Commodity Futures Trading Commission
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Proposed Rule on Financial Resources Requirements for DCOs and SIDCOs

The Commodity Futures Trading Commission is proposing financial resources requirements for derivatives clearing organizations (DCOs) and systemically important DCOs (SIDCOs).

Commodity Exchange Act (CEA)

Commodity Exchange Act, Section 5b(c)(2): Sets forth core principles with which a DCO must comply to be registered and to maintain registration as a DCO.

Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)

Section 725(c) of the Dodd-Frank Act amends Section 5b(c)(2) of the CEA by revising certain core principles and adding new ones. The Dodd-Frank Act also allows the Commission to adopt implementing rules and regulations for the core principles pursuant to its rulemaking authority under Section 8a(5) of the CEA.

Section 805(a) of the Dodd-Frank Act allows the Commission to prescribe regulations for those DCOs that the Financial Stability Oversight Council has determined are systemically important.

Core Principle B

Core Principle B, as amended by the Dodd-Frank Act, requires a DCO to possess financial resources that, at a minimum, exceed the total amount that would enable the DCO to meet its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible market conditions; and enable the DCO to cover its operating costs for a period of 1 year, as calculated on a rolling basis.

Default resources

The proposed rule would require a DCO to maintain sufficient financial resources to meet its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible market conditions. For purposes of determining the largest financial exposure, the exposures of affiliated clearing members would be combined and treated as those of a single clearing member.

Because the failure of a SIDCO to meet its obligations would have a greater impact on the financial system than the failure of other DCOs, the proposed rule would require a DCO that is also a SIDCO to maintain sufficient financial resources to meet its financial obligations to its clearing members notwithstanding a default by the clearing members creating the two largest financial exposures for the SIDCO in extreme but plausible market conditions.

Financial resources that a DCO would be permitted to use to meet the requirement include: (1) margin of a defaulting clearing member; (2) the DCO's own capital; (3) guaranty fund deposits; (4) default insurance; and (5) potential assessments for additional guaranty fund contributions.

At appropriate intervals, but not less than quarterly, a DCO would have to compute the current market value of each financial resource. Haircuts would have to be applied as appropriate and evaluated on a quarterly basis.

The value of assessments would be subject to a 30 percent haircut, and a DCO would only be permitted to count the value of assessments, after the haircut, to meet up to 20 percent of the requirement. A DCO that is also a SIDCO would not be able to count the value of assessments to meet the obligations arising from a default by the clearing member creating the single largest financial exposure; it could however count the value of assessments, after the 30 percent haircut, to meet up to 20 percent of the obligations arising from a default by the clearing member creating the second largest financial exposure.

The financial resources allocated to meet the requirement would have to be sufficiently liquid to enable a DCO to fulfill its obligations during the settlement cycle. A DCO would be allowed to take into account a committed line of credit or similar facility for the purpose of meeting the liquidity requirement. A DCO also would be required to have sufficient cash to meet the average daily settlement variation pay per clearing member over the last fiscal quarter.

A DCO would be required, on a quarterly basis, to perform stress testing that would allow it to make a reasonable calculation of the financial resources needed to meet the requirement.

Operating resources

The proposed rule would also require a DCO to maintain sufficient financial resources to cover its operating costs for at least one year, calculated on a rolling basis. Financial resources that a DCO would be permitted to use to meet the requirement include the DCO's own capital and any other financial resource deemed acceptable by the Commission.

At appropriate intervals, but not less than quarterly, a DCO would have to compute the current market value of each financial resource. Haircuts would have to be applied as appropriate and evaluated on a quarterly basis.

The financial resources allocated to cover operating expenses for one year would have to include unencumbered, liquid financial assets (i.e., cash and/or highly liquid securities) equal to at least six months' operating costs. A DCO would be allowed to take into account a committed line of credit or similar facility for the purpose of meeting the liquidity requirement.

A DCO would be required, on a quarterly basis, to make a reasonable calculation of its projected operating costs over a 1-year period.

Reporting

Each fiscal quarter, or at any time upon Commission request, a DCO would be required to report to the Commission:

- The amount of financial resources necessary to meet the regulatory requirements;
- The value of each financial resource available;
- For guaranty fund deposits, the value of each individual clearing member's guaranty fund deposit; and
- A written explanation of the methodology used to compute its financial requirements.

A DCO also would have to provide the Commission with a financial statement, including the balance sheet, income statement, and statement of cash flows, of the DCO or its parent company