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FIA Cleared Swaps Operations Committee Clearing Member Recommendations for an Efficient Swap Client Clearing Model February 3, 2015

FIA's Cleared Swaps Operations Committee has been working to develop recommendations for efficient swap client clearing. FIA believes that these proposed practices will help facilitate the growth of the industry in a manner consistent with existing regulatory guidance. FIA has been involved in an ongoing dialogue concerning operational flow of Swap Execution Facility (SEF) trades with a variety of market participants and with the Commodity Futures Trading Commission (CFTC).

SEF Recommendations

The CFTC's September 26, 2013 Straight-Through Processing Guidance states that "a SEF must facilitate pre-execution screening by each Clearing FCM [Futures Commission Merchant] in accordance with Regulation 1.73 on an order-by-order basis." In order to meet this requirement, clearing firms need SEFs to provide the following:

1. SEFs should ensure a pre-trade limit check is performed on all trades executed on the SEF and/or pursuant to the SEF rules.
    - This control feature should capture both FCM and Derivatives Clearing Organization (DCO) checks.

2. SEFs should either generate or receive a unique limit token[1] for all screened orders and should ensure that this limit token is passed to the DCO (even when delegating submission to a third party) and to the FCM (directly or via a hub) in all status messages:
    - This should include voice trades processed via the SEF (i.e., swap block trades done pursuant to the rules of a SEF), as well as transactions executed electronically.
    - FCM or FCM designee should be responsible for setting the token, except in the case that a limit has been pushed to a SEF; then the SEF should be responsible for setting the token.
    - Minimum standard limit token parameters:

[1] Note: Working group will be formed to define detailed specifications

- Limit tokens (for both ping and push models) should have unique FCM and Client identifiers that include a numerical linkage to each individual execution/filled order.
    - These identifiers should be included in each trade submission message to the DCOs

3. SEFs should send all trade status messages in real time to the FCM (directly or via a hub), including:
    - New orders for limit screening
    - Execution/partial execution of screened orders
    - Cancellation of approved orders, including those that were cancelled due to token expiration
    - Partial cancellations of approved orders (i.e., client reduces notional, only partial fill occurred)
    - Rejected trades/void ab initio of executed trades

4. SEFs should verify that the transaction submitted to the DCO for clearing is the same transaction that was screened pre-execution by the FCM and that there are no unnecessary manual steps that increase the latency as to when the DCO receives an executed transaction.
    - In the case that manual affirmation is necessary for voice executed trades, reasonable time limits should be enforced. This should not exceed 15 minutes.
    - Manual affirmation should not be used for electronically executed transactions.

5. SEFs should ensure the following details are included in the trade record sent to the DCO:
    - All parties to the transaction as well as the FCM, agency executing broker, non-participant access provider, etc.
    - Limit token as discussed above

6. With the exception of the scenarios outlined in the sub-bullet below, amendments to a screened order should be resubmitted to the FCM for limit screening. This includes, but is not limited to, amendments to the Clearing FCM and/or fund allocation shapes. Exceptions include:
    - Decrease in the notional amount or a partial cancellation of the order

- Change in the trade price
- Change in the trade execution counterparty

7. SEFs should provide FCMs with the option to execute (either directly or via a hub) a hard kill switch (kill all open orders and stop future approvals) and a soft kill switch (reject new orders). FCMs should also have the ability to revoke approval on a specific order prior to execution.

8. SEFs should provide FCMs (either directly or via a hub) with the option to set a time parameter for limit reservations.

9. SEFs should not allow the reservation to roll forward to the following day (end-of-day defined by the SEF)

10. SEFs should ensure that a limit reservation can only be used once and an expired token cannot be used.

    - Note: while a reservation can only be used once, it could affect multiple tickets over a period of time – i.e., if $10M approved, it could represent two $5M executions. In this example, SEFs should not allow the credit reservation to be used for two $10M executions

11. SEFs should have controls in place in order to be alerted when DCO confirmation messages do not happen on a timely basis and then should alert parties accordingly.

12. SEFs should have controls to facilitate compliance with CFTC no action relief for trade resubmission (i.e., new trade old terms).

13. When offering bunched order allocation tools on their platform, SEFs should:

    - Pass DCO bunched order IDs and bunched order/allocation indicators and linking identifiers between bunched orders, decrements and ultimate allocations.
    - Ensure economic details of allocations and decrements match the original bunched order.

14. Where third parties are involved in providing messaging services between the SEF and DCO, they should adhere to these proposed recommendations and the SEF should be responsible for ensuring compliance.

DCO Recommendations

1. Once token parameters have been standardized, DCOs should check that the FCM and the Client on a transaction match the FCM and Client embedded on a token.

2. DCOs should perform a pre-trade credit check on each transaction. Until this functionality is built, at a minimum, DCOs should provide the FCMs with their limit utilization and total credit line using real-time messaging.

3. DCOs should be guided by the CFTC in respect of removing last look to the FCM (i.e. request/consent messaging) for any SEF trades that have had a pre-execution limit check (i.e., valid limit token).

4. In reporting clearing status of a trade, DCOs should:
    - Inform SEFs and FCMs of trade rejections and pass a rejection reason.
    - Pass FCMs trade execution messages and limit tokens, when available.

5. SEFs should pass DCO bunched order IDs and bunched order/allocation indicators so that the DCO can implement processes for the bunched order process, such as:
    - Validating bunched order IDs and allocation amounts (eliminate over allocation)
    - Passing bunched order IDs in end-of-day reports and messaging
    - Labeling transactions as bunched order or allocation in end-of-day reports and messaging

6. DCOs should include the following information in messaging and end-of-day reports:
    - SEF Trade ID
    - SEF Name/LEI

7. DCOs should report and message FCMs in a standard way, regardless of trade source and should ensure rigorous testing with trade sources to ensure the same standard of incoming data.

8. DCOs should offer impartial access to any post-clearing allocation platform.

9. DCOs should document policies and procedures relating to the steps to be taken by the DCO following registration of a trade which the parties subsequently notify the DCO to have been an erroneous trade.