posed by swaps. According to the Senate Report:¹⁵

With appropriate collateral and margin requirements, a central clearing organization can substantially reduce counterparty risk and provide an organized mechanism for clearing transactions. * * * While large losses are to be expected in derivatives trading, if those positions are fully margined there will be no loss to counterparties and the overall financial system and none of the uncertainty about potential exposures that contributed to the panic in 2008.

Notably, Congress did not focus on just one asset class, such as CDS; rather, Congress determined that all swaps that a DCO plans to accept for clearing must be submitted to the Commission for a determination as to whether or not those swaps are required to be cleared pursuant to section 2(h)(2)(D) of the CEA.

D. G-20 and International Commitments on Clearing

The financial crisis generated international consensus on the need to strengthen financial regulation by improving transparency, mitigating systemic risk, and protecting against market abuse. As a result of the widespread recognition that transactions in the OTC derivatives market increased risk and uncertainty in the global economy and became a significant contributor to the financial crisis, a series of policy initiatives were undertaken to better regulate the financial markets.

discussed herein. See Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade Under Section 2(h)(8) of the Commodity Exchange Act, 76 FR 77728 (Dec. 14, 2011).

¹⁴ S. Rep. 111–176, at 32 (April 30, 2010). See also Letter from Senators Christopher Dodd and Blanche Lincoln to Congressmen Barney Frank and Collin Peterson (June 30, 2010) (“Congress determined that clearing is at the heart of reform—bringing transactions and counterparties into a robust, conservative, and transparent risk management framework.”).

¹⁵ S. Rep. 111–176, at 33.

⁸ The President’s Working Group on Financial Markets, “Policy Statements on Financial Market Developments,” Mar. 2008, available at http://www.treasury.gov/resource-center/fin-mkts/Documents/pwgpolicystatemktturmoil_03122008.pdf.

⁹ ISDA, ISDA Margin Survey, 2009, available at http://www.isda.org/c_and_a/pdf/ISDA-Margin-Survey-2009.pdf.

¹⁰ The TED spread measures the difference in yield between three-month Eurodollars as represented by London Interbank Offered Rate (LIBOR), and three-month Treasury Bills. LIBOR contains credit risk while T-bills do not. As the spread got larger, it meant that lenders demanded more return to compensate for credit risk than they would need if they loaned the money to the U.S. Department of the Treasury without any credit risk.

¹¹ The U.S. Financial Crisis: Credit Crunch and Yield Spreads, by James R. Barth et al., page 5, available at <http://apeaweb.org/confer/bei08/papers/blp.pdf>.

In September 2009, leaders of the Group of 20 (G-20)—whose membership includes the United States, the European Union, and 18 other countries—agreed that: (1) OTC derivatives contracts should be reported to trade repositories; (2) all standardized OTC derivatives contracts should be cleared through central counterparties and traded on exchanges or electronic trading platforms, where appropriate, by the end of 2012; and (3) non-centrally cleared contracts should be subject to higher capital requirements.

In June 2010, the G-20 leaders reaffirmed their commitment to achieve these goals. In its October 2010 report on Implementing OTC Derivatives Market Reforms (the October 2010 Report), the Financial Stability Board (FSB) made 21 recommendations addressing practical issues that authorities may encounter in implementing the G-20 leaders' commitments.¹⁶ The G-20 leaders again reaffirmed their commitments at the November 2011 Summit, including the end-2012 deadline. The FSB has issued three implementation progress reports. The most recent report urged jurisdictions to push forward aggressively to meet the G-20 end-2012 deadline in as many reform areas as possible. On mandatory clearing, the report observed that “[j]urisdictions now have much of the information they requested in order to make informed decisions on the appropriate legislation and regulations to achieve the end-2012 commitment to centrally clear all standardised OTC derivatives.”¹⁷

Specifically with regard to required clearing, the Technical Committee of the International Organization of Securities Commissions (IOSCO) has published a final report, *Requirements for Mandatory Clearing*, outlining recommendations that regulators should follow to carry out the G-20's goal of requiring standardized swaps to be cleared.¹⁸

Nations around the world have been preparing for the move to mandatory clearing. For example, the Japanese Financial Services Authority (JFSA) has proposed requiring certain financial institutions to clear yen-denominated

interest rate swaps that reference LIBOR and CDS that reference the Japanese iTraxx indices by the end of 2012. After that, the requirement will be expanded to other entities engaging in these swaps. In addition, the JFSA is considering expanding its mandatory clearing coverage to include U.S. dollar- and euro-denominated interest rate swaps, as well as yen-denominated interest rate swaps referencing TIBOR. The JFSA also will consider mandating single-name CDS referencing Japanese reference entities, and index and single-name CDS on North American and European reference entities.

The Monetary Authority of Singapore (MAS) released a consultation paper addressing mandatory clearing on February 13, 2012. Based on a preliminary review MAS expects Singapore dollar interest rate swaps, U.S. dollar interest rate swaps, and Asian currency non-deliverable forwards to meet its proposed mandatory clearing criteria. Additional swaps will be considered for mandatory clearing via clearinghouse submission or upon the review of MAS.

The Securities and Futures Commission and Hong Kong Monetary Authority jointly released a consultation paper addressing mandatory clearing on October 17, 2011. This consultation plan described a phased implementation approach where clearing requirements will initially cover standardized interest rate swaps and non-deliverable forwards. Hong Kong regulators have said they will consider extending the mandatory clearing requirements in subsequent phases. In July, the Hong Kong regulators published consultation conclusions and stated that the precise mandatory clearing obligations would be set out in subsidiary legislation which they will be consulting on in the fourth quarter of 2012.

On April 18, 2012, the Australian Council of Financial Regulators published a consultation on a number of OTC derivatives, including mandatory clearing. The Council of Financial Regulators is developing advice for the government which is expected to adopt legislation by end-2012.

Finally, in the European Union, specific clearing determinations have yet to be made. However, the European Markets Infrastructure Regulation (EMIR) provides that contracts become subject to the clearing obligation through either a “bottom up” approach or a “top down” approach. The “bottom up” approach is where a national authority authorizes a central counterparty (CCP) to clear certain classes of OTC derivatives. The “top

down” approach is where the European Securities and Markets Authority (ESMA) identifies classes of OTC derivatives which should be subject to the clearing obligation but for which no CCP is authorized to clear. Based on this framework, ESMA has the authority to make clearing determinations for classes of OTC derivative contracts.

With the adoption of these final rules, the Commission is taking a critical step toward meeting the G-20 commitment and fulfilling the requirements of the Dodd-Frank Act. The Commission has consulted with authorities from around the globe to ensure that our efforts are as coordinated as possible.

E. Overview of Section 2(h) and § 39.5

The Commission promulgated § 39.5 of its regulations to implement procedural aspects of section 2(h) of the CEA.¹⁹ Regulation 39.5 establishes procedures for: (1) Determining the eligibility of a DCO to clear swaps; (2) the submission of swaps by a DCO to the Commission for a clearing requirement determination; (3) Commission initiated reviews of swaps; and (4) the staying of a clearing requirement.

The determinations and rules adopted in this release implement the clearing requirement under section 2(h) of the CEA for certain swaps and require that those swaps must be submitted for clearing to Commission-registered DCOs. Under section 2(h)(1)(A), “it shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a [DCO] that is registered under [the CEA] or a [DCO] that is exempt from registration under [the CEA] if the swap is required to be cleared.”²⁰

A clearing requirement determination may be initiated by a swap submission. Section 2(h)(2)(B)(i) of the CEA requires a DCO to “submit to the Commission each swap, or any group, category, type or class of swaps that it plans to accept for clearing, and provide notice to its members of the submission.” In addition under section 2(h)(2)(B)(ii) of the CEA, “[a]ny swap or group, category, type, or class of swaps listed for clearing by a [DCO] as of the date of enactment shall be considered submitted to the Commission.”

¹⁹ See 76 FR 44464 (July 26, 2011); 17 CFR 39.5.

²⁰ See section 2(h) of the CEA. The Commission also may conduct a Commission-initiated review of swaps for required clearing. Section 2(h)(2)(A)(i) of the CEA requires the Commission on an ongoing basis to “review each swap, or any group, category, type, or class of swaps to make a determination as to whether the swap, category, type or class of swaps should be required to be cleared.”

¹⁶ See “Implementing OTC Derivatives Market Reforms,” Financial Stability Board, Oct. 25, 2010, available at http://www.financialstabilityboard.org/publications/r_101025.pdf.

¹⁷ OTC Derivatives Working Group, “OTC Derivatives Market Reforms: Third Progress Report on Implementation,” Financial Stability Board, June 15, 2012, available at http://www.financialstabilityboard.org/publications/r_120615.pdf.

¹⁸ IOSCO's report, published in February 2012, is available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD374.pdf>.

F. Submissions from DCOs

On February 1, 2012, Commission staff sent a letter requesting that DCOs submit all swaps that they were accepting for clearing as of that date, pursuant to § 39.5 of the Commission's regulations.²¹ The Commission received submissions relating to CDS and interest rate swaps from: The International Derivatives Clearinghouse Group (IDCH)²² on February 17, 2012; the CME Group (CME), ICE Clear Credit, and ICE Clear Europe, each dated February 22, 2012; and a submission from LCH.Clearnet Limited (LCH) on February 24, 2012.²³

The clearing requirement determinations and rules adopted in this release cover certain CDS and interest rate swaps currently being cleared by a DCO. The Commission intends subsequently to consider other swaps submitted by DCOs, such as agricultural, energy, and equity indices.

As stated in the NPRM, the decision to focus on CDS and interest rate swaps in the initial clearing requirement determinations is a function of both the market importance of these swaps and the fact that they already are widely cleared. In order to move the largest number of swaps to required clearing in its initial determinations, the Commission believes that it is prudent to focus on those swaps that have the highest market shares and, accordingly, the biggest market impact. Further, for these swaps there is already a blueprint for clearing and appropriate risk management. CDS and interest rate swaps fit these considerations and therefore are well suited for required clearing consideration.²⁴

Notably, market participants recommended that the Commission take this approach, and comments received on the NPRM supported this approach as well.²⁵ In addition, interest rate

swaps account for about \$500 trillion of the \$650 trillion global OTC swaps market, in notional dollars—the highest market share of any class of swaps.²⁶ LCH claims to clear about \$302 trillion of those—meaning that, in notional terms, LCH clears approximately 60% of the interest rate swap market.²⁷ While CDS indices do not have as prominent a market share as interest rate swaps, CDS indices are capable of having a sizeable market impact, as they did during the 2008 financial crisis. Overall, the CDS marketplace has almost \$29 trillion in notional outstanding across both single and multi-name products.²⁸ CDS on standardized indices accounts for about \$10 trillion of the global OTC market in notional dollar amount outstanding.²⁹ Since March 2009, the ICE Clear Credit and ICE Clear Europe have combined to clear over \$30 trillion in gross notional for all CDS.³⁰ Because of the market shares and market impacts of these swaps, and because these swaps are currently being cleared, the Commission decided to review CDS and interest rate swaps in its initial clearing requirement determinations. The Commission recognizes that while this is an appropriate basis for the initial determinations, swap clearing is likely to evolve and clearing requirement determinations made at later times may be based on a variety of other factors beyond the extent to which the swaps in question are already being cleared.

II. Comments on the Notice of Proposed Rulemaking

The Commission received 29 comments during the 30-day public comment period following publication of the NPRM, and four additional comments after the comment period closed. The Commission considered each of these 33 comments in formulating the final regulations.³¹

The Chairman and Commissioners, as well as Commission staff, participated in numerous meetings with clearinghouses, market participants, trade associations, public interest groups, and other interested parties. In addition, the Commission has consulted

Managed Funds Association (MFA), and Americans for Financial Reform (AFR).

²⁶ BIS data, December 2011, available at <http://www.bis.org/statistics/otcder/dt1920a.pdf>.

²⁷ *Id.*; LCH data.

²⁸ BIS data, December 2011, available at <http://www.bis.org/statistics/otcder/dt1920a.pdf>.

²⁹ *Id.*

³⁰ ICE Clear Credit data, as of the April 26, 2012 clearing cycle.

³¹ Comment letters received in response to the NPRM may be found on the Commission's Web site at <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1252>.

with other U.S. financial regulators including: (i) The Securities and Exchange Commission (SEC); (ii) the Board of Governors of the Federal Reserve System; (iii) the Office of the Comptroller of the Currency; and (iv) the Federal Deposit Insurance Corporation (FDIC). Staff from each of these agencies has had the opportunity to provide oral and/or written comments to this adopting release, and the final regulations incorporate elements of the comments provided.

The Commission is mindful of the benefits of harmonizing its regulatory framework with that of its counterparts in foreign countries. The Commission has therefore monitored global advisory, legislative, and regulatory proposals, and has consulted with foreign regulators in developing the final regulations.

A. Overview of Comments Received

None of the 33 comments received expressed outright opposition to the Commission's clearing requirement proposal.³² Indeed, 22 of the comment letters strongly supported the Commission's proposal and urged the Commission to finalize its proposal promptly.³³ These comments also supported the Commission's analysis under the five-factor statutory test, and agreed with the Commission's conclusion that swaps within the four proposed classes of interest rate swaps and the two proposed classes of CDS were appropriate for required clearing.³⁴ All three DCOs clearing the swaps subject to the final rules expressed strong support for the proposal and agreed with the overall approach taken by the Commission.³⁵

However, a number of commenters requested that the Commission make specific modifications to the proposed

³² An unsigned comment submitted on September 4, 2012, questioned the need for additional regulation as a general matter.

³³ See letters from Futures Industry Association Principle Traders Group (FIA PTG), Arbor Research and Trading, LLC, R.J. O'Brien & Associates, Svenokur, LLC, Chris Barnard, CRT Capital Group (Robert Gorham), LLC, DRW Trading Group, Javelin, The Swaps and Derivatives Market Association (SDMA), Knight Capital Americas LLC, Bart Sokol (CRT Capital Group), Jefferies & Company, Inc., MarketAxess, Eris Exchange, Coherence Capital Partners LLC, Citadel, Americans for Financial Reform (AFR), D.E. Shaw Group, AllianceBernstein, LCH.Clearnet Group Limited (LCH), CME Group Inc. (CME), and IntercontinentalExchange, Inc. (ICE).

³⁴ See, e.g., letter from Citadel (reviewing each of the five statutory factors and supporting the Commission's analysis).

³⁵ CME applauded the Commission's decision to require classes of swaps be cleared rather than take a product-by-product approach. CME also commended the decision not to propose classes of swaps on a DCO-by-DCO basis.

²¹ The letter made it clear that DCOs should submit both pre-enactment swaps and swaps for which DCOs have initiated clearing since enactment of the Dodd-Frank Act. Pre-enactment swaps refer to those swaps that DCOs were accepting for clearing as of July 21, 2010, the date of enactment of the Dodd-Frank Act.

²² As discussed in detail below, IDCH has been purchased by LCH.Clearnet Group.

²³ Other swaps submissions were received from Kansas City Board of Trade (KCBT) and the Natural Gas Exchange (NGX). KCBT and NGX do not accept any CDS or interest rate swaps for clearing.

²⁴ The Commission will consider all other swaps submitted under § 39.5(b) as soon as possible after this determination is published. These other swaps include certain CDS that were submitted to the Commission after the initial February 2012 submissions discussed above. If the Commission determines that additional swaps should be required to be cleared, such determination likely will be proposed as a new class under § 50.4.

²⁵ See, e.g., letters from the CME Group (CME), the Futures Industry Association (FIA), the

rules,³⁶ and, in several instances, commenters requested clarification of various points.³⁷ A number of commenters requested that the Commission delay implementation of the clearing requirement until certain milestones are met.³⁸ Each of these comments is discussed in detail below.

The Futures Industry Association (FIA) expressed concern about the 30-day comment period providing sufficient time to comment on the proposal, and recommended that the Commission provide a longer comment period for future proposals.³⁹ The Commission is cognizant of the importance of affording the public sufficient time to comment on important proposals. However, given the CEA's requirement that the Commission make its clearing requirement determinations within 90 days, in most instances, providing a 30-day comment period will be appropriate. In fact, some commenters stressed the importance of completing the determination process in an efficient manner. As R.J. O'Brien noted in its comment letter, implementing the clearing mandate as soon as possible "will improve the financial industry's credibility and show the rest of the world we are serious about improving the financial safety of our markets." Providing for a longer comment period likely would impede the Commission's ability to meet the 90-day statutory deadline for completing the determination process.

Lastly, two commenters encouraged the Commission to issue proposed determinations for energy, agricultural, and equity swaps as soon as possible.⁴⁰ As required under the CEA, the Commission will continue to review swap submissions received from DCOs for purposes of the clearing requirement in as timely a manner as possible.

³⁶ See, e.g., letter from ISDA (requesting changes to the delegation provisions of proposed § 50.6).

³⁷ See, e.g., letter from The Financial Services Roundtable (FSR) (requesting that the Commission clarify the meaning of "conditional notional amount").

³⁸ See, e.g., letter from ISDA (requesting that no determination take effect until there is "a further determination that a product has an adequate clearing history to support a finding of operational readiness to clear by DCOs and market participants"), and letter from Vanguard (requesting that the Commission delay mandatory clearing until new rules for segregation of customer funds and swap positions are fully operational and capable of being tested for three months).

³⁹ FIA specifically mentioned its inability to respond to questions asked in the NPRM with regard to competitiveness, which it viewed as important to the Commission's analysis of competitiveness under one of the five statutory factions. See Sections II.D and II.F below.

⁴⁰ See letters from AFR and Chris Barnard.

B. Generally Applicable Comments

A number of comments are equally applicable to both the CDS and interest rate swap proposals. While most of these issues are discussed in Section III below, certain threshold comments are addressed at the outset.

i. Submission of Swaps Required To Be Cleared and Failures to Clear

CME sought clarification that market participants do not have to clear those swaps that fall within a class of swaps under § 50.4, but for which no DCO provides clearing or for which the DCO provides clearing to only a limited number of market participants. Other commenters expressed similar concerns about not requiring clearing where no DCO offers customer clearing.⁴¹ Freddie Mac requested clarification regarding the legal status of a swap that is submitted for clearing to a DCO, but fails to clear.

The Commission confirms that if no DCO clears a swap that falls within a class of swaps under § 50.4, then the clearing requirement does not apply to that swap. In essence, it is a two-step process to determine whether the clearing requirement applies to a particular swap. First, a market participant must determine whether its swap falls within one of the classes under § 50.4. Then, if the swap falls within one of the classes, the market participant must determine if any of the eligible DCOs clear that swap. The second step requires market participants to determine if all the product specifications required under the DCO's rules are met. If no eligible DCO will accept the swap for clearing because there is a different product specification, then the swap is not required to be cleared. Market participants need not submit swaps to a DCO if they know that the DCO does not clear that particular swap.⁴²

In response to Freddie Mac's request for clarification, if counterparties submit their swap to a DCO for clearing and the swap fails to clear because it contains a term or terms that prevent any eligible DCO from clearing the swap, then the swap is not subject to the Commission's clearing requirement. On the other hand, if the swap fails to clear because one or both of the counterparties have not met the DCO's or their clearing members' credit requirements,⁴³ then

⁴¹ See Section II.D for a discussion of iTraxx and the availability of client clearing.

⁴² The rule text of § 50.2(a) has been modified to clarify this two-step process.

⁴³ It is the Commission's understanding that clearing failures generally arise under two circumstances: (1) Failure of the swap to meet the

the swap remains subject to the clearing requirement and must be cleared as soon as technologically practicable after the counterparties learn of the credit issue. The Commission notes that section 739 of the Dodd-Frank Act amended section 22(a)(4)(B) of the CEA to provide that, regarding contract enforcement between two eligible counterparties, "[n]o agreement, contract, or transaction between eligible contract participants or persons reasonably believed to be eligible contract participants shall be void, voidable, or unenforceable * * * under this section or any other provision of Federal or State law, based solely on the failure of the agreement, contract, or transaction * * * to be cleared in accordance with section 2(h)(1)." Accordingly, a swap that fails to clear because of credit issues may not be voided by either eligible counterparty solely for the failure of the swap to be cleared in accordance with section 2(h)(1), but the basis for the failure to clear must be addressed by the counterparties and they must promptly resubmit the swap for clearing.

With regard to clearing that is not available to all market participants, the Commission will not require a swap to be cleared unless clearing is generally available to all types of market participants.⁴⁴

ii. Adequacy of DCO Clearing History and Commission Review

ISDA raised a general issue regarding whether the clearing requirement determination for CDS and interest rate swaps properly differentiates between swaps that a DCO currently clears and those that are not currently cleared by a DCO. ISDA expressed concern about delegating to the Director of the Division of Clearing and Risk the authority to determine whether newly-cleared swaps fall within a previously-established class. ISDA's specific comments and recommendations are discussed, and in part adopted, in Section III below.

However, ISDA's general recommendation is that the Commission not impose a clearing requirement until there is "a further determination that a product has an adequate clearing history to support a finding of operational readiness to clear by DCOs and market participants." Specifically, ISDA requests that each product have been actually cleared by a DCO and exhibit

product specifications required by the DCO; or (2) a credit issue with one or both of the counterparties to the swap. Generally speaking, identification of a product specification problem can be identified extremely quickly.

⁴⁴ See Section II.D for a discussion of iTraxx and the availability of client clearing.

non-zero open interest (for both inter-dealer and customer clearing) on each day during a six-month period prior to the effective date of the clearing requirement determination.

In contrast with ISDA's comments, the three DCOs eligible to clear swaps within the classes under proposed § 50.4 praised the Commission for taking the class-based approach rather than a product-by-product approach.⁴⁵ In addition, CME and ICE both endorsed the Commission's decision not to limit applicability of the clearing requirement to individual DCOs.

The Commission observes that ISDA's recommendation that each DCO demonstrate non-zero open interest for six months may be inconsistent with section 2(h)(2) of the CEA, which requires each DCO to submit to the Commission all swaps that "it plans to accept for clearing." The use of the phrase "plans to accept" indicates that Congress intended for the Commission to review swap submissions prior to a DCO's commencing clearing operations for those swaps. Under these circumstances, the DCO would not be able to demonstrate open interest. In addition, adopting ISDA's suggestion could pose a significant deterrent to competition among DCOs insofar as DCOs seeking to offer swaps for required clearing would have to wait until they attract open interest and retain it for six months before they would be on a level playing field with incumbent DCOs.

The Commission believes that it can address ISDA's concerns about DCO product expansion and risk management through its ongoing supervision and risk surveillance programs.⁴⁶ In addition, under § 39.5(a)(1) the Commission can review the presumption of eligibility for any DCO offering new swaps falling into a class that it is already clearing, and under § 39.5(a)(2), the Commission must review the eligibility of any DCO that wishes to clear a swap that is not within a class already being cleared by that DCO.⁴⁷ The many benefits of a class-based approach are discussed with

regard to both CDS and interest rate swaps below.

iii. Customer Segregation for Swaps

Under section 2(h)(2)(D)(ii)(V) of the CEA, in making a clearing requirement determination, the Commission must take into account the existence of reasonable legal certainty in the event of the insolvency of the relevant DCO or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property.⁴⁸ Several commenters raised general concerns about customer segregation for cleared swaps.

Vanguard recommended that the Commission should not implement mandatory clearing for any swaps until the Commission's final swap customer segregation rules under the legally segregated, operationally commingled (LSOC) model are fully operational and capable of being tested for at least three months prior to mandatory clearing.

The Securities Industry and Financial Markets Association's Asset Management Group (SIFMA AMG) expressed similar concerns about unresolved issues concerning LSOC rules and the operational readiness of futures commission merchants (FCMs) and DCOs to comply with those rules. SIFMA AMG requested clarification of certain matters related to the LSOC model and requests that the Commission issue new rules to require FCMs to issue reports as frequently as technologically feasible, require DCOs to take all steps necessary to ensure reported information is accurate, and require DCOs to complete margin calculations as frequently as technologically feasible. SIFMA AMG recommended that the Commission implement a three-month testing period for LSOC rule implementation after the Commission and the market have completed their ongoing rule clarification efforts.

Both Vanguard and SIFMA AMG requested that all customer margin, including excess margin above the amount required by the DCO, be protected from fellow-customer risk.

ISDA noted that the commodity broker liquidation provisions under the U.S. bankruptcy code and the Commission's Part 190 regulations have never been applied to a DCO. In addition, ISDA stated that the Orderly Liquidation Authority under Title II of the Dodd-Frank Act has never been applied to any entity. For clearinghouses located in the United Kingdom, ISDA observed that the

Commission is relying on legal opinions, noting the lack of practical experience with DCO insolvency in the United Kingdom. In light of the absence of practical experience with DCO insolvency, ISDA recommended that the Commission study the issue with the goal of documenting uncertainties and proposing solutions.

In response to these comments, the Commission observes that the compliance date for LSOC was November 13, 2012. The Commission worked with market participants to ensure that compliance by that date was accomplished.⁴⁹ For reasons discussed below, the compliance schedule for this first clearing requirement will commence on March 11, 2013.⁵⁰ Accordingly, as requested by SIFMA AMG, parties in the first compliance category⁵¹ will have more than 3 months of experience under the LSOC rules prior to required clearing taking effect. Those parties in the second and third categories will have over 6 and 9 months of testing prior to required clearing, respectively.⁵² During this time, the Commission will continue to work with market participants to resolve matters that require clarification regarding LSOC.

Moreover, in response to requests for enhanced LSOC protections, the Commission understands that the industry is working toward a February implementation date for DCO rules regarding acceptance of excess collateral. The Commission recognizes

⁴⁹ The Commission notes that under § 22.13 a DCO may, subject to certain conditions contained therein, accept cleared swaps customer collateral in excess of the amount required by the DCO. Acceptance of this excess collateral is entirely at the election of the DCO. Thus, the timing of resolution of any issues that may arise as a result of the optional acceptance of such collateral is separate and apart from the November 13th compliance date for implementation of the regulatory requirements set forth in the Part 22 rules.

⁵⁰ See Section IV for a complete discussion of compliance dates.

⁵¹ Under the compliance schedule for required clearing, § 50.25, Category 1 Entities are swap dealers, security-based swap dealers, major swap participants, major security-based swap participants, and active funds. This category must come in compliance with the clearing requirement by March 11, 2013.

⁵² Category 2 Entities are commodity pools, private funds, and persons predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature according to section 4(k) of the Bank Holding Company Act, provided that such participants are not third-party subaccounts. Category 2 Entities must comply with the clearing requirement by June 10, 2013, for all swaps entered into on or after that date. Category 3 Entities are all other counterparties not electing an exception for a swap under section 2(h)(7), including third-party subaccounts and ERISA plans. Category 3 Entities must comply with the clearing requirement by September 9, 2013, for all swaps entered into on or after that date.

⁴⁵ Many other commenters also agreed with this approach. See, e.g., TriOptima and Citadel.

⁴⁶ See discussion of the Commission's DCO examination and risk surveillance programs in the NPRM, 77 FR at 47173-74.

⁴⁷ In its comment letter, Freddie Mac questioned how the Commission would review a proposal from a DCO to clear swaps that are required to be cleared under § 50.4. In addition to its general authority to ensure compliance with the core principles, the Commission has authority to review a DCO's eligibility to clear swaps subject to a clearing requirement at any time under § 39.5(a).

⁴⁸ This factor is discussed further in Sections II.D and II.F below.

that this issue is of particular concern to third-party subaccounts that will be required to begin clearing swaps executed on or after September 9, 2013. Given the industry's February goal, the Commission believes that issues regarding the acceptance of excess collateral will be resolved before the beginning of September.

In response to ISDA's request that the Commission conduct a study regarding insolvencies of DCOs and clearing members, the Commission observes that its staff have actively participated in, and taken leading roles in, a number of international efforts related to clearinghouse and clearing member insolvency, including an important cross-border study regarding insolvency regimes.⁵³ In addition, the Commission and other U.S. authorities, including the FDIC, have been engaged, and continue to engage, in regulatory coordination and cooperation, related to insolvencies under Title II.

C. Credit Default Swaps

i. DCO Submissions

Pursuant to § 39.5, the Commission received filings with respect to CDS cleared by CME, ICE Clear Credit, and ICE Clear Europe, each a registered DCO.⁵⁴ The CME and ICE Clear Credit submissions included the CDS that each clears on North American corporate indices, covering various tenors and series.⁵⁵ The ICE Clear Europe submission included, among other swaps, the CDS contracts on European corporate indices that they clear, with

⁵³ See, e.g., "Survey of Regimes for the Protection, Distribution, and/or Transfer of Client Assets" (Technical Committee of the International Organization of Securities Commissions, March, 2011); "Consultative Report on the Recovery and Resolution of Financial Market Infrastructures" (Committee on Payment and Settlement Systems and the International Organization of Securities Commissions, July, 2012). Staff are also actively participating in further efforts in these contexts by the International Organization of Securities Commissions and the Resolution Steering Group of the Financial Stability Board.

⁵⁴ In the case of CME and ICE Clear Europe, the submissions also included other swaps beyond those in the CDS and interest rate swap categories. These submissions, including a description of the specific swaps covered, are available on the Commission's Web site at: <http://sirt.cftc.gov/sirt/sirt.aspx?Topic=ClearingOrganizationProducts>.

⁵⁵ The Commission has received subsequent submissions from CME and ICE Clear Credit relating to CDS. In particular, CME submitted a filing with regard to the current series of each of the CDX.NA.IG and CDX.NA.HY (Series 19). ICE Clear Credit made filings with regard to the clearing of the 3-year tenor of the CDX.HY Series 15 and the clearing of the CDX.EM indices. With the exception of the CDX.EM submission, upon which the Commission has not yet begun the determination process, the substance of each of the other submissions was addressed in both the proposed clearing determination and the final clearing determination set forth herein.

information on each of the different tenors and series. Each of the submissions contained information relating to the five statutory factors set forth in section 2(h)(2)(D) of the CEA and other information required under § 39.5.

CME, ICE Clear Credit, and ICE Clear Europe provided notice of their § 39.5 swap submissions to their members by posting their submissions on their respective Web sites.⁵⁶ The submissions also are published on the Commission's Web site.⁵⁷

Regulation 39.5(b)(3)(viii) also directs a DCO's submission to include a summary of any views on the submission expressed by members. CME's submission did not address this. In their submissions, ICE Clear Credit and ICE Clear Europe stated that neither has solicited nor received any comments to date and will notify the Commission of any such comments. The Commission did not receive any additional feedback from DCOs beyond the information included in comment letters posted on the Commission's Web site.

The CDS cleared by CME, ICE Clear Credit, and ICE Clear Europe that were submitted to the Commission are standardized contracts providing credit protection on an untranching basis, meaning that settlement is not limited to a specific range of losses upon the occurrence of credit events among the reference entities included within an index. Besides single-name CDS, untranching CDS on indices are the only type of CDS being cleared by these DCOs. Other swaps, such as credit index tranches, options, and first- or Nth-to-default baskets on these indices, are not currently cleared.

CME and ICE Clear Credit each clear CDS on indices administered by Markit. The Markit CDX family of indices is the standard North American credit default swap family of indices, with the primary corporate indices being the CDX North American Investment Grade (consisting of 125 investment grade corporate reference entities) (CDX.NA.IG) and the CDX North American High Yield (consisting of 100 high yield corporate reference entities) (CDX.NA.HY). The standard currency for CDS on these indices is the U.S. dollar.

CME offers the CDX.NA.IG at the 3-, 5-, 7- and 10-year tenors for Series 9 and

⁵⁶ Available at <http://www.cmegroup.com/market-regulation/rule-filings.html> and https://www.theice.com/publicdocs/regulatory_filings/ICEClearCredit_022212.pdf. ICE Clear Europe did not provide a link to its relevant Web page.

⁵⁷ See <http://sirt.cftc.gov/sirt/sirt.aspx?Topic=ClearingOrganizationProducts>.

each subsequent series, to the extent that those contracts that have not reached their termination date.⁵⁸ CME also offers the CDX.NA.HY at the 5-year tenor for Series 11, and each subsequent series. ICE Clear Credit offers the CDX.NA.IG Series 8, and each subsequent series of that index that is still outstanding, at the 3-, 5-, 7- and 10-year tenors.⁵⁹ ICE Clear Credit also offers the CDX.NA.IG. Series 8 to Series 10, at the 7-year tenor. For the high yield index, ICE Clear Credit clears all series from the current series through the CDX.NA.HY Series 9 at the 5-year tenor.⁶⁰ Each of these cleared CDX.NA contracts is denominated in U.S. dollars.

ICE Clear Europe made a submission covering the index CDS that it clears. As with CME's and ICE Clear Credit's submissions, the contracts that ICE Clear Europe clears are based on Markit indices with corporate reference entities, though in this case, the entities are based in Europe. ICE Clear Europe clears euro-denominated contracts referencing the three primary indices: iTraxx Europe (covering 125 European investment grade corporate reference entities); the iTraxx Europe Crossover (covering 50 European high yield reference entities); and the iTraxx Europe High Volatility (a 30-entity subset of the European investment grade index).

For the iTraxx Europe and Crossover, ICE Clear Europe clears outstanding contracts in the Series 7 and 8, respectively, through the current series. For the High Volatility index, ICE Clear Europe clears outstanding contracts in the Series 9 through the current series. In terms of tenors, ICE Clear Europe clears the 5-year tenor for all swaps, as well as the 10-year tenor for the iTraxx Europe index.

⁵⁸ As administrator of these indices, Markit reviews the composition of underlying reference entities in the indices every six months. Once Markit establishes the constituents to be included within the indices, a new series of the respective index is created. The most recent series is identified as the "on-the-run" series, with all older series being identified as "off-the-run." Additionally, each time one of the reference entities within an index suffers a credit event, a new version of an existing series of the index is created. In addition to the series and version variations that may exist on the index, the parties can choose the tenor of the CDS on a given index. While the 5-year tenor is the most common, and therefore most liquid, other standard tenors may include the 1-, 2-, 3-, 7-, and 10-year.

⁵⁹ ICE Clear Credit began clearing the 3- and 7-year tenors on the CDX.NA.IG after its initial § 39.5 submission of February 22, 2012.

⁶⁰ ICE Clear Credit also made a § 39.5 submission with regard to the 3-year tenor of CDX.NA.HY, Series 15. The Commission is not including this contract within the clearing determination at this time.

Based upon those portions of the CME, ICE Clear Credit, and ICE Clear Europe swap submissions relating to the CDS contracts discussed above, as well as the analysis conducted by the Commission pursuant to § 39.5(b) and set forth below, the Commission has reviewed the following classes of swaps for purposes of the clearing requirement determination.

ii. Identification of CDS Specifications

Under § 39.5, the decision of the Commission to require that a group, category, type, or class of swaps be

required to be cleared is informed by a number of factors. As an initial matter, the Commission has looked to the DCOs' submissions with regard to the swaps they currently clear. After analyzing the key attributes of the swaps submitted, the Commission proposed establishing two classes of CDS to be subject to the clearing requirement and, pursuant to this final rulemaking, is finalizing those classes as proposed. The first class is based on the untranched indices covering North American corporate credits, the CDX.NA.IG and

the CDX.NA.HY. The second class is based on the untranched indices covering European corporate credits, the iTraxx Europe, the iTraxx Europe Crossover, and the iTraxx Europe High Volatility. Given the different markets that the CDS indices cover, the different standard currencies, and other logistical differences in how the CDS markets and documentation work, the Commission believes this is an appropriate basis for creating these two classes.

The following table sets forth the specific specifications of each class:

TABLE 1

Specification	North American Untranchéd CDS Indices Class
1. Reference Entities	Corporate.
2. Region	North America.
3. Indices	CDX.NA.IG. CDX.NA.HY.
4. Tenor	CDX.NA.IG: 3Y, 5Y, 7Y, 10Y. CDX.NA.HY: 5Y.
5. Applicable Series	CDX.NA.IG 3Y: Series 15 and all subsequent Series, up to and including the current Series. CDX.NA.IG 5Y: Series 11 and all subsequent Series, up to and including the current Series. CDX.NA.IG 7Y: Series 8 and all subsequent Series, up to and including the current Series. CDX.NA.IG 10Y: Series 8 and all subsequent Series, up to and including the current Series. CDX.NA.HY 5Y: Series 11 and all subsequent Series, up to and including the current Series.
6. Tranchéd	No.
Specification	European Untranchéd CDS Indices Class
1. Reference Entities	Corporate.
2. Region	Europe.
3. Indices	iTraxx Europe. iTraxx Europe Crossover. iTraxx Europe HiVol.
4. Tenor	iTraxx Europe: 5Y, 10Y. iTraxx Europe Crossover: 5Y. iTraxx Europe HiVol: 5Y.
5. Applicable Series	iTraxx Europe 5Y: Series 10 and all subsequent Series, up to and including the current Series. iTraxx Europe 10Y: Series 7 and all subsequent Series, up to and including the current Series. iTraxx Europe Crossover 5Y: Series 10 and all subsequent Series, up to and including the current Series. iTraxx Europe HiVol 5Y: Series 10 and all subsequent Series, up to and including the current Series.
6. Tranchéd	No.

The Commission believes that indices based on other types of entities would be viewed as a separate class and would be subject to a separate determination by the Commission. For example, given the differences that exist with regard to volumes and risk management of indices based on sovereign issuers, as opposed to corporate issuers, it is likely that such CDS would represent their own class of swaps. Similarly, to the extent indices from other regions were submitted by a DCO, it is likely that the Commission would take the view that they are part of their own class of swaps as well.

The Commission believes it appropriate to define the classes of swaps as untranchéd CDS contracts referencing Markit's broad-based corporate indices. These corporate

indices have the most net notional outstanding, the most trading volumes, and the best available pricing. The risk management frameworks for the corporate index swaps are the most well-established, and have the most available data in terms of CDS spreads and corporate default studies for analysis of the underlying constituents of the indices. Agreements based on these indices also are widely accepted and use standardized terms.⁶¹

Both of the CDS classes presented herein assume that the relevant CDS

⁶¹ To the extent other vendors successfully develop similar indices, the Commission would conduct the analysis required by § 39.5, either on its own initiative or based on a DCO submission. If based on that analysis the Commission issued a clearing requirement determination, it is likely that such indices would be considered to be part of an existing class of CDS that are required to be cleared.

agreement will use the standardized terms established by Markit/ISDA with regard to the specific index and be denominated in a currency that is accepted for clearing by DCOs. To the extent that a CDS agreement on an index listed within the classification is not accepted for clearing by any DCO because it uses non-standard terms or is denominated in a currency that makes it ineligible for clearing, that CDS is not subject to the requirement that it be cleared, notwithstanding that the CDS is based on such index.

Also as proposed, this clearing determination is limited to only those series of the referenced indices that are currently being cleared.⁶² Further, to the

⁶² As discussed in further detail below, the clearing requirement does not require existing

extent that any swap on a CDS index is of a tenor such that it is scheduled to terminate prior to July 1, 2013, such a swap is not part of this clearing determination. Given the implementation periods provided for under § 50.25, discussed below in Section IV, the Commission does not want to create a situation where certain market participants will be required to clear a contract based upon their status under the implementation provisions, but other parties will never be required to clear that same contract before its scheduled termination.

Similarly, the classes only include those tenors of contracts which are currently being cleared. AFR commented that both the 1- and 2-year tenors of the CDX.NA.IG should be included in the clearing requirement determination, citing concerns that if market participants shift to these shorter tenors, that shift would undermine a clearing requirement that included only longer tenors. Because no DCO clears the 1- or 2-year tenor of CDX.NA.IG, the Commission has decided to include within today's clearing determination only those tenors of the CDX.NA.IG that were proposed. The Commission will monitor the market's use of shorter tenors. To the extent that the market generates significant volumes of such shorter tenors of CDX.NA.IG, the Commission would expect that one or more DCOs will begin offering those tenors for clearing.

If no DCO were to offer these swaps for clearing, the Commission has the authority to commence a Commission-initiated review under section 2(h)(2)(A)(i) of the CEA to determine whether the swaps should be required to be cleared. Under section 2(h)(4), to the extent that the Commission finds that a particular swap or group, category, type, or class of swaps would otherwise be subject to mandatory clearing but no DCO has listed the swap, group, category, type, or class of swaps for clearing, the Commission shall (i) investigate the relevant facts and circumstances; (ii) issue a public report containing the results of the investigation within 30 days; and (iii) take such actions as the Commissions determines to be necessary and in the public interest, which may include requiring the retaining of adequate margin or capital by parties to the swap.

The clearing requirement determination will also cover each new series of these indices that is created every six months. The Commission

swaps in the older series to be cleared. The requirement is prospective, only requiring newly executed swaps in these older series to be cleared.

believes this will provide certainty to the market, as opposed to awaiting a new determination for each new series.⁶³ Recognizing that there may be changes to indices and their constituents,⁶⁴ the Commission will analyze each new series to ensure that the indices should continue to be included within the existing class of swaps subject to a clearing determination. To the extent that the new series raises issues, such as a DCO's ability to risk manage the contracts, the Commission can issue a stay of the clearing requirement for that series under § 39.5(d). No commenter raised any questions regarding new series.

As proposed, the Commission has decided that the classes be limited to untranching CDS on the aforementioned indices. With these untranching CDS, the contract covers the entire index loss distribution of the index, and settlement is not linked to a specified number of defaults. Tranching swaps, first- or "Nth" to-default, options, or any other product variations on these indices are excluded from these classes. These other swaps based on the indices, such as tranches, have very different profiles in terms of the § 39.5 analysis. Besides very different notional and trading volumes, the risk management processes and operations may be significantly different. The Commission believes it appropriate to exclude tranching swaps, and other variations on the indices, from the classes of swaps set forth herein. Such swaps, if accepted by DCOs and submitted for Commission review, likely would be viewed as a separate class or as separate classes.

AFR notes that market participants can use tranching CDS on the indices to replicate contracts and portfolios that would otherwise be subject to a clearing requirement. The Commission recognizes this concern and will continue to monitor activity in tranching CDS indices, as well as how the development of risk management processes at DCOs could allow for the clearing of those products. Today's clearing determination does not foreclose the possibility that tranching products may be subject to another clearing determination in the future.

⁶³ The timing of announcement of index constituents would make it impossible for the Commission to analyze the index and issue a clearing determination on the roll date, given the timeframes imposed on the Commission by § 39.5.

⁶⁴ See Financial Times, "CDS Market—Markit's Weird Selection," September 27, 2012, discussing the inclusion of constituents (CIT, Calpine, and Charter Communications) in the latest series of the CDX.NA.HY that do not have actively traded CDS contracts.

D. Determination Analysis for Credit Default Swaps

Section 2(h)(2)(D)(i) of the CEA requires the Commission to review whether a swap submission under section 2(h)(2)(B) is consistent with section 5b(c)(2) of the CEA (DCO core principles). Section 2(h)(2)(D)(ii) of the CEA also requires the Commission to consider five factors in a determination based on swap submission: (1) The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data; (2) the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded; (3) the effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the DCO available to clear the contract; (4) the effect on competition, including appropriate fees and charges applied to clearing; and (5) the existence of reasonable legal certainty in the event of the insolvency of the relevant DCO or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property.⁶⁵

i. Consistency With Core Principles for Derivatives Clearing Organizations

Section 2(h)(2)(D)(i) of the CEA requires the Commission to review whether a submission is consistent with the core principles for DCOs. Each of the DCO submissions relating to CDS provided data to support the Commission's analysis of the five factors under section 2(h)(2)(D) of the CEA. The Commission also was able to call upon independent analysis conducted with regard to the CDS market, as well as its knowledge and reviews of the registered DCOs' operations and risk management processes, covering topics such as product selection criteria, pricing sources, participant eligibility, and other relevant rules. The discussion of all of these factors is set forth below.

⁶⁵ ISDA highlighted the possibility that a CDS index subject to a clearing requirement determination could undergo such significant changes to its underlying constituents during its lifecycle that such an index would no longer be considered a broad-based index, subject to the Commission's jurisdiction. The Commission notes that the indices subject to the clearing requirement determinations discussed herein contain a minimum of 30 constituents of equal weighting, limiting the likelihood of such scenario. Nonetheless, in the event of such a scenario, the Commission could review the determination, and if appropriate, stay the determination under § 39.5(d) with regard to the index and/or series so impacted.

The swaps submitted by CME, ICE Clear Credit, and ICE Clear Europe pursuant to § 39.5(b) are currently being cleared by those organizations. As discussed above, the risk management, rules, and operations used by each DCO to clear these swaps are subject to review by the Commission's risk management, legal, and examinations staff on an on-going basis.

Additionally, each of the DCOs has established procedures to review any new swaps it may consider offering for clearing. Before the indices referenced herein were accepted for clearing by any of the DCOs, they were subject to review by the risk management functions of those organizations. Such analysis generally focuses on the DCO's ability to risk manage positions in the prospective swaps and on any specific operational issues that may arise from the clearing of such swaps. In the case of the former, this involves ensuring that adequate pricing data is available, both historically and on a "going forward" basis, such that a margining methodology could be established, back-tested, and used on an on-going basis. Operational issues may include analysis of additional contract terms for new swaps that may require different settlement procedures. Each of the contracts submitted by CME, ICE Clear Credit, and ICE Clear Europe and discussed herein has undergone an internal review process by the respective DCO and found to be within their product eligibility standards.

In their submissions, CME and ICE Clear Credit enclosed their risk management procedures. In its submission, ICE Clear Europe references its risk management procedures, which it had previously submitted to the Commission in connection with its application to register as a DCO. As part of its risk management and examination functions, the Commission reviews each DCO's risk management procedures, including its margining methodologies.

ICE Clear Credit uses a multi-factor model to margin the CDX.NA.IG and CDX.NA.HY indices, as well as the single-name CDS it clears. The margining methodology is designed to capture the risk of movements in credit spreads, liquidation costs, jump-to-default risk for those names on which credit protection has been sold, large position concentration risks, interest rate sensitivity, and basis risk associated with offsetting index derived single names and opposite "outright" single names. These factors are similarly used by ICE Clear Europe to calculate the margining requirements for their iTraxx swap listings and the underlying single-name constituents.

CME's CDS model also weighs a number of factors to calculate the initial margin for a portfolio of CDS positions. These include macro-economic risk factors, such as movements associated with systematic risk resulting in large shifts in credit spreads across a portfolio, shifts in credit spreads based on tenors, and changes in relative spreads between investment grade and high yield spreads. Additional factors include specific sector risks, the idiosyncratic risk of extreme moves in particular reference entities, and the liquidity risk associated with unwinding the portfolio. In all cases, the methodologies are designed to protect against any 5-day move in the value of the given CDS portfolio, with a 99% confidence level.

In addition to initial margin, each of the DCOs collects variation margin on a daily basis to capture changes in the mark-to-market value of the positions. To do this, the DCOs calculate end-of-day settlement prices using clearing members' price submissions for cleared swaps. Each of the DCOs maintains processes for ensuring the quality of clearing member price submissions, including the ability to compel trades at quoted prices on a random basis and to enforce fines on incomplete or incorrect submissions. ICE Clear Credit and ICE Clear Europe also use Markit services for CDX and iTraxx price submissions. CME uses other third-party data providers for pricing support as necessary on its cleared CDS products.

As part of their rule frameworks, each of these three DCOs also maintains participant eligibility requirements. On April 20, 2012, CME filed its amended rule concerning CDS Clearing Member Obligations and Qualifications (Rule 8H04). Pursuant to the amended rule, published to comply with Commission Regulation 39.12(a)(2), a CDS clearing member would have to maintain at least \$50 million of capital. The amended rule would also require a CDS clearing member's minimum capital requirement to be "scalable" to the risks it poses. Furthermore, CME already has client clearing available for its CDS index contracts.

Similarly, on March 23, 2012, ICE Clear Credit filed its amended Rule 201(b) to incorporate the \$50 million minimum capital requirement for clearing members. ICE Clear Europe has adopted similar rules to comply with § 39.12(a)(2). ICE Clear Credit also has client clearing available for its CDX index contracts.

In addition to the CDS indices discussed above, ICE Clear Credit and ICE Clear Europe offer single-name CDS

for clearing.⁶⁶ As part of their margining methodology, they are seeking approval to offer portfolio margining for the single-name CDS and the CDS indices co-mingled as a single portfolio.⁶⁷ Given that the single-name reference entities will likely also be constituents of a given index within a portfolio, the Commission generally believes that such portfolio margining initiatives are consistent with the sound risk management policies for DCOs that are required under § 39.13(g)(4). Moreover, DCOs such as ICE Clear Credit already use margining methodologies that provide for appropriate portfolio margining treatment with regard to clearing members' proprietary positions.⁶⁸ The Commission is committed to working toward establishing similar portfolio margining programs for DCOs clearing customer positions in CDS indices and single-name CDS.⁶⁹ Specifically, the Commission anticipates addressing ICE's portfolio margining petitions for CDS in the near term.

Based upon the Commission's ongoing reviews of DCOs' risk management frameworks and clearing rules, and its annual examinations of the DCOs, the Commission believes that the submissions of CME, ICE Clear Credit, and ICE Clear Europe are consistent with section 5b(c)(2) of the CEA and the related Commission regulations. In analyzing the CDS products submissions discussed herein, the Commission does not believe that a clearing determination with regard to the specified CDS products would be inconsistent with CME, ICE Clear Credit, or ICE Clear Europe's continued ability to maintain such compliance with the DCO core principles set forth in Part 39 of the Commission's regulations.

⁶⁶ Such single-name CDS are defined as "security-based swaps" under section 721(a) of the Dodd-Frank Act.

⁶⁷ See ICE Clear Credit's petitions to the Commission and SEC, dated October 4, 2011. The petition to the Commission is available at <http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/iceclearcredit100411public.pdf>. See also ICE Clear Europe's petition available at <http://www.cftc.gov/stellent/groups/public/@requestsandactions/documents/ifdocs/iceclearcredit4dfrequest.pdf>.

⁶⁸ See ICE Clear Credit's certification to the Commission, dated as of November 25, 2011. The certification is available at <http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/ml112511icecc001.pdf>.

⁶⁹ A discussion of comments concerning portfolio margining is included below.

ii. Consideration of the Five Statutory Factors for Clearing Requirement Determinations

a. Outstanding Notional Exposures, Trading Liquidity, and Adequate Pricing Data

Section 2(h)(2)(D)(ii)(I) of the CEA requires the Commission to take into account the existence of outstanding notional exposures, trading liquidity, and adequate pricing data.

The most recent BIS study⁷⁰ found that, as of December 2011, the size of the overall CDS marketplace exceeded \$28.6 trillion in notional amount outstanding. Of that amount, \$11.8 trillion was in multi-name CDS agreements. Within this sub-category of CDS, CDS on indices accounted for more than 89% of the total notional amount outstanding, with over \$10 trillion in notional outstanding. Overall, CDS on index products account for 37% of all notional amounts of CDS contracts outstanding.

The predominant provider of CDS indices is Markit. Markit offers indices covering corporate and sovereign entities, among others, in the United States, Europe, and Asia. Recent Markit data shows daily transaction volumes of

1,559 transactions using its licensed family of CDX indices, and 1,828 daily transactions in its European iTraxx indices.⁷¹ Further, it shows a rolling month gross notional amount of \$745 billion in gross notional amount for the CDX family of indices and €680 billion for the iTraxx family. Nearly all of the CDX contracts and volumes come from indices that are subject to the clearing requirement determination. With regard to the European iTraxx, more than 80% of those daily contract volumes and 84% of the daily gross notional volumes come from the iTraxx investment grade and high yield indices contemplated by the clearing requirement determination.

One point highlighted by this data, however, is the declining trading liquidity in the off-the-run series that can occur. Of the volumes noted by Markit, nearly 60% was in the current on-the-run series, as compared to all other outstanding series combined.⁷² The submissions of ICE Clear Credit, ICE Clear Europe, and CME also note the decline in average weekly gross

notional amounts and contracts for benchmark tenors for off-the-run indices. The decline however can be more precipitous among older off-the-run indices. While many market factors can contribute to the actual volumes for a specific off-the-run contract, subject to certain exceptions, the trend is generally toward lower volumes.⁷³

Set forth below is a table of data taken from DTCC as of November 7, 2012, highlighting the net notional amounts and outstanding CDS index contracts, across all tenors, for each index and series included in this clearing determination.⁷⁴

⁷³ The current "on-the-run" series tend to have the most liquidity, while the older "off-the-run" series tend to have less liquidity, as many investors exit positions in an existing series and enter new positions in the new series when it becomes available (*i.e.*, they "roll" their positions to the new series) thereby increasing liquidity in the "on-the-run" series.

⁷⁴ Data from November 7, 2012, available at www.dtcc.com. In 2006, DTCC began providing warehouse services for confirmed CDS trades through its Trade Information Warehouse (TIW). With the commitment of global market participants in 2009 to ensure that all OTC derivatives trades are recorded by a central repository, TIW has become a global repository for all CDS trades. With all major market participants submitting their trades to the TIW, it is estimated that 98% of all CDS trades are included within the warehouse, making it the primary source of CDS transaction data.

⁷⁰ See BIS data, available at <http://www.bis.org/statistics/otcder/dt1920a.pdf>.

⁷¹ Based on data published on www.markit.com as of September 27, 2012.

⁷² The term "on-the-run" refers to current series of an index, while older series are referred to "off-the-run." Each six months when a new series is created (or "rolls" using market terminology), the new series is considered the "on-the-run" index, and all others are considered "off-the-run."

Table 2

DTCC DATA - BY CONTRACT AND SERIES						
DTCC DATA	NET NOTIONAL \$	OPEN		DTCC DATA	NET NOTIONAL \$	OPEN
CONTRACT/SERIES	OUTSTANDING	CONTRACTS		CONTRACT/SERIES	OUTSTANDING	CONTRACTS
CDX.NA.IG.19	66,726,525,313	4,252		CDX.NA.HY.19	18,711,387,000	3,375
CDX.NA.IG.18	25,242,980,217	3,961		CDX.NA.HY.18	11,541,266,409	3,449
CDX.NA.IG.17	14,206,051,225	1,539		CDX.NA.HY.17	5,210,899,501	1,206
CDX.NA.IG.16	20,827,143,020	1,531		CDX.NA.HY.16	5,455,287,000	705
CDX.NA.IG.15	12,170,776,001	756		CDX.NA.HY.15	9,325,100,909	561
CDX.NA.IG.14	10,198,264,081	588		CDX.NA.HY.14	11,458,175,000	183
CDX.NA.IG.13	6,157,634,760	460		CDX.NA.HY.13	1,437,587,000	95
CDX.NA.IG.12	4,869,179,644	343		CDX.NA.HY.12	1,371,245,731	62
CDX.NA.IG.11	4,190,465,694	297		CDX.NA.HY.11	8,291,604,030	233
CDX.NA.IG.10	5,926,634,799	346				
CDX.NA.IG.9	105,430,399,716	2,067				
CDX.NA.IG.8	17,469,789,333	240				
ITRAXX EUROPE SERIES 18	38,510,438,087	4,588		ITRAXX EUROPE CROSSOVER SERIES 18	10,029,587,719	3,908
ITRAXX EUROPE SERIES 17	25,990,566,144	5,754		ITRAXX EUROPE CROSSOVER SERIES 17	5,412,535,536	4,288
ITRAXX EUROPE SERIES 16	7,653,052,828	2,472		ITRAXX EUROPE CROSSOVER SERIES 16	1,447,868,452	1,005
ITRAXX EUROPE SERIES 15	8,497,672,575	1,685		ITRAXX EUROPE CROSSOVER SERIES 15	2,565,759,387	743
ITRAXX EUROPE SERIES 14	3,591,025,566	1,011		ITRAXX EUROPE CROSSOVER SERIES 14	1,178,421,409	528
ITRAXX EUROPE SERIES 13	4,606,938,470	1,202		ITRAXX EUROPE CROSSOVER SERIES 13	688,838,218	485
ITRAXX EUROPE SERIES 12	5,819,694,487	632		ITRAXX EUROPE CROSSOVER SERIES 12	982,576,569	319
ITRAXX EUROPE SERIES 11	3,377,529,200	427		ITRAXX EUROPE CROSSOVER SERIES 11	967,068,894	153
ITRAXX EUROPE SERIES 10	7,771,594,503	543		ITRAXX EUROPE CROSSOVER SERIES 10	632,592,631	143
ITRAXX EUROPE SERIES 9	73,791,616,614	3,698				
ITRAXX EUROPE SERIES 8	16,035,466,103	751				
ITRAXX EUROPE SERIES 7	14,848,063,469	297				
ITRAXX EUROPE HIVOL SERIES 18	732,900,895	31				
ITRAXX EUROPE HIVOL SERIES 17	432,663,278	50				
ITRAXX EUROPE HIVOL SERIES 16	461,075,069	39				
ITRAXX EUROPE HIVOL SERIES 15	351,245,323	61				
ITRAXX EUROPE HIVOL SERIES 14	1,020,850,710	69				
ITRAXX EUROPE HIVOL SERIES 13	832,944,990	78				
ITRAXX EUROPE HIVOL SERIES 12	1,750,515,674	68				
ITRAXX EUROPE HIVOL SERIES 11	666,174,288	58				
ITRAXX EUROPE HIVOL SERIES 10	1,327,323,849	52				

Notwithstanding the declining volumes that occur when an index is no longer on-the-run, the Commission does not believe that is sufficient reason to exclude the older series from the classes of CDS that are subject to the clearing requirement. As the DTCC data indicates, there are still significant volumes and outstanding notional amounts in each of these series.⁷⁵ From the perspective of the DCO, the risk management of the older series of swaps should not provide significant additional challenges. With the significant notional and contract volumes still outstanding according to DTCC, many clearing members already have these positions on their books and are meeting their risk management requirements, even in the face of

⁷⁵ The Commission is monitoring volumes in the on-the-run iTraxx Europe HiVol. With the newest roll of the indices occurring on September 20, 2012, this index has yet to show significant volumes in the latest series based on DTCC data. The Commission will continue to monitor these volumes and take action as appropriate.

declining trading volumes. While the volumes may decline, the data included in the submissions indicates that volume still does exist, and parties should be able to trade these CDS indices as necessary. Additionally, as discussed further below, the clearing requirement would apply only to new swaps executed in the off-the-run indices.

Both AFR and ISDA specifically supported the inclusion of “off-the-run” CDS indices in the clearing determination. AFR noted that without including those indices, the market might enter into such swaps so as to avoid the clearing requirement. In addition, ISDA expressed concern about the potential negative impact on the relative liquidity between cleared and uncleared CDS swaps should a clearing requirement cease to apply during the lifecycle of the CDS.

Given the contract and notional volumes listed above, there is adequate data available on pricing. The pricing

for the CDS on these indices is fairly consistent across clearinghouses. The DCOs generally require a clearing member with open interest in a particular index to provide a price on that index for end-of-day settlement purposes. After applying a process to remove clear outliers, a composite price is calculated using the remaining prices. To ensure the integrity of the submissions, clearing members’ prices may be “actionable,” meaning that they may form the basis of an actual trade that the member will be forced to enter. DCOs also have compliance programs that may result in fines for clearing members that fail to submit accurate pricing data.

Beyond clearing member submissions, there are a number of third-party vendors that provide pricing services on these swaps. Third-party vendors typically source their data from a broader range of dealers. The data includes both direct contributions as well as feeds to automated trading

systems. This data is reviewed for outliers and aggregated for distribution.

b. Availability of Rule Framework, Capacity, Operational Expertise and Resources, and Credit Support Infrastructure

Section 2(h)(2)(D)(ii)(II) of the CEA requires the Commission to take into account the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded. The Commission has determined that this factor is satisfied by each of CME, ICE Clear Credit, and ICE Clear Europe.

CME, ICE Clear Credit, and ICE Clear Europe, respectively, currently are clearing the swaps each submitted under § 39.5. They have developed respective rule frameworks, capacity, operational expertise and resources, and credit support infrastructure to clear the contracts on terms that are consistent with the material terms and trading conventions on which the contracts currently are trading. The Commission believes that these are scalable and that CME, ICE Clear Credit, and ICE Clear Europe would be able to risk manage the additional swaps that might be submitted due to the clearing requirement determination.

Following the financial crisis, the major market participants committed in 2009 to the substantial reforms to the OTC derivatives markets.⁷⁶ Among the commitments from CDS dealers and buy side participants was to actively engage with central counterparties to broaden the range of cleared swaps and market participants. These changes were in addition to those generated through organizations like ISDA and their protocols standardizing CDS. For broadly traded swaps like the CDS indices, the ultimate impact of these initiatives was operational platforms,⁷⁷ rule frameworks, and other infrastructure initiatives that replicated the uncleared market and supported the move of these CDS to a centrally cleared environment. In this way, the CDS clearing services offered by DCOs,

⁷⁶ See the June 2, 2009 letter to The Honorable William C. Dudley, President of the Federal Reserve Bank of New York, available at <http://www.newyorkfed.org/newsevents/news/markets/2009/060209letter.pdf>.

⁷⁷ In its comment letter supporting the NPRM, MarketAxess Holdings Inc. (MarketAxess) noted that the electronic trading platform it operates supports the trading of CDX and iTraxx products. MarketAxess stated that it intends to apply for registration as a SEF once the Commission issues related final rules.

including CME, ICE Clear Credit, and ICE Clear Europe, were designed to be cleared in a manner that is consistent with the material terms and trading conventions of a bilateral, uncleared market.

In addition, CME, ICE Clear Credit, and ICE Clear Europe are registered DCOs. To be registered as such, CME, ICE Clear Credit, and ICE Clear Europe have, on an on-going basis, demonstrated to the Commission that they are each in compliance with the DCO core principles set forth in the CEA and Commission regulations, as discussed above. As a general matter, any DCO that does not have the rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the swaps that are subject to required clearing is not in compliance with the core principles or the Commission regulations promulgating these principles.

Commenters raised issues with regard to the operational capabilities of clearinghouses to manage the clearing of iTraxx for customers. Commenters such as ISDA, FIA, MFA, and D.E. Shaw all highlighted the fact that no registered DCO currently offers customer clearing for iTraxx. Besides the lack of approved customer clearing of the iTraxx indices at any DCO, the commenters noted substantive concerns about the ability of clearinghouses to manage the “restructuring” credit event applicable to iTraxx (and certain other CDS indices) in the context of customer clearing. For the CDX.NA.IG and CDX.NA.HY indices, credit events are limited to a “failure to pay” or the bankruptcy of the companies included in the index. A credit event results in the removal of the defaulted constituent from the index, with the protection seller settling the amounts owed to the protection buyer with regard to that individual constituent. The standardized terms of the iTraxx, however, also include “restructuring” as a credit event. When a restructuring event occurs with regard to an index constituent, the impacted company is removed from the index by the creation of a single-name CDS referencing that entity. The protection buyer and seller have the option to continue that single-name CDS or to settle the contract with regard to the restructured credit.

ISDA, MFA, and FIA note that this process raises issues for DCOs. Specifically highlighted were those situations where a DCO does not, in fact, already offer clearing of the single-name CDS that is subject to the restructuring event. To the extent that the SEC or foreign regulator prohibits

the DCO from clearing a particular single-name CDS, a process would need to be developed to address such circumstances. Similarly, the customer account in which the new single-name CDS would be held, in the absence of portfolio margining, would need to be addressed. MFA comments that the approval of portfolio margining petitions would remove much of the complexity of the “spin-off” of the single-name CDS from the iTraxx indices. Given the inclusion of the iTraxx within the clearing determination, MFA states that the petitions need to be approved so that the new single-name CDS can be held within the cleared swap account and margined with the iTraxx index CDS. Finally, the commenters believe that DCOs need to demonstrate that their customer clearing platforms are technologically viable and sufficiently tested before a clearing determination with regard to the iTraxx indices is finalized. For these reasons, these commenters believe a delay in the implementation of a clearing requirement for the iTraxx indices would be appropriate until such time as customer clearing platforms have been established, the necessary regulatory approvals have been granted and operational testing has been conducted for an appropriate period of time. In MFA’s view the delay should be 60 to 90 days, and in ISDA’s view, the testing period should consist of voluntary client clearing for at least 90 days.

On the other hand, ICE supports the Commission’s inclusion of iTraxx CDS indices within its clearing requirement determination. ICE states that ICE Clear Europe has already begun the process of pursuing regulatory approval for client clearing of iTraxx, and indicates that ICE Clear Credit will do the same.⁷⁸

⁷⁸ ICE Clear Europe’s submission, pursuant to Commission Regulation 40.6, amending its rulebook to accommodate client clearing is available on the Commission’s Web site at: <http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul091312icre001.pdf>. ICE Clear Europe is registered as a recognized clearing house with the United Kingdom’s Financial Services Authority (U.K. FSA) and requires approval from the U.K. FSA to offer iTraxx clearing to customers. ICE Clear Credit’s submission with regard to iTraxx clearing for both proprietary and customer accounts is available on the Commission’s Web site at <http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul092812icc001.pdf>. To the extent that ICE Clear Credit successfully launches iTraxx clearing, it would address ISDA’s concern with regard to the Commission issuing a clearing determination for swaps that cannot be cleared at a U.S.-based DCO. It should be noted, however, that the Commission does not believe a DCO clearing a particular swap needs to be based in the U.S. for the Commission to find a swap subject to a clearing determination, to the extent that swap satisfies the factors required

While recognizing that the standard credit events under the iTraxx add some complexity relative to the CDX indices, ICE notes that it has worked with market participants and DTCC to develop industry-wide solutions to the “restructuring” event. Further, ICE states that ICE Clear Credit has already implemented applicable parts of this solution with regard to the clearing of the CDX.EM CDS index of emerging market sovereign constituents.⁷⁹ ICE claims that any additional processes necessary with regard to clearing iTraxx index CDS are being addressed currently by the industry, and will not present any insurmountable challenges.

Citadel also commented that they did not believe that there were any substantive reasons why the iTraxx index CDS should not be required to be cleared. The “restructuring” credit event and the spinning out of a newly cleared single-name CDS do not, in Citadel’s view, present any new issues to market participants. Further, because DCOs already offer clearing on the iTraxx on a dealer-to-dealer basis, they have the necessary processes upon which to build out the client clearing platform. Citadel also states that even if the ICE Clear Credit’s and ICE Clear Europe’s petitions to the SEC for portfolio margining were not approved generally,⁸⁰ limited exemptions may be available for the single names associated with the spun-off single name. Citadel does agree with other commenters that to the extent that client clearing cannot be offered with sufficient lead time to allow for proper operational testing, a delay may be appropriate in implementing a clearing requirement for the iTraxx indices. Citadel believes 60 days voluntary customer clearing should be sufficient for such testing.

The Commission believes that the introduction of client clearing must occur before any clearing determination could become effective with regard to the iTraxx indices, or any other CDS indices that the Commission may consider.⁸¹ The Commission agrees with

by statute and regulation to be included in the Commission’s analysis.

⁷⁹ It is not clear, however, the extent to which clearing members are in fact offering customer clearing of the CDX.EM indices cleared by ICE Clear Credit.

⁸⁰ It should be noted that the Commission strongly supports the petitions for the portfolio margining of single-name CDS and CDS indices. The Commission believes that all customers should be able to benefit from the reasonable application of portfolio margining, and that the benefits thereof should not just be available to the proprietary positions in the house accounts of clearing members.

⁸¹ The Commission agrees with the comments of MFA that the availability of client clearing should be considered when making clearing

all commenters that subject to resolution of all operational issues surrounding client clearing of the iTraxx indices, specifically the iTraxx Europe, Crossover, and High Volatility, these indices are appropriate for inclusion in a clearing requirement. The Commission is encouraged by the work currently being done by the DCOs, by other regulators, and by the market as a whole, to establish client clearing in the near term. The Commission recognizes that additional time may be necessary to allow for the DCOs to obtain the necessary regulatory approvals and design a workable framework for dealing with the issues presented by the client clearing of the iTraxx indices, before the clearing of this class of indices can be required of market participants.

As part of this clearing requirement determination, the Commission is including the iTraxx class of CDS, as proposed. The Commission believes that the compliance schedule outlined in Section IV below should provide adequate time for market participants to resolve the outstanding issues with regard to client clearing of the iTraxx indices. Under this schedule, the requirement for market participants to begin clearing would commence on March 11, 2013, for swaps entered into on or after that date between Category 1 Entities. Category 2 Entities would be required to clear swaps beginning on June 10, 2013, for swaps entered into on or after that date, and Category 3 Entities would be required to clear swaps beginning on September 9, 2013, for swaps entered into on or after that date. However, if no DCO has begun offering client clearing for iTraxx by February 11, 2013, then compliance with the required clearing of iTraxx will commence sixty days after the date on which iTraxx is first offered for client clearing by an eligible DCO.

If an eligible DCO offers client clearing for iTraxx on or before September 9, 2013, the following phased implementation schedule will apply: Category 1 Entities would be required to clear iTraxx indices entered into on or after the date 60 days after the date on which iTraxx is first offered for client clearing by an eligible DCO; Category 2 Entities would be required to clear iTraxx entered into on or after the date 150 days after the date on which iTraxx is first offered for client clearing

determinations. Consequently, DCOs accepting, or planning to accept, swaps for clearing should make client clearing available in compliance with Commission regulations. In the absence of such client clearing, the Commission will delay compliance with required clearing of iTraxx indices.

by an eligible DCO; and Category 3 Entities would be required to clear iTraxx entered into on or after the date 240 days after the date on which iTraxx is first offered for client clearing by an eligible DCO. There will be no phasing of compliance if an eligible DCO offers client clearing for iTraxx after September 9, 2013. Rather, all three categories of market participants will be expected to come into compliance by 60 days after the date on which iTraxx is first offered for client clearing by an eligible DCO.

c. Effect on the Mitigation of Systemic Risk

Section 2(h)(2)(D)(ii)(III) of the CEA requires the Commission to take into account a clearing requirement’s effect on the mitigation of systemic risk, taking into account the size of the market for the contract subject to the clearing requirement and the resources of the DCOs clearing the contract. The Commission agrees with the § 39.5 swap submissions of CME, ICE Clear Credit, and ICE Clear Europe that requiring certain classes of CDS to be cleared would reduce systemic risk in this sector of the swaps market. As CME noted, the 2008 financial crisis demonstrated the potential for systemic risk arising from the interconnectedness of OTC derivatives market participants and the limited transparency of bilateral, *i.e.*, uncleared, counterparty relationships. According to the Quarterly Report (Second Quarter 2012) on Bank Trading and Derivatives Activities of the Office of the Comptroller of the Currency (OCC Report),⁸² CDS index products account for a significant percentage of the notional value of swaps positions held by financial institutions. According to ICE Clear Credit, the CDS indices it offers for clearing are among the most actively traded swaps with the largest pre-clearing outstanding positions, and ICE Clear Credit’s clearing members are among the most active market participants. ICE Clear Credit also noted that its clearing members clear a significant portion of their clearing-eligible portfolio.

Clearing the CDS indices subject to this determination will reduce systemic risk in the following ways: mitigating counterparty credit risk because the DCO would become the buyer to every seller of CDS indices subject to this determination and vice-versa; providing counterparties with daily mark-to-market valuations and exchange of

⁸² Available at <http://occ.treas.gov/topics/capital-markets/financial-markets/trading/derivatives/dq212.pdf>.

variation margin pursuant to a risk management framework set by the DCO and reviewed by the Commission's Division of Clearing and Risk; posting initial margin with the DCO in order to cover potential future exposures in the event of a default; achieving multilateral netting, which substantially reduces the number and notional amount of outstanding bilateral positions; reducing swap counterparties' operational burden by consolidating collateral management and cash flows; and eliminating the need for novations or tear-ups because clearing members may offset opposing positions.

As discussed in the NPRM, the DCOs collect substantial amounts of collateral in the form of initial margin and guaranty fund contributions to cover potential losses on CDS portfolios. The methodologies for calculating these amounts are based on covering 5-day price movements on a portfolio with a 99% confidence level for initial margin, and longer liquidation periods and higher confidence levels under "extreme but plausible" conditions in the case of guaranty fund requirements. Beyond these financial resources, the clearinghouses have in place established risk monitoring processes, system safeguards, and default management procedures, which are subject to testing and review, to address potential systemic shocks to the financial markets.

AFR specifically supported the Commission's analysis on the mitigation of systemic risk with regard to the CDS clearing determination.⁸³ ISDA commented generally that the Commission's analysis of this factor should have addressed the centralization of risk at DCOs as a result of the determinations, and the new capital, collateral, and disclosure requirements that have decreased risk in uncleared swaps.⁸⁴ The Commission believes its analysis of other factors did in fact focus on the management of risk at DCOs and their ability to manage the risks associated with the untranching of CDS indices included within the determination. In connection with future determinations, the Commission will continue to take those issues raised by ISDA into consideration.

d. Effect on Competition

Section 2(h)(2)(D)(ii)(IV) of the CEA requires the Commission to take into account the effect on competition,

⁸³ Other commenters such as Citadel generally agreed with the Commission's analysis of the reduction of systemic risk for both the interest rates and CDS determinations.

⁸⁴ See Section II.F for further discussion of this comment.

including appropriate fees and charges applied to clearing. Of particular concern to the Commission is whether this determination would harm competition by creating, enhancing, or entrenching market power in an affected product or service market, or facilitating the exercise of market power.⁸⁵ Under U.S. Department of Justice guidelines, market power is viewed as the ability "to raise price [including clearing fees and charges], reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives."⁸⁶

In the NPRM, the Commission identified the following putative product and service markets as potentially affected by this clearing determination: a DCO service market encompassing those clearinghouses that currently (or with relative ease in the future could) clear the CDS subject to this determination, and a CDS product market or markets encompassing the CDS that are subject to this determination.⁸⁷ Without defining the precise contours of these markets at this time,⁸⁸ the Commission recognizes that,

⁸⁵ See U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines [hereinafter "Horizontal Merger Guidelines"] at § 1 (Aug. 19, 2010), available at <http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf>.

⁸⁶ *Id.*, see also U.S. Department of Justice (DOJ) and the Federal Trade Commission (FTC), Antitrust Guidelines for Collaborations Among Competitors at § 1.2 (April 2000), available at <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf> ("The central question is whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement").

⁸⁷ Included among these could be a separate product market for CDS indices licensing. AFR stated that this factor should not focus on Markit as an index provider, but rather on clearing entities. For purposes of its consideration of this factor, the Commission believes its analysis appropriately covers competition as it relates to clearinghouses, as well as to other market participants.

⁸⁸ The federal antitrust agencies, the DOJ and FTC, use the "hypothetical monopolist test" as a tool for defining antitrust markets for competition analysis purposes. The test "identifies a set of products that are reasonably interchangeable with a product," and thus deemed to reside in the same relevant antitrust product or service market. "[T]he test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ('hypothetical monopolist') likely would impose at least a small but significant and non-transitory increase in price ('SSNIP') on at least one product in the market." In most cases, a SSNIP of five percent is posited. If consumers would respond to the hypothesized SSNIP by substituting alternatives to a significant degree to render it unprofitable, those alternative products/services are included within the relevant market. This methodological exercise is repeated until it has been determined that consumers have no further interchangeable products/services available to them. Horizontal Merger Guidelines at § 4.1.

depending on the interplay of several factors, this clearing determination potentially could impact competition within the affected markets. Of particular importance to whether any impact is, overall, positive or negative, is: (1) Whether the demand for these clearing services and swaps is sufficiently elastic that a small but significant increase above competitive levels would prove unprofitable because users of the CDS products and DCO clearing services would substitute other products/clearing services co-existing in the same market(s), and (2) the potential for new entry into these markets. The availability of substitute products/clearing services to compete with those encompassed by this determination, and the likelihood of timely, sufficient new entry in the event prices do increase above competitive levels, each operate independently to constrain anticompetitive behavior.

The Commission recognized in the NPRM that, depending on the interplay of several factors, the clearing requirement potentially could impact competition within the affected market and discussed various factors that could impact that market.

In response to the Commission's recognition of the fact that currently no DCO clears CDS indices licensed by any provider other than Markit, Markit commented that it did not believe the determination would foreclose or materially impact competition in the CDS products, including licensing. Markit noted that its open licensing policy encourages competition among DCOs, SEFs, market makers, and others. Markit further commented that, given the costs associated with clearing, CDS indices that are not subject to a determination may be at a competitive advantage, including those that may be established by other index providers.

In support of the NPRM, Citadel stated that the clearing requirement will have a strong positive impact on competition in the swap market and the market for clearing services. Citadel noted that central clearing will remove a significant barrier to entry for alternative swap market liquidity providers and will enable smaller entities to compete on more equal terms because central clearing eliminates the consideration of counterparty credit risk from the selection of execution counterparties. Citadel further commented that buy-side market participants will benefit from a wider range of potential execution counterparties and asserted that this increased competition yields benefits to market participants including narrower bid-ask spreads, improved access to best

execution, and increased market depth and liquidity, all of which facilitate the emergence of an all-to-all market with electronic and/or anonymous execution. Citadel also commented that substitution of the DCO for the bilateral counterparty decouples execution from post-trade processing and settlement.⁸⁹ Finally, Citadel commented that the certainty as to when the first clearing requirement will begin gives DCOs and FCMs the confidence to invest in their client clearing offerings, and to compete actively for buy-side business both on the quality and efficiency of their services as well as on price.

While FIA commented that the NPRM included a full discussion of the potential competitive impact of the clearing proposal, as discussed above, FIA indicated that it was unable to conduct the analysis it believes would be necessary to respond to the Commission's questions in the NPRM within the 30-day comment period provided.

In response to FIA's comment, as discussed above, the Commission notes that the 30-day public comment period was necessary for the Commission to adhere to the CEA's 90-day determination process. Moreover, while FIA indicated that it would like more time to conduct further analysis of competitive issues for future determinations, FIA did not identify any specific concerns about the competitiveness issue analysis that could materially change the Commission's determination if such additional information were made available to the Commission. The comments provided by Markit and Citadel are consistent with the NPRM's conclusion that the clearing requirement potentially could impact competition within the affected market, but both commenters go on to assert that such an impact would not be negative. Accordingly, the Commission believes that its consideration of competitiveness as described in the NPRM is sufficient for purposes of finalizing the clearing requirement rule.

e. Legal Certainty in the Event of the Insolvency

Section 2(h)(2)(D)(ii)(V) of the CEA requires the Commission to take into

⁸⁹ The Commission observes that issues regarding the bundling of clearing services and execution are beyond the scope of this rulemaking. See generally Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 FR 20128, 20154-55 (Apr. 3, 2012) (discussing the application of § 1.71(d)(2)).

account the existence of reasonable legal certainty in the event of the insolvency of the relevant DCO or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property. The Commission proposed this clearing requirement based on its view that there is reasonable legal certainty with regard to the treatment of customer and swap counterparty positions, funds, and property in connection with cleared swaps, namely the CDS indices subject to this determination, in the event of the insolvency of the relevant DCO (CME, ICE Clear Credit, or ICE Clear Europe) or one or more of the DCO's clearing members.

In the case of a clearing member insolvency at CME or ICE Clear Credit, subchapter IV of Chapter 7 of the U.S. Bankruptcy Code (11 U.S.C. 761-767) and Part 190 of the Commission's regulations would govern the treatment of customer positions.⁹⁰ Pursuant to section 4d(f) of the CEA, a clearing member accepting funds from a customer to margin a cleared swap, must be a registered FCM. Pursuant to 11 U.S.C. 761-767 and Part 190 of the Commission's regulations, the customer's CDS positions, carried by the insolvent FCM, would be deemed "commodity contracts."⁹¹ As a result, neither a clearing member's bankruptcy nor any order of a bankruptcy court could prevent either CME or ICE Clear Credit from closing out/liquidating such positions.⁹² However, customers of clearing members would have priority over all other claimants with respect to customer funds that had been held by the defaulting clearing member to margin swaps, such as the customers' positions in CDS indices subject to this determination.⁹³ Customer funds would be distributed to swaps customers, including CDS customers, in accordance with Commission regulations and section 766(h) of the Bankruptcy Code. Moreover, the Bankruptcy Code and the Commission's rules thereunder (in

⁹⁰ The Commission observes that an FCM or DCO also may be subject to resolution under Title II of the Dodd-Frank Act to the extent it would qualify as covered financial company (as defined in section 201(a)(8) of the Dodd-Frank Act).

⁹¹ If an FCM is also registered as a broker-dealer, certain issues related to its insolvency proceeding would also be governed by the Securities Investor Protection Act.

⁹² See 11 U.S.C. 556 ("The contractual right of a commodity broker [which term would include a DCO or FCM] * * * to cause the liquidation, termination or acceleration of a commodity contract * * * shall not be stayed, avoided, or otherwise limited by operation of any provision of [the Bankruptcy Code] or by order of a court in any proceeding under [the Bankruptcy Code].").

⁹³ See 11 U.S.C. 766(h).

particular 11 U.S.C. 764(b) and 17 CFR 190.06) permit the transfer of customer positions and collateral to solvent clearing members.

Similarly, 11 U.S.C. 761-767 and Part 190 would govern the bankruptcy of a DCO, in conjunction with DCO rules providing for the termination of outstanding contracts and/or return of remaining clearing member and customer property to clearing members.

With regard to ICE Clear Europe, the Commission understands that the default of a clearing member of ICE Clear Europe would be governed by the rules of that DCO. ICE Clear Europe, a DCO based in the United Kingdom, has represented that under English law its rules would supersede English insolvency laws. Under its rules, ICE Clear Europe would be permitted to close out and/or transfer positions of a defaulting clearing member that is an FCM pursuant to the U.S. Bankruptcy Code and Part 190 of the Commission's regulations. According to ICE Clear Europe's submission, the insolvency of ICE Clear Europe itself would be governed by both English insolvency law and Part 190.

ICE Clear Europe has obtained legal opinions that support the existence of such legal certainty in relation to the protection of customer and swap counterparty positions, funds, and property in the event of the insolvency of one or more of its clearing members. In addition, ICE Clear Europe has obtained a legal opinion from U.S. counsel regarding compliance with the protections afforded to FCM customers under New York law.

In response to the NPRM, Citadel commented that it agreed with the Commission's analysis that reasonable certainty exists in the event of an insolvency of a DCO or one or more DCO members. As discussed above, the Commission received three comments related to customer segregation. In essence, Vanguard and SIFMA AMG recommend that the Commission delay implementation of the clearing requirement until three months after the LSOC model is implemented, clarified, and perhaps supplemented with additional rulemaking. ISDA requests that the Commission further study the issue of insolvency for DCOs.

As stated above, the Commission believes that the concerns of Vanguard and SIFMA AMG are largely addressed by the delayed implementation timeframe for this determination. With regard to ISDA's request, as discussed above, the Commission is actively engaging in efforts to study and prepare for potential scenarios involving

clearinghouse and clearing member insolvency.

iii. Conclusions Regarding the Five Statutory Factors and Clearing Requirement Determination

Based on the foregoing discussion and analysis, the Commission has taken into account each of the five factors provided for under section 2(h)(2)(D)(ii) of the CEA. Based on these considerations, and having reviewed the relevant DCOs' submissions for consistency with section 5b(c)(2) of the CEA, the Commission is determining that the two classes of CDS identified in § 50.4(b) are required to be cleared.

E. Interest Rate Swaps

i. Introduction

Interest rate swaps are agreements wherein counterparties agree to exchange payments based on a series of cash flows over a specified period of time typically calculated using two different rates multiplied by a notional amount. The BIS estimated that, as of December 2011, over \$500 trillion in notional amount of single currency interest rate swaps were outstanding representing 75% to 80% of the total estimated notional amount of

derivatives outstanding.⁹⁴ Based on these factors and on the swap submissions received under § 39.5(b), the Commission believes that interest rate swaps represent a substantial portion of the swaps market and warrant consideration by the Commission for required clearing.

The Commission's proposal for interest rate swaps was presented in two parts. The first part, Section II.E of the NPRM, discussed the Commission's rationale for determining how to classify and define the interest rate swaps identified in the DCO submissions (IRS submissions) to be considered for the clearing requirement. The second part, Section II.F, presented the Commission's consideration of the IRS submissions in accordance with section 2(h)(2)(D) of the CEA. This final release follows the same basic two-part structure. In each part, the discussion in the NPRM preamble for the corresponding part is summarized. Comments received from the public are summarized where appropriate together with the Commission's consideration of the comments.

ii. DCO Submissions

The Commission received submissions from three registered DCOs

eligible to clear interest rate swaps: LCH.Clearnet Limited (LCH), the clearing division of the Chicago Mercantile Exchange Inc. (CME), and International Derivatives Clearinghouse, LLC (IDCH).⁹⁵ On August 14, 2012, LCH acquired IDCH and changed the name of IDCH to LCH.Clearnet LLC (LCH.LLC). LCH.LLC has submitted a request to the CFTC for approval of changes to its DCO rules that would result in LCH.LLC clearing the same interest rate swaps that LCH clears. As noted in the NPRM, IDCH had no cleared swap positions. Accordingly, the change in ownership of IDCH would not change the Commission's proposal in terms of swap class assessments or volume and liquidity considerations. The proposed clearing requirement rule is not DCO specific. Upon approval of LCH.LLC's application for its DCO rule changes, LCH.LLC would become a U.S.-domiciled DCO capable of accepting the full range of interest rate swap products contemplated in the proposal.⁹⁶

The following table summarizes the interest rate swap classes and relevant specifications that each DCO identified in its IRS submission.

TABLE 3—INTEREST RATE SWAP SUBMISSIONS SUMMARY⁹⁷

	LCH	CME
Swap Classes	Fixed-to-floating, basis, forward rate agreements (FRAs), overnight index swaps (OIS).	Fixed-to-floating. ⁹⁸
Currencies ⁹⁹	USD, EUR, GBP, JPY, AUD, CAD, CHF, SEK, CZK, DKK, HKD, HUF, NOK, NZD, PLN, SGD, ZAR.	USD, EUR, GBP, JPY, CAD, and CHF.
Rate Indexes	For Fixed-to-floating, basis, FRAs: LIBOR in seven currencies, BBR-BBSW, BA-CDOR, PRIBOR, CIBOR-DKNA13, CIBOR2-DKNA13, EURIBOR-Telerate, EURIBOR-Reuters, HIBOR-HIBOR, HIBOR-HKAB, HIBOR-ISDC, BUBOR-Reuters, NIBOR, BBR-FRA, BBR-Telerate, PLN-WIBOR, PLZ-WIBOR, STIBOR, SOR-Reuters, JIBAR. For OIS: FEDFUNDS, SONIA, EONIA, TOIS.	USD-LIBOR, CAD-BA, CHF-LIBOR, GBP-LIBOR, JPY-LIBOR, and EURIBOR.
Maximum Stated Termination Dates.	For Fixed-to-floating and basis: USD, EUR, and GBP out to 50 years, AUD, CAD, CHF, SEK and JPY out to 30 years and the remaining nine currencies out to 10 years. For OIS and FRAs: USD, EUR, GBP, and CHF out to two years	USD, EUR, and GBP out to 50 years, and CAD, JPY, and CHF out to 30 years.

iii. Interest Rate Swap Market Conventions and Risk Management

The NPRM described how interest rate swaps present a wide range of variable product classes and product specifications within each class. Notwithstanding the large variety of

contracts, there are commonalities that make it possible to categorize interest rate swaps for clearing, pricing, and risk purposes. Firstly, the vast majority of interest rate swaps use the ISDA definitions and contract conventions that allow market participants to agree

quickly on common terms for each transaction. In fact, the DCOs clearing interest rate swaps all use ISDA definitions in their product specifications.

Secondly, counterparties enter into swaps to achieve particular economic

⁹⁴ BIS, OTC Derivatives Market Activity as of December 2011, Table 1, available at <http://www.bis.org/statistics/otcder/dt1920a.pdf>. The BIS data provides the broadest market-wide estimates of interest rate swap activity available to the Commission.

⁹⁵ The IRS submissions received by the Commission are available at <http://www.cftc.gov/IndustryOversight/IndustryFilings/index.htm>. Submission materials marked by the submitting DCO for confidential treatment pursuant to

§§ 39.5(b)(5) and 145.9(d) are not available for public review.

⁹⁶ IDCH was eligible under § 39.5 to clear interest rate swaps. When LCH.LLC assumed IDCH's DCO license, LCH.LLC was deemed eligible to clear interest rate swaps as well.

⁹⁷ LCH.LLC (formerly IDCH) has applied to the Commission for DCO rule change approvals that would effectively implement clearing of the same interest rate swaps that LCH now clears. LCH.LLC

is not accepting interest rate swaps for clearing until such time as it launches under its new clearing rules. Accordingly, IDCH's product list that was included in the NPRM has been removed from the summary.

⁹⁸ Subsequent to its original submission, CME has added clearing of OIS for USD, EUR, GBP, and JPY.

⁹⁹ In this final rule, currencies are identified either by their full name or by the three letter ISO currency designation for the currency.

results. While the results desired may differ in small ways depending on each counterparty's specific circumstances and goals, there are certain common swap conventions that are used to identify and achieve commonly desired economic results when entering into interest rate swaps. For example, a party that is trying to hedge variable interest rate risk may enter into a fixed rate to floating rate swap, or a party that is seeking to fix interest rates for periods in the future may enter into a forward rate agreement.

The IRS submissions identified commonly known classes of swaps that they clear including: fixed rate to floating rate swaps, that are sometimes referred to as plain vanilla swaps (fixed-to-floating swaps); floating rate to floating rate swaps, also referred to as basis swaps (basis swaps); overnight index swaps (OIS); and forward rate agreements (FRAs).¹⁰⁰ These class terms are also being used in industry efforts to develop a taxonomy for interest rate swaps.¹⁰¹

Furthermore, within these general classes, certain specifications are essential for defining the economic result and the value of the swap. Each of the IRS submissions naturally used these common specifications when identifying the swaps that the DCO clears. Within each of those specifications, there are common terms used by the DCOs and markets, which allows for further classification of the full range of interest rate swaps that are executed. Accordingly, as described in the NPRM, while there are a wide variety of interest rate swaps when taking into account all possible contract specifications, certain specifications are

commonly used by the DCOs and market participants. This allows for the identification of classes of swaps and primary specifications within each class.

The DCOs also risk manage and set margins for interest rate swaps on a portfolio basis rather than on a transaction- or product-specific basis. In other words, the DCOs analyze the cumulative risk of a party's portfolio. By looking at risk on a portfolio basis, the DCOs effectively take into account how swaps with different attributes, such as underlying currency, stated termination dates, underlying floating rate indexes, swap classes, etc., are correlated and thus can offset risk across attributes. This is possible because, although individual transactions may have unique contract terms, given the commonalities of transactions as discussed above, swap portfolios can be risk managed on a cumulative value basis taking into account correlations among the cleared swaps. Consequently, DCOs can be expected to fairly rapidly, and efficiently manage the risk of portfolios of interest rate swaps within and across classes in a default scenario through a small number of large hedging transactions that hedge large numbers of similarly correlated positions held by the defaulting party.¹⁰² As such, liquidity for specific, individual swaps is not the focus of DCOs from a risk management perspective. Rather, liquidity is viewed as a function of whether a portfolio of swaps has common specifications that are determinative of the economics of the swaps in the portfolio such that a DCO can price and risk manage the portfolio

through block hedging and auctions in a default situation.¹⁰³

iv. Interest Rate Swap Classification for Clearing Requirement Determinations

Section 2(h)(2)(A) of the CEA provides that the Commission "shall review each swap, or any group, category, type, or class of swaps to make a determination as to whether" any thereof shall be required to be cleared. In reviewing the IRS submissions, the Commission considered in the NPRM whether its clearing requirement determination should address individual swaps, or categories, types, classes, or other groups of swaps.

Based on the market conventions as discussed above, and the DCO recommendations in the IRS submissions, the Commission proposed a clearing requirement for four classes of interest rate swaps: Fixed-to-floating swaps, basis swaps, OIS, and FRAs. At the time the IRS submissions were submitted to the Commission, LCH offered all four classes for clearing, as did IDCH, and CME offered one of them for clearing. Subsequent to the publication of the NPRM, CME has added clearing of OIS, and has stated publicly that it intends to add clearing of basis swaps and FRAs in the near future. In addition, upon launch of LCH.LLC, it is expected that LCH.LLC will begin clearing the same swaps cleared by LCH that are included in the swap classes designated by the Commission.

These four classes represent a substantial portion of the interest rate swap market. The following table provides an indication of the outstanding positions in each class.

TABLE 4—INTEREST RATE SWAPS NOTIONAL AND TRADE COUNT BY CLASS¹⁰⁴

Swap class	Notional amount (USD Bns)	Gross notional percent of total	Total trade count	Total trade count percent of total
Fixed-to-Floating	299,818	60	3,239,092	75
FRA	67,145	13	202,888	5
OIS	43,634	9	109,704	3
Basis	27,593	5	119,683	3
Other ¹⁰⁵	65,689	13	617,637	14

¹⁰⁰ These are sometimes also referred to as "types," "categories," or "groups." For purposes of the clearing requirement determination, the Commission uses the term "class," in order to be consistent with the approach taken by the European Securities and Markets Authority (ESMA) in its Discussion Paper, "Draft Technical Standards for the Regulation on OTC Derivatives, CCPs, and Trade Repositories," (Feb. 16, 2012), available at <http://www.esma.europa.eu/system/files/2012-95.pdf>. It is also noted that other categorizations are sometimes used for certain purposes. However, these four classes are common terms used by the

DCOs and are common terms used in industry taxonomies.

¹⁰¹ See, e.g., ISDA Swap Taxonomies, available at <http://www2.isda.org/identifiers-and-otc-taxonomies/>; Financial Products Markup Language, available at <http://www.fpml.org/>; and Federal Reserve Bank of New York Staff Reports, "An Analysis of OTC Interest Rate Derivatives Transactions: Implications for Public Reporting" (March 2012) at 3, available at http://www.newyorkfed.org/research/staff_reports/sr557.pdf.

¹⁰² After putting on these hedging positions, the DCO has the time needed to address any residual

risk of the defaulted portfolio through auctioning off the defaulted portfolio together with the hedging transactions.

¹⁰³ See 77 FR at 47188 and LCH IRS submission, at 4 (discussing LCH's management of the Lehman Brothers' bankruptcy in September 2008, where upon Lehman's default, LCH needed to risk manage a portfolio of approximately 66,000 interest rate swaps, which it hedged with approximately 100 new swap trades in less than five days and only used approximately 35% of the initial margin Lehman had posted).

TABLE 4—INTEREST RATE SWAPS NOTIONAL AND TRADE COUNT BY CLASS¹⁰⁴—Continued

Swap class	Notional amount (USD BNs)	Gross notional percent of total	Total trade count	Total trade count percent of total
Total	503,879	100	4,289,004	100

¹⁰⁴ TriOptima data, as of March 16, 2012. See Section II.F below for a description of the TriOptima data. The TriOptima data provided information on nine other classes of swaps, none of which is included in the IRS submissions.

¹⁰⁵ In the NPRM, the total notional amount for the “Other” category was incorrectly listed as \$132,162 billion as a result of inadvertently including the FRA amounts in the “Other” category. Correcting this error also resulted in changes to the “Gross Notional Percent of Total” column. These corrections do not change the Commission’s analysis in the NPRM. The fact that the four classes of interest rate swaps included in the clearing requirement represent a larger proportion of the total notional amount of interest rate swaps outstanding is consistent with Congressional intent to mitigate systemic risk by implementing clearing of swaps as discussed in the NPRM. See 77 FR 47171.

For purposes of the clearing requirement determination, the Commission developed the following class definitions based on information provided by the submitting DCOs and market conventions.

1. “Fixed-to-floating swap”: A swap in which the payment or payments owed for one leg of the swap is calculated using a fixed rate and the payment or payments owed for the other leg are calculated using a floating rate.

2. “Floating-to-floating swap” or “basis swap”: A swap in which the payments for both legs are calculated using floating rates.

3. “Forward Rate Agreement” or “FRA”: A swap in which payments are exchanged on a pre-determined date for a single specified period and one leg of the swap is calculated using a fixed rate and the other leg is calculated using a floating rate that is set on a pre-determined date.

4. “Overnight indexed swap” or “OIS”: A swap for which one leg of the swap is calculated using a fixed rate and the other leg is calculated using a floating rate based on a daily overnight rate.

As described in the NPRM, the LCH and CME IRS submissions addressed issues of classification for purposes of the interest rate swap clearing requirement. In its submission, LCH discussed the classification of interest rate swaps and recommended establishing clearing requirements for classes of interest rate swaps. In effect, LCH recommended the use of a set of basic product specifications to identify and describe each class of swaps subject to the clearing requirement. CME recommended a clearing determination for all non-option interest rate swaps denominated in a currency cleared by any qualified DCO.

As an alternative, the Commission considered whether to establish clearing requirements on a product-by-product basis. The Commission noted in the NPRM that such a determination would need to identify the multitude of specifications of each product that would be subject to the clearing

requirement. In this regard, LCH stated in its IRS submission that the clearing requirement “would be sub-optimal for the overall market if participants are forced to read pages of rules to decipher whether or not a swap is required to be cleared, or to have to make complex and time consuming decisions at the point of execution.”¹⁰⁶ A class-based approach would allow market participants to determine quickly as a threshold matter whether they might need to submit a swap to a DCO for clearing by checking initially whether the swap has the basic specifications that define each class subject to the clearing requirement.¹⁰⁷

A product-by-product designation also would be difficult to administer because the Commission would be required to consider each and every product submitted. On the other hand, designating classes of interest rate swaps for the clearing requirement provides a cost effective, workable method for the Commission to review variations in new swap products that DCOs will submit for clearing determinations on a going forward basis without undertaking a full Commission review of each and every swap to determine if those variations are consistent with the five factors the Commission is directed to consider under section 2(h)(2)(D) of the CEA. For such swaps, as described in greater detail below in Section III.F, the Commission proposed delegating to the Director of the Division of Clearing and

¹⁰⁶ LCH IRS submission, at 6.

¹⁰⁷ In addition, as noted by LCH, in its IRS submission, a product-by-product requirement may be evaded more easily because the specifications of a particular swap contract would need to match the specifications of each product subject to a clearing requirement. The clearing requirement could be evaded by adding, deleting, or modifying one or more of the contract’s specifications, including minor specifications that have little or no impact on the economics of the swap. By using a class-based approach that allows for ranges of contract specifications established by the DCOs within each class, the Commission is reducing the potential for evasion in accordance with section 2(h)(4)(A) of the CEA, which directs the Commission to prescribe rules necessary to prevent evasion of the clearing requirements.

Risk, with the consultation of the General Counsel, the authority to confirm whether the swap fits within the identified class and is therefore subject to the clearing requirement.

After consideration of the issues summarized above, the Commission proposed in the NPRM to follow the general approach recommended by LCH and CME of establishing the clearing requirement for classes of interest rate swaps, rather than for individual swap products.

v. Interest Rate Swap Specifications

In the NPRM, after consideration of the appropriateness of classifying interest rate swaps, the Commission analyzed the IRS submissions and proposed to set out the parameters of the four classes of interest rate swaps submitted by using the following affirmative specifications for each class: (i) Currency in which the notional and payment amounts are specified; (ii) rates referenced for each leg of the swap; and (iii) stated termination date of the swap. The Commission further proposed three “negative” or “limiting” specifications for each class: (i) No optionality (as specified by the DCOs); (ii) no dual currencies; and (iii) no conditional notional amounts.¹⁰⁸

The Commission proposed the three affirmative specifications because they are fundamental specifications used in the swap market to determine the economic result of a swap transaction. Counterparties enter into swaps to achieve particular economic results. For

¹⁰⁸ The term “conditional notional amount” refers to notional amounts that can change over the term of a swap based on a condition established by the parties upon execution such that the notional amount of the swap is not a known number or schedule of numbers, but may change based on the occurrence of some future event. This term does not include what are commonly referred to as “amortizing” or “roller coaster” notional amounts for which the notional amount changes over the term of the swap based on a schedule of notional amounts known at the time the swap is executed. Furthermore, it would not include a swap containing early termination events or other terms that could result in an early termination of the swap if a DCO clears the swap with those terms. The Commission discusses this definition and comments received on it below.

example, counterparties may enter into interest rate swaps to hedge an economic risk, to facilitate a purchase, or to take a view on the future direction of an interest rate. The counterparties enter into a swap that they believe will best achieve their desired economic result at a reasonable cost.

As noted in the NPRM, the IRS submissions identified four different classes of swap contracts that are being cleared at this time: fixed-to-floating swaps, basis swaps, OIS, and FRAs. These classes of interest rate swaps reflect industry categorization and allow counterparties to achieve a particular economic result. For example, a fixed-to-floating swap may be used by a counterparty to hedge interest rate risk related to bonds it has issued or which it owns.

All three DCO submitters identified currency as a specification for distinguishing swaps that are subject to clearing. A swap that requires calculation or payment in a currency different than the currency of the related underlying purposes of the swap would introduce currency risk.¹⁰⁹ Thus, the currency designated for the swap is a basic factor in pricing the swap and achieving the economic results of the swap desired by each party.

Furthermore, the swaps listed by all three DCOs in their IRS submissions all identified the interest rates used for each leg of the swap as a basic term that defines the swap. The rates are basic determinants of the economic value of each stream of payments of an interest rate swap.

Finally, the stated termination date, or maturity, of a swap is a basic specification for establishing the value of a swap transaction because interest rate swaps are based on an exchange of payments over a specified period of time ending on the stated termination date. The value of a swap at any one point in time depends in part on the value of each payment stream over the remaining life of the swap. For example, if a party wants to hedge variable interest rate risk for bonds it has issued that mature in ten years, it will generally enter into a swap with a stated termination date that matches the final maturity date of the bonds being hedged.¹¹⁰ To terminate the swap prior

¹⁰⁹ For example, parties seeking to hedge interest rate risk in connection with bonds or to invest funds using swaps are more likely to enter into swaps that designate the same currency in which the bonds are payable or that the funds to be invested are held.

¹¹⁰ Although hedging an economic risk expected to remain outstanding for, say, ten years with a matching ten year swap may generally be the most efficient and precise approach, the Commission

to such date would result in only a partial hedge and to execute a swap with a stated termination date that is later than the final bond maturity date would simply create exposed rate risk during the extended period beyond the final maturity date of the bonds.

As noted above, the Commission also considered in the NPRM whether there are product specifications that the Commission should explicitly exclude from the initial clearing requirement determination. In this regard, the Commission considered swaps with optionality, multiple currency swaps, and swaps with conditional notional amounts. The Commission proposed that these three specifications should be included as so-called “negative” or “limiting” specifications.

By using the three affirmative specifications and three limiting specifications to further identify the swaps within each class that are subject to the clearing requirement, counterparties contemplating entering into a swap can determine quickly as a threshold matter whether the particular swap may be subject to a clearing requirement. If the swap is in a specified class and has the six specifications, the parties will know that they need to verify whether a DCO will clear that particular swap. This will reduce the burden on swap counterparties related to determining whether a particular swap may be subject to the clearing requirement.

The Commission also considered in the NPRM whether to define classes of swaps on the basis of other product specifications. Other potential specifications are numerous because of the nearly limitless alternative interest rate swaps that are theoretically possible. In the NPRM, the Commission summarized its consideration by breaking down alternative specifications into two general categories: Specifications that are commonly used to address mechanical issues for most swaps, and specifications that are less common and address idiosyncratic issues related to the particular needs of a counterparty. The Commission noted that certain specifications are specifically identified for most swap transactions, but asserted that many such specifications are not, generally speaking, fundamental to determining the economic result the parties are trying to achieve. For example, the day count fraction selected affects calculation periods and therefore the

recognizes that parties may achieve a similar result by using swaps with different stated termination dates. However, such substitution generally provides a less precise hedge.

amounts payable for each payment period. The parties, and the DCOs, can make mechanical adjustments to period pricing at the time a swap is cleared based on the day count fraction alternative selected by the parties and the day count fraction does not drive the overall economic result the parties are trying to achieve or substantially differentiate the pricing and risk management of the swap relative to other swaps in the same class and having the same basic class defining specifications.

Furthermore, as noted in the NPRM, DCOs can provide clearing for the standard alternatives of each of these specifications without affecting risk management. Using the same day count fraction example, LCH will accept U.S. dollar-LIBOR trades for clearing with nine alternative day count fractions based on the common day count fractions used in the market.¹¹¹ While this specification, and other specifications of this kind, may affect the amounts owed on a swap, they can be accounted for mechanically in the payment amount calculations and do not change the basic substantive economic result the parties want to achieve.

Regarding the latter, idiosyncratic specifications, examples include special representations added to address particular legal issues, unique termination events, special fees, and conditions tied to events specific to the parties. None of the DCOs clear interest rate swaps with terms in the second group. Accordingly, such specifications are not included in the classes of swaps subject to the clearing requirement proposed by this rule, and the Commission considered only the first group of more common specifications that are identified by the submitting DCOs in their product specifications.

In short, the Commission recognizes that these other specifications may have an effect on the economic result to be

¹¹¹ Each DCO identifies the standard term or range of terms it will accept for each specification. Accordingly, swap counterparties can review the DCO's product specifications to determine whether a swap will satisfy the DCO's requirements for these specifications. Additionally, CME has developed, and LCH has committed to developing by the time the clearing requirement must be complied with in accordance with the Commission's implementation schedule, product screening mechanisms by which parties can determine whether the DCO will clear a particular swap. As discussed in greater detail throughout this release, if counterparties want to enter into a swap that is in a class subject to required clearing and no DCO will clear the swap because it has other specifications that no DCO will accept, then the parties can still enter into that transaction on an uncleared basis.

achieved with the swap.¹¹² However, counterparties and DCOs may account for the effects of such specifications with adjustments to other specifications or in the price of the swap. Furthermore, DCOs account for various alternatives or range of alternatives for these terms without impairing risk management. Finally, as described above in more detail, including these specifications in the description of the swaps subject to a clearing requirement could increase the burden on counterparties when checking whether a swap may be subject to required clearing. Accordingly, the Commission has determined not to include other, non-class defining specifications in the swap class definition.

vi. General Comments Received Regarding the Specifications Determination

Numerous commenters expressed support for including the Commission's four interest rate swap classes and six class specifications in the clearing requirement and were of the view that the classes satisfy the five statutory factors the Commission is required to consider for the clearing requirement determination.¹¹³ CME expressed support for the class-based approach in the rulemaking rather than swap-by-swap and stated that the Commission "struck an appropriate balance for the initial slate of classes subject to the requirement." LCH commented that the six swap specifications selected are consistent with its recommendation in its IRS submission and reaffirmed the reasons cited in the NPRM for using these specifications.

Citadel agreed with the Commission's class-based approach rather than a product-by-product based approach. Citadel stated that the class designation approach "reflects the risk management approach utilized across the industry, and most importantly by DCOs" to determine margin levels and other safeguards and is therefore the starting point for the approved classes. Citadel

¹¹² LCH recommended in its submission that floating rate tenor (also known as frequency) also be a class level specification and the Commission acknowledges that floating rate tenor can, in some cases, be a fundamental specification for achieving the economic benefits of an interest rate swap. However, it is the Commission's view that floating rate tenor is more akin to the other non-class specifications in that it is not fundamental to all economic results that may be considered by parties when contemplating a swap and it is a specification for which the DCOs can fairly easily offer all of the standard tenors that parties may consider.

¹¹³ AllianceBernstein, R.J. O'Brien, Citadel, Eris Exchange, CME, FIA, D.E. Shaw, Arbor Research, LCH, Knight Capital, Jefferies, Coherence Capital, CRT Capital, Javelin Capital, SDMA, Chris Barnard, and Svenokur.

further noted that different tenors or series of the same instruments, while displaying different characteristics, can be priced both based on market activity and by reference to more liquid contracts of the same instruments and are risk managed with the same risk management frameworks. Finally, Citadel expressed concern that not including products that otherwise share essential characteristics as swaps that are otherwise required to be cleared and that can be priced with reference to cleared swaps could risk the development of separate markets that avoid the clearing requirement.

AFR noted that the interest rate swap classes selected properly reflect the risk profile of the interest rate swap market and will avoid uncertainty and complexity for the Commission and market participants. AFR also noted that details of product specifications such as slightly different tenors, are largely irrelevant, especially in the interest rate market and stated that any suggestion of a product-by-product approach should be interpreted as a tactic to delay implementation. Furthermore, AFR encouraged the Commission to designate swap classes to include low volume swaps that can be risk managed in ways that high-volume swaps in the class are risk managed. AFR's concern is that if the low-volume swaps are not included, they could be used to avoid the clearing requirement by replicating the swaps that are required to be cleared with the low-volume swaps. Citadel's and AFR's comments are consistent with the Commission's rationale for establishing the four classes of swaps and the six specifications for each class on which the Commission based its consideration of the five factors set forth in section 2(h)(2)(D)(ii) of the CEA. As noted in the NPRM, the Commission is directed under the CEA to make its determination for "each swap, or any group, category, type, or class of swaps." The Commission first needed to establish the classes and class-defining specifications to which would then consider using the five statutory factors.

ISDA commented that the Commission should not use what ISDA characterized as a newly-articulated standard for choosing the swap class-defining specifications based on whether they are "fundamental to determining the economic result that parties are trying to achieve." ISDA expressed concern with what it characterized as a standard that it is not grounded in the five statutory factors of section 2(h)(2)(D)(ii) of the CEA and will fail to discriminate between swaps that may differ in terms of the five factors. Furthermore, in ISDA's view, the

fundamental economic result depends on facts and circumstances of each transaction and the parties.

The phrase "fundamental to determining the economic result that parties are trying to achieve" used by the Commission in the NPRM does not establish a new standard or replace the statutory five factor determination required by the CEA. Rather, the Commission used this phrase to describe one of several reasons for establishing which product specifications to use in defining each class to which the statutory five factor analysis was then applied. The phrase was used in the context of identifying the primary product specifications the submitting DCOs and the market use to value or price swaps within a class. As described at length in Section II.D of the NPRM, in establishing the swap classes to be considered, the Commission looked at how DCOs grouped the cleared interest rate swaps by certain defining types and specifications, how markets trade and view the products as classes, and how swaps that share certain common specifications can be priced and risk managed together as a class. The Commission's analysis for establishing the classes to be considered was not based on any new standard. Rather, the aforementioned phrase summarizes one element of the Commission's analysis of how to define the classes to be considered under the five factors established in the CEA.

Furthermore, the five factor statutory analysis was separately undertaken for each class. For the reasons stated in defining the classes and class specifications, the Commission believes that the swaps within each class are sufficiently similar to apply the statutory analysis to each class. As noted above, many commenters agreed with this conclusion.

Finally, regarding ISDA's view that the fundamental economic result depends on facts and circumstances of each transaction and the parties, the Commission recognizes that individual swap counterparties may have highly specific economic results they are trying to achieve with a swap and accordingly set the terms of the swap to achieve those specific results. However, the Commission's use of the phrase in the NPRM can be more clearly understood in context. The Commission was addressing whether certain specifications, other than the six specifications used to define each class, should be considered to be class-defining specifications. The Commission noted that certain specifications "affect the value of the swap in a mechanical way, they are not,

generally speaking, fundamental to determining the economic result.” The Commission provided an example of how other specifications may affect the amounts payable on a swap on each payment date, but when valuing a swap for pricing and risk management purposes, together with other swaps within a class, these other specifications can be accounted for by making price adjustments off a standard price curve and therefore do not change the basic pricing economics of the swap to an extent that would necessitate classifying the swap separately from other swaps defined by the six specifications identified by the Commission.

ISDA further commented that, although an overly intricate set of product specifications would impose burdens on the market, broad class designations impose greater burdens by creating the need for filtering products that a DCO will accept for clearing from the designated class. In ISDA’s view, the Commission’s statement in the NPRM that DCOs and vendors are “likely” to develop screening tools acknowledges the issue, but does not provide a solution. ISDA recommended that limiting clearing to swaps with prior clearing history supplemented by an advance DCO notice process would strike a reasonable balance.

In response, the Commission notes that the identification of the four interest rate swap classes and the parameters for the six specifications within each class provides a fairly detailed and easy to use initial screening mechanism for market participants to determine whether a particular swap needs to be submitted for clearing. If a market participant determines that a swap falls into a class under § 50.4, then the party will need to take reasonable efforts to determine whether any eligible DCO will accept the swap for clearing.¹¹⁴ The Commission noted in the NPRM that the DCOs or other vendors would likely develop screening tools for this purpose. The Commission further notes that each DCO and its members and the FCMs who clear through the DCO, in effect, already have the capability through their own onboarding processes and transaction affirmation platforms to screen swap transactions nearly instantaneously to determine whether the transactions will be accepted by the DCO. While those systems alone should be able to serve as a screening mechanism sufficient to allow for compliance with the clearing requirement, the Commission

encourages the DCOs to create a tool to provide all market participants with the ability to independently screen potential swap transactions quickly and easily. CME commented that it already has a tool to screen particular swaps for eligibility. LCH stated in its comments that while the current information on its Web site is designed for dealer use, LCH is committed to revising the information to be easily understandable by all counterparties.

Furthermore, the Commission does not agree that ISDA’s proposal to limit the determination to swaps with prior clearing history would ease the screening process. DCOs, particularly LCH, already have prior clearing history for swaps with tens of thousands of different product specification combinations.¹¹⁵ Accordingly, even if the Commission adopted such an approach, the result would have the problems that a product-by-product approach would have, as acknowledged by ISDA. Also, the Commission agrees that an appropriate DCO notice framework will facilitate product screening and addresses this comment in Section III below.

In addition, ISDA expressed concern that the discussion of specifications that are not included in the six class-specific specifications identified by the Commission could be read as a directive to abandon such other specifications to the extent they are not included in the swaps DCOs will accept for clearing. ISDA requested confirmation that footnote 97 of the NPRM (revised as footnote 111 in this final release) establishes that if a DCO does not accept a swap because the swap contains terms that the DCO does not clear, then entering into the swap as an uncleared transaction is permissible. ISDA further requested that the Commission state that entering into a swap that is not accepted for clearing does not raise a presumption of evasion.

Similarly, Freddie Mac also expressed concern that the discussion of fundamental specifications and “mechanical specifications” may signal the Commission’s judgment that parties are required to clear swaps that have sufficiently close substitutes. Freddie Mac requested that the Commission clarify the treatment of swaps that no DCO will clear and that parties may enter into uncleared swaps within a designated class if a DCO will not accept the swap provided that the variation in specifications is for a

legitimate business purpose. Freddie Mac noted that section 2(h)(1)(A) of the CEA refers to an obligation to “submit” the swap for clearing rather than requiring that a swap must be successfully cleared. Freddie Mac expressed concern that failure to clarify this issue would lead to uncertainty as to the legality of uncleared swaps and that executing swap dealers or other market participants could use that uncertainty to insist on contractual rights to have the option to terminate a swap that fails to clear.

The Commission confirms that the discussion of the class-defining swap specifications and other specifications served only to explain the Commission’s differentiation between the class specifications and other specifications market participants use. The Commission is not requiring parties to take affirmative steps to substitute a clearable swap for an unclearable swap within a designated class.¹¹⁶

Regarding issues of what constitutes evasion of the clearing requirement when using a close substitute swap that is not cleared by a DCO and ISDA’s request regarding a presumption regarding evasion of the clearing requirement, this issue, along with other evasion and abuse issues, are addressed in Section III.G of this release.

With respect to the “negative specifications,” AFR commented that some of these specifications, such as dual currency and optionality, are composites of two derivatives including a basic interest rate swap that may be subject to the clearing requirement and that market participants should be required to clear components of such swaps that can be cleared to prevent evasion.

This initial determination is based on the IRS submissions and because none of them include swaps that have the negative specifications, the Commission believes it is beneficial for swap market participants to expressly exclude those specifications so that parties that execute swaps with those specifications will know definitively that they are not subject to the clearing requirement. While the Commission is sensitive to concerns that the clearing requirement could be evaded by adding negative specifications to a swap to make it non-clearable, no data or other information is available at this time to indicate that compound swaps are being used for evasion. If the Commission observes such behavior or otherwise becomes aware that is occurring, it will consider

¹¹⁴ See Section III.B for a discussion of the reasonable efforts standard in this context.

¹¹⁵ See, e.g., <http://www.swapclear.com/why/> (stating that since 1999, LCH has cleared more than 2.2 million OTC interest rate swaps, \$329 trillion notional, and compressed more than \$145 trillion (as of September 2012)).

¹¹⁶ See Sections II and III for further discussion of this issue.

taking appropriate action under its authority provided in the CEA.

The FSR requested clarification regarding the conditional notional amount specification. The FSR interpreted footnote 93 of the NPRM (footnote 108 of this adopting release) to mean that interest rate swaps entered into in connection with loans to hedge interest rate risk (the notional amounts of which are tied at all times to the outstanding principal amount of the loan) would not be subject to the clearing requirement if the principal amount of the loan would foreseeably vary over its term in an unscheduled or unpredictable manner.¹¹⁷ The FSR used the examples of a swap used to hedge a construction loan, where the loan would be drawn over time based on the needs of the construction project, and without a fixed draw schedule, or a swap entered into in connection with a revolving credit agreement or a credit agreement that permits voluntary prepayments. The FSR noted that such adjustment may be implemented through a partial termination event, permitting or requiring the lender/swap provider to reduce the outstanding notional amount of the swap so as to protect both the customer and the lender/swap provider from over-hedging.

In response to the FSR, the Commission clarifies that a “conditional notional amount” is a specification included in the swap at the time of execution that provides that the notional amount will change during the stated term of the swap in an unscheduled manner upon the occurrence of defined events or conditions. There are two elements to such a specification: First, the change in notional amount must be triggered by a defined event or condition, and second, the change must not be clearly predictable at the time the swap is executed. Accordingly, the two examples provided by the FSR might be swaps that have a conditional notional amount if the swaps include specifications or terms that provide for a change in notional amount triggered by an event tied to the hedged loan or credit line and the specific timing of that event is not sufficiently foreseeable or predictable when the swap is entered

¹¹⁷ In a similar vein, ISDA commented that exclusions from the clearing requirements should be available if a party enters into one swap to hedge another swap and the hedge would no longer be functional if one trade of the pair would be cleared and the other not. Section 2(h)(7) of the CEA is clear with respect to this issue, and provides that only certain non-financial entities may elect not to clear certain swaps that hedge or mitigate commercial risk of the entity. The CEA does not extend this election to financial entities.

into such that the swap notional amount change could have been scheduled in advance. For example, a swap in which the parties agree that the notional amount will automatically be reduced upon a draw on a related construction loan identified in the swap or a prepayment of a loan identified in the swap would qualify as a swap with a conditional notional amount.

However, the Commission notes that such a specification would not qualify if the reduction in the notional amount is voluntary. In this regard, a voluntary partial or full termination right is not an indication of a conditional notional amount. A party to a cleared swap can affect the same result as exercising a voluntary termination right at any time by entering into an equal and offsetting cleared swap. Clearing eliminates bilateral counterparty credit risk and therefore entering into an offsetting swap that is cleared with any party has the same effect as terminating the original swap. Accordingly, including a voluntary termination right in a swap that otherwise would be clearable and is subject to the clearing requirement serves no economic purpose that would distinguish the swap from other swaps in the class that are required to be cleared.

As noted in the beginning of this Section II.E, the preceding analysis identified the classes of interest rate swaps and specifications within the classes to be considered by the Commission in the clearing requirement determination. In the following section in the NPRM, as summarized in this final release, the Commission took into account the statutory provisions under section 2(h)(2)(D) of the CEA with respect to the four classes of interest rate swaps and, within each class, the six identified product specifications.

F. Proposed Determination Analysis for Interest Rate Swaps

i. Consistency With Core Principles for Derivatives Clearing Organizations

As noted above, section 2(h)(2)(D)(i) of the CEA requires the Commission to review whether a swap submission is consistent with the core principles for DCOs in making a clearing determination. As discussed in the NPRM, LCH and CME already clear all swaps identified in their respective IRS submissions and therefore each is subject to the Commission’s review and surveillance procedures summarized in the NPRM. Accordingly, LCH and CME already are required to comply with the core principles set forth in section 5b(c)(2) of the CEA with respect to the swaps being considered by the

Commission for the clearing requirement. The Commission further described in the NPRM its activities as a regulator to monitor and effect ongoing compliance with the core principles applicable to DCOs including periodic examinations and daily risk surveillance. Further, the Commission stated that the Commission does not believe that subjecting any of the interest rate swaps identified in the IRS submissions to a clearing requirement would alter compliance by the respective DCOs with the core principles.

Based upon the Commission’s ongoing reviews of DCOs’ risk management frameworks and clearing rules, and its annual examinations of the DCOs, the Commission believes that the submissions of LCH and CME are consistent with section 5b(c)(2) of the CEA and the related Commission regulations. In analyzing the IRS submissions discussed herein, the Commission does not believe that a clearing requirement with regard to the specified interest rate swap classes would be inconsistent with LCH or CME’s continued ability to maintain such compliance with the DCO core principles set forth in part 39 of the Commission’s regulations.

ii. Consideration of the Five Statutory Factors for Clearing Requirement Determinations

Section 2(h)(2)(D)(ii) of the CEA identifies five factors the Commission shall consider in making a clearing requirement determination. The process for submission and review of swaps for a clearing requirement determination is further detailed in § 39.5 of the Commission’s regulations. This section summarizes the Commission’s consideration the four classes of swaps identified in the preceding section under the statutory five factors in the context of the process established by regulation.

a. Outstanding Notional Exposures, Trading Liquidity, and Adequate Pricing Data

Section 2(h)(2)(D)(ii)(I) of the CEA requires the Commission to take into account the existence of outstanding notional exposures, trading liquidity, and adequate pricing data. In the NPRM, the Commission considered available market data and LCH cleared swap information. Unlike CDS for which substantially all of the trading data has been collected in one place, there is no single data source for notional exposures and trading liquidity for the

entire interest rate swap market.¹¹⁸ However, the Commission considered several sources of data on the interest rate swap market that collectively provides the information the Commission needs to make a clearing requirement determination. As described in the NPRM, the data sources that the Commission considered include: general estimates published by the Bank for International Settlements (BIS data); market data published weekly by TriOptima (TriOptima data) covering swap trade information submitted voluntarily by 14 large derivatives dealers (G14 Dealers); trade-by-trade data provided voluntarily by the G14 Dealers to the OTC Derivatives Supervisors Group for a three month period between June and August 2010 (ODSG data); and trade-by-trade data for swaps cleared by LCH for the first calendar quarter of 2012 (LCH data).¹¹⁹

The NPRM explained in detail that each data source used has a number of limitations that are important to understand when considering the data. The Commission incorporates the discussion of those limitations found in the NPRM into this final release.

For this determination, the Commission only considered the swaps identified in the IRS submissions. Accordingly, where possible, the Commission presented and discussed only the data for swaps identified in the submissions. The analysis of interest rate swap data in the NPRM was presented based on the four swap classes and the class specifications. This information was used by the Commission to determine whether there exists significant outstanding notional amounts, trading liquidity, and pricing data to include each class and specification identified in the IRS submissions.

For purposes of this final release, the Commission is incorporating the data

¹¹⁸ See Bank of England, "Thoughts on Determining Central Clearing Eligibility of OTC Derivatives," Financial Stability Paper No. 14, March 2012, at 11, available at http://www.bankofengland.co.uk/publications/Documents/fsr/fs_paper14.pdf.

¹¹⁹ All DCOs were required to begin providing daily position data to the Commission as of November 8, 2012. CME's available data was considered too limited to provide any indication of the complete interest rate swap market. Because LCH clears a large portion of the swap products it offers clearing for (based on available information, LCH claims to have cleared approximately 50 to 90 percent of the dealer open interest in the different interest rate swap products that it clears), its data provides some indication of the possible notional exposures and liquidity in the products submitted by LCH that the Commission considered. Given the limitations on other available data, the Commission believes it is useful to consider the LCH data along with the market-wide BIS data, ODSG data, and TriOptima data.

tables in the NPRM by reference and the considerations and conclusions drawn by the Commission following review of the data is summarized below.¹²⁰ Readers are encouraged to refer to the NPRM to review the data presented. None of the comments received in response to the NPRM raised issues with the data analyzed in the NPRM.

1. Interest Rate Swap Class

In the NPRM, the Commission considered data relevant to the different interest rate swap classes included in the IRS submissions. The BIS data provided certain big picture information. It indicated that interest rate swaps in total constituted nearly 80% of the derivatives market and interest rate swap notional amounts generally increased for all three kinds of swaps between 2008 and 2011 with total interest rate swap notional amounts reported growing by about 15% during that period. Additionally, all three classes of swaps identified by the BIS data have substantial notional amounts outstanding. As of December 2011, FRAs had about \$50.5 trillion outstanding, optional swaps had about \$51 trillion outstanding, and other interest rate swaps had about \$403 trillion outstanding. Given this information, the Commission concluded that none of the kinds of swaps identified by the BIS should be eliminated from consideration by the Commission for a clearing requirement based on the BIS data alone. However, the BIS data did not provide enough detail to reach further conclusions regarding the swaps identified in the IRS submissions.

The TriOptima data and the ODSG data sets were used to identify notional amounts and trade counts for all four classes of swaps identified in the IRS submissions. Trading liquidity as an indication of how effectively DCOs can risk manage a portfolio of swaps can be evidenced in several ways. The data available for this purpose included total notional amount outstanding, total number of swaps outstanding, and the

¹²⁰ The ODSG data has not been updated since 2010. The BIS data that was available when the NPRM was published was from the second half of 2011 and the TriOptima and LCH data used was from the first quarter of 2012. The BIS has not published updated data as of this writing. TriOptima stopped publishing the interest rate swap data in April, 2012. DTCC began collecting similar data at that time and is now provisionally registered by the Commission as a SDR. The Commission has reviewed data from DTCC and LCH and confirmed that the recent data available is consistent with the data used in the NPRM to develop the interest rate swap clearing requirement rule, taking into consideration normal changes in market activity.

average number of transactions over a given period of time.

The TriOptima data showed that all four classes have significant outstanding notional amounts with basis swaps being the lowest at about \$27.6 trillion and the highest being fixed-to-floating swaps at \$288.8 trillion. Total trade counts for each type were also significant with the lowest being 109,704 for OIS and the highest being fixed-to-floating swaps at 3,239,092.

The average number of swap trades per week for each class of swaps was evidenced by the ODSG data. According to the ODSG data set, basis swaps were traded at the lowest frequency compared to the other three classes at 240 times on average each week during the ODSG data period. Because the ODSG data is from the summer of 2010 and gross notional amounts and trading activity in interest rate swaps have both increased generally, the Commission believes that trading activity has likely increased for all classes since the ODSG data was collected.

The LCH data generally confirmed the assessment of market-wide data. There is substantial outstanding notional volumes and trade liquidity for each of the four classes already being cleared at LCH.

LCH cleared the following percentage of each class of swap as reported by TriOptima:¹²¹

- 75% of the Fixed-to-Floating swaps,
- 41% of FRAs,¹²²
- 84% of OIS, and
- 41% of Basis Swaps.

Accordingly, a substantial portion of each class is already being cleared voluntarily.

Swap Class Conclusion

The Commission concluded in the NPRM that the four classes of swaps currently being cleared have significant outstanding notional amounts and trading liquidity. The Commission further noted that a substantial percentage of each of the four classes was already being cleared.

A number of commenters commented that the four interest rate swap classes are cleared in material volumes at this

¹²¹ Percentages are calculated based on total notional amount cleared by LCH divided by total notional outstanding as reported by TriOptima. The TriOptima data is used because it is the most current data set that provides data broken out according to the classes being cleared.

¹²² LCH started clearing FRAs in December 2011 and cleared volumes have increased significantly each month since the start date. As of March 31, 2012, the date for which the data was presented in the NPRM, LCH had a total notional amount outstanding of cleared FRAs of \$27.7 trillion. As of October 15, 2012, that amount had increased to \$58.6 trillion.

time and expressed support for including the four interest rate swap classes in the clearing requirement designation based on the data available.¹²³ Citadel agreed with the Commission's conclusion that the data presented in the NPRM demonstrate substantial outstanding notional exposures and a high level of trading liquidity in the relevant classes of swaps. Citadel commented that liquidity, for purposes of the clearing requirement, should be determined on grounds other than trading activity alone. Specifically, market depth can be evidenced by the number of dealers quoting two-way markets in a product, and the notional sizes of the quoted bids and offers, is also a liquidity indicator. Citadel noted that multiple dealers regularly quote two-way markets in the swaps covered by the proposed rule in meaningful sizes through a variety of mediums, including in periods of market stress, and therefore it believes there is ample trading liquidity to support a clearing requirement for the classes designated. For the reasons described above, the Commission reaffirms the aforementioned conclusions provided in the NRPM regarding the classes of interest rate swaps proposed in the NPRM for required clearing.

2. Currency

As discussed above in Section II.E, the currency in which the notional and payment amounts are specified is a primary product specification and all four data sources provide interest rate swap data by currency.

The BIS data addressed seven of the seventeen currencies identified in the submissions individually. All seven currencies had substantial outstanding notional amounts as of December 2011, ranging from nearly \$5.4 trillion for the Swiss franc to about \$185 trillion in euro. For all currencies, the outstanding notional amounts were higher at the end of the most recent three-year period as compared to the beginning of the period.

The Commission believes that the BIS data supports the conclusion that there exists significant outstanding notional amounts in each currency identified in the BIS data and that there is no indication that notional amounts in

those currencies are decreasing at a rate that would warrant elimination of those currencies from consideration for a clearing requirement.

The TriOptima data showed that total outstanding notional amounts as of March 16, 2012, ranged from \$400 billion for Czech koruna to over \$176 trillion notional amount for euro.¹²⁴ While there may be sufficient outstanding notional amounts in all seventeen currencies, the Commission noted in the NPRM that there is a clear demarcation between the four currencies with the highest outstanding notional amounts: euro, U.S. dollar, British pound, and yen, and all other currencies. The four top currencies ranged from about 9% to 36% of the total notional amount of all interest rate swaps outstanding and 11% to 33% of the total number of swap trades. The remaining currencies ranged from about 2% down to 0.1% of the total notional amount traded and 3% down to 0.2% of total number of trades. In fact, the four major currencies accounted for about 93% of the total notional amount outstanding in the TriOptima data set.

The ODSG data provided an indication of trading liquidity in terms of average weekly notional amount traded and number of new trades completed during the period covered by the data set. Of the four major currencies, Japanese yen had the lowest weekly average notional at \$323 billion and the British pound had the lowest average number of trades each week at 1,233.

The TriOptima data provided an overall, more current view of trades outstanding, which provides a broader picture of the trading potential for each currency for purposes of DCO risk management. As of March 16, 2012, all but one of the seventeen currencies had outstanding trade counts in excess of 14,000 with the exception being the Danish krone at 6,849. Again, the four highest currencies by trade count: euro, U.S. dollar, British pound, and yen, accounted for about 85% of the total number of trades recorded and outstanding at the time the data was collected.

The LCH data showed that the relative notional amount and number of swaps in each currency cleared is generally correlated with the notional amount and number of swaps of each currency reported by the more general market data sets. As a percentage of the total notional amount outstanding as

reported by TriOptima, LCH cleared the following percentages:¹²⁵

- 66% of euro,
- 61% of U.S. dollars,
- 58% of British pounds,
- 59% of Japanese yen, and
- 42% of other currencies.

Of the interest rate swaps identifying U.S. dollars, euro, British pounds or yen as the applicable currency, significantly more than half were already being cleared by LCH. While the level of clearing of other currencies was, on a combined basis reasonably high at 42%, the Commission noted the level is noticeably lower than the percentage of swaps being cleared for the top four currencies.

Currency Specification Conclusion

The Commission concluded in the NPRM that all of the data sets demonstrate the existence of significant outstanding notional amounts and trading liquidity in the seventeen currencies identified in the IRS submissions. However, the Commission noted that swaps using the four currencies with the highest outstanding notional amounts and trade frequency: euro, U.S. dollar, British pound, and yen, account for an outsized portion of both notional amounts outstanding and trading volumes. Furthermore, the Commission noted that these four currencies are already being cleared more than the other currencies generally.

While it is important that this determination include a substantial portion of the interest rate swaps traded to have a substantive, beneficial impact on systemic risk, the Commission also recognized that the final rule is the Commission's first swap clearing requirement determination. As noted in the phased implementation rules for the clearing requirement, the Commission believes that introducing too much required clearing too quickly could unnecessarily increase the burden of the clearing requirement on market participants. In recognition of these considerations, the Commission determined in the NPRM to focus the remainder of this initial clearing requirement determination analysis on swaps referencing the four most heavily traded currencies. The Commission noted that the decision not to include the other thirteen currencies at this time does not limit the Commission's authority to reconsider required clearing of those currencies in the future.

¹²³ See letters from FIA PTC, Arbor Research and Trading, LLC, R.J. O'Brien, Svenokur, LLC, Chris Barnard, CRT Capital Group (Robert Gorham), LLC, DRW Trading Group, Javelin, SDMA, Knight Capital Americas LLC, Bart Sokol (CRT Capital Group), Jefferies & Company, Inc., MarketAxess, Eris Exchange, Coherence Capital Partners LLC, Citadel, AFR, D.E. Shaw Group, AllianceBernstein, LCH, CME, and ICE.

¹²⁴ TriOptima data, as of March 16, 2012.

¹²⁵ The TriOptima data is used for this calculation because it is the most current data set that provides data broken out according to the classes currently being cleared.

LCH commented that it supports the Commission's decision to initially limit the interest rate swap clearing determination to swaps with USD, EUR, GBP, and JPY as the underlying currency, and recommended that the Commission propose mandatory clearing of swaps in the other 13 currencies identified in the IRS submission after the initial phase of the clearing requirement is well-established. LCH stated that there is ample volume and liquidity in swaps denominated in those currencies to support a clearing requirement determination and that it would be beneficial for the market if the Commission would clarify whether and/or when it plans to make clearing of swaps denominated in other currencies mandatory.

The Commission reaffirms the conclusions in its proposed determination to limit the interest rate swap clearing determination to interest rate swaps with USD, EUR, GBP, and JPY as the underlying currency, at this time. In response to LCH, the Commission reiterates that not including interest rate swaps in the other 13 currencies in this determination in no way forestalls the Commission from initiating a new clearing requirement determination for interest rate swaps in those currencies. The decision not to include them at this time was based on the fact that this is the initial clearing requirement determination and the Commission is mindful that market participants will be undertaking significant activity to implement compliance for the first time. Accordingly, the Commission has effectively delayed consideration of these currencies so that the market will have time to adapt to mandatory clearing of interest rate swaps in the four primary currencies, with the expectation that thereafter, the additional currencies can be added fairly easily. The Commission expects to initiate a clearing determination for interest rate swaps in the 13 currencies at some time in 2013.

3. Floating Rate Index Referenced

The ODSG data and LCH data provided an indication of the rate indices used on a transaction-by-transaction basis. Rate indexes are currency specific. The ODSG data showed minimal activity for the EUR-LIBOR index with about \$1 billion of notional amount and five trades made for the three month period in 2010 that the ODSG data covers. EUR-LIBOR does not appear on the LCH data table because, although swaps referencing that index can be cleared at LCH, LCH had no open interest for that index as of

March 31, 2012. Given the minimal notional amounts and trade liquidity for the EUR-LIBOR index, the Commission determined in the NPRM not to include EUR-LIBOR under the clearing requirement.

The other rate indexes all showed significant notional amounts and trading liquidity. The rates with the least activity, the U.S. dollar Fedfund index and British pound-LIBOR index, each have over one trillion dollars in notional outstanding already cleared at LCH and \$93 billion and \$82 billion in notional amount, respectively, were cleared per week on average. In terms of number of trades cleared at LCH, swaps referencing Fedfunds were cleared on average 116 times per week and swaps referencing British pound-LIBOR were cleared 888 times per week on average. All of the other indices cleared have similar or substantially higher numbers of trades and notional amounts cleared.

In the NPRM, the Commission noted that the rate indexes used for over-the-counter interest rate swaps reference not only the generic index, but a reference definition for the index such as the ISDA definition or Reuters definition. While the Commission recognized the importance of these reference definitions for each swap contract, the Commission concluded that such definitions are not relevant for purposes of the clearing requirement determination. Furthermore, if the parties to a swap identify a specific reference definition for an index, they need only confirm whether any eligible DCO accepts that reference definition. If none do, then the swap in question is not accepted for clearing and it is not subject to the clearing requirement.

Rate Index Specification Conclusion

The Commission concluded in the NPRM that with the exception of the EURO-LIBOR index, swaps using all of the rate indexes identified in the IRS submissions have significant outstanding notional amounts and trading liquidity and that significant notional amounts of swaps using these rate indexes are already cleared by DCOs.

The Commission received no comments on the rate index specification determination, and confirming its conclusions regarding the rate index specifications identified in the NPRM.

4. Stated Termination Dates

Stated termination date (sometimes referred to as "maturities") data is often presented by aggregating stated termination dates for swaps into specified term periods or "buckets."

The IRS submissions showed that the DCOs have been clearing interest rate swaps with final termination dates out to at least ten years for all seventeen currencies noted above and out to 50 years for some classes and currencies.

Stated termination dates can fall on any day of the year. Given this continuum of termination dates, the DCOs have indicated that they manage the cleared swap portfolio risk using a swap curve.¹²⁶ Swap curves are also used by market participants to price interest rate swaps. By pricing swaps in this way, the economic results of an interest rate swap can be fairly closely approximated, and therefore hedged, using two or more other swaps with different maturities principally by matching the weighted average duration of those swaps with the duration of the swap being hedged.¹²⁷ In the same manner, a large portfolio of interest rate swaps can be hedged fairly closely with a small number of hedging swaps that have the same duration as the entire portfolio or subsets of related swaps within the portfolio. In effect, for DCO risk management purposes, the termination dates of interest rate swaps are assessed based on how they affect the overall duration aspects of the portfolio of swaps cleared.¹²⁸ Accordingly, the primary determination with respect to the stated termination date specification is, for each class and currency, at what point, if any, along the continuum of swap maturities does the notional outstanding and trading liquidity become insufficient to structure the swap curve effectively for DCO risk management purposes.

The TriOptima data provided sufficient detail to discern notional amounts and trade counts only for each swap class. The ODSG data provided sufficient detail to discern notional amounts and trade counts only for each currency. The LCH data provided enough detail for both swap class and currency.

The TriOptima data and LCH data summarized in the NPRM showed that for fixed-to-floating swaps and basis swaps, there was significant outstanding notional amounts and number of trades for all maturity buckets being cleared.

¹²⁶ The "swap curve" is the term generally used by market participants for interest rate swap pricing and is similar to, and is sometimes established, in part, based on, "yield curves" used for pricing bonds.

¹²⁷ Other factors, such as convexity, may also be taken into account in determining the appropriate hedge ratio between the initial swap and the other swaps used to hedge its exposure.

¹²⁸ For further discussion of the use of portfolio risk management by DCOs, see the discussion of interest rate swap market conventions and risk management in Section II.E above.

For FRAs, the TriOptima data showed a steep drop off after two years, although in the two to five year bucket, there is still over \$1 trillion dollars of outstanding notional amount and 1,646 trades. The LCH data showed substantial outstanding notional amounts of FRAs out to two years and none thereafter. The IRS submissions provide that the DCOs do not clear FRAs with payment dates beyond three years. Accordingly, the Commission need not consider FRAs with maturities beyond three years until such time as a DCO submits such swaps for clearing.

For OIS, the TriOptima data showed notional amounts for all maturity buckets, but the drop off was steep beyond two years. After ten years, outstanding notional amounts drop below \$100 billion for each maturity bucket. The LCH data showed no outstanding notional amounts cleared beyond two years. The IRS submissions provide that the DCOs do not accept for clearing OIS swaps beyond two years. Accordingly, the Commission did not consider OIS swaps beyond two years in this clearing requirement determination.

The ODSG data and LCH data presented in the NPRM showed notional amounts traded for maturity buckets by currency. There were traded and cleared notional amounts for euro, U.S. dollars, and British pounds out to the 30 to 50 year bucket and for yen out to the twenty to thirty year bucket. The LCH data confirms that substantial notional amounts of swaps in euro, U.S. dollars, and British pounds are being cleared out to 50 years and yen out to 30 years.

Stated Termination Date Specification Conclusion

For the classes of swaps considered by the Commission in the NPRM, the TriOptima data showed that there were significant outstanding notional amounts and number of trades out to 50 years for fixed-to-floating swaps and basis swaps, out to 10 years or more for OIS, and out to 2 years for FRAs. With respect to currencies, the ODSG data and LCH data show significant outstanding notional amounts and number of trades in swaps out to 50 years for U.S. dollars, euro, and British pounds and out to 30 years for yen.

Citadel noted that different tenors of the same instruments, while displaying incrementally different characteristics, are priceable both based on market activity and also with reference to more liquid or on-the-run (or, as the case may be, already cleared) transactions of the same instruments, and are risk managed using the same risk management frameworks. Accordingly, swaps within a designated class with incrementally different tenors do not require a new review that would incur excessive delay. For the aforementioned reasons, the Commission confirming its conclusions regarding required clearing for interest rate swaps with the stated termination date specifications as proposed in the NPRM.

5. Adequate Pricing Data

In the NPRM, the Commission took into account the adequacy of the pricing data for the four classes of interest rate swaps. LCH stated in its IRS submission that there is adequate pricing data for risk and default management. It explained that its risk and default management is based on the following factors under normal and stressed conditions:

- Outstanding notional, by maturity bucket and currency;
- Number of participants with live open positions, by maturity bucket and currency;
- Notional throughput of the market, by maturity bucket and currency;
- Size tradable that would not adjust the market price, by maturity bucket;
- Number of potential direct clearing members clearing the products that are part of the mutualized default fund and default management process;
- Interplay between on-the-run and off-the-run contracts; and
- Product messaging components and structure.

LCH carries out a fire drill of its default management procedures and readiness twice a year. According to LCH, the fire drill presents an opportunity to further benchmark market liquidity and behavior and for models and assumptions to be recalibrated based on practitioner input. LCH also tests liquidity assumptions from the outset when developing clearing capabilities for a new product

and thereafter, on a daily basis. This testing informs how LCH develops and modifies its risk management framework to provide adequate risk coverage in compliance with the core principles applicable to DCOs. Based on this framework, LCH contends that there is adequate pricing data for the swaps offered for clearing.

CME represented in its IRS submission that its interest rate swap valuations are fully transparent and rely on pricing inputs obtained from wire service feeds. Further, CME uses conventional pricing methodologies, including OIS discounting, to produce its zero coupon curve off of which cleared swaps of all stated termination dates are priced. In addition, customers are provided with direct access to daily reports showing curve inputs, daily discount factors, and valuations for each cleared swap position.

It is also worth noting that those interest rate swaps that are the subject of this proposal are capable of being priced off of deep and liquid debt markets. Because of the stability of access to pricing data from these markets, the pricing data for non-exotic interest rate swaps that are currently being cleared is generally viewed as non-controversial.

In response to the NPRM, Citadel commented that its experience regarding trading liquidity further lead it to conclude that there is sufficient data in the market for DCOs to perform required pricing and risk management of the classes of swaps included in the proposed rule. Finally, Citadel commented that access to reliable pricing data will only improve over time as the Dodd-Frank rules promoting transparency are implemented. No other comments were received on this factor.

Based on consideration of the existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data, as described in the NPRM, the Commission is reaffirming in this release its decision to include interest rate swaps with the following specifications in the clearing requirement rule and to consider the other four factors identified in section 2(h)(2)(D) of the CEA with respect to these swaps.

TABLE 5—INTEREST RATE SWAP DETERMINATION

Specification	Fixed-to-floating swap class			
	U.S. Dollar (USD)	Euro (EUR)	Sterling (GBP)	Yen (JPY).
1. Currency	LIBOR	EURIBOR	LIBOR	LIBOR.
2. Floating Rate Indexes	28 days to 50 years ...	28 days to 50 years ...	28 days to 50 years ...	28 days to 30 years.
3. Stated Termination Date Range	No	No	No	No.
4. Optionality	No	No	No	No.
5. Dual Currencies	No	No	No	No.

TABLE 5—INTEREST RATE SWAP DETERMINATION—Continued

6. Conditional Notional Amounts	No	No	No	No
Specification	Basis Swap Class			
1. Currency	U.S. Dollar (USD)	Euro (EUR)	Sterling (GBP)	Yen (JPY).
2. Floating Rate Indexes	LIBOR	EURIBOR	LIBOR	LIBOR.
3. Stated Termination Date Range	28 days to 50 years ...	28 days to 50 years ...	28 days to 50 years ...	28 days to 30 years.
4. Optionality	No	No	No	No.
5. Dual Currencies	No	No	No	No.
6. Conditional Notional Amounts	No	No	No	No.
Specification	Forward Rate Agreement Class			
1. Currency	U.S. Dollar (USD)	Euro (EUR)	Sterling (GBP)	Yen (JPY).
2. Floating Rate Indexes	LIBOR	EURIBOR	LIBOR	LIBOR.
3. Stated Termination Date Range	3 days to 3 years	3 days to 3 years	3 days to 3 years	3 days to 3 years.
4. Optionality	No	No	No	No.
5. Dual Currencies	No	No	No	No.
6. Conditional Notional Amounts	No	No	No	No.
Specification	Overnight Index Swap Class			
1. Currency	U.S. Dollar (USD)	Euro (EUR)	Sterling (GBP).	
2. Floating Rate Indexes	FedFunds	EONIA	SONIA.	
3. Stated Termination Date Range	7 days to 2 years	7 days to 2 years	7 days to 2 years.	
4. Optionality	No	No	No.	
5. Dual Currencies	No	No	No.	
6. Conditional Notional Amounts	No	No	No.	

b. Availability of Rule Framework, Capacity, Operational Expertise and Resources, and Credit Support Infrastructure

Section 2(h)(2)(D)(ii)(II) of the CEA requires the Commission to take into account the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the proposed classes of swaps on terms that are consistent with the material terms and trading conventions on which they are now traded. The Commission stated in the NPRM that it believed that LCH and CME,¹²⁹ have developed rule frameworks, capacity, operational expertise and resources, and credit support infrastructure to clear the interest rate swaps they currently clear on terms that are consistent with the material terms and trading conventions on which those swaps are being traded. The Commission noted that LCH already clears more than half the global interest rate swaps in the four proposed classes of the clearing requirement and that CME also already cleared the more commonly traded swaps under this

¹²⁹ IDCH was also included in this discussion in the NPRM. However, as discussed above, IDCH has been acquired by LCH and is now LCH.LLC and its rules and product offering are being revised to be substantially the same as LCH's. Accordingly, the rule frameworks, capacity, operational expertise and resources, and credit support infrastructure for IDCH is not discussed in this final release, but is being assessed by the Commission as part of LCH.LLC's request for approval of its rulebook and risk management framework revisions.

clearing requirement proposal. The Commission further notes that CME has recently added, or has stated publicly that it intends to add by the end of 2012, swaps in all four classes and at least the four currencies included in the final rule.

The Commission also noted that the DCOs each developed their interest rate swap clearing offerings in conjunction with market participants and in response to the specific needs of the marketplace. In this manner, the clearing services of each DCO are designed to be consistent with the material terms and trading conventions of a bilateral, uncleared market.

LCH submitted that it has the capability and expertise to manage the risks inherent in the current book of interest rate swaps cleared and the increased volume that the clearing requirement could generate for all of its currently clearable products. LCH has developed operational models, controls, and risk algorithms to ensure that it can process trades, and is capable of calculating the level of risk it has with any counterparty—both direct clearing members and their customers.

CME's IRS submission cited to its rule books to demonstrate the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear qualified, interest rate swap contracts on terms that are consistent with the material terms and trading conventions on which the contracts are then traded.

After considering the information provided by the DCOs in the IRS submissions and the nature and extent of clearing already undertaken by the DCOs of existing bilateral swaps, the Commission concluded in the NPRM that there is available rule framework, capacity, operations expertise and resources, and credit support infrastructure consistent with the material terms and trading conventions on which the swaps included in the four interest rate swap classes are designated.

Citadel commented that the fact that all swaps included in the four interest rate swap classes are being cleared in material volumes provides clear evidence that there is the rule framework, capacity, operational expertise and resources, and credit support infrastructure necessary to clear each of the swaps that are included in the Commission's determination. Further, Citadel stated that because registered DCOs are required to be in compliance on an on-going basis with the DCO core principles in the CEA, they "by definition" have demonstrated that they satisfy this factor. In addition, Citadel noted that the DCOs have been preparing for and anticipating increased volumes as a result of the clearing requirement since the enactment of the Dodd-Frank Act, if not earlier. Also, under the Commission's implementation rule,¹³⁰ there is a 270-

¹³⁰ 77 FR at 44441-44456.

day period provided to allow DCOs, customers, FCMs, and all others engaged in the clearing process to test and ramp up customer clearing volumes voluntarily, and be in position to manage full production clearing volumes during the phase-in of the clearing requirement. Citadel stated that it believed the DCOs and FCMs are well prepared for a surge in clearing volumes and have the framework, capacity, expertise, resources and infrastructure to support it in a safe and sound manner and that Citadel's own experience in commencing voluntary clearing of swaps confirms its observations.

For the reasons described above, and as discussed in the NPRM, the Commission reaffirms that there is available rule framework, capacity, operations expertise and resources, and credit support infrastructure consistent with the material terms and trading conventions on which the swaps included in the four interest rate swap classes are designated.

c. Effect on the Mitigation of Systemic Risk

Section 2(h)(2)(D)(ii)(III) of the CEA requires the Commission to consider the effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the DCO available to clear the contract. CME, LCH, and IDCH stated in their IRS submissions that subjecting interest rate swaps to central clearing would help mitigate systemic risk. As stated above in the analysis of interest rate swap market data, the Commission believes that the market for these swaps is significant and mitigating counterparty risk through clearing likely would reduce systemic risk in the swap market and the financial system as a whole.

According to LCH's IRS submission, if all clearable swaps are required to be cleared, the inevitable result will be a less disparate marketplace from a systemic risk perspective. CME submits that the 2008 financial crisis demonstrated the potential for systemic risk arising from the interconnectedness of OTC derivatives market participants and that centralized clearing will reduce systemic risk.

IDCH stated in its IRS submission that, given the tremendous size of the interest rate derivatives market, the potential mitigation of systemic risk through centralized clearing of interest rate swaps is significant. IDCH asserted that clearing such swaps brings the risk mitigation and collateral and operational efficiency afforded to cleared and exchange-traded futures contracts to bilaterally negotiated OTC

interest rate derivatives. The submission of interest rate swaps for clearing affords the parties the credit, risk management, capital, and operational benefits of central counterparty clearing of such transactions, and facilitates collateral efficiency. Cleared swaps allow market participants to free up counterparty credit lines that would otherwise be committed to open bilateral contracts. Additionally, according to IDCH, an efficient system for centralized clearing allows parties to mitigate the risk of a bilateral OTC derivative. Instead of holding offsetting positions with different counterparties and being exposed to the risk of each counterparty, a party may enter into an economically offsetting position that is cleared. Although the positions are not offset, the initial margin requirement will be reduced to close to zero. To eliminate risk without using centralized clearing, the party must enter into a tear-up agreement with the counterparty, or enter into a novation.

While the clearing requirement would remove a large portion of the interconnectedness of current OTC markets that leads to systemic risk, the Commission noted in the NPRM that central clearing concentrates risk in a handful of entities. However, the Commission observed that central clearing was developed and designed to handle such concentration of risk. LCH has extensive experience risk managing very large volumes of interest rate swaps. Based on available data, it is believed that about half of all interest rate swaps transacted are cleared by LCH. CME submitted that it has the necessary resources available to clear the swaps that are the subject of its submission. The Commission notes that CME or its predecessors have cleared futures since 1898 and is the largest futures clearinghouse in the world. CME has not defaulted during that time.

Accordingly, the Commission stated in the NPRM, and reaffirms in this release that it believes that LCH and CME have the resources needed to clear the interest rate swaps included in its determination and to manage the risk posed by clearing interest rate swaps that are required to be cleared. In addition, the Commission believes that the central clearing of the interest rate swaps that are the subject of this determination and final rule would serve to mitigate counterparty credit risk thereby having a positive effect on reducing systemic risk.

In support of the Commission's determination regarding systemic risk, Citadel commented that the transition from an interconnected network of bilateral derivatives exposures to central

clearing in regulated clearing houses will mitigate systemic risk. In support of this assertion, Citadel cited a New York Federal Reserve Board staff paper¹³¹ and noted that central clearing stands as a pillar of the Dodd-Frank Act. Citadel explained that central clearing eliminates the prospect of firms becoming too interconnected to fail by virtue of their bilateral swap positions and ensures that sufficient margin is reserved against each side of each swap, while further mitigating any default event through mutualization funds, clearing member obligations, and the additional financial safeguards of the regulated DCO.

Citadel further asserted that the Commission's determination takes the decisive step, long anticipated and prepared for by the market, of making mandatory central clearing of the most liquid and standardized swaps a reality. Citadel went on to express confidence that the transition to required clearing of liquid swaps will support and incentivize the expansion of the cleared product set, because it will be more economically efficient for market participants to hold as much of their portfolios as possible in a single margined basket at a DCO. Citadel concluded that the Commission's clearing requirement rule thus provides the certainty needed for market participants to transition more of their swap portfolios from bilateral to cleared trades, thereby reducing or eliminating bilateral counterparty credit risk, and by extension, systemic risk.

By contrast, ISDA commented on how mandatory clearing may centralize risk in DCOs and questioned the risk-mitigating aspects of central clearing as contrasted with the new regulatory regime for uncleared swaps. ISDA also questioned the Commission's assertion that central clearing was designed to address the concentration of risk. In response to ISDA's comment, the Commission observes that while the regime for bilateral, uncleared swaps will be greatly improved after full implementation of the Dodd-Frank Act reforms, central clearing provides for certain risk management features that cannot be replicated on a bilateral basis. To name just one critical distinction, a clearinghouse addresses the tail risk of open positions through mutualization. Each clearing member must contribute to a default fund that protects the system as a whole.

¹³¹ See, e.g., Policy Perspectives on OTC Derivatives Market Infrastructure by Duffie, Li, and Lubke (March 2010), available at http://www.newyorkfed.org/research/staff_reports/sr424.pdf.

d. Effect on Competition

Section 2(h)(2)(D)(ii)(IV) of the CEA requires the Commission to take into account the effect on competition, including appropriate fees and charges applied to clearing. Of particular concern to the Commission is whether the determination would harm competition by creating, enhancing, or entrenching market power in an affected product or service market, or facilitating the exercise of market power. Market power is viewed as the ability to raise price, including clearing fees and charges, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives.¹³²

In the NPRM, the Commission identified one putative service market as potentially affected by this proposed clearing determination: a DCO service market encompassing those clearinghouses that currently (or with relative ease in the future could) clear the interest rate swaps subject to this proposal. The Commission recognized that, depending on the interplay of several factors, the clearing requirement potentially could impact competition within the affected market and discussed various factors that could impact that market.

As discussed above, in support of the NPRM, Citadel stated that the clearing requirement will have a strong positive impact on competition in the swap market and the market for clearing services. Citadel noted that central clearing will remove a significant barrier to entry for alternative swap market liquidity providers and will enable smaller entities to compete on more equal terms because central clearing eliminates the consideration of counterparty credit risk from the selection of execution counterparties. Citadel further commented that buy-side market participants will benefit from a wider range of potential execution counterparties and asserted that this increased competition yields benefits to market participants including narrower bid-ask spreads, improved access to best execution, and increased market depth and liquidity, all of which establish a prerequisite for the emergence of an all-to-all market with electronic and/or anonymous execution. Citadel also commented that substitution of the DCO for the bilateral counterparty decouples execution from post-trade processing and settlement. Finally, Citadel commented that the certainty as to when the first clearing requirement will begin gives DCOs and FCMs the

confidence to invest in their client clearing offerings, and to compete actively for buy-side business both on the quality and efficiency of their services as well as on price.

FIA commented that the NPRM included a full discussion of the potential competitive impact of the clearing proposal. However, as discussed above, FIA indicated that it was unable to conduct the analysis it believes would be necessary to respond to the Commission's questions in the NPRM within the 30-day comment period provided.

In response to FIA's comment, the Commission notes that the 30-day public comment period was necessary for the Commission to adhere to the CEA's 90-day determination process. Moreover, while FIA indicated that it would like more time to conduct further analysis of competitive issues for future determinations, FIA did not identify any specific concerns about the competitiveness issue analysis that could materially change the Commission's determination if such additional information were made available to the Commission. The comments provided by Citadel are consistent with the NPRM's conclusion that the clearing requirement potentially could impact competition within the affected market, but go on to assert that such an impact would not be negative. Accordingly, the Commission believes that its consideration of competitiveness as described in the NPRM is sufficient for purposes of finalizing the clearing requirement rule.

e. Legal Certainty in the Event of the Insolvency

Section 2(h)(2)(D)(ii)(V) of the CEA requires the Commission to take into account the existence of reasonable legal certainty in the event of the insolvency of the relevant DCO or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property. The Commission's proposal was based on its view that there is reasonable legal certainty with regard to the treatment of customer and swap counterparty positions, funds, and property in connection with cleared swaps, namely the interest rate swaps subject to the proposal, in the event of the insolvency of the relevant DCO or one or more of the DCO's clearing members.

In the case of a clearing member insolvency at CME or IDCH (now, LCH.LLC), *i.e.*, DCOs subject to the bankruptcy laws of the United States, subchapter IV of Chapter 7 of the U.S. Bankruptcy Code (11 U.S.C. 761–767)

and Part 190 of the Commission's regulations would govern the treatment of customer positions.¹³³ Pursuant to section 4d(f) of the CEA, a clearing member accepting funds from a customer to margin a cleared swap, must be a registered FCM. Pursuant to 11 U.S.C. 761–767 and Part 190 of the Commission's regulations, the customer's interest rate swap positions, carried by the insolvent FCM, would be deemed "commodity contracts."¹³⁴ As a result, neither a clearing member's bankruptcy nor any order of a bankruptcy court could prevent a United States domiciled DCO from closing out/liquidating such positions.¹³⁵ However, customers of clearing members would have priority over all other claimants with respect to customer funds that had been held by the defaulting clearing member to margin swaps, such as the interest rate swaps included in the clearing determination.¹³⁶ Customer funds would be distributed to swap customers, including interest rate swap customers, in accordance with Commission regulations and section 766(h) of the Bankruptcy Code. Moreover, the Bankruptcy Code and the Commission's rules thereunder (in particular 11 U.S.C. 764(b) and 17 CFR 190.06) permit the transfer of customer positions and collateral to solvent clearing members.

Similarly, 11 U.S.C. 761–767 and Part 190 would govern the bankruptcy of a DCO, in conjunction with DCO rules providing for the termination of outstanding contracts and/or return of remaining clearing member and customer property to clearing members.

With regard to LCH, the Commission understands that the default of a clearing member of LCH would be governed by the rules of that DCO. LCH, a DCO based in the United Kingdom, has represented that under English law its rules would supersede English insolvency laws. Under its rules, LCH would be permitted to close out and/or transfer positions of a defaulting clearing member that is an FCM

¹³³ The Commission observes that an FCM or DCO also may be subject to resolution under Title II of the Dodd-Frank Act to the extent it would qualify as covered financial company (as defined in section 201(a)(8) of the Dodd-Frank Act).

¹³⁴ If an FCM is also registered as a broker-dealer, certain issues related to its insolvency proceeding would also be governed by the Securities Investor Protection Act.

¹³⁵ See 11 U.S.C. 556 ("The contractual right of a commodity broker [which term would include a DCO or FCM] * * * to cause the liquidation, termination or acceleration of a commodity contract * * * shall not be stayed, avoided, or otherwise limited by operation of any provision of [the Bankruptcy Code] or by order of a court in any proceeding under [the Bankruptcy Code]").

¹³⁶ See 11 U.S.C. 766(h).

¹³² See Section II.D above for a more detailed discussion of these issues.

pursuant to the U.S. Bankruptcy Code and Part 190 of the Commission's regulations. According to LCH's submission, the insolvency of LCH itself would be governed by both English insolvency law and Part 190.

LCH has obtained legal opinions that support the existence of such legal certainty in relation to the protection of customer and swap counterparty positions, funds, and property in the event of the insolvency of one or more of its clearing members. In addition, LCH has obtained a legal opinion from U.S. counsel regarding compliance with the protections afforded to FCM customers under New York law.

In response to the NPRM, Citadel commented that it agreed with the Commission's analysis that reasonable certainty exists in the event of an insolvency of a DCO or one or more DCO members. As discussed above, the Commission received three comments related to customer segregation. In essence, Vanguard and SIFMA AMG recommend that the Commission delay implementation of the clearing requirement until three months after the LSOC model is implemented, clarified, and perhaps supplemented with additional rulemaking. ISDA requests that the Commission further study the issue of insolvency for DCOs.

As stated above, the Commission believes that the concerns of Vanguard and SIFMA AMG are largely addressed by the delayed implementation timeframe for this determination. With regard to ISDA's request, as discussed above, the Commission is actively engaging in efforts to study and prepare for potential scenarios involving clearinghouse and clearing member insolvency.

iii. Conclusions Regarding the Five Statutory Factors and Clearing Requirement Determination

In the foregoing discussion and analysis, the Commission has taken into account each of the five factors provided for under section 2(h)(2)(D)(ii) of the CEA for the interest rate swap classes that are the subject of this determination. Based on these considerations, and having reviewed the relevant DCOs' submissions for consistency with section 5b(c)(2) of the CEA, the Commission is determining that the four classes of interest rate swaps identified in § 50.4(a) are required to be cleared.

III. Final Rules

The Commission is adopting the following rules under section 2(h)(2), as well as its authority under sections 5b(c)(2)(L) and 8a(5) of the CEA. In

issuing a determination regarding whether a swap or class of swaps is required to be cleared, "the Commission may require such terms and conditions to the requirement as the Commission determines to be appropriate."¹³⁷

A. Regulation 50.1: Definitions

As proposed, § 50.1 set forth two defined terms: "business day" and "day of execution." The definition of business day excluded Saturdays, Sundays, and legal holidays. The definition of "day of execution" served as a means of addressing situations where executing counterparties are located in different time zones. It was intended to avoid difficulties associated with end-of-day trading by deeming swaps executed after 4:00 p.m., or on a day other than a business day, to have been executed on the immediately succeeding business day. The Commission recognized that market participants should not be required to maintain back-office operations 24 hours a day or 7 days a week in order to meet the proposed deadline for submitting swaps that are required to be cleared to a DCO. The Commission also was attempting to be sensitive to possible concerns about timeframes that may discourage trade execution late in the day. To account for time-zone issues, the "day of execution" was defined to be the calendar day of the party to the swap that ends latest, giving the parties the maximum amount of time to submit their swaps to a DCO while still requiring such submission on a same-day basis.

The Commission received two comments on these definitions. LCH commended the Commission for including flexibility on the timing of swap submission for those swaps executed late in the day, but requested that the Commission clarify that DCOs can continue to accept swaps for clearing late in the day. In response to this request, the Commission confirms that the 4:00 p.m. cut off for same-day submission to a DCO is intended to give market participants flexibility and respond to concerns about counterparties in different time zones. This definition should not be interpreted as a prohibition on late-day submission of swaps to DCOs or as impeding DCO's ability to accept such swaps.

FIA observed an apparent conflict between the proposed definitions of "business day" and "day of execution" and regulation 23.506(b).¹³⁸ As with

LCH, FIA's concern focused on the ability of DCOs to expand their business hours. As explained above, the definitions do not proscribe a DCO's ability to set business hours. Accordingly, the Commission is adopting the definitions as proposed.

B. Regulation 50.2: Treatment of Swaps Subject to a Clearing Requirement

As proposed, § 50.2(a) required all persons, other than those who elect the exception in accordance with § 39.6 (now § 50.50),¹³⁹ to submit a swap that is part of the class described in § 50.4 for clearing by a DCO as soon as technologically practicable and no later than the end of the day of execution. The objective of this provision was to ensure that swaps subject to a clearing requirement are submitted to DCOs for clearing in a timely manner.

ISDA recommended that the Commission clarify the rule text to recognize that non-clearing members are deemed to have met the requirements of § 50.2 once they submit the swap to their FCM clearing member. ISDA also requested that the Commission recognize that in some cross-border transactions clearing members will not necessarily be FCMs. Similarly, ISDA asked that there be an exclusion for foreign governments and governmental entities as set forth in the end-user exception final rulemaking. Lastly, ISDA asked that there be an exception in the rule for system outages and force majeure events.

In response to ISDA's first comment, the Commission is modifying the rule text by adding new paragraph (c) to clarify that submission of a swap to an FCM or a DCO clearing member is sufficient to meet the timeliness requirements of the rule. For U.S. customers, this will mean submission to a registered FCM. For cross-border transactions, the Commission recognizes that submission of the swap may be to a non-FCM clearing member when the customer is not a U.S. person.¹⁴⁰

clearing requirement to a DCO as soon as technologically practicable after execution, but no later than the close of business on the day of execution. See 17 CFR 23.506(b), 77 FR 21278, 21307 (Apr. 9, 2012). To the extent that a swap dealer or major swap participant is subject to both § 23.506(b) and § 50.2(a), the entity should comply with § 23.506(b) when its counterparty is another swap dealer or major swap participant, but if the swap is between a swap dealer and a non-swap dealer, then the non-swap dealer counterparty can elect to follow the timing requirements of § 50.2(a) or § 23.506(b).

¹³⁹ The Commission is recodifying § 39.6 as § 50.50 so that market participants are able to locate all rules related to the clearing requirement in one part of the Code of Federal Regulations.

¹⁴⁰ If the person submitting the swap is a customer, as § 1.3(k) defines that term, then only a

¹³⁷ Section 2(h)(2)(D)(iii) of the CEA.

¹³⁸ This regulation directs swap dealers and major swap participants to submit swaps subject to the

With regard to foreign governments and governmental entities, the Commission reiterates the position taken in the end-user exception rulemaking that “foreign governments, foreign central banks, and international financial institutions should not be subject to Section 2(h)(1) of the CEA.”¹⁴¹ Finally, the Commission declines to include an explicit exception for unforeseen outages and other events. The Commission recognizes that these situations may occur and has adopted rules relating to system safeguards and disaster recovery for market infrastructures¹⁴² and market participants.¹⁴³ However, none of the straight-through-processing rules adopted by the Commission included carve-outs for system outages or force majeure events,¹⁴⁴ and the Commission does not believe it is necessary to include such provisions in this rule. In the case of serious market-wide disruptions, the Commission would take this mitigating fact into account in reviewing compliance with § 50.2.

Additionally, in an effort to clarify that a market participant does not have to submit a swap that falls within the § 50.4 classes, but that the entity knows are not offered for clearing by any DCO because the swap contains specifications that are not accepted for clearing, the Commission is modifying the text of § 50.2 to include a reference to “eligible” DCOs that offer such swaps for clearing.

Proposed § 50.2(b) would require persons subject to § 50.2(a) to undertake reasonable efforts to determine whether a swap is required to be cleared. In the NPRM, the Commission indicated that it would consider such reasonable efforts to include checking the Commission’s Web site or the DCO’s Web site for verification of whether a swap is required to be cleared, or consulting third-party service providers for such verification.

CME commented on the Commission’s observation in the NPRM that DCOs could design and develop

registered FCM may accept that swap for clearing, even if the customer seeks to clear the swap on a DCO located outside of the U.S.

¹⁴¹ See *End-User Exception to the Clearing Requirement for Swaps*, 77 FR 42560, 42562 (July 19, 2012).

¹⁴² See, e.g., *Derivatives Clearing Organization General Provisions and Core Principles*, 76 FR 69334, 69443–69444 (Nov. 8, 2011) (adopting § 39.18 relating to system safeguards).

¹⁴³ See *Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules*, 77 FR 20128, 20208–20209 (Apr. 3, 2012) (adopting § 23.603 relating to business continuity and disaster recovery).

¹⁴⁴ *Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management*, 77 FR 21278, 21307 (Apr. 9, 2012).

systems that will enable market participants and trading platforms to check whether or not their swap is subject to a clearing requirement and be provided with an answer within seconds (or faster). CME stated that its platform already provides market participants with a tool to screen a particular swap for eligibility for clearing upon submission to CME. The Commission recognizes that this technological capability will be beneficial to market participants, particularly pre-execution, and is necessary to ensure timely clearing of swaps subject to the clearing requirement.

Freddie Mac observed that § 50.2(a) and (b) could be interpreted to require two different standards of care: strict liability for the former and a reasonable inquiry standard for the latter. In response to Freddie Mac’s comment, the Commission clarifies that § 50.2(a) establishes a requirement regarding the timely submission of swaps to DCOs. It is a bright-line standard, but it is not intended to introduce a new scienter requirement regarding submission for clearing beyond that provided for in the statute.¹⁴⁵ With regard to § 50.2(b), the Commission’s objective was to afford market participants clarity about what efforts they must expend in determining whether their swaps are required to be cleared. In the absence of some central screening mechanism available to all market participants for the purpose of immediately determining whether any eligible DCO offers a particular swap for clearing,¹⁴⁶ the Commission believes it appropriate to provide clarity regarding what constitutes reasonable search or verification efforts.¹⁴⁷

C. Regulation 50.3: Notice to the Public

The Commission proposed § 50.3(a) to require each DCO to post on its Web site a list of all swaps that it will accept for clearing and clearly indicate which of those swaps the Commission has determined are required to be cleared pursuant to part 50 of the Commission’s regulations and section 2(h)(1) of the CEA.

ISDA commented that DCOs should provide swap information, including product specifications, in a manner that is easy to access and use. ISDA also called upon DCOs to provide at least

¹⁴⁵ See Section III.G for further discussion regarding scienter.

¹⁴⁶ See discussion in Section II.E regarding LCH’s and CME’s efforts to provide such a screening mechanism.

¹⁴⁷ The Commission notes that it will consider whether verification efforts are reasonable in light of all the facts and circumstances of a market participant’s particular situation.

one-month’s advance notice for new swaps that they plan to accept for clearing and to provide a description of the margin methodology used in clearing the swap. The Commission agrees that DCOs should provide information in a manner that is easy to use and accessible to the public. Regulation § 50.3(b) builds upon the requirements of § 39.21(c)(1), which requires each DCO to disclose publicly information concerning the terms and conditions of each contract, agreement, and transaction cleared and settled by the DCO. The Commission also welcomes ISDA’s suggestion that DCOs voluntarily provide advance notice of new swaps that they plan to clear and make relevant information regarding their margining methodologies available.¹⁴⁸

LCH commented that it is committed to revising the information on its Web site so that it is provided in a format that is easily understandable by all swaps counterparties, including customers.

Regulation § 50.3(b) requires the Commission to post on its Web site a list of those swaps it has determined are required to be cleared and all DCOs that are eligible to clear such classes of swaps. No comments were received on this provision. The Commission is adopting the rule as proposed in order to provide market participants with sufficient notice regarding which swaps are subject to a clearing requirement. For clarification, the Commission will include on its Web site any swaps that it has determined through delegated authority under § 50.6 fall within a class of swaps described in § 50.4.

D. Regulation 50.4: Classes of Swaps Required To Be Cleared

As discussed at length above, proposed § 50.4 set forth the classes of interest rate swaps and CDS that the Commission proposed for required clearing. Proposed § 50.4(a) included a table listing those types of interest rate swaps the Commission would require to be cleared, and proposed § 50.4(b) included a table listing those types of CDS indices the Commission would require to be cleared.

ISDA recommended that the Commission clarify that the stated termination date ranges in § 50.4(a) be applied only at trade inception for purposes of determining whether the swap is required to be cleared. The Commission confirms ISDA’s

¹⁴⁸ 17 CFR 39.21 requires that DCOs provide market participants with “sufficient information to enable the market participants to identify and evaluate accurately the risks and costs associated with using the services” of the DCO.

understanding of the stated termination date range applying only at trade inception or upon an ownership event change, as discussed in detail below.

As discussed above, the Commission is adopting § 50.4(a) and (b). The Commission believes that this format provides market participants with a clear understanding of which swaps are required to be cleared. By using basic specifications to identify the swaps subject to the clearing requirement, counterparties contemplating entering into a swap can determine quickly as a threshold matter whether or not the particular swap may be subject to a clearing requirement. If the swap has the basic specifications of a class of swaps determined to be subject to a clearing requirement, the parties will know that they need to verify whether an eligible DCO will clear that particular swap. This will reduce the burden on swap counterparties related to determining whether a particular swap may be subject to the clearing requirement.

i. Disentangling Complex Swaps

TriOptima commented that the complete swap must be assessed against the clearing requirement and parties should not be required to disentangle non-clearable swaps in order to clear the clearable components. The Commission confirms TriOptima's view regarding those swaps that may have components that can be cleared, but would require disentangling the clearable part of the swap. Adherence to the clearing requirement does not require market participants to structure their swaps in a particular manner or disentangle swaps that serve legitimate business purposes.¹⁴⁹

ii. Swaptions and Extendible Swaps

In response to the Commission's inquiry in the NPRM regarding how to treat a swap that becomes effective upon the exercise of a swaption, ISDA suggested that the resulting swap should only be required to be cleared if the underlying swap and the counterparties to the swap were subject to a clearing requirement at the time that the swaption was executed. ISDA also commented that the same approach should apply to extendible swaps, *i.e.*, a swap for which a party has the option to extend the term of the swap. ISDA reasoned that the parties to a swaption or an extendible swap would not have taken into account the cost of clearing the resultant swap if they negotiated the price of the option before a clearing

requirement was applicable to the underlying swap or extended swap. LCH similarly commented that a swaption entered into before a clearing requirement is applicable to the underlying swap would not have been priced with an expectation that the swap created on exercise would be cleared. For this reason, LCH also stated that an underlying swap of a swaption should be subject to an applicable clearing requirement only if the swaption was entered into after the clearing requirement applicable to the underlying swap becomes effective.

The Commission agrees that the cost of clearing may not be reflected in the pricing of the swaption or extendible swap if the clearing requirement for the underlying swap or the extendible swap arises after the execution of the swaption or extendible swap. The Commission is thus clarifying that the clearing requirement only applies to swaps resulting from the exercise of a swaption or extendible swap extension if the clearing requirement would have been applicable to the underlying swap or the extended swap at the time the counterparties executed the swaption or extendible swap.

iii. Ownership Event Changes

In the NPRM, the Commission asked whether it should clarify that the clearing requirement applies to all new swaps and changes in the ownership of a swap, including assignment, novation, exchange, transfer, or conveyance. ISDA responded that a swap that is not subject to the clearing requirement at the time it is executed should not become subject to it upon an ownership event change unless the parties can agree on pricing and other terms necessary to reflect the costs of clearing and until the swap can be transitioned from uncleared to cleared with accuracy.¹⁵⁰

As the Commission acknowledged above, the cost of clearing may not be reflected in the pricing of a swap if the clearing requirement arises after the execution of that swap. However, unlike with the exercise of a swaption, typically, the original counterparties to a swap that is assigned, novated, exchanged, transferred, or conveyed, along with the new party in ownership, each have an opportunity to revisit the terms of the original swap and account

for new costs.¹⁵¹ While there may be cost implications for the remaining party when its counterparty changes, these cost implications can arise for any number of foreseeable or unforeseeable reasons,¹⁵² and if the remaining party is concerned about potential cost implications resulting from a change of its counterparty, it would be able to protect itself through the terms of the swap, such as including consent rights or required price adjustments upon such an event.¹⁵³ The Commission is concerned that if such swaps are not treated as new swaps for the purposes of the clearing requirement, it could be creating incentives to "trade" historical swaps through the assignment, novation, exchange, transfer, or conveyance processes to avoid required clearing. Accordingly, for purposes of this rule, a change in ownership of a swap would subject the swap to required clearing under section 2(h)(1) of the CEA in the same manner and to the same extent as a newly executed swap.

Furthermore, for swaps executed after the clearing requirement is in place, the Commission also believes it is important to clarify that a change in ownership may result in a requirement to clear. For example, a financial entity and an end user under section 2(h)(7) of the CEA enter into a swap that is not required to be cleared, and later if the end user transfers its ownership interest in the swap to another party that is a financial entity not eligible to claim an exception under section 2(h)(7), then the swap would be required to be cleared if the other prerequisites to the requirement exist.

E. Regulation 50.5: Clearing Transition Rules

As proposed, § 50.5 would codify section 2(h)(6) of the CEA. Under proposed § 50.5(a), swaps that are part of a class described in § 50.4 but were entered into before the enactment of the Dodd-Frank Act would be exempt from clearing so long as the swap is reported to an SDR pursuant to § 44.02 and section 2(h)(5)(A) of the CEA. Similarly, under proposed § 50.5(b), swaps entered

¹⁵¹ Going forward, prior to or at the time of ownership change, parties will have to account for any additional costs of clearing.

¹⁵² For example, an ownership change for a bilateral swap may have foreseeable or unforeseeable credit or tax implications for the remaining party.

¹⁵³ The Commission observes that the ISDA Master Agreement used for most bilateral swaps requires the prior written consent of the remaining party for any transfer of the agreement other than for certain limited transfers of payments upon default or upon a merger, acquisition, or transfer of all assets.

¹⁴⁹ See discussion below regarding § 50.10 and the evasion and abuse standards.

¹⁵⁰ Aside from a general assertion about the challenges of selecting a DCO for clearing, ISDA did not elaborate on its implied assertion that swaps subject to ownership changes may be difficult to transition to clearing accurately.

into after the enactment of the Dodd-Frank Act but before the application of the clearing requirement would be exempt from the clearing requirement if reported pursuant to § 44.03 and section 2(h)(5)(B) of the Act.

LCH suggested that the Commission change the citations in § 50.5(a) from § 44.02 to § 46.3, and in § 50.5(b) from § 44.03 to § 45.3 for swaps entered after the enactment of the Dodd-Frank Act but prior to the compliance date for reporting to an SDR and to § 45.3 for swaps entered into after the compliance date for SDR reporting but prior to the application of a clearing requirement. The Commission agrees with LCH and is modifying the rule to provide more accurate cross references to parts 45 and 46. In addition, under § 50.5(b), the Commission cross references § 46.3 or § 45.3, as appropriate, because until April 2013, certain market participants may properly rely on § 46.3 for reporting swaps executed after the enactment of the Dodd-Frank Act.

F. Regulation 50.6: Delegation of Authority

Under proposed § 50.6(a), the Commission would delegate to the Director of the Division of Clearing and Risk, or the Director's designee, with the consultation of the General Counsel or the General Counsel's designee, the authority to determine whether a swap falls within a class of swaps described in § 50.4 and to communicate such a determination to the relevant DCOs.

ICE supported the Commission's proposal and agreed that this approach would allow DCOs to add new swaps in a timely and efficient manner and rely on the DCOs' risk management processes and governance for adding new products to an existing class. Citadel also supported the proposed delegation provision based on the view that the Commission carefully oversees DCO risk management and it is beneficial to move products into clearing without excessive delay. LCH generally supported the Commission's proposal, but requested confirmation that if the DCO makes a material change to an existing type of swap, the Commission would follow the full clearing requirement determination process.

By contrast, ISDA objected to proposed § 50.6 based on a concern that the Commission would be delegating the clearing determination for DCO product expansions to the DCOs themselves, which would contradict the requirement that the Commission review each DCO submission under section 2(h)(2)(B)(iii)(II) of the CEA. Based on the breadth of the swaps

classes under § 50.4, ISDA commented that DCOs will be able to add new swaps under the clearing requirement without review by the Commission under the five statutory factors. ISDA recommended that the delegation provision be supplemented to include (1) a requirement that new DCO product offerings raise no materially different considerations regarding the Commission's determination; (2) a public comment period; and (3) a compliance phase-in period of 90 days.

In response to LCH's request for clarification, the Commission confirms that if a DCO makes a material change to an existing type of swap, the Commission would follow the full clearing requirement determination process. Under the example provided by LCH—extending the tenor of swaps clearing—the DCO's change would require a change to the rule text under § 50.4, which would require Commission action.

In response to ISDA's comments, the Commission observes that the proposed delegation provision was not intended to displace Commission review under section 2(h)(2)(B)(iii)(II) of the CEA. With respect to swaps within the classes identified in § 50.4 that are already being cleared by at least one DCO, the delegation provision will facilitate other DCOs' ability to offer new swaps for required clearing so long as those swaps fall within one of the classes previously established by the Commission. With respect to swaps that meet the specifications identified in § 50.4, but have not been previously offered for clearing by any DCO, the Commission agrees with ISDA that the delegation is limited to those swaps that are consistent with the prior determination. For instance, if a new swap falls within a class under § 50.4, but clearing the swap requires that DCOs adopt a new margining methodology or pricing methodology, the Commission would subject that swap to a new clearing requirement determination process.¹⁵⁴ Accordingly, the Commission is modifying the rule to limit the delegation authority to those instances where the newly submitted swap falls within the class under § 50.4 and is consistent with the Commission's clearing requirement determination for that class of swaps. In addition, the Commission is modifying the rule to require that the Director of the Division of Clearing and Risk notify the

¹⁵⁴ Without this delegation process a new swap that falls within a class under § 50.4 could have automatically been included in the clearing requirement without review. The delegation provision provides a check on that process.

Commission prior to exercising any authority delegated under § 50.6.

The Commission declines to adopt ISDA's other recommendations. Provided that inclusion of the new swaps under § 50.4 is consistent with the Commission's previous clearing requirement determination, there is no need for an additional public comment period beyond that provided for as part of the initial clearing requirement determination process. Moreover, under the CEA and Commission regulation, any counterparty to a swap can apply for a stay of the clearing requirement.¹⁵⁵ This stay provision would serve to notify the Commission of objections to inclusion of a particular swap in a previously-defined class. In addition, the Commission does not believe that an additional phase-in period is necessary. Provided that including the new swap is consistent with the prior determination, the compliance phasing for the original class will afford sufficient time for operational and systems implementation. If such time had not been sufficient, the Director of the Division of Clearing and Risk could submit the matter to the Commission for its consideration, or the Commission could itself exercise the delegated authority, under § 50.6(b).

G. Regulation 50.10: Prevention of Evasion of the Clearing Requirement and Abuse of an Exception or Exemption to the Clearing Requirement

The Commission proposed § 50.10 under the rulemaking authority in sections 2(h)(4)(A), 2(h)(7)(F), and 8a(5) of the CEA. Proposed § 50.10 would prohibit evasions of the requirements of section 2(h) of the CEA and abuse of any exemption or exception to the requirements of section 2(h), including the end-user exception or any other exemption or exception that the Commission may provide by rule, regulation, or order.¹⁵⁶

Proposed § 50.10(a) would make it unlawful for any person to knowingly or recklessly evade, participate in, or facilitate an evasion of any of the requirements of section 2(h).¹⁵⁷ This

¹⁵⁵ See section 2(h)(3) of the CEA and regulation 39.5(d).

¹⁵⁶ As noted in the proposing release, the Commission preliminarily viewed evasion of the clearing requirement and abuse of an exemption or exception to the clearing requirement, including the end-user exception, to be related concepts and are informed by new enforcement authority under the Dodd-Frank Act, which added new sections 6(e)(4)-(5), and 9(a)(6), to the CEA. See Proposed Clearing Requirement Determination, 77 FR 47170, 47207 (Aug. 7, 2012).

¹⁵⁷ Proposed § 50.10(a) was informed by and consistent with section 6(e)(4) and (5) of the CEA.

would apply to any requirement under section 2(h) of the CEA or any Commission rule or regulation promulgated thereunder.¹⁵⁸ In the proposing release, the Commission noted, however, that section 2(h)(1)(A) of the CEA provides that it “shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing” to a DCO if the swap is required to be cleared. Unlike the knowing or reckless standard under proposed § 50.10(a), section 2(h)(1)(A) imposes a non-scienter standard on swap market participants.¹⁵⁹

Proposed § 50.10(b) would make it unlawful for any person to abuse the end-user exception to the clearing requirement as provided under section 2(h)(7) of the CEA and § 39.6 (now § 50.50).¹⁶⁰ The proposing release stated that an abuse of the end-user exception to the clearing requirement may also, depending on the facts and circumstances, be an evasion of the requirements of section 2(h). The Commission’s preliminary view was informed by section 9(a)(6) of the CEA, which cross-references both the prevention of evasion authority in section 2(h)(4) and prevention of abuse to the exception to the clearing requirement in section 2(h)(7)(F).¹⁶¹ Thus, the Commission proposed to interpret a violation of section 9(a)(6) of the CEA to also be a violation of proposed § 50.10(b).

Proposed § 50.10(c) would make it unlawful for any person to abuse any exemption or exception to the requirements of section 2(h) of the CEA, including any exemption or exception,

which states that any DCO, swap dealer, or major swap participant that “knowingly or recklessly evades or participates in or facilitates an evasion of the requirements of section 2(h) shall be liable for a civil monetary penalty in twice the amount otherwise available for a violation of section 2(h).”

¹⁵⁸ These requirements include the clearing requirement under section 2(h)(1), reporting of data under section 2(h)(5), and the trade execution requirement under section 2(h)(8), among other requirements. For example, it would be a violation of proposed § 50.10(a) for a SEF to knowingly or recklessly evade or participate in or facilitate an evasion of the trade execution requirement under section 2(h)(8).

¹⁵⁹ Any person engaged in a swap that would be required to be cleared under section 2(h) and Part 50 of the Commission’s Regulations, and such person did not submit the swap for clearing, absent an exemption or exception, would be subject to a Commission enforcement action regardless of whether the person knowingly or recklessly failed to submit the swap for clearing.

¹⁶⁰ See End-User Exception to the Clearing Requirement for Swaps, 77 FR 42560 (July 19, 2012).

¹⁶¹ Proposed § 50.10(b) is adopted under the authority in both section 2(h)(4)(A) and section 2(h)(7)(F).

as the Commission may provide by rule, regulation, or order.¹⁶²

In the preamble to the NPRM, the Commission proposed to adopt a “principles-based” approach to applying proposed § 50.10 and declined to provide a bright-line test of non-evasive or abusive conduct, because such an approach may be a roadmap for engaging in evasive or abusive conduct or activities. The Commission, however, did propose additional guidance to provide clarity to market participants. The Commission proposed to determine on a case-by-case basis in light of all the relevant facts and circumstances, whether particular transactions or other activities constitute a violation of § 50.10. Similar to its approach in the final rules further defining the term “swap” (the “Product Definition Rules”), the Commission proposed that it would not consider transactions or other activities structured in a manner solely motivated by a legitimate business purpose to constitute evasion or abuse.¹⁶³

i. In General

Four commenters discussed different aspects of proposed § 50.10, including the standard of intent that proposed § 50.10 requires and the proposed legitimate business purpose guidance. After considering the comments as discussed more fully below, the Commission has determined that § 50.10 is necessary to prevent evasion of the requirements of section 2(h) and abuses of any exemption or exception to the requirements of section 2(h). Therefore, the Commission is adopting § 50.10 as proposed, but the Commission is providing additional interpretive guidance regarding § 50.10 as set out below.

ii. Standard of Intent

Two commenters discussed the relevant standard of intent for proposed § 50.10. ISDA commented that § 50.10(a), (b), and (c) should be

¹⁶² This provision was informed by the Dodd-Frank Act amendments in section 2(h)(4)(A) to prescribe rules necessary to prevent evasions of the clearing requirements; section 2(h)(7)(F) to prescribe rules necessary to prevent abuse of the exceptions to the clearing requirements; and the Commission’s general rulemaking authority in section 8a(5) to promulgate rules that, in the judgment of the Commission, are reasonably necessary to accomplish any purposes of the CEA.

¹⁶³ The Commission’s discussion of § 50.10 is similar to its approach for the anti-evasion rules §§ 1.3(xxx)(6) and 1.6 that it recently adopted in a joint final rulemaking with the Securities and Exchange Commission. See Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48208, 48350–48354 (Aug. 13, 2012).

governed by a single standard of intent. ISDA noted that proposed § 50.10(a) would make it unlawful for any person to “knowingly or recklessly” evade the requirements of section 2(h); whereas, proposed § 50.10(b) and (c) would make it unlawful to “abuse” exceptions or exemptions to the requirements of section 2(h). ISDA requested the Commission clarify that all three provisions are subject to a scienter standard.

FreddieMac commented that the statutory “knowing or reckless” standard for evasion indicates that Congress intended that parties to a swap should be deemed in compliance with the clearing requirement at least where they have submitted a swap for clearing in good faith and have a reasonable expectation of clearing.

In consideration of the comments, the Commission clarifies that it interprets the “knowingly or recklessly” standard in § 50.10(a) to be the same as the “abuse” standard in § 50.10(b) and (c). The Commission believes that a “knowingly or recklessly” standard is consistent with and an appropriate standard of intent for any “abuse” of any exemption or exception to the requirements of section 2(h). Additionally, the purpose of § 50.10 is to prevent evasion of the requirements under section 2(h) or to prevent an abuse of an exemption or exception to the requirements under section 2(h). Therefore, the Commission confirms that it would not constitute a violation of § 50.10 where a party submits a swap for clearing in good faith and the party has a reasonable expectation of clearing.

iii. Legitimate Business Purpose

Four commenters discussed the proposed guidance on what constitutes a legitimate business purpose. TriOptima supported the proposed principles-based approach to prevent evasion and the proposed guidance. TriOptima also requested the Commission clarify that activities and transactions carried out for the purpose of reducing counterparty credit risk constitute a legitimate business purpose.

FreddieMac commented that the proposing release creates ambiguity as to the circumstances in which a swap is required to be submitted for clearing. In particular, FreddieMac commented that the NPRM appears to represent the Commission’s view that swaps that differ in regard to “mechanical” terms may be sufficiently close substitutes such that parties may be required to use such a “substitute swap” (where one is available) that is subject to a clearing

requirement.¹⁶⁴ FreddieMac asserted that the Commission should not pre-judge when a swap that is required to be cleared is a close substitute for a swap that is not subject to a clearing requirement. Furthermore, FreddieMac commented that the Commission should clarify that a swap that would otherwise be required to be cleared but for a variation in one or more material contract terms should not also be required to be submitted for clearing, provided that such variation of the terms is for legitimate business purposes.

In response to the proposed guidance, ISDA asserted that the Commission did not clearly respond to its comment to the Product Definition Rules that variations based on considerations of the costs and burdens of regulation should be considered to have a legitimate business purpose.¹⁶⁵ ISDA requested the Commission clarify that if a business has a choice, in the absence of fraud, deceit, or unlawful activity, of entering into an uncleared swap, rather than a cleared swap, “because [the uncleared swap] is cheaper, or free of unwanted aspects of clearing or trading, then that choice should be identified by the Commission as legitimate.” ISDA also asserted that presence of fraud, deceit, or unlawful activity is a proper prerequisite to evasion or abuse violations. Furthermore, ISDA argued that market participants will be subject to constant uncertainty when structuring and transacting in markets that offer legitimate alternatives if the proposal were adopted.

The Commission is guided by the central role that clearing plays under the Dodd-Frank Act. As noted in the proposing release, “the requirement that swaps be cleared by DCOs is one of the cornerstones of that reform.”¹⁶⁶ But even given the importance of central clearing as a means to mitigate counterparty credit risk, reduce systemic risk, and protect U.S. taxpayers, the Commission accepts that a person may have legitimate business purposes for entering into swaps that are not subject to the clearing requirement.

In that regard, commenters requested that the Commission confirm that considering the costs and burdens of regulation, or reduction of counterparty credit risk, are legitimate business purposes. As stated in the proposing release, the Commission will not

provide a bright-line test of non-evasive or abusive conduct because such an approach may be a roadmap for engaging in evasive or abusive conduct or activities.¹⁶⁷ The Commission expects, however, that a person acting for legitimate business purposes will naturally weigh many costs and benefits associated with different transactions, including different swap classes and swap specifications that may or may not be subject to the clearing requirement. Therefore, the Commission clarifies that a person’s specific consideration of, for example, costs or regulatory burdens, including the avoidance thereof, is not, in and of itself, dispositive that the person is acting without a legitimate business purpose in a particular case.¹⁶⁸ The Commission will view legitimate business purpose considerations on a case-by-case basis in conjunction with all other relevant facts and circumstances.

In the context of the clearing requirement and § 50.10(a), however, the Commission does not believe it would be sufficient to satisfy the legitimate business purpose test where a person’s principal purpose of entering into a swap that is not subject to the clearing requirement is to circumvent the costs of clearing.¹⁶⁹ Circumventing the costs of clearing may be a consideration, but cannot be the principal consideration in order to satisfy the legitimate business purpose test. The Commission notes ISDA’s comment regarding evasion, and the Commission has determined that to permit such an outcome would create an exception that would swallow the rule and could render the central clearing objectives and benefits under the Dodd-Frank Act meaningless. Moreover, section 2(h)(4)(A) requires the Commission prescribe the rules that the Commission determines “to be necessary to prevent evasions of the mandatory clearing requirements,”¹⁷⁰ which evinces Congress’s concern that evasion of the clearing requirement

would undermine a central purpose of the Dodd-Frank Act. As noted above, the Commission determines that the proposed rules are necessary to prevent evasions of the mandatory clearing requirements, and is therefore adopting them.

Furthermore, the Commission believes that this standard will not subject market participants to significant uncertainty, and the benefits of central clearing will outweigh the costs and burdens of any such uncertainty. In response to Freddie Mac’s comment regarding the Commission discussion of “mechanical” specifications in the NPRM, that discussion served only to explain the Commission’s decision not to include those specifications in the set of class-defining specifications identified by the Commission for its class-based clearing requirement determination. The Commission is not pre-judging whether a swap that contains non class-defining specifications that are not accepted by a DCO would constitute evasion. The Commission recognizes that including such specifications in a swap could serve a legitimate business purpose if, for example, such specifications would legitimately result in a more accurate hedge of a business risk. In keeping with the Commission’s guidance that it will use a principles-based approach, assessing whether any particular swap that includes such terms would constitute evasion will be done on a case-by-case basis in light of all the relevant facts and circumstances.

Finally, the Commission declines to adopt ISDA’s suggestion that the presence of fraud, deceit, or other unlawful activity is a prerequisite to establishing a violation of evasion or abuse under § 50.10. Although it is likely that fraud, deceit, or unlawful activity will be present where knowing or reckless evasion or abuse has occurred, the Commission does not believe that these factors are prerequisites to a violation of § 50.10. Rather, the presence or absence of fraud, deceit, or unlawful activity is one circumstance the Commission will consider when evaluating a person’s conduct or activities.

IV. Implementation

The Commission proposed to require compliance with the clearing requirement for the classes of swaps identified in proposed § 50.4 according to the compliance schedule contained in

¹⁶⁴ See NPRM at 47191, fn. 97 (discussing a category of interest rate swap specifications “that are commonly used to address mechanical issues”).

¹⁶⁵ See Product Definition Rules, 77 FR at 48302, fn. 1052.

¹⁶⁶ NPRM at 47171.

¹⁶⁷ NPRM at 47207.

¹⁶⁸ Examples described in the guidance are illustrative and not exhaustive of the conduct or activities that could be considered evasive or abusive. In considering whether conduct or activities is evasive or abusive, the Commission will consider the facts and circumstances of each situation.

¹⁶⁹ ISDA also requested clarification that avoiding “unwanted aspects of clearing or trading” should be considered to be a legitimate business purpose. ISDA did not specify what it means by “unwanted aspects,” nor did it explain how avoiding aspects of clearing or trading could be distinguished from evasion. Accordingly, the Commission is declining to include this concept as part of its guidance regarding legitimate business purposes.

¹⁷⁰ Section 2(h)(4)(A) of the CEA, 7 U.S.C. 2(h)(4)(A).

§ 50.25.¹⁷¹ Under this schedule, compliance with the clearing requirement would be phased by type of market participant entering into a swap subject to the clearing requirement.

The Commission received no comments specifically addressing the use of § 50.25. Vanguard recommended that the Commission should not implement mandatory clearing for any swaps until market participants have time to negotiate and execute all necessary documentation. Vanguard recommended the Commission delay compliance with the clearing requirement until six months after August 29, 2012, the date on which ISDA and FIA published a standard form of the futures agreement addendum for cleared swaps, *i.e.*, February 28, 2013. SIFMA AMG also expressed concern about legal documentation and negotiations taking many months, and the difficulty buy-side clients face in finding FCMs to clear for them. SIFMA AMG also recommended the clearing requirement be delayed for six months.

In response to Vanguard's and SIFMA AMG's comments and light of the circumstances discussed below, compliance with the clearing requirement will not be required for any swaps until March 11, 2013. This extension of at least 6 months beyond publication of the FIA-ISDA clearing addendum applies to all market participants and addresses Vanguard's and SIFMA AMG's concerns about documentation. The Commission accounted for precisely this type of documentation issue in its adoption of § 50.25. Accordingly, Category 2 Entities and Category 3 Entities have 90 and 180 days beyond March 11, 2013, to come into compliance with the new clearing requirement, which is well beyond the six months from August 29, 2012, as requested by Vanguard and SIFMA AMG. The Commission also notes that any market participant may petition for relief under § 140.99 if that entity is unable to find an FCM to clear its swaps or if it needs additional time to complete requisite documentation.¹⁷²

On September 10, 2012, the Commission clarified the timing of its swap dealer registration rules. The swap dealer registration regulations go into

effect on October 12, 2012, and entities that have more than the de minimis level of dealing (swaps entered into after October 12) must register by no later than two months after the end of the month in which they surpass the de minimis level. By way of example, if an entity reaches \$8 billion in swap dealing the day after October 12, then the entity would have to register within two months after the end of October, or by December 31, 2012.

Given that swap dealers will not be required to register until the end of the year, and in light of requests for clarification regarding the application of § 50.25, the Commission is clarifying that swaps executed prior to specific compliance dates set forth below are not subject to the clearing requirement.

To promote certainty for market participants, the Commission is setting specific dates for compliance. Accordingly, the requirement for Category 1 Entities to begin clearing will commence on Monday, March 11, 2013, for swaps they enter into on or after that date. Category 2 Entities are required to clear swaps beginning on Monday, June 10, 2013, for swaps entered into on or after that date, and Category 3 Entities would be required to clear swaps beginning on Monday, September 9, 2013, for swaps entered into on or after that date.

For example, no swap executed between two Category 1 Entities prior to March 11, 2013, is required to be cleared. In other words, Category 1 Entities entering into swaps falling within one of the classes identified in § 50.4 on or after March 11, 2013, are required to clear those swaps. Category 2 Entities must begin clearing swaps pursuant to the new clearing requirement on or after June 10, 2013, and Category 3 Entities must begin clearing such swaps if they are entered into on or after the September 9, 2013.

The above schedule will apply to compliance with required clearing for iTraxx. However, if no DCO has begun offering client clearing for iTraxx by February 11, 2013, then compliance with the required clearing of iTraxx will commence sixty days after the date on which iTraxx is first offered for client clearing by an eligible DCO. If an eligible DCO offers client clearing for iTraxx on or before September 9, 2013, the following phased implementation schedule will apply: Category 1 Entities are required to clear iTraxx indices entered into on or after the date 60 days after the date on which iTraxx is first offered for client clearing by an eligible DCO; Category 2 Entities are required to clear iTraxx entered into on or after the date 150 days after the date on which

iTraxx is first offered for client clearing by an eligible DCO; and Category 3 Entities are required to clear iTraxx entered into on or after the date 240 days after the date on which iTraxx is first offered for client clearing by an eligible DCO. There will be no phasing of compliance if an eligible DCO offers client clearing for iTraxx after September 9, 2013. Rather, all three categories of market participants will be expected to come into compliance by 60 days after the date on which iTraxx is first offered for client clearing by an eligible DCO.

This clarification avoids the possibility that Active Funds that are included in Category 1 Entities would be required to clear before swap dealers, and provides market participants with certainty as to when they must begin clearing swaps.

With regard to Active Funds, in order to promote orderly implementation of part 23 and the part 50 rules, both of which refer to Active Funds, the Commission is harmonizing the annual calculation period for both implementation of part 23's swap trading relationship documentation requirements under § 23.504¹⁷³ and the clearing requirement compliance schedule under § 50.25. For purposes of implementing § 23.504, the Commission defined an Active Fund, as any private fund as defined in section 202(a) of the Investment Advisers Act of 1940, that is a not a third party subaccount and that executes 200 or more swaps per month based on a monthly average over the 12 months preceding the adopting release, *i.e.*, September 11, 2012.¹⁷⁴ For purposes of § 50.25, the Commission defined Active Fund in the same manner except that the monthly average over the 12 months would be preceding the date of publication of the clearing requirement determination in the **Federal Register**, *i.e.*, whatever date this adopting release is published.¹⁷⁵ Market participants have asked the Commission to harmonize these two dates so that there will be one self-identified list of Active Funds for purposes of both implementation schedules under parts 23 and 50. The Commission agrees with this approach and is modifying both compliance schedules to require private funds to calculate the number of swaps they enter into as a monthly average

¹⁷¹ 17 CFR 50.25, Swap Transaction Compliance and Implementation Schedule: Clearing Requirement Under Section 2(h) of the CEA, 77 FR 44441 (July 30, 2012). Regulation 50.25 defines the terms Category 1 Entity and Category 2 Entity; this release uses the term Category 3 Entity to refer to counterparties to swaps falling under § 50.25(b)(3).

¹⁷² 17 CFR 140.99 sets for the process for addressing requests for exemptive, no-action, and interpretative letters.

¹⁷³ Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 FR 55904 (Sept. 11, 2012).

¹⁷⁴ See 77 FR at 55940.

¹⁷⁵ See Swap Transaction Compliance and Implementation Schedule: Clearing Requirement Under Section 2(h) of the CEA, 77 FR at 44456.

over the past 12 months preceding November 1, 2012.

In addition, the Commission clarifies that for purposes of calculating the number of swaps a fund executes as a monthly average over the 12 months preceding November 1, 2012, for both part 23 and part 50, private funds as defined in section 202(a) of the Investment Advisers Act of 1940 are not required to include foreign exchange swaps, in light of the final determination from the Secretary of the Treasury to exempt such swaps from the CEA.¹⁷⁶

Finally, ISDA commented that the inter-affiliate exemption should be finalized prior to requiring compliance with the clearing requirement. The Commission has proposed its inter-affiliate exemption rules¹⁷⁷ and anticipates that it will finalize those rules prior to the aforementioned compliance dates for these clearing requirement determinations.

V. Cost-Benefit Considerations

A. Statutory and Regulatory Background

As discussed in the NPRM, and above, certain OTC derivatives, such as credit default swaps (CDS) played a prominent role in the financial crisis in the fall of 2008, highlighting the risk that opaque OTC markets can create for the financial system by linking together financial institutions in ways that are not well-understood.¹⁷⁸ The failure to adequately collateralize the risk exposures posed by OTC derivatives, along with the contagion effects of the vast web of uncollateralized counterparty credit risk, led many to conclude that OTC derivatives should be centrally cleared.

A fundamental premise of the Dodd-Frank Act is that the use of properly functioning central clearing can reduce systemic risk. Congress included the statutory clearing requirement in the Dodd-Frank amendments to the CEA to standardize and reduce counterparty risk associated with swaps, and, in turn, mitigate the potential systemic impact of such risks and reduce the likelihood for swaps to cause or exacerbate instability in the financial system. The clearing requirement determinations and regulations contained in this adopting release identify certain classes

of swaps that are required to be cleared pursuant to the Dodd-Frank Act's¹⁷⁹ clearing requirement incorporated within amended section 2(h)(1)(A) of the CEA.¹⁸⁰

The Commission's regulations establishing the process for the review of swaps that are submitted for a mandatory clearing determination are found in Part 39 of the Commission's regulations. Regulation 39.5 provides an outline for the Commission's review of swaps for required clearing.¹⁸¹ Regulation 39.5 requires the Commission to review all swaps submitted by DCOs or those swaps that the Commission opts to review on its own initiative.¹⁸² Under section 2(h)(2)(D) of the CEA, in reviewing swaps for required clearing, the Commission must take into account the following factors: (1) Significant outstanding notional exposures, trading liquidity and adequate pricing data, (2) the availability of rule framework, capacity, operational expertise and credit support infrastructure, (3) the effect on the mitigation of systemic risk, (4) the effect on competition and (5) the existence of reasonable legal certainty in the event of the insolvency of the DCO or one or more of its clearing members.¹⁸³ Regulation 39.5 also directs DCOs to provide to the Commission other information, such as product specifications, participant eligibility standards, pricing sources, risk management procedures, a description of the manner in which the DCO has provided notice of the submission to its members and any additional information requested by the Commission. This information is designed to assist the Commission in identifying those swaps that are required to be cleared.

On February 1, 2012, Commission staff sent a letter requesting that registered DCOs submit all swaps that they were accepting for clearing as of that date, pursuant to § 39.5 of the Commission's regulations. The Commission received submissions relating to CDS and interest rate swaps,

as well as agricultural and energy swaps.

This initial Commission determination addresses certain interest rate swaps and CDS, and is the first of a series of determinations that the Commission anticipates making as part of a phased approach to implementing mandatory clearing. The Commission chose to issue its first clearing requirement proposal for interest rate swaps and CDS because those swaps represent a significant share of the market in the case of interest rate swaps, and pose a unique risk profile in the case of CDS. In addition, the market has been clearing both types of swaps for some time, and market participants asked that the Commission begin with interest rate swaps and CDS. The Commission intends subsequently to consider other swaps submitted by DCOs, such as agricultural, energy, and equity indices.

As stated in both the NPRM and above, the decision to initially focus on CDS and interest rate swaps from amongst the swaps submitted to the Commission for mandatory clearing determinations pursuant to section 2(h)(2) is a function of both the market importance of these swaps and the fact that they already are widely cleared. In order to move the largest number of swaps to required clearing in its initial determinations, the Commission believes that it is prudent to focus on those swaps that have the highest market shares and market impact. Further, for these swaps there is already a blueprint for clearing and appropriate risk management. CDS and interest rate swaps fit these considerations and therefore are well suited for required clearing consideration.¹⁸⁴ In the discussion that follows, the importance of central clearing is explained and highlighted to provide the background for the Commission's consideration of the costs and benefits in this rulemaking as the Commission exercises its discretion under section 2(h)(2)(D) of the CEA to determine whether swaps that are submitted for a mandatory clearing determination are required to be cleared.

B. Overview of Swap Clearing

The following background discussion provides context for the Commission's consideration of the costs and benefits of its clearing determinations in this rulemaking.

¹⁷⁶ See <http://www.treasury.gov/press-center/press-releases/Documents/11-16-2012%20FX%20Swaps%20Determination%20pdf.pdf> (finalizing Determinations of Foreign Exchange Swaps and Forwards, 75 FR 66829 (Oct. 28, 2010)).

¹⁷⁷ Clearing Exemption for Swaps Between Certain Affiliated Entities, 77 FR 50425 (Aug. 21, 2012).

¹⁷⁸ 77 FR 47170 (Aug. 7, 2012). See also Section I.B above.

¹⁷⁹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

¹⁸⁰ This section states: "It shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a derivatives clearing organization that is registered under this Act or a derivatives clearing organization that is exempt from registration under this Act if the swap is required to be cleared."

¹⁸¹ 76 FR 44464 (July 26, 2011).

¹⁸² See § 39.5(b), § 39.5(c). Under section 2(h)(2)(B)(ii) of the CEA, "[a]ny swap or group, category, type, or class of swaps listed for clearing by a [DCO] as of the date of enactment shall be considered submitted to the Commission."

¹⁸³ Section 2(h)(2)(D) of the CEA and § 39.5(b)(ii).

i. How Clearing Reduces Risk

When a bilateral swap is cleared, the clearinghouse becomes the counterparty to each of the original counterparties to the swap. This standardizes counterparty credit risk for the original swap participants in that they each bear the same risk—*i.e.*, the risk attributable to facing the clearinghouse as counterparty. In addition, clearing mitigates counterparty risk to the extent that the clearinghouse is a more creditworthy counterparty relative to the original swap participants.

Clearinghouses have demonstrated resilience in the face of past market stress. Most recently, they remained financially sound and effectively settled positions in the midst of turbulent events in 2007–2008 that threatened the financial health and stability of many other types of entities.

Given the variety of effective clearinghouse tools to monitor and manage counterparty credit risk, the Commission believes that DCOs will continue to be some of the most creditworthy counterparties in the swap markets. These tools include the contractual right to: (1) Collect initial and variation margin associated with outstanding swap positions; (2) mark positions to market regularly (usually one or more times per day) and issue margin calls whenever the margin in a customer's account has dropped below predetermined levels set by the DCO; (3) adjust the amount of margin that is required to be held against swap positions in light of changing market circumstances, such as increased volatility in the underlying; and (4) close out the swap positions of a customer that does not meet margin calls within a specified period of time.

Moreover, in the event that a clearing member defaults on their obligations to the DCO, the latter has a number of remedies to manage associated risks, including transferring the swap positions of the defaulted member, and covering any losses that may have accrued with the defaulting member's margin and other collateral on deposit. In order to transfer the swap positions of a defaulting member and manage the risk of those positions while doing so, the DCO has the ability to: (1) Hedge the portfolio of positions of the defaulting member to limit future losses; (2) partition the portfolio into smaller pieces; (3) auction off the pieces of the portfolio, together with their corresponding hedges, to other members of the DCO; and (4) allocate any remaining positions to members of the DCO. In order to cover the losses associated with such a default, the DCO

would typically draw from (in order):

(1) The initial margin posted by the defaulting member; (2) the guaranty fund contribution of the defaulting member; (3) the DCO's own capital contribution; (4) the guaranty fund contribution of non-defaulting members; and (5) an assessment on the non-defaulting members. These mutualized risk mitigation capabilities are largely unique to clearinghouses, and help to ensure that they remain solvent and creditworthy swap counterparties even when dealing with defaults by their members or other challenging market circumstances.

ii. Movement of Swaps Into Clearing

There is significant evidence that some parts of the OTC swap markets (the interest rate swaps and CDS markets in particular) have been migrating into clearing over the last number of years in response to market incentives as well as in anticipation of the Dodd-Frank Act's clearing requirement. LCH data, for example, shows that the outstanding volume of interest rate swaps cleared by LCH has grown steadily since at least November 2007, as has the monthly registration of new trade sides.¹⁸⁵ Data provided to the Commission shows that the notional amount of cleared interest rate swaps is approximately \$72 trillion as of January 2007, and just over \$236 trillion in September 2010, an increase of 228% in three and a half years.¹⁸⁶ Together, those facts indicate increased demand for LCH clearing services related to interest rate swaps, a portion of which preceded the Dodd-Frank Act.¹⁸⁷ Data available through CME and TriOptima indicate similar patterns of growing demand for interest rate swap clearing services, although their publically available data does not provide a picture of demand prior to the passage of the Dodd-Frank Act.¹⁸⁸

¹⁸⁵ As a measure of volume, LCH accounts for each swap it clears as one trade side, which represents one counterparty to each two-sided trade.

¹⁸⁶ Data provided to the Commission by LCH. In the context of interest rate swaps, the notional amount refers to the specified amount on which the exchanged swap payments are calculated. It is a nominal amount that is not exchanged between counterparties.

¹⁸⁷ See <http://www.lchclearnet.com/swaps/volumes/>. Since the Dodd-Frank Act was passed in July 2010, outstanding trade sides at LCH have increased from approximately 1.6 million to 2.3 million in September of 2012, an increase of approximately 44%. Indeed, the number of new trade sides being submitted for clearing per month increased from approximately 55,000 trade sides per month to 150,000 trade sides per month, an increase of approximately 270%.

¹⁸⁸ See <http://www.cmegroup.com/trading/interest-rates/cleared-otc/index.html#data> and [http://www.trioptima.com/repository/historical-](http://www.trioptima.com/repository/historical-reports.html)

In addition to interest rate swap clearing, major CDS market participants are clearing their CDS indices and single names in significant volumes. As explained above, in 2008, prior to the enactment of the Dodd-Frank Act, the Federal Reserve Bank of New York (FRBNY) began encouraging market participants to establish a central counterparty to clear CDS.¹⁸⁹ In the past four years CDS clearing has grown significantly. As a representation of this growth, CME now has initial margin for CDS in excess of \$1.8 billion and a guaranty fund of approximately \$629 million,¹⁹⁰ and ICE Clear Credit has initial margin on deposit for CDS of \$10.8 billion and a guaranty fund equal to \$4.4 billion.¹⁹¹ ICE Clear Europe has initial margin for CDS totaling \$6.8 billion and a guaranty fund of \$2.7 billion.¹⁹²

iii. The Clearing Requirement and Role of the Commission

In the Dodd-Frank Act, Congress directed that clearing shift from a voluntary practice to a mandatory practice for certain swaps and gave the Commission responsibility for determining which swaps would be required to be cleared. Under section 2(h)(2) of the CEA, the Commission is required to review each swap, or group, category, type, or class of swaps that a DCO clears and submits to the Commission in order to determine whether the submitted swaps are required to be cleared. In making these clearing determinations and promulgating the final rules, the Commission has taken its direction from the statutory text and is implementing the statute by determining, in accordance with the five factors set forth in the statute, whether swaps submitted to the Commission for a mandatory

reports.html. Notably, CME launched its interest rate swap clearing service in the fall of 2010, after the Dodd-Frank Act was passed.

¹⁸⁹ See Federal Reserve Bank of New York, Press Release, "New York Fed Welcomes Further Industry Commitments on Over-the-Counter Derivatives," Oct. 31, 2008, available at <http://www.newyorkfed.org/newsevents/news/markets/2008/an081031.html>, which references documents prepared by market participants describing the importance of clearing. See also Ciara Linnane and Karen Brettell, "NY Federal Reserve pushes for central CDS counterparty," Reuters, Oct. 6, 2008.

¹⁹⁰ See <http://www.cmegroup.com/clearing/cme-clearing-overview/safeguards.html> for data regarding CME's guaranty fund, posted as of May 10, 2012.

¹⁹¹ See https://www.theice.com/clear_credit.jhtml for data on the size of guaranty fund, posted as of May 10, 2012.

¹⁹² *Id.* The data is not adequate to enable the Commission to determine how much of the movement into clearing is attributable to natural market forces or anticipated requirements under the Dodd-Frank Act.

clearing determination are required to be cleared. As described above, the Commission has decided to initially focus on interest rate swaps and CDS because of the market importance of these swaps and the fact that they already are widely cleared.

In determining pursuant to section 2(h)(2)(D) whether these particular swaps should be required to be cleared, the Commission has taken into account the fact that voluntary clearing of swaps has increased over the past years (perhaps due in part to anticipation of the clearing requirement to be imposed under the Dodd-Frank Act, but perhaps due in part to a realization of the benefits of clearing after the financial crisis). These industry efforts and the extent to which voluntary clearing of swaps has already occurred provide a useful reference point for the Commission's consideration of the costs and benefits of its actions in determining whether particular swaps should be required to be cleared.¹⁹³

In the discussion that follows, the Commission summarizes and evaluates the costs and benefits of the new clearing requirements resulting from the Commission's clearing determinations in this rulemaking. In the context of this relevant statutory provision and ongoing industry initiatives, in the sections that follow, the Commission also has considered its clearing determinations in light of cost-benefit issues raised by commenters and suggested alternatives.

In general, the Commission believes that the costs and benefits related to the required clearing of the classes of interest rate swaps and CDS resulting from this rulemaking are attributable, in part to (1) Congress's stated goal of reducing systemic risk by, among other things, requiring clearing of swaps and the statutory clearing mandate in section 2(h) of the CEA to achieve that objective; and (2) the Commission's determination under section 2(h)(2)(D) that these particular classes of swaps should be required to be cleared. The

¹⁹³ The Commission also recognizes that there might not be a linear relationship between the quantity of swaps that are cleared (whether measured by number of swaps, the notional value of swaps, or some other measure of swap quantity, such as the exposure resulting from the swaps) and the costs and benefits resulting from clearing. For example, if the Commission were to assume that the rule would result in a doubling of the quantity of a certain type of swap that is cleared, it would not necessarily be the case that the costs and benefits of clearing that type of swap would double. Rather, the relationship could be non-linear for a variety of reasons (such as variations among the users of that type of swap). In fact, it may be reasonable to assume that where the costs of clearing are relatively low and the benefits are relatively high, market participants already voluntarily clear swaps even in the absence of a clearing requirement.

Commission will discuss the costs and benefits of the overall move from voluntary clearing to required clearing for the particular swaps subject to this new clearing requirement.¹⁹⁴ However, in so doing, the Commission believes that it is not readily ascertainable whether an increased use of clearing following such determinations should be attributed to statutory or regulatory requirements that particular swaps be required to be cleared, as compared to swap market participants' market-based decisions to increase the use clearing to reduce risks and costs.¹⁹⁵

C. Consideration of the Costs and Benefits of the Commission's Action

i. CEA Section 15(a)

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following 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. Accordingly, the Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors.

As stated above, the Commission received a total of 33 comment letters following the publication of the NPRM, many of which strongly supported the proposed regulations. Some commenters generally addressed the cost-and-benefit aspect of the current rule; none of them, however, provided any quantitative data in response to the Commission's requests for comment. In the sections that follow the Commission considers: (1) Costs and benefits of required

¹⁹⁴ Embedded in this approach is the assumption that costs and benefits of increased clearing prior to the determination is not a function of the Dodd-Frank Act or the clearing determination contained herein. As stated above, the Commission acknowledges that some increases in clearing that have already occurred are likely the result of anticipated clearing requirements. However, it is not possible to estimate how much of the increases in clearing are the result market forces, and how much is a function of expected requirements related to clearing. Both factors have likely contributed to the increases in clearing that have occurred prior to this rule.

¹⁹⁵ It is also possible that some market participants would respond to the current rule's requirement that certain types of swaps be cleared by decreasing their use of such swaps. This possibility contributes to the uncertainty regarding how the current rule will affect the volume of swaps that are cleared.

clearing for the classes of swaps identified in this adopting release; (2) alternatives contemplated by the Commission and the costs and benefits relative to the approach adopted herein; (3) the impact of required clearing for swaps under the identified classes of swaps in light of the 15(a) factors. The Commission also discusses the corresponding comments accordingly.

ii. Costs and Benefits of Required Clearing Under the Final Rule

In order to comply with required clearing under this adopting release, market participants are likely to face certain startup and ongoing costs relating to technology and infrastructure, new or updated legal agreements, ongoing fees from service providers, and costs related to collateralization of their positions. The per-entity costs related to changes in technology, infrastructure, and legal agreements are likely to vary widely, depending on each market participant's existing technology infrastructure, legal agreements, operations, and anticipated needs in each of these areas. For market participants that already use clearing services, some of these costs may be expected to be lower, while the opposite will likely be true for market participants that must begin to use clearing services only because of the new clearing requirement. The costs of collateralization, on the other hand, are likely to vary depending on a number of factors, including whether an entity is subject to capital requirements or not, and the differential between the cost of capital for the assets the entity uses as collateral, and the returns the entity realizes on those assets.

There are also significant benefits associated with increased clearing, including reducing and standardizing counterparty credit risk, increased transparency, and easier access to the swap markets. These effects together will contribute significantly to the stability and efficiency of the financial system. The Commission lacks data to quantify these benefits with any degree of precision. The Commission notes, however, that the extraordinary financial system turbulence of 2008 has had profound and long-lasting adverse effects on the economy, and therefore reducing systemic risk provides significant, if unquantifiable, benefits.¹⁹⁶ Also, as is the case for the

¹⁹⁶ For example, the PEW Economic Policy Group estimates total costs of the acute stage of the crisis for U.S. interests were approximately \$12.04 trillion, including lost GDP, wages, real estate wealth, equity wealth, and fiscal costs. Their estimates include \$7.4 trillion in losses in the

costs related to clearing, these benefits would be relatively less to the extent that market participants are already using clearing in the absence of a requirement.

a. Technology, Infrastructure, and Legal Costs

With respect to technology and infrastructure, for market participants that already use swap clearing services or trade futures, many of the backend requirements for technology and infrastructure that supports cleared swaps are likely to be quite similar, and therefore necessary changes to those systems are likely to require relatively lower costs. Market participants that are not currently using swap clearing services or trade futures, however, may need to implement appropriate infrastructure and technology to connect with an FCM that will clear swaps on their behalf.

Similarly for legal fees, the costs related to clearing the swaps that are subject to this clearing requirement are likely to vary widely depending on whether market participants already use clearing services or trade futures. For those market participants that have not already engaged an FCM, it has been estimated, in response to another rulemaking, that smaller financial institutions will spend between \$2,500 and \$25,000 reviewing and negotiating legal agreements when establishing a new business relationship with an FCM.¹⁹⁷ Commenters on this rulemaking did not provide data that would enable the Commission to determine to what degree these estimates would apply to larger entities establishing a relationship with an FCM or to determine costs associated with

equity markets between June 2008 and March 2009, but do not include subsequent gains in equity markets that restored markets to their mid-2008 levels by the end of 2009. In addition, their calculations do not include continued declines in real estate markets subsequent to March 2009. See Pew Economic Policy Group, "The Cost of the Financial Crisis: The Impact of the September 2008 Economic Collapse," March 2010. The IMF estimated that the cost to the banking sector of the financial crisis through 2010 was approximately \$2.2 trillion and reported a range of estimates for total cost to the taxpayer of GSE bailouts that ranged from \$160 billion (Office of Management and Budget, February 2010) to \$500 billion (Barclays Capital, December 2009). See IMF, "Global Financial Stability Report: Responding to the Financial Crisis and Measuring Systemic Risks," October 2010. Both studies acknowledge that the estimates are subject to uncertainties.

¹⁹⁷ See comments to End-User Exception to Mandatory Clearing of Swaps; Proposed Rule, 75 FR 80747 (Dec. 23, 2011), including Chatham Financial letter at 2, available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58077>, and Webster Bank letter at 3, available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58076>.

entities that already have established relationships with one or more FCMs, but need to revise those agreements.¹⁹⁸ Even accepting the data provided for smaller financial institutions, the Commission lacks sufficient data to calculate a reasonable estimate of the potential costs that are likely to depend significantly on the specific business needs of each entity and therefore are expected to vary widely among market participants.

Citadel commented that the fact that all the interest rate swaps and CDS included in the Commission's proposal are already being cleared by registered DCOs in material volumes provides clear evidence that there is the rule framework, capacity, operational expertise and resources, and credit support infrastructure necessary to clear each of the swaps that are the subject of the Commission's determination.

SIFMA AMG and Vanguard expressed concern about legal documentation and negotiations taking many months, and recommended the clearing requirement be delayed. They also raised doubt about the readiness of market participants to comply with the Commission's upcoming swap customer segregation rules. Vanguard further stated that it has "serious reservations about the potential impact on cost, liquidity, and heightened margin risk which could result from the premature roll-out of the clearing mandate."

In light of the "lack of experience and practical know-how" related to DCO insolvency, ISDA recommended that the Commission conduct a study on insolvency. Citadel, on the other hand, stated that reasonable legal certainty exists in the event of an insolvency of a DCO or one or more DCO members with regard to the treatment of customer and swap counterparty positions, funds, and property.

Commission Response

In response to Vanguard and SIFMA AMG's concerns about legal documentation and operational readiness, the Commission has clarified that compliance with the clearing requirement will not be required for any swaps until March 11, 2013, which responds to commenters' recommendation that the clearing requirement be delayed for six months to allow for documentation. Moreover, Category 2 and Category 3 entities will have until June 10, 2013, and September

¹⁹⁸ In its letter, FIA stated that it does not collect information from its members concerning fees charged for particular services, and thus is unable to respond to the Commission's request for data regarding FCM fees. No other commenter responded to the request for information regarding legal fees.

9, 2013, respectively, to come into compliance with the new requirement.¹⁹⁹ In response to ISDA's statements regarding insolvency, as explained above, Commission staff actively participates in a number of international efforts related to clearinghouses and clearing member insolvency, as well as in coordination efforts with U.S. authorities.²⁰⁰

Additionally, the Commission is exercising the anti-evasion rulemaking authority granted to it by the Dodd-Frank Act. In terms of legal costs, market participants will be responsible for complying with the new anti-evasion requirements. Generally, rule § 50.10 states that it is unlawful for any person to knowingly or recklessly evade or participate in or facilitate an evasion of the requirements of section 2(h) of the CEA, to abuse the exception to the clearing requirement as provided under section 2(h)(7) of the CEA and Commission rules, or to abuse any exemption or exception to the requirements of section 2(h) of the CEA, including any exemption or exception as the Commission may provide by rule, regulation, or order.

This rule is expected to help ensure that would-be evaders cannot engage in conduct or activities that constitute an evasion of the requirements of section 2(h) or an abuse of any exemption or exception to such requirements. The Commission also sets forth guidance as to how it would determine if such evasion or abuse has occurred, while at the same time preserving the Commission's ability to determine, on a case-by-case basis, with consideration given to all the facts and circumstances, that other types of transactions or activities constitute an evasion or abuse under § 50.10.²⁰¹

The Commission believes that participants in the swap markets should have policies and procedures already in place to ensure that their employees, affiliates, and agents will refrain from engaging in activities, including devising transactions, for the purpose of

¹⁹⁹ See Section IV above, clarifying that compliance for Category I, II, and III Entities will apply, respectively, to swaps executed on or after March 11, 2013, June 10, 2013, and September 9, 2013.

²⁰⁰ See Section II.B above.

²⁰¹ The Commission has not adopted a "bright-line" standard for evasion in order to avoid providing a "road-map" for evasion. The Commission's discussion of § 50.10 is similar to its approach for the anti-evasion rules §§ 1.3(xxx)(6) and 1.6 that it recently adopted in a joint final rulemaking with the Securities and Exchange Commission. See Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48208, 48350–48354 (Aug. 13, 2012).

evading, or in reckless disregard of, the requirements of section 2(h) of the CEA and Commission regulations or to abuse any exemption or exception to such requirements. The Commission believes that it will not be necessary for firms that currently have adequate compliance programs to hire additional staff or significantly upgrade their systems to comply with the proposed rule. Firms may, however, incur some costs, such as costs associated with training staff on the new clearing requirement rules.

In addition, market participants may incur costs when determining whether they are properly relying on a legitimate business purpose. The Commission in choosing a principles-based approach rather than a bright-line test, recognizes that there may be direct costs and indirect costs due to perceived uncertainty related to determining what constitutes a legitimate business purpose for entering into swaps that are not subject to the clearing requirement. As stated above, the Commission will not provide a bright-line test of non-evasive or abusive conduct because such an approach may be a roadmap for engaging in evasive or abusive conduct or activities. However, the Commission has provided guidance above regarding what is meant by certain key terms in § 50.10, and the Commission has clarified its belief that where a person's principal purpose in entering into a swap that is not subject to the clearing requirement is to circumvent the costs of clearing, the legitimate business purpose test would not be satisfied. The Commission anticipates that this guidance will mitigate costs related to determining whether particular conduct or activity could be construed as being an evasion of the requirements of section 2(h) or an abuse of any exemption or exception to the requirements.²⁰²

b. Ongoing Costs Related to FCMs and Other Service Providers

In the NPRM, the Commission considered ongoing costs associated with fees charged by FCMs that market participants will bear, in addition to costs associated with technological and legal infrastructure. Regarding fees, DCOs typically charge FCMs an initial transaction fee for each of the FCM's customers' interest rate swaps that are cleared, as well as an annual maintenance fee for each of their customers' open positions. Not including customer-specific and volume discounts, the transaction fees for interest rate swaps at the CME range

from \$1 to \$24 per million notional amount for interest rate swaps and the maintenance fees are \$2 per year per million notional amount for open positions.²⁰³ LCH transaction fees for interest rate swaps range from \$1-\$20 per million notional amount, and the maintenance fee ranges from \$5-\$20 per swap per month, depending on the number of outstanding swap positions that an entity has with the clearinghouse.²⁰⁴ For CDS, ICE Clear Credit charges an initial transaction fee of \$6 per million notional amount. There is no maintenance fee charged by ICE for maintaining open CDS positions.²⁰⁵

FCMs will also bear additional fees with respect to their house accounts at the DCO to the extent that they clear more swaps due to the clearing requirement. For example, for interest rate swaps that they clear through CME, clearing members are charged a transaction fee that ranges from \$0.75 to \$18.00 per million notional, depending on the transaction maturity.²⁰⁶ Members, however, are not charged annual maintenance fees for their open house positions.²⁰⁷ For CDS, clearing members at ICE Clear Credit are charged \$5-\$6 per transaction per million notional and there is no maintenance fee.²⁰⁸

As discussed above, it is difficult to predict precisely how the requirement to clear the classes of swaps covered by this new requirement will increase the use of swap clearing, as compared to the use of clearing that would occur in the absence of the requirement. However, the Commission expects that application of the clearing requirement to the swaps covered by the new rule will generally increase the use of clearing, leading to the ongoing transaction costs noted above.

In addition, the Commission understands that FCM customers that only transact in swaps occasionally are typically required to pay a monthly or

annual fee to each FCM that ranges from \$75,000 to \$125,000 per year.²⁰⁹ Again, although it is difficult to predict precisely how many FCM customers would be subject to such fees based on the clearing requirement for CDS and interest rate swaps, the Commission expects that some market participants that previously did not use clearing would be subject to the requirements of the current rule.

In the NPRM, the Commission asked a series of questions related to FCM fees and invited comment on the fee information presented. No commenter responded to the questions asked or provided any additional information with regard to clearing fees. As noted above, FIA raised the issue only to explain that it does not collect such information from its members.

c. Costs Related to Collateralization of Cleared Swap Positions

As mentioned above, market participants that enter into swaps with the specifications identified in the classes subject to this adopting release will be required to post collateral with their FCM and/or at the DCO. The incremental cost of collateral resulting from the application of the clearing requirement depends on the extent to which such swaps are already being cleared (even in the absence of the requirement) or otherwise collateralized bilaterally. The incremental cost also depends on whether such swaps are, if not collateralized, priced to include implicit contingent liabilities and counterparty credit risk born by the counterparty to the swap.

1. Quantitative Approach Presented in the NPRM

A conservative approach would be to assume that all the swaps that are currently not cleared would be covered by the new clearing requirement, and that they are completely uncollateralized, and not priced to include implicit contingent liabilities and counterparty credit risk born by the counterparty. Under this approach, imposition of the clearing requirement for those types of swaps would create additional costs due to: (1) The difference between cost of capital and returns on that capital for assets posted to meet initial margin for the entire term of the swap; and (2) the difference

²⁰³ See CME pricing charts at: <http://www.cme.com/trading/cds/files/CDS-Fees.pdf>; <http://www.cmegroup.com/trading/interest-rates/files/CME-IRS-Customer-Fee.pdf>;

and <http://www.cmegroup.com/trading/interest-rates/files/CME-IRS-Self-Clearing-Fee.pdf>.

²⁰⁴ See LCH pricing for clearing services related to OTC interest rate swaps at: http://www.lchclearnet.com/swaps/swapclear_for_clearing_members/fees.asp.

²⁰⁵ See ICE Clear Credit fees for CDS at: https://www.theice.com/publicdocs/clear_credit/circulars/ICEClearCredit%20Fee%20Schedule%20Notice_FINAL.pdf.

²⁰⁶ See CME pricing charts.

²⁰⁷ See *id.*

²⁰⁸ See ICE Clear Credit fees for CDS at: https://www.theice.com/publicdocs/clear_credit/circulars/ICEClearCredit%20Fee%20Schedule%20Notice_FINAL.pdf.

²⁰⁹ See letters from Chatham and Webster Bank. The Commission is not aware of similar annual fees charged to larger customers. The Commission believes that FCMs are more likely to charge such fees to smaller customers in order to cover the fixed costs that are not likely covered through fees charged on a per-swap basis to customers that use swaps less frequently.

²⁰² See above at Section III.G.

between cost of capital and returns on that capital for assets paid to meet the cost of capital for variation margin to the extent a party is “out of the money” on each swap. Under the assumptions mentioned above, if every interest rate swap and CDS that is not currently cleared were moved into clearing, the additional initial margin that would need to be posted is approximately \$19.2 billion for interest rate swaps and \$53 billion for CDS.²¹⁰

In the NPRM, the Commission calculated its estimated additional initial margin amounts based on the following assumptions. According to representations made to the Commission by LCH, they clear approximately 51% of the interest rate swaps market. The total amount of initial margin on deposit at LCH for interest rate swaps is approximately \$20 billion.²¹¹ Therefore, if all remaining interest rate swaps were moved into clearing, approximately \$19.2 billion (\$20B/0.51 – \$20B = 19.2B) would have to be posted in initial margin.

Similarly, the initial margin related to CDS currently on deposit at CME, ICE Clear Credit, and ICE Clear Europe is approximately \$21.4 billion.²¹² This amount includes initial margin based on both index-based CDS and single-name CDS positions. BIS data indicates that approximately 36.6% of the CDS market comprises index-based CDS.²¹³ In the NPRM, the Commission noted that if it is assumed that approximately 36.6% of the overall portfolio-based CDS margin (*i.e.*, CDS indices and single-name CDS margined together) currently held by DCOs for CDS positions is related to index-based CDS, and then add any

margin held by DCOs attributable solely to index-based CDS, it can be estimated that approximately \$9.0 billion in margin currently held by those DCOs is related to index-based CDS. ISDA data indicates that 14.5% of the index-based CDS market is currently cleared.²¹⁴ Therefore, the Commission noted in the NPRM that if the entire index-based CDS market moved into clearing, \$53 billion (\$9.0B/0.145 – \$9.0 = \$53B) in initial margin would have to be posted at DCOs.

Both of the above estimates assume that additional interest rate swaps brought into clearing would have similar margin requirements per unit of notional amount to those interest rate swaps that are already in clearing, and assumes that additional CDS brought into clearing would have similar margin requirements per unit of notional amount to those CDS that are already being cleared. These assumptions, in turn, assume similar levels of liquidity, compression, netting, and similar tenors for the swaps that are currently cleared and those that are not. While the Commission recognizes that these factors are unlikely to be identical among both groups of products, adequate information to quantify the impact of each of these possible differences between the two groups of swaps on the amount of additional collateral that would have to be posted is not available.

In any case, the Commission noted that it is probable that the estimates in the NPRM significantly overstate the amount of additional capital that would be posted for a number of reasons described below. First, these estimates are based upon the assumption that every interest rate swap and index-based CDS not currently cleared is brought into clearing as a result of the Commission’s determinations herein. However, in this adopting release the Commission has set forth clearing requirements only for certain classes of interest rate swaps and CDS, and not for

all interest rate swaps and CDS. Therefore, there will still be certain types of interest rate swaps, such as those related to the thirteen additional currencies cleared by LCH, that are not required to be cleared. Moreover, the clearing requirement will apply only to new swap transactions²¹⁵ whereas market estimates include legacy transactions. In addition, these estimates assume that no additional voluntary clearing would be taking place in the absence of the Commission’s determinations. The Commission also observes that, to the extent that portfolio margining for products such as CDS is expanded to all market participants, it is likely to reduce the additional margin that is required. In some instances, these margin reductions for well-balanced portfolios could be significant.

In addition, non-financial entities entering into swaps for the purpose of hedging or mitigating commercial risk are not required to use clearing under section 2(h)(7) of the CEA. As a consequence, many entities will not be required to clear, even when entering into interest rate swaps or CDS that are otherwise required to be cleared. Third, some interest rate swaps and CDS involve cross border transactions to which the Commission’s clearing requirement will not apply.²¹⁶ Fourth, collateral is already posted with respect to many non-cleared interest rate swaps and CDS. ISDA conducted a recent survey which reported that 93.4% of all trades involving credit derivatives, and 78.1% of all trades involving fixed income derivatives are subject to collateral agreements.²¹⁷ Moreover, although the Commission cannot verify the accuracy of the estimate, ISDA estimated that the aggregate amount of collateral in circulation in the non-cleared OTC derivatives market at the end of 2011 was approximately \$3.6 trillion.²¹⁸

²¹⁰ The numbers calculated above may either over-estimate or under-estimate the amount of additional initial margin that would need to be posted under the conservative assumptions stated above. For instance, differences in the amount of netting that is possible within portfolios currently being cleared versus those not currently being cleared could have a significant impact on the amount of additional margin that is required to be posted. Other factors such as differences in liquidity among swaps currently being cleared and those not being cleared could also impact the amount of additional margin that is posted.

²¹¹ The total amount of initial margin on deposit at CME for interest rate swaps is \$5 billion, but for purposes of this estimate, the Commission is not including that amount.

²¹² The total amount of initial margin on deposit only includes those amounts reported to the Commission by registered DCOs. Other clearinghouses, such as LCH.Clearnet.SA, clear the indices included in the proposed determination, however, the relative size of the open interest in the relevant CDS indices is substantially smaller than each of the DCOs included in this calculation.

²¹³ BIS estimates that the gross notional value of outstanding CDS contracts is \$28.6 trillion, and that \$10.5 trillion of that is index related CDS. See BIS data, available at <http://www.bis.org/statistics/otcder/dt21.pdf>.

²¹⁴ In the NPRM, the Commission noted that ISDA has estimated that 14.5% of the index-based CDS market is currently being cleared, whereas the total outstanding notional at CME, ICE Clear Europe, and ICE Credit represents approximately 7.5% of the global index-based CDS market estimated by BIS. Such a discrepancy would be expected if one or more of the following occurred: (1) If ISDA overestimated the percentage of the index-based CDS that is currently being cleared; (2) if BIS overestimated the size of the global index-based swap market; (3) if a significant amount of compression occurs as index-based CDS are moved into clearing; and/or (4) if a significant portion of the cleared index-based CDS market is held at clearinghouses other than CME, ICE Clear Europe, and ICE Clear Credit. The Commission noted in the NPRM that it believes that the compression of CDS positions moving into clearing is the most likely explanation and therefore used the ISDA estimate.

²¹⁵ As well as, applying to swaps subject to a change in ownership, as explained above in Section III.D.

²¹⁶ Cross-Border Application of Certain Swaps Provisions in the Commodity Exchange Act, 77 FR 41214 (July 12, 2012).

²¹⁷ See ISDA Margin Survey 2012, at 15, available at <http://www2.isda.org/functional-areas/research/surveys/margin-surveys/>. Although it is unclear exactly how many of the derivatives covered by this survey are swaps, it is reasonable to assume that a large part of them are.

²¹⁸ This estimate, however, does not adjust for double counting of collateral assets. The same survey reports that as much as 91.1% of cash used as collateral and 43.8% of securities used as collateral are being reused, and therefore are counted two or more times in the ISDA survey. See ISDA Margin Survey 2012, at 20 and 11, respectively.

2. Comments Received in Response to NPRM Consideration of Costs and Benefits

In the NPRM, the Commission requested comment regarding the total amount of additional collateral that would be required due to the proposed clearing requirement. In particular, the Commission sought quantifiable data and analysis.²¹⁹ No commenter addressed the quantitative approach laid out by the Commission in the NPRM. Nor did any commenter provide quantifiable data and analysis to support or refute such analysis. Citadel stated that the Commission's determination is justified on a cost-benefit basis, but did not address the costs of collateral directly. FIA noted that the NPRM's cost-benefit discussion "is among the more thoughtful and comprehensive the Commission has ever prepared," but did not address the costs of collateral, fees, or other costs.

3. Additional Research Reviewed by the Commission

Despite the lack of feedback from commenters regarding the costs of collateral, the Commission continued to research market and academic literature in the public domain for additional data. The Commission identified and obtained two relevant papers. These papers are presented as additional informative background regarding the costs of mandatory clearing. The Commission has reviewed, but has not been able to verify, the conclusions reached in these papers.

In a recent research note, Morgan Stanley estimated the global increase in initial margin for interest rate swaps trades as a result of the swap clearing requirements.²²⁰ Its "bull case" figure of \$20 billion is largely consistent with the Commission's estimate of \$19.2 billion in the NPRM calculated above, though its methodology is different. Morgan Stanley obtained this figure in several steps. First, it considered two main groups of interest rate swaps traders: dealers and buy-side investors, which Morgan Stanley believes have interest rate swaps with notional values of approximately \$339 trillion and \$89 trillion, respectively, outstanding. Next, Morgan Stanley projected that the

amount of new interest rate swaps that will be cleared as a percentage of current notional would be 10% for dealers and 80% for buy-side participants, assuming that "most of the eligible dealer-to-dealer trades are already centrally cleared." Finally, Morgan Stanley multiplied the resulting amount of new interest rate swaps that will be cleared for each group of traders by an initial margin to notional ratio that they estimated.²²¹ Currently, according to Morgan Stanley, "the aggregate dealer initial margin as a percentage of notional reported by LCH is approximately 0.0005%." For dealers, the value of 0.00005 was therefore chosen as their initial margin to notional ratio. For buy-side investors, however, Morgan Stanley scaled up LCH's benchmark ratio of 0.00005 by a growth factor of 5 to "[capture] the extent to which buy-side portfolios are less diversified than dealers and may enjoy less netting efficiencies." Overall, the report argued, dealers and buy-side participants should expect their aggregate initial margin to increase by \$2 billion ($\$339,000\text{B} \times 10\% \times 0.00005 \approx \2B) and \$18 billion ($\$89,000\text{B} \times 80\% \times 0.00005 \times 5 \approx \18B), respectively, resulting in a total estimate of \$20 billion in additional margin for the bull case scenario. By scaling up LCH's benchmark ratio by a growth factor in the range between 10–20 for each group of investors, Morgan Stanley further obtained a "base case" figure of \$480 billion and a "bear case" figure of \$1.3 trillion. The difference between the Commission's estimate and Morgan Stanley's base case figure or bear case figure can largely be attributed to the following: the Commission used LCH's current *overall* initial margin to notional ratio in its calculations, whereas Morgan Stanley used LCH's current *dealer* initial margin to notional ratio; more importantly, the Commission made the simplifying assumption that the initial margin to notional ratio will stay more or less constant, whereas Morgan Stanley scaled up its benchmark ratio by a growth factor in a range between 10–20 based on its "discussions with clearing and banking industry professionals and estimates made by [BIS]" as well as its internal estimates.²²² Putting aside the growth

factor effect, it is worth emphasizing that Morgan Stanley's estimates refer to the *global* increase in initial margin, which may potentially be much larger than the additional amount of initial margin required for those entities under the Commission's jurisdiction.

Also, the Commission notes that in Morgan Stanley's calculations, the additional collateral required for buy-side swaps represents the vast majority of the additional collateral required in each scenario (approximately 95%, 74%, and 81% of the total additional capital required for the "bull case," "base case," and "bear case," respectively). A critical assumption driving each of these calculations is that swaps with 80% of the total buy-side notional amount are moved into clearing as a result of the mandate. However, the Commission believes this assumption may be high in light of the end-user exception, which includes an exemption for small financial institutions with less than \$10 billion in assets.²²³ Adjusting this assumption downward would result in dramatic reductions in Morgan Stanley's calculations regarding the amount of additional collateral that may be required as a result of the mandate.

TABB Group has also conducted a study recently that estimated the global "margin shortfall" (*i.e.*, the additional amount of initial margin that will be required) for all OTC swaps due to clearing requirements and anticipated margin requirements for uncleared swaps.²²⁴ According to their model, the total amount of margin that will be required for both cleared and uncleared swaps is estimated to be between \$2.9 trillion to \$4.1 trillion, depending on the degree of netting for each type of traders. Further, they estimate that \$1.34 trillion of margin is already posted for all OTC swaps, leaving an additional \$1.56–2.76 trillion in margin that would need to be posted for all swaps, including both cleared and uncleared positions. The table below summarizes TABB Group's margin estimates by trader type.

higher CCP collateral requirements and counterparty diversification regulations."

²²³ See End User Exception to the Clearing Requirement for Swaps, 77 FR 42560 (July 19, 2012).

²²⁴ See TABB Group, "The New Global Risk Transfer Market: Transformation and the Status Quo," (Sept. 2012).

²¹⁹ 77 FR at 47214.

²²⁰ See Morgan Stanley, Morgan Stanley Research, "Swap Central Clearing: What is the Impact on Collateral?" (August 2012).

²²¹ This ratio is the initial margin divided by the notional outstanding.

²²² In particular, Morgan Stanley assumed that "dealer [initial margin] may grow over time due to

TABLE 6—MARGIN ESTIMATES BY TRADER TYPE IN BILLIONS OF U.S. DOLLARS²²⁵

Trader type	Gross notional	Gross margin (1.5% of notional)	Estimated netting benefit	Estimated margin posted
Dealers with CCP	248,561	3,728	3,710 (99.5%)	19
Other Dealers	305,624	4,584	1,605–2,521 (35–55%)	2,063–2,980
Financial Institutions	59,964	899	225–405 (25–45%)	495–675
Non-Financial End Users	33,851	508	76–178 (15–35%)	330–432
Others	60,000			
Total				2,906–4,105

As shown in the table, if the amount for non-financial end-users is excluded, then the margin shortfall will be adjusted down to \$1.23–2.33 trillion. Like the Commission, the TABB Group considered all the OTC swaps, some of which are not covered by the clearing requirement.

The TABB Group estimates are considerably higher than those of the Commission and of Morgan Stanley largely because of different estimates about what amount of netting will be possible for swaps not currently being cleared, and in particular, for the swaps between dealers that do not involve a CCP.

4. Collateral Costs and Costs of Capital

Given the increased collateral demands that required clearing of interest rate swaps and CDS is likely to bring, there will be corresponding demand for capital. To calculate the additional collateral cost to market participants, the Commission in the NPRM estimated the difference between the cost of capital for the additional collateral and the returns on that capital. Although no comments discussed this issue in comments on the NPRM, the Commission notes that in comments regarding other Commission rules, commenters have sometimes taken the view that the difference between the cost and returns on capital for funds that are used as collateral is substantial.

The Commission described a comment on behalf of the Working Group of Commercial Energy Firms in the NPRM. In this comment, an economic consulting firm, NERA, used an estimate of 13.08% for the pre-tax weighted average cost of capital for the firm, and an estimate of 3.49% for the pre-tax yield on collateral, for a difference as 9.59% which NERA used as the net pre-tax cost of collateral.²²⁶

²²⁵ *Id.*

²²⁶ The NERA study is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=50037> and their comments defending their cost of capital are available in their

However, as noted in the NPRM, these estimates use the borrowing costs for the entire firm, but only consider the returns on capital for one part of the firm, when determining the spread between the two.²²⁷ The result is an over-stated difference, and therefore a higher cost associated with collateral than would result if the costs of capital and returns of capital were compared on a consistent basis.²²⁸

However, as the Commission noted in the NPRM, this cost is not only likely overstated, for the reasons mentioned above, but it also may not be a new cost. Rather, it is a displacement of a cost that is embedded in uncleared, uncollateralized (or under-collateralized) swaps. Entering into a swap is costly for any market participant because of the default risk posed by its counterparty, whether the counterparty is a DCO, swap dealer, or other market participant. When a market participant faces the DCO, the DCO accounts for that counterparty risk by requiring collateral to be posted, and the cost of capital for the collateral is part of the cost that is necessary in order to maintain the swap position. When a market participant faces a dealer or other counterparty in an uncleared swap, however, the uncleared swap contains an implicit line of credit upon which the market participant effectively draws when its swap position is out of the money. Counterparties charge for this implicit line of credit in the spread they offer on uncollateralized, uncleared swaps. It can be shown that the cash

flows of an uncollateralized swap (*i.e.*, a swap with an implicit line of credit) are, over time, substantially equivalent to the cash flows of a collateralized swap with an explicit line of credit.²²⁹ Moreover, because the counterparty credit risk created by the implicit line of credit is the same as the counterparty risk that would result from an explicit line of credit provided to the same market participant, to a first order approximation, the charge for each should be the same as well.²³⁰ This means that the cost of capital for additional collateral posted as a consequence of requiring uncollateralized swaps to be cleared does not introduce an additional cost, but rather takes a cost that is implicit in an uncleared, uncollateralized swap and makes it explicit. This observation applies to capital costs associated with both initial margin and variation margin.

The Commission received no comment regarding the costs of collateral it presented in the NPRM.

5. Regulatory Capital Implications

Another potential impact of the new clearing requirement that the Commission described in the NPRM may result from the fact that financial institutions are required to hold additional capital with respect to their swap positions pursuant to prudential regulatory capital requirements. Basel III standards are designed to incentivize central clearing of derivatives by applying a lower capital weighting to

letter at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=57015>.

²²⁷ Moreover, according to Morgan Stanley's research note cited above, many dealers and buy-side investors currently hold enough unencumbered collateral to meet at least part of the incremental initial margin requirements. In other words, each of these entities will need to raise only a portion of the additional capital required.

²²⁸ This aspect of the NERA study has been described in greater detail by MIT professors John Parsons and Antonio Mello, available at <http://bettingthebusiness.com/2012/01/22/phantom-costs-to-the-swap-dealer-designation-and-otc-reform/> and <http://bettingthebusiness.com/2012/03/19/nera-doubles-down/>.

²²⁹ Antonio S. Mello, and John E. Parsons, "Margins, Liquidity, and the Cost of Hedging," MIT Center for Energy and Environmental Policy Research, May 2012.

²³⁰ See *id.* at 12; Mello and Parsons state in their paper, "Hedging is costly. But the real source of the cost is not the margin posted, but the underlying credit risk that motivates counterparties to demand that margin be posted." The paper goes on to demonstrate that, "To a first approximation, the cost charged for the non-margined swap must be equal to the cost of funding the margin account. This follows from the fact that the non-margined swap just includes funding of the margin account as an embedded feature of the package." *Id.* at 15–16.

them than for similar uncleared derivatives positions.²³¹ Moreover, bilateral margining regulations are currently being developed by the Commission and U.S. prudential regulators that will subject uncleared swaps entered into by swap dealers and major swap participants to increased margin requirements in the near future.²³² Therefore, the Commission expects that, all things being equal, the capital that certain financial institutions are required to hold is likely to be reduced as a consequence of their increased use of swap clearing.

The Commission received no comment regarding the regulatory capital discussion it presented in the NPRM.

6. Operational Issues Related to Collateralization

The Commission also discussed in the NPRM the operational costs that may result from the collateral requirements that apply to the clearing requirement. With uncleared swaps, the Commission noted, counterparties may agree not to collect variation margin until certain thresholds of exposure are reached, thus reducing or perhaps entirely eliminating the need to exchange variation margin as exposure changes. DCOs, on the other hand, collect and pay variation margin on a daily basis and sometimes more frequently. As a consequence, more required clearing may increase certain operational costs associated with moving variation margin to and from the DCO. On the other hand, increased clearing is also likely to lead to benefits from reduced operational costs related to valuation disputes, as parties to cleared swaps agree to abide by the DCO's valuation procedures. To the extent that the requirement to clear the types of swaps covered by the new clearing requirement leads to increased use of clearing, these costs and benefits are likely to result.

The Commission received no comment regarding the operational costs of collateral discussion it offered in the NPRM.

²³¹ See Basel Committee on Banking Supervision reforms—Basel III, available at <http://www.bis.org/bcbs/basel3/b3summarytable.pdf> (indicating that Basel III reforms will create capital incentives for banks to use central counterparties for derivatives).

²³² The Commission's proposed is Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 FR 23732 (Apr. 28, 2011); and the U.S. prudential regulators proposed a similar requirement, Margin and Capital Requirements for Covered Swap Entities, 76 FR 27564 (May 11, 2011).

7. Guaranty Fund Contribution as a Collateral Cost

As explained in the NPRM, increases in clearing as a result of the clearing requirement also may result in additional costs for clearing members in the form of guaranty fund contributions. However, the Commission noted, it may be that increased clearing of swaps would decrease guaranty fund contributions for certain clearing members. Market participants that currently transact swaps bilaterally, and do not clear such swaps, must either become clearing members of an eligible DCO or submit such swaps for clearing through an existing clearing member of an eligible DCO, once the clearing requirement applies to such swaps. A party that chooses to become a clearing member of a DCO must make a guaranty fund contribution based on the risk that its positions pose to the DCO. A party that chooses to clear swaps through an existing clearing member may have a share of the clearing member's guaranty fund contribution passed along to it in the form of fees. While the addition of new clearing members and new customers for existing clearing members may result in existing clearing members experiencing an increase in their guaranty fund requirements, it should be noted that if (1) new clearing members are not among the two clearing members used to calculate the guaranty fund and (2) any new customers trading through a clearing member do not increase the size of uncollateralized risks at either of the two clearing members used to calculate the guaranty fund, all else held constant, existing clearing members may experience a decrease in their guaranty fund requirement.

The Commission received no comment regarding the guaranty fund costs discussion it presented in the NPRM.

d. Benefits of Clearing

In the NPRM, the Commission also described the benefits of swap clearing, which in general, are significant. Thus, to the extent that the new clearing requirement for certain classes of interest rate swaps and CDS leads to increased use of clearing, these benefits are likely to result. As is the case for the costs noted above, it is difficult to predict the precise extent to which the use of clearing will increase as a result of the new requirement, and therefore the benefits of the requirement cannot be precisely quantified. But the Commission believes that the benefits of increased clearing resulting from this requirement will be significant, because

the classes of swaps required to be cleared represent a substantial portion of the total swap markets.

Currently outstanding interest rate swaps and CDS indices represent about 77.8% and 1.6%, respectively, of the total global swaps market, when measured by notional amount.²³³ As noted above, the new clearing requirement requires that only certain classes of interest rate swaps and CDS indices be cleared, but such classes likely represent the most common swaps within those overall asset classes, and therefore are likely to comprise a relatively large portion of those asset classes. The Commission reiterates the conclusion stated in the NPRM, which is that by requiring these particular swaps to be cleared, the benefits of clearing are expected to be realized across a relatively large portion of the market.

The new clearing requirement that swaps within certain classes be cleared is expected to increase the number of swaps in which market participants will face a DCO, and therefore, will face a highly creditworthy counterparty. DCOs are some of the most creditworthy counterparties in the swap market because, as explained above, they have at their disposal a number of risk management tools that enable them to manage counterparty risk effectively. Those tools include contractual rights that enable them to use margin to manage current and potential future exposure, to close out and transfer defaulting positions while minimizing losses that result from such defaults, and to protect solvency during the default of one or more members through a waterfall of financial resources from which they can draw, as outlined above. Also, clearing protects swap customers from the risk of having to share losses in the event of the default of another clearing member.

Under § 50.2(a) of this adopting release, swaps meeting the specifications of the classes of swaps that are required to be cleared must be submitted to clearing "as soon as technologically practicable after execution, but in any event by the end of the day of execution."²³⁴ This conforms to the requirements established in the recently finalized rule

²³³ BIS data, December 2011, available at <http://www.bis.org/statistics/derstats.htm>. As explained above, the Commission observes that while CDS accounts for a smaller portion of the total swaps market, its unique risk profile involving jump-to-default risk contributed to the Commission's decision to include it in among the first clearing determinations.

²³⁴ See § 50.2(a) (setting for the timeframe for submission of swaps to DCOs).

regarding timing of acceptance for clearing,²³⁵ which is designed to promote rapid submission of these swaps for clearing and reduce the unnecessary counterparty risk that can develop between the time of execution and submission to clearing.²³⁶

As it noted in the NPRM, the Commission expects that the requirement for rapid submission, processing, and acceptance or rejection of swaps for clearing will be beneficial in several respects. It is important to note that when two parties enter into a bilateral swap with the intention of clearing it, each party bears counterparty risk until the swap is cleared. Once the swap is cleared, the clearinghouse becomes the counterparty to each of the original parties, which minimizes and standardizes counterparty risk.

Where swaps of the type covered by the new clearing requirement are not executed on an exchange, the requirements of § 50.2(a) should significantly reduce the amount of time needed to process them. Although costs associated with latency-period counterparty credit risk cannot be completely eliminated in this context, the rules will reduce the need to discriminate among potential counterparties in executing off-exchange swaps, as well as the potential costs associated with swaps that are rejected from clearing. By reducing the counterparty risk that could otherwise develop during the latency period, these rules promote a market in which all eligible market participants have access to counterparties willing to trade on terms that approximate the best available terms in the market. This is likely to improve price discovery and promote market integrity.

Another benefit of the new clearing requirement is the mitigation of systemic risk. Counterparty risk readily develops into systemic risk in an interconnected financial system especially in times of financial stress due to various types of contagion effects.²³⁷ By ensuring that outstanding

potential future and current exposures are collateralized in a timely fashion for more swaps, this new clearing requirement contributes to the mitigation of systemic risk.

The Commission's consideration of the effect on the mitigation of systemic risk is generally supported by comments, which provided general observations regarding the mitigation of systemic risk. Citadel and Eris Exchange both stated that implementing the clearing requirement is a significant milestone toward "achieving the Dodd-Frank Act's objectives of reducing interconnectedness, mitigating systemic risk, increasing transparency, and promoting competition in the swaps market." Freddie Mac commented that it "supports the Commission's goal to reduce systemic risk through central clearing of swaps where appropriate." On the other hand, ISDA urged the Commission to consider the argument that "clearing involves a greater centralization of risk than the over-the-counter markets ever did." ISDA also questioned the risk-mitigating aspects of central clearing as contrasted with the new regulatory regime for uncleared swaps. In response to ISDA's comment, the Commission observes that while the regime for bilateral, uncleared swaps will be greatly improved after full implementation of the Dodd-Frank Act reforms, central clearing provides for certain risk management features that cannot be replicated on a bilateral basis. To name just one critical distinction, a clearinghouse addresses the tail risk of open positions through mutualization. Each clearing member must contribute to a default fund that protects the system as a whole. Also, recent experience indicates that all DCOs were able to withstand the 2008 financial crisis in a relatively sound manner.²³⁸

Regarding competition, Markit stated that the new clearing requirement might lower barriers to entry in the index provider market "because new indices would not necessarily be subject to the clearing mandate, which can be costly." Citadel commented that the framework established by the Commission

promotes competition among swap dealers, as "counterparty credit risk no longer features as a consideration in the selection of executive counterparties."

In addition, § 50.10 and related guidance provides market participants with a useful framework for behavior under the requirements of section 2(h), which will promote the benefits of swap clearing without introducing uncertainty regarding market behavior. Activity conducted principally for a legitimate business purpose, absent other indicia of evasion or abuse, would not constitute a violation of § 50.10 as described in the Commission's interpretation.

D. Consideration of Alternative Swap Classes for Clearing Determinations

The Commission's determination to require initially the clearing of certain CDS and interest rate swaps is a function of both the market importance of these products and the fact that they already are widely cleared. In order to move the largest number of swaps to required clearing in its initial determination, the Commission continues to believe that it is prudent to focus on swaps that are widely used and for which there is already a blueprint for clearing and appropriate risk management. CDS and interest rate swaps that match these factors are therefore well suited for required clearing.

As noted in the NPRM and discussed above, interest rate swaps with a notional amount of \$504 trillion are currently outstanding—the highest proportion of the \$648 trillion global swaps market of any class of swaps.²³⁹ CDS indices with a notional amount of about \$10.4 trillion are currently outstanding.²⁴⁰ While CDS indices do not have as prominent a share of the entire swaps market as interest rate swaps, uncleared CDS is capable of having a sizeable market impact, as it did during the 2008 financial crisis. In addition, many of the swaps within each of the classes that will now be subject to required clearing are already cleared by one or more clearinghouses. LCH claims to clear interest rate swaps with a notional amount of about \$284 trillion—meaning that, in notional terms, LCH represents that they clear just over 50% of the interest rate swap market.²⁴¹ The swap market has made a smooth transition into clearing CDS on its own initiative. As a result, DCOs, FCMs, and many market participants

²³⁵ See Client Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 FR 21278 (Apr. 9, 2012).

²³⁶ The Commission notes that if a market participant executed a swap that is required to be cleared on a SEF or DCM, then that market participant will be deemed to have met their obligation to submit the swap to a DCO because of the straight-through processing rules previously adopted by the Commission.

²³⁷ For a comprehensive discussion of the various types of contagion effects in times of financial stress, see Brunnermeier, M., A. Crockett, C. Goodhart, A. Persaud, and H. Shin: "The Fundamental Principles of Financial Regulation," (2009), available at <http://www.princeton.edu/~markus/research/papers/Geneva11.pdf>.

²³⁸ No DCO required government assistance, and all DCOs were able to manage their open positions in both swaps and futures. Even difficult default situations were handled in an orderly fashion. For example, during the Lehman Brothers' bankruptcy in September 2008, LCH was able to manage the default of Lehman's significant swap portfolio. See 77 FR at 47188 and LCH IRS submission, at 4 (discussing LCH's management of the Lehman Brothers' bankruptcy in September 2008, where upon Lehman's default, LCH needed to risk manage a portfolio of approximately 66,000 interest rate swaps, which it hedged with approximately 100 new swap trades in less than five days and only used approximately 35% of the initial margin Lehman had posted).

²³⁹ BIS data, June 2011, available at http://www.bis.org/publ/otc_hy1111.pdf.

²⁴⁰ See *id.*

²⁴¹ See *id.*

already have experience clearing the types of swaps that will be subject to required clearing. The Commission expects, therefore, that DCOs and FCMs are equipped to handle the increases in volume and outstanding notional amount in these swaps that is likely to be cleared as the result of this rule. Because of the wide use of these swaps and their importance to the market, and because these swaps are already cleared safely, the Commission continues to believe it is reasonable to initially subject certain types of interest rate swaps and CDS to the clearing requirement.

In reviewing the swap submissions provided by DCOs, the Commission decided to classify swaps according to certain key specifications for CDS and interest rate swaps. These specifications inform whether a particular swap falls within one of the classes of swaps that the Commission has determined are required to be cleared. The two classes of CDS that are required to be cleared are (1) U.S. dollar-denominated CDS covering North America corporate credits and (2) euro-denominated CDS referencing European corporate obligations. The four classes of interest rate swaps required to be cleared are (1) fixed-to-floating swaps, (2) basis swaps, (3) OIS, and (4) FRAs. In formulating each of the six classes under this adopting release, the Commission considered a number of alternatives.

Regarding CDS, the Commission outlined three key specifications comprising (1) region and nature of reference entity, (2) the nature of the CDS itself, and (3) tenor. Each of these specifications will assist market participants in determining whether a swap falls within the CDS classes of swaps required to be cleared. For the first, a distinguishing characteristic is whether the reference entity is in North American or European and whether it is one of Markit's CDX.NA.IG, CDX.NA.HY, iTraxx Europe, iTraxx Europe Crossover and iTraxx Europe High Volatility indices. The second key specification relates to whether the CDS is tranching or untranching. The classes that are required to be cleared include only untranching CDS where the contract covers the entire index loss distribution of the index and settlement is not linked to a specified number of defaults. Tranching swaps, first- or "Nth" to-default, options, or any other product variations on these indices are excluded from these classes. Finally, the third key specification entails whether a swap falls within a tenor, specific to an index, that is required to be cleared. The Commission has determined that each of the 3-, 5-, 7-, and 10-year tenors be

included within the class of swaps subject to the clearing requirement determination for CDX.NA.IG; the 5-year tenor be included for CDX.NA.HY; each of the 5- and 10-year for iTraxx Europe; the 5-year for iTraxx Europe Crossover; and, the 5-year for iTraxx Europe High Volatility. In addition, it should be noted that only certain series will be viewed as required to be cleared.

The Commission considered a number of possible alternatives. First, the Commission could have used a narrower or broader group of reference entities. For example, the Commission has not included the CDX.NA.IG.HVOL within the North American swap class, but it considered doing so. The Commission concluded that while doing so would have increased the number of swaps required to be cleared, there is not sufficient liquidity to justify required clearing at this time given that the recent series of CDX.NA.IG.HVOL has not been cleared by ICE (and is not offered at all by CME).

Several commenters raised issues regarding the operational capabilities of clearinghouses to manage the clearing of iTraxx CDS indices for customers.²⁴² More specifically, they pointed out that no registered DCO currently offers customer clearing for iTraxx and expressed concerns about the ability of clearinghouses to manage restructuring credit events applicable to iTraxx. On the other hand, Citadel and ICE both supported the inclusion of iTraxx CDS indices in the clearing requirement. In particular, ICE stated that ICE Clear Europe has begun the process of pursuing regulatory approval for clearing of iTraxx and that ICE Clear Credit will do the same; moreover, ICE said that it has worked closely with market participants and DTCC to develop an industry wide solution for processing a restructuring credit event.

Having considered the different views, the Commission is including the iTraxx class of CDS as proposed. The Commission believes that the uncertainty surrounding the implementation of customer clearing for iTraxx will be resolved within the next few months, which will allow this standard and liquid class of CDS to be cleared. If no eligible DCO offers iTraxx for client clearing, compliance with the required clearing of iTraxx will commence sixty days after the date on which iTraxx is first offered for client clearing by an eligible DCO.

The Commission also considered whether it could include tranching CDS in the clearing requirement. The Commission recognized in the NPRM

that there is a significant market for tranching swaps using the indices. In these transactions, parties to the CDS contract agree to address only a certain range of losses along the entire loss distribution curve. Other swaps such as first or "Nth" to default baskets, and options, also exist on the indices. However, these swaps are not being cleared currently and were not submitted by a DCO for consideration under § 39.5. As a result, including tranching CDS was not a viable alternative for this determination.

AFR noted that requiring clearing of only untranching CDS indices may give rise to arbitrage opportunities, as the payoff properties desired from an index can be closely replicated by trading tranches of that index. The Commission recognizes this concern and will take into account the possibility of arbitrage opportunities in its future reviews of tranching CDS for clearing determination.

Regarding tenor, the Commission could have included more of those offered within the classes of swaps required to be cleared. For example, the Commission noted in the NPRM that the CDX.NA.IG has 1- and 2-year tenors and the CDX.NA.HY, has 3-, 7-, and 10-year tenors that have not been included among the specified tenors. The iTraxx Europe has 3- and 7-year tenors and the Crossover and High Volatility each have 3-, 7-, and 10-year tenors that have not been included. In addition, the Commission could have included all series of active indices. The Commission's concern, regarding both tenors and series, is that certain tenors and series have lower liquidity and may be difficult for a DCO to adequately risk manage, which is reflected in the fact that those tenors and series are not currently cleared by any DCO. While including more tenors and series would have increased the volume of swaps required to be cleared to some degree, the Commission concluded that doing so could raise costs for DCOs and other market participants and be less desirable relative to the factors established in § 39.5.

AFR commented that both the 1- and 2-year tenors of the CDX.NA.IG should be included in the clearing requirement. It is concerned that "market participants might shift to those tenors to avoid mandatory clearing [of the longer tenors]." The Commission notes that no DCO currently clears the 1- or 2-year tenor of CDX.NA.IG, making the clearing of either swap infeasible. However, the Commission recognizes that requiring mandatory clearing of these shorter tenors may prevent

²⁴² ISDA, FIA, MFA, and D.E. Shaw.

arbitrage opportunities if they generate sufficient trading volumes in the future.

With regard to interest rate swaps, as mentioned above, the Commission is finalizing a clearing requirement for four classes of interest rate swaps: Fixed-to-floating swaps, basis swaps, OIS, and FRAs. Within those four classes, there are three affirmative specifications for each class ((i) Currency in which the notional and payment amounts are specified, (ii) rates referenced for each leg of the swap, and (iii) stated termination date of the swap). There are also three “negative” specifications for each class ((i) No optionality (as specified by the DCOs); (ii) no dual currencies; and (iii) no unknown notional amounts). The Commission considered whether to establish clearing requirements on a product-by-product basis. As noted in the NPRM, such a determination would need to identify the multitude of legal specifications of each product that would be subject to the clearing requirement. Although the industry uses standardized definitions and conventions, the product descriptions would be lengthy and require counterparties to compare all of the legal terms of their particular swap against the terms of the many different swaps that would be included in a clearing requirement. The Commission continues to believe that for interest rate swaps, a product-by-product determination would be unnecessarily burdensome for market participants in trying to assess whether each swap transaction is subject to the requirement. A class-based approach allows market participants to determine quickly whether they need to submit their swap to a DCO for clearing by checking initially whether the swap has the basic specifications that define each class subject to the clearing requirement.

As an alternative to the classes selected, LCH recommended in its IRS submission that the Commission use the following specifications to classify interest rate swaps for purposes of making a clearing determination: (i) Swap class (*i.e.*, what the two legs of the swap are (fixed-to-floating, basis, OIS, etc.)); (ii) floating rate definitions used; (iii) the currency designated for swap calculations and payments; (iv) stated final term of the swap (also known as maturity); (v) notional structure over the life of the swap (constant, amortizing, roller coaster, etc.); (vi) floating rate frequency; (vii) whether optionality is included; and (viii) whether a single currency or more than one currency is used for denominating payments and notional amount. In its submission,

CME recommended a clearing determination for all non-option interest rate swaps denominated in a currency cleared by any qualified DCO.

The Commission noted in the NPRM that these alternative specifications fall into two general categories: specifications that are commonly used to address mechanical issues for most swaps, and specifications that are less common and address idiosyncratic issues related to the particular needs of a counterparty. Examples of the latter are special representations added to address particular legal issues, unique termination events, special fees, and conditions tied to events specific to the parties. None of the DCOs clear interest rate swaps with terms in the second group. While such specifications may affect the value of the swap, such specifications are not, generally speaking, fundamental to determining the economic result the parties are trying to achieve.²⁴³ The Commission is finalizing the three affirmative specifications described above because it believes that they are fundamental specifications used by counterparties to determine the economic result of a swap transaction for each party.²⁴⁴

The Commission also noted in the NPRM that it could have not included the negative specifications for interest rate swaps, which would have had the potential effect of including more interest rate swaps within the universe of those required to be cleared. However, the Commission continues to believe that swaps with optionality (such as swaptions or swaps with embedded options), multiple currency swaps, and swaps with notional amounts that are not specified at the time of execution raise concerns regarding adequate pricing measures and consistency across swap contracts. Additionally, at this time, no DCO is offering them for clearing.

Another alternative considered by the Commission and discussed in the NPRM was that of stating the clearing requirement in terms of a particular type of swap, rather than using broad characteristics to describe the type of swaps for which clearing would be

²⁴³ As noted in Section II.E above, mechanical specifications include characteristics such as floating rate reset tenors, reference city for business days, business day convention, and others that have some small impact on valuation but that do not fundamentally alter the economic consequence of the swap for the parties that enter into it.

²⁴⁴ In a comment, ISDA questioned the Commission’s description of mechanical and idiosyncratic factors. In response, the Commission clarified that it is not introducing a new test for interest rate swaps, but was merely setting forth and describing relevant class-defining specifications. See Section II.D above for a full discussion.

required. For example, rather than requiring that all interest rate swaps that meet the six specifications in § 50.4(a) be cleared, the Commission noted in the NPRM that the rule could have specified that only certain sub-types of those interest rate swaps—such as all such interest rate swaps with a term of five years—are required to be cleared. Such an approach might permit the Commission to account for variation in liquidity and outstanding notional values among different sub-types of swap, and thereby focus the clearing requirement on very particular swaps to account for these differences within the same general class. Also, generally speaking, limiting the clearing requirement to fewer swaps could reduce some costs associated with clearing.

However, this advantage was weighed against an important disadvantage of this approach. A highly focused clearing requirement could increase the ability for market participants to replicate the economic results of a swap that is required to be cleared by substituting a swap not required to be cleared; this greater latitude for clearing avoidance, in turn, could increase systemic risk and dampen the beneficial effects of clearing noted above.²⁴⁵ Under the approach proposed by the Commission, all swaps that fall within identified classes are covered by the clearing requirement, provided an eligible DCO offers the swap for clearing, which reduces the risk of such avoidance and the associated reduction of benefits. Moreover, stating the clearing requirement in more general terms reduces the costs associated with determining whether or not a particular swap is subject to the clearing requirement.

Numerous commenters expressed support for the Commission’s specifications determination.²⁴⁶ CME stated that “the Commission has struck an appropriate balance for the initial slate of classes subject to the requirement.” LCH commented that “the Commission’s decision to classify interest rate swaps based on six principle swap specifications * * * is sound.” Citadel stated that the Commission’s class designation approach “reflects the risk management approach utilized across the industry, and most importantly by DCOs” to

²⁴⁵ For instance, in the example noted above, swaps with a term of five years and one day would not be required to be cleared.

²⁴⁶ AllianceBernstein, R.J. O’Brien, Citadel, Eris Exchange, CME, FIA, D.E. Shaw, Arbor Research, LCH, Knight Capital, Jefferies, Coherence Capital, CRT Capital, Javelin Capital, SDMA, Chris Barnard, and Svenokur.

determine necessary margin and other safeguards.

On the other hand, regarding interest rate swaps, ISDA is concerned that the Commission's class-based approach will impose great burdens and uncertainties in terms of "the search efforts needed to filter out from among the broad class those specific products that a DCO will accept for clearing." The Commission notes that ISDA's concern may not be justified, as CME already has a platform in place that "provides market participants with a tool to screen a particular swap for eligibility for clearing upon submission of the swap to CME."

The Commission also considered requiring clearing for all seventeen currencies of interest rate swaps that are currently offered for clearing, but decided instead to require clearing at this time for interest rate swaps in four currencies (EUR, USD, GBP, and JPY). As noted in the NPRM, the Commission recognizes that requiring interest rate swaps in all seventeen currencies submitted by LCH to be cleared would provide the benefit of some incremental reduction in overall counterparty, and thus systemic, risk attendant to clearing a greater portion of interest rate swaps. However, as noted above, the Commission continues to believe that initiating the clearing requirement in a measured manner with respect to interest rate swaps in the four specified currencies familiar to many market participants is the preferable approach at this time because it would give market participants an opportunity to identify and address any operational challenges related to required clearing. Moreover, the currencies included in the required classes constitute approximately 93% of cleared interest rate swaps, which suggests that significant reductions in counterparty risk and gains in systemic protection will be accomplished by limiting the clearing determination to them.²⁴⁷

LCH supported the Commission's determination, and recommended that the Commission propose mandatory clearing of swaps denominated in the other 13 currencies once the initial phase of mandatory clearing is well-established. LCH stated that there is "ample volume and liquidity in swaps denominated in these currencies to support mandatory clearing." The Commission will evaluate the benefits of this recommendation against the cost burdens in its future determinations.

Similarly, the Commission considered requiring clearing of all CDS that are

currently being cleared, but did not propose to include, in the initial clearing requirement, certain types of CDS that have a less significant role in the current market.²⁴⁸

AFR and Chris Barnard both urged the Commission to rapidly designate energy, agriculture and equity swaps for mandatory clearing as well. The Commission reiterates that it will continue to review swap submissions received from DCOs and will issue clearing requirement for other classes of swaps so as to realize the benefits of clearing in a timely manner.

E. Section 15(a) Factors

As noted above, the requirement to clear swaps within the classes of swaps covered by this adopting release is expected to result in increased use of clearing, although it is difficult to quantify the extent of that increase. Thus, this section discusses the expected results from an overall increase in the use of swap clearing in terms of the factors set forth in section 15(a) of the CEA.

i. Protection of Market Participants and the Public

As described above, required clearing of CDS and interest rate swaps resulting from this clearing determination is expected to reduce counterparty credit risk for market participants that will now be required to clear those swaps because they will face the DCO rather than another market participant that lacks the full array of risk management tools that the DCO has at its disposal. This increase in clearing of CDS and interest rate swaps also reduces uncertainty in times of market stress because market participants facing a DCO are less concerned with the impact of such stress on the solvency of their counterparty for cleared trades. Moreover, by reducing uncertainty about counterparty solvency for market participants facing a DCO, the clearing determinations under this adopting release are likely to reduce the risk of contagion if one or more DCO customers or clearing members fails during a time of market stress, which creates benefits for the public.

By requiring clearing of swaps within certain classes, all of which are already available for clearing, the Commission continues to expect, as it stated in the NPRM, that this rule will encourage a

²⁴⁸ For instance, the Commission decided not to include CDX.NA.IG.HiVol from the proposed determination given the lack of volume in the current on-the-run and recent off-the-run series. In addition, CME currently does not clear any HiVol contracts, and ICE Clear Credit no longer clears the most recent series.

smooth transition to clearing by creating an opportunity for market participants to work out challenges related to required clearing of swaps while operating in familiar terrain. More specifically, the DCOs will clear an increased volume of swaps that they already understand and have experience managing. Similarly, FCMs likely will realize increased customer and transaction volume as the result of the requirement, but will not have to simultaneously learn how to operationalize clearing for new types of swaps. Additionally, the experience that current FCMs have with these swaps is likely to benefit customers that are new to swap clearing, as the FCM guides them through initial process of clearing swaps.²⁴⁹

In addition, uncleared swaps subject to collateral agreements can be the subject of valuation disputes. These valuation disputes sometimes require several months, or longer, to resolve. Uncollateralized exposure can grow significantly during that time, leaving one of the two parties exposed to counterparty credit risk that was intended to be covered through a collateral agreement. DCOs eliminate, or reduce, valuation disputes for cleared swaps as well as the risk that uncollateralized exposure can develop and accumulate during the time when such a dispute would have otherwise occurred, thus providing additional protection to market participants that transact in swaps subject to required clearing.²⁵⁰

As far as costs are concerned, market participants that do not currently have established clearing relationships with an FCM will have to set up and maintain such a relationship in order to clear swaps that are required to be cleared. As discussed above, market participants that conduct a limited number of swaps per year will likely be required to pay monthly or annual fees that FCMs charge to maintain both the relationship and outstanding swap positions belonging to the customer. In addition, the FCM is likely to pass along fees charged by the DCO for establishing and maintaining open positions.

²⁴⁹ As discussed in Section II.C and II.E above, DCOs offering clearing for CDS and interest rate swaps have established extensive risk management practices, which focus on the protection of market participants. See also Sections II.D and II.F for a discussion of the effect on the mitigation of systemic risk in the CDS market and in the interest rate swaps market, as well as the protection of market participants during insolvency events at either the clearing member or DCO level.

²⁵⁰ See Sections II.D and II.F above for a further discussion of how DCOs obtain adequate pricing data for the CDS and interest rate swaps that they clear. Based on this pricing data, valuation disputes are minimized, if not eliminated for cleared swaps.

²⁴⁷ See Section II.F above for more thorough discussion of the data.

ii. Efficiency, Competitiveness, and Financial Integrity of Swap Markets

The Commission continues to expect, as it explained in the NPRM, that increased clearing of the CDS and interest rate swaps subject to this adopting release is expected to reduce uncertainty regarding counterparty credit risk in times of market stress and promote liquidity and efficiency during those times. Increased liquidity promotes the ability of market participants to limit losses from exiting positions effectively when necessary in order to manage risk during a time of market stress.

In addition, to the extent that positions move from facing multiple counterparties in the bilateral market to being run through a smaller number of clearinghouses, clearing likely facilitates increased netting. This netting effect reduces operational risk and may reduce the amount of collateral that a party must post or pay in terms of initial and variation margin.

As discussed in Sections II.D and II.F above, in setting forth this new clearing requirement, the Commission took into account a number of specific factors that relate to the financial integrity of the swap markets. Specifically, the NPRM and the discussion above includes an assessment of whether the DCOs clearing CDS and interest rate swaps have the rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear CDS and interest rate swaps on terms that are consistent with the material terms and trading conventions on which the contract is then traded. The Commission also considered the financial resources of DCOs to handle additional clearing, as well as the existence of reasonable legal certainty in the event of a clearing member or DCO insolvency.²⁵¹

As discussed above, bilateral swaps create counterparty risk that may lead market participants to discriminate among potential counterparties based on their creditworthiness. Such discrimination is expensive and time consuming insofar as market participants must conduct due diligence in order to evaluate a potential counterparty's creditworthiness. Requiring the certain types of swaps subject to this clearing determination to be cleared reduces the number of transactions for which such due diligence is necessary, thereby contributing to the efficiency of the swap markets.

In setting forth a clearing requirement for both CDS and interest rate swaps, the Commission considered the effect on competition, including appropriate fees and charges applied to clearing. As discussed in more detail in Sections II.D and II.F above, there are a number of potential outcomes that may result from required clearing. Some of these outcomes may impose costs, such as if a DCO possessed market power and exercised that power in an anticompetitive manner, and some of the outcomes would be positive, such as if the clearing requirement facilitated a stronger entry-opportunity for competitors.

As far as costs are concerned, the markets for some swaps within the classes that are required to be cleared may be less liquid than others. All other things being equal, swaps for which the markets are less liquid have the potential to develop larger current uncollateralized exposures after a default on a cleared position, and therefore will require posting of relatively greater amounts of initial margin.

iii. Price Discovery

As the Commission noted in the NPRM, clearing of CDS and interest rate swaps subject to this new clearing requirement is likely to encourage better price discovery because it eliminates the importance of counterparty creditworthiness in pricing swaps cleared through a given DCO. That is, by making the counterparty creditworthiness of all swaps of a certain type essentially the same, prices should reflect factors related to the terms of the swap, rather than the idiosyncratic risk posed by the entities trading it.²⁵²

As discussed in Sections II.D and II.F above, DCOs obtain adequate pricing data for the CDS and interest rate swaps that they clear. Each DCO establishes a rule framework for its pricing methodology and rigorously tests its pricing models to ensure that the cornerstone of its risk management regime is as sound as possible.

iv. Sound Risk Management Practices

If a firm enters into swaps to hedge certain positions and then the counterparty to those swaps defaults unexpectedly, the firm could be left with large outstanding exposures and unhedged positions. As explained in the

NPRM and stated above, when a swap is cleared, the DCO becomes the counterparty facing each of the two original counterparties to the swap. This standardizes and reduces counterparty credit risk for each of the two original participants. To the extent that a market participant's hedges comprise swaps that are required to be cleared, the requirement enhances their risk management practices by reducing their counterparty risk. Accordingly, for counterparties required to clear those CDS and interest rate swaps subject to this requirement, risk management will be enhanced.

In addition, from systemic perspective, required clearing reduces the complexity of unwinding/transferring swap positions from large entities that default. Procedures for transfer of swap positions and mutualization of losses among DCO members are already in place, and the Commission continues to anticipate that they are much more likely to function in a manner that enables efficient transfer of positions than legal processes that apply to uncleared, bilateral swaps.²⁵³

v. Other Public Interest Considerations

In September 2009, the President and the other leaders of the "G20" nations met in Pittsburgh and committed to a program of action that includes, among other things, central clearing of all standardized swaps.²⁵⁴ Together, interest rate swaps and CDS represent more than 75% of the notional amount of outstanding swaps, and therefore, requiring the most active, standardized classes of swaps within those groups to be cleared represents a significant step toward the fulfillment of that commitment.

VI. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires that agencies consider whether the rules they propose will have a

²⁵³ As discussed in Sections II.C and II.E above, sound risk management practices are critical for all DCOs, especially those offering clearing for CDS and interest rate swaps. In the discussion above, the Commission considered whether each DCO submission under review was consistent with the core principles for DCOs. In particular, the Commission considered the DCO submissions in light of Core Principle D, which relates to risk management. See also Sections II.D and II.F for a discussion of the effect on the mitigation of systemic risk in the CDS market and in the interest rate swaps market, as well as the protection of market participants during insolvency events at either the clearing member or DCO level.

²⁵⁴ A list of the G20 commitments made in Pittsburgh can be found at: <http://www.g20.utoronto.ca/analysis/commitments-09-pittsburgh.html>.

²⁵² See Chen, K., et al., "An Analysis of CDS Transactions: Implications for Public Reporting," September 2011, Federal Reserve Bank of New York Staff Reports, at 14, available at http://www.newyorkfed.org/research/staff_reports/sr517.pdf.

²⁵¹ See Sections II.D and II.F.

significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact.²⁵⁵ As stated in the NPRM, the clearing requirement determinations and rules proposed by the Commission will affect only eligible contract participants (ECPs) because all persons that are not ECPs are required to execute their swaps on a DCM, and all contracts executed on a DCM must be cleared by a DCO, as required by statute and regulation; not by operation of any clearing requirement.²⁵⁶ Accordingly, the Chairman, on behalf of the Commission, certified pursuant to 5 U.S.C. 605(b) that the proposed rules would not have a significant economic impact on a substantial number of small entities. The Commission then invited public comment on this determination. The Commission received no comments.

The Commission has previously determined that ECPs are not small entities for purposes of the RFA.²⁵⁷ However, in its proposed rulemaking to establish a schedule to phase in compliance with certain provisions of the Dodd-Frank Act, including the clearing requirement under section 2(h)(1)(A) of the CEA, the Commission received a joint comment (Electric Associations Letter) from the Edison Electric Institute (EEI), the National Rural Electric Cooperative Association (NRECA) and the Electric Power Supply Association (EPSA) asserting that certain members of NRECA may both be ECPs under the CEA and small businesses under the RFA.²⁵⁸ These members of NRECA, as the Commission understands, have been determined to be small entities by the Small Business Administration (SBA) because they are “primarily engaged in the generation, transmission, and/or distribution of electric energy for sale and [their] total electric output for the preceding fiscal year did not exceed 4 million megawatt hours.”²⁵⁹ Although the Electric Associations Letter does not provide details on whether or how the NRECA members that have been determined to

be small entities use the interest rate swaps and CDS that are the subject of this rulemaking, the Electric Associations Letter does state that the EEI, NRECA, and EPSA members “engage in swaps to hedge commercial risk.”²⁶⁰ Because the NRECA members that have been determined to be small entities would be using swaps to hedge commercial risk, the Commission expects that they would be able to use the end-user exception from the clearing requirement and therefore would not be affected to any significant extent by this rulemaking.

Thus, because nearly all of the ECPs that may be subject to the proposed clearing requirement are not small entities, and because the few ECPs that have been determined by the SBA to be small entities are unlikely to be subject to the clearing requirement, the Chairman, on behalf of the CFTC, hereby certifies pursuant to 5 U.S.C. 605(b) that the rules herein will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act (PRA)²⁶¹ imposes certain requirements on federal agencies (including the Commission) in connection with conducting or sponsoring any collection of information as defined by the PRA. As stated in the NPRM, § 50.3(a), would require each DCO to post on its Web site a list of all swaps that it will accept for clearing and clearly indicate which of those swaps the Commission has determined are required to be cleared, builds upon the requirements of § 39.21(c)(1), which requires each DCO to disclose publicly information concerning the terms and conditions of each contract, agreement, and transaction cleared and settled by the DCO. The Commission received no comments related to PRA. Thus, this rulemaking will not require a new collection of information from any persons or entities.

List of Subjects

17 CFR Part 39

Business and industry, Reporting requirements, Swaps.

17 CFR Part 50

Business and industry, Clearing, Swaps.

²⁶⁰ See Electric Associations Letter, at 2. The letter also suggests that EEI, NRECA, and EPSA members are not financial entities. See *id.*, at note 5, and at 5 (the associations’ members “are not financial companies”).

²⁶¹ 44 U.S.C. 3507(d).

For the reasons stated in the preamble, amend 17 CFR parts 39 and 50 as follows:

PART 39—DERIVATIVES CLEARING ORGANIZATIONS

- 1. The authority citation for part 39 continues to read as follows:

Authority: 7 U.S.C. 2 and 7a–1 as amended by Pub. L. 111–203, 124 Stat. 1376.

§ 39.6 [Removed and Reserved]

- 2. Remove and reserve § 39.6.

PART 50—CLEARING REQUIREMENT AND RELATED RULES

- 3. The authority citation to part 50 is revised to read as follows:

Authority: 7 U.S.C. 2(h) and 7a–1 as amended by Pub. L. 111–203, 124 Stat. 1376.

- 4. Add subpart A, consisting of §§ 50.1 through 50.24 to read as follows:

Subpart A—Definitions and Clearing Requirement

Sec.

50.1 Definitions.

50.2 Treatment of swaps subject to a clearing requirement.

50.3 Notice to the public.

50.4 Classes of swaps required to be cleared.

50.5 Swaps exempt from a clearing requirement.

50.6 Delegation of authority.

50.7–50.9 [Reserved]

50.10 Prevention of evasion of the clearing requirement and abuse of an exception or exemption to the clearing requirement.

50.11–50.24 [Reserved]

Subpart A—Definitions and Clearing Requirement

§ 50.1 Definitions.

For the purposes of this part, *Business day* means any day other than a Saturday, Sunday, or legal holiday.

Day of execution means the calendar day of the party to the swap that ends latest, provided that if a swap is:

(1) Entered into after 4:00 p.m. in the location of a party; or

(2) Entered into on a day that is not a business day in the location of a party, then such swap shall be deemed to have been entered into by that party on the immediately succeeding business day of that party, and the day of execution shall be determined with reference to such business day.

§ 50.2 Treatment of swaps subject to a clearing requirement.

(a) All persons executing a swap that:

(1) Is not subject to an exception under section 2(h)(7) of the Act or § 50.50 of this part; and

²⁵⁵ See 5 U.S.C. 601 *et seq.*

²⁵⁶ To the extent that this rulemaking affects DCMs, DCOs, or FCMs, the Commission has previously determined that DCMs, DCOs, and FCMs are not small entities for purposes of the RFA. See, respectively and as indicated, 47 FR 18618, 18619, Apr. 30, 1982 (DCMs and FCMs); and 66 FR 45604, 45609, Aug. 29, 2001 (DCOs).

²⁵⁷ See 66 F.R. 20740, 20743 (Apr. 25, 2001).

²⁵⁸ See joint letter from EEI, NRECA, and EPSA, dated Nov. 4, 2011, (Electric Associations Letter), commenting on Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA, 76 FR 58186 (Sept. 20, 2011).

²⁵⁹ Small Business Administration, Table of Small Business Size Standards, Nov. 5, 2010.

(2) Is included in a class of swaps identified in § 50.4 of this part, shall submit such swap to any eligible derivatives clearing organization that accepts such swap for clearing as soon as technologically practicable after execution, but in any event by the end of the day of execution.

(b) Each person subject to the requirements of paragraph (a) of this section shall undertake reasonable efforts to verify whether a swap is required to be cleared.

(c) For purposes of paragraph (a) of this section, persons that are not clearing members of an eligible derivatives clearing organization shall be deemed to have complied with

paragraph (a) of this section upon submission of such swap to a futures commission merchant or clearing member of a derivatives clearing organization, provided that submission occurs as soon as technologically practicable after execution, but in any event by the end of the day of execution.

§ 50.3 Notice to the public.

(a) In addition to its obligations under § 39.21(c)(1), each derivatives clearing organization shall make publicly available on its Web site a list of all swaps that it will accept for clearing and identify which swaps on the list are required to be cleared under section 2(h)(1) of the Act and this part.

(b) The Commission shall maintain a current list of all swaps that are required to be cleared and all derivatives clearing organizations that are eligible to clear such swaps on its Web site.

§ 50.4 Classes of swaps required to be cleared.

(a) *Interest rate swaps.* Swaps that have the following specifications are required to be cleared under section 2(h)(1) of the Act, and shall be cleared pursuant to the rules of any derivatives clearing organization eligible to clear such swaps under § 39.5(a) of this chapter.

Specification	Fixed-to-floating swap class			
Currency	U.S. dollar (USD)	Euro (EUR)	Sterling (GBP)	Yen (JPY).
Floating Rate Indexes	LIBOR	EURIBOR	LIBOR	LIBOR.
Stated Termination Date Range	28 days to 50 years ...	28 days to 50 years ...	28 days to 50 years ...	28 days to 30 years.
Optionality	No	No	No	No.
Dual Currencies	No	No	No	No.
Conditional Notional Amounts	No	No	No	No.
Specification	Basis swap class			
Currency	U.S. dollar (USD)	Euro (EUR)	Sterling (GBP)	Yen (JPY).
Floating Rate Indexes	LIBOR	EURIBOR	LIBOR	LIBOR.
Stated Termination Date Range	28 days to 50 years ...	28 days to 50 years ...	28 days to 50 years ...	28 days to 30 years.
Optionality	No	No	No	No.
Dual Currencies	No	No	No	No.
Conditional Notional Amounts	No	No	No	No.
Specification	Forward rate agreement class			
Currency	U.S. dollar (USD)	Euro (EUR)	Sterling (GBP)	Yen (JPY).
Floating Rate Indexes	LIBOR	EURIBOR	LIBOR	LIBOR.
Stated Termination Date Range	3 days to 3 years	3 days to 3 years	3 days to 3 years	3 days to 3 years.
Optionality	No	No	No	No.
Dual Currencies	No	No	No	No.
6. Conditional Notional Amounts	No	No	No	No.
Specification	Overnight index swap class			
Currency	U.S. dollar (USD)	Euro (EUR)	Sterling (GBP).	
Floating Rate Indexes	FedFunds	EONIA	SONIA.	
Stated Termination Date Range	7 days to 2 years	7 days to 2 years	7 days to 2 years.	
Optionality	No	No	No.	
Dual Currencies	No	No	No.	
Conditional Notional Amounts	No	No	No.	

(b) *Credit default swaps.* Swaps that have the following specifications are required to be cleared under section

2(h)(1) of the Act, and shall be cleared pursuant to the rules of any derivatives clearing organization eligible to clear

such swaps under § 39.5(a) of this chapter.

Specification	North American untranch CDS indices class
Reference Entities	Corporate.
Region	North America.
Indices	CDX.NA.IG; CDX.NA.HY.
Tenor	CDX.NA.IG: 3Y, 5Y, 7Y, 10Y; CDX.NA.HY: 5Y.
Applicable Series	CDX.NA.IG 3Y: Series 15 and all subsequent Series, up to and including the current Series. CDX.NA.IG 5Y: Series 11 and all subsequent Series, up to and including the current Series. CDX.NA.IG 7Y: Series 8 and all subsequent Series, up to and including the current Series. CDX.NA.IG 10Y: Series 8 and all subsequent Series, up to and including the current Series. CDX.NA.HY 5Y: Series 11 and all subsequent Series, up to and including the current Series.
Tranching	No.

Specification	European untranchcd CDS indices class
Reference Entities	Corporate.
Region	Europe.
Indices	iTraxx Europe. iTraxx Europe Crossover. iTraxx Europe HiVol.
Tenor	iTraxx Europe: 5Y, 10Y. iTraxx Europe Crossover: 5Y. iTraxx Europe HiVol: 5Y.
Applicable Series	iTraxx Europe 5Y: Series 10 and all subsequent Series, up to and including the current Series. iTraxx Europe 10Y: Series 7 and all subsequent Series, up to and including the current Series. iTraxx Europe Crossover 5Y: Series 10 and all subsequent Series, up to and including the current Series. iTraxx Europe HiVol 5Y: Series 10 and all subsequent Series, up to and including the current Series.
Tranchcd	No.

§ 50.5 Swaps exempt from a clearing requirement.

(a) Swaps entered into before July 21, 2010 shall be exempt from the clearing requirement under § 50.2 of this part if reported to a swap data repository pursuant to section 2(h)(5)(A) of the Act and § 46.3(a) of this chapter.

(b) Swaps entered into before the application of the clearing requirement for a particular class of swaps under §§ 50.2 and 50.4 of this part shall be exempt from the clearing requirement if reported to a swap data repository pursuant to section 2(h)(5)(B) of the Act and either § 46.3(a) or §§ 45.3 and 45.4 of this chapter, as appropriate.

§ 50.6 Delegation of Authority.

(a) The Commission hereby delegates to the Director of the Division of Clearing and Risk or such other employee or employees as the Director may designate from time to time, with the consultation of the General Counsel or such other employee or employees as the General Counsel may designate from time to time, the authority:

(1) After prior notice to the Commission, to determine whether one or more swaps submitted by a derivatives clearing organization under § 39.5 falls within a class of swaps as described in § 50.4, provided that inclusion of such swaps is consistent with the Commission's clearing requirement determination for that class of swaps; and

(2) To notify all relevant derivatives clearing organizations of that determination.

(b) The Director of the Division of Clearing and Risk may submit to the Commission for its consideration any matter which has been delegated in this section. Nothing in this section prohibits the Commission, at its election, from exercising the authority delegated in this section.

§ 50.7–50.9 [Reserved].

§ 50.10 Prevention of evasion of the clearing requirement and abuse of an exception or exemption to the clearing requirement.

(a) It shall be unlawful for any person to knowingly or recklessly evade or participate in or facilitate an evasion of the requirements of section 2(h) of the Act or any Commission rule or regulation promulgated thereunder.

(b) It shall be unlawful for any person to abuse the exception to the clearing requirement as provided under section 2(h)(7) of the Act or an exception or exemption under this chapter.

(c) It shall be unlawful for any person to abuse any exemption or exception to the requirements of section 2(h) of the Act, including any exemption or exception as the Commission may provide by rule, regulation, or order.

■ 5. Designate § 50.25 under new subpart B under the following heading and add reserved §§ 50.26 through 50.49.

Subpart B—Compliance Schedule

Sec.
50.25 Clearing requirement compliance schedule.

50.26–50.49 [Reserved]

■ 6. Add subpart C, consisting of § 50.50, to read as follows:

Subpart C—Exceptions and Exemptions to Clearing Requirement

§ 50.50 Exceptions to the clearing requirement.

(a) *Non-financial entities.* (1) A counterparty to a swap may elect the exception to the clearing requirement under section 2(h)(7)(A) of the Act if the counterparty:

(i) Is not a “financial entity” as defined in section 2(h)(7)(C)(i) of the Act;

(ii) Is using the swap to hedge or mitigate commercial risk as provided in paragraph (c) of this section; and

(iii) Provides, or causes to be provided, the information specified in paragraph (b) of this section to a registered swap data repository or, if no registered swap data repository is available to receive the information from the reporting counterparty, to the Commission. A counterparty that satisfies the criteria in this paragraph (a)(1) and elects the exception is an “electing counterparty.”

(2) If there is more than one electing counterparty to a swap, the information specified in paragraph (b) of this section shall be provided with respect to each of the electing counterparties.

(b) *Reporting.* (1) When a counterparty elects the exception to the clearing requirement under section 2(h)(7)(A) of the Act, one of the counterparties to the swap (the “reporting counterparty,” as determined in accordance with § 45.8 of this part) shall provide, or cause to be provided, the following information to a registered swap data repository or, if no registered swap data repository is available to receive the information from the reporting counterparty, to the Commission, in the form and manner specified by the Commission:

(i) Notice of the election of the exception;

(ii) The identity of the electing counterparty to the swap; and

(iii) The following information, unless such information has previously been provided by the electing counterparty in a current annual filing pursuant to paragraph (b)(2) of this section:

(A) Whether the electing counterparty is a “financial entity” as defined in section 2(h)(7)(C)(i) of the Act, and if the electing counterparty is a financial entity, whether it is:

(1) Electing the exception in accordance with section 2(h)(7)(C)(iii) or section 2(h)(7)(D) of the Act; or

(2) Exempt from the definition of “financial entity” as described in paragraph (d) of this section;

(B) Whether the swap or swaps for which the electing counterparty is electing the exception are used by the electing counterparty to hedge or mitigate commercial risk as provided in paragraph (c) of this section;

(C) How the electing counterparty generally meets its financial obligations associated with entering into non-cleared swaps by identifying one or more of the following categories, as applicable:

(1) A written credit support agreement;

(2) Pledged or segregated assets (including posting or receiving margin pursuant to a credit support agreement or otherwise);

(3) A written third-party guarantee;

(4) The electing counterparty's available financial resources; or

(5) Means other than those described in paragraphs (b)(1)(iii)(C)(1), (2), (3) or (4) of this section; and

(D) Whether the electing counterparty is an entity that is an issuer of securities registered under section 12 of, or is required to file reports under section 15(d) of, the Securities Exchange Act of 1934, and if so:

(1) The relevant SEC Central Index Key number for that counterparty; and

(2) Whether an appropriate committee of that counterparty's board of directors (or equivalent body) has reviewed and approved the decision to enter into swaps that are exempt from the requirements of sections 2(h)(1) and 2(h)(8) of the Act.

(2) An entity that qualifies for an exception to the clearing requirement under this section may report the information listed in paragraph (b)(1)(iii) of this section annually in anticipation of electing the exception for one or more swaps. Any such reporting under this paragraph shall be effective for purposes of paragraph (b)(1)(iii) of this section for swaps entered into by the entity for 365 days following the date of such reporting. During such period, the entity shall amend such information as necessary to reflect any material changes to the information reported.

(3) Each reporting counterparty shall have a reasonable basis to believe that the electing counterparty meets the requirements for an exception to the clearing requirement under this section.

(c) *Hedging or mitigating commercial risk.* For purposes of section 2(h)(7)(A)(ii) of the Act and paragraph (b)(1)(iii)(B) of this section, a swap is used to hedge or mitigate commercial risk if:

(1) Such swap:

(i) Is economically appropriate to the reduction of risks in the conduct and

management of a commercial enterprise, where the risks arise from:

(A) The potential change in the value of assets that a person owns, produces, manufactures, processes, or merchandises or reasonably anticipates owning, producing, manufacturing, processing, or merchandising in the ordinary course of business of the enterprise;

(B) The potential change in the value of liabilities that a person has incurred or reasonably anticipates incurring in the ordinary course of business of the enterprise;

(C) The potential change in the value of services that a person provides, purchases, or reasonably anticipates providing or purchasing in the ordinary course of business of the enterprise;

(D) The potential change in the value of assets, services, inputs, products, or commodities that a person owns, produces, manufactures, processes, merchandises, leases, or sells, or reasonably anticipates owning, producing, manufacturing, processing, merchandising, leasing, or selling in the ordinary course of business of the enterprise;

(E) Any potential change in value related to any of the foregoing arising from interest, currency, or foreign exchange rate movements associated with such assets, liabilities, services, inputs, products, or commodities; or

(F) Any fluctuation in interest, currency, or foreign exchange rate exposures arising from a person's current or anticipated assets or liabilities; or

(ii) Qualifies as bona fide hedging for purposes of an exemption from position limits under the Act; or

(iii) Qualifies for hedging treatment under:

(A) Financial Accounting Standards Board Accounting Standards Codification Topic 815, Derivatives and Hedging (formerly known as Statement No. 133); or

(B) Governmental Accounting Standards Board Statement 53, Accounting and Financial Reporting for Derivative Instruments; and

(2) Such swap is:

(i) Not used for a purpose that is in the nature of speculation, investing, or trading; and

(ii) Not used to hedge or mitigate the risk of another swap or security-based swap position, unless that other position itself is used to hedge or mitigate commercial risk as defined by this rule or § 240.3a67-4 of this title.

(d) For purposes of section 2(h)(7)(A) of the Act, a person that is a "financial entity" solely because of section 2(h)(7)(C)(i)(VIII) shall be exempt from

the definition of "financial entity" if such person:

(1) Is organized as a bank, as defined in section 3(a) of the Federal Deposit Insurance Act, the deposits of which are insured by the Federal Deposit Insurance Corporation; a savings association, as defined in section 3(b) of the Federal Deposit Insurance Act, the deposits of which are insured by the Federal Deposit Insurance Corporation; a farm credit system institution chartered under the Farm Credit Act of 1971; or an insured Federal credit union or State-chartered credit union under the Federal Credit Union Act; and

(2) Has total assets of \$10,000,000,000 or less on the last day of such person's most recent fiscal year.

Issued in Washington, DC, on November 29, 2012, by the Commission.

Sauntia S. Warfield,

Assistant Secretary of the Commission.

Note: The following appendices will not appear in the Code of Federal Regulations: Appendices to Clearing Requirement Determination Under Section 2(h) of the CEA—Commission Voting Summary and Statement of the Chairman.

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 Sommers, Chilton, O'Malia and Wetjen voted in the affirmative; no Commissioner voted in the negative.

Appendix 2—Statement of Chairman Gary Gensler

I support the final rule requiring certain interest rate swaps and credit default swap (CDS) indices to be cleared, as provided by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

Central clearing is one of the three major building blocks of Dodd-Frank swaps market reform—in addition to promoting market transparency and bringing swap dealers under comprehensive oversight—and this rule completes the clearing building block.

Central clearing lowers the risk of the highly interconnected financial system. It also democratizes the market by eliminating the need for market participants to individually determine counterparty credit risk, as now clearinghouses stand between buyers and sellers.

In a cleared market, more people have access on a level playing field.

Small and medium-sized businesses, banks and asset managers can enter the market and trade anonymously and benefit from the market's greater competition.

Clearinghouses have lowered risk for the public and fostered competition in the futures markets since the late 19th century. Following the 2008 financial crisis, President Obama convened the G-20 leaders in Pittsburgh in 2009, and an international

consensus formed that standardized swaps should be cleared by the end of 2012.

The CFTC has already completed a number of significant Dodd-Frank reforms laying the foundation of risk management for clearinghouses, futures commission merchants and other market participants that participate in clearing. Other reforms paving the way for this rule include straight-through processing for swaps and protections for customer funds.

This rule, which fulfills President Obama's G-20 commitment on clearing, is the last step on the path to required central clearing between financial entities. It benefited from significant domestic and international consultation. Moving forward, we will work

with market participants on implementation. I would like to thank my fellow Commissioners and the CFTC staff for all of their hard work and dedication so that now clearing will be a reality in the swaps market.

For this first set of determinations, the Commission looked to swaps that are currently cleared by four derivatives clearing organizations (DCOs).

This set includes standard interest rate swaps in U.S. dollars, euros, British pounds and Japanese yen, as well as five CDS indices on North American and European corporate names.

With this rule, swap dealers and the largest hedge funds will be required to clear these swaps in March. Compliance would be

phased in for other market participants through the summer of 2013.

I believe that the Commission's determination for each class satisfies the five factors provided for by Congress in the Dodd-Frank Act, including the first factor that addresses outstanding exposures, liquidity and pricing data.

Under the rule, a DCO must post on its Web site a list of all swaps it will accept for clearing and must indicate which swaps the Commission had determined are required to be cleared. In addition, the Commission will post this information on our Web site.

[FR Doc. 2012-29211 Filed 12-12-12; 8:45 am]

BILLING CODE 6351-01-P