Commodity Futures Trading Commission
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Orderly Liquidation Termination Provision in Swap Trading Relationship Documentation for Swap Dealers and Major Swap Participants

The Commodity Futures Trading Commission (Commission) is proposing a regulation establishing a requirement that swap trading relationship documentation for swap dealers and major swap participants include a provision regarding termination rights in the event a party becomes subject to the orderly liquidation provisions of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act or the Federal Deposit Insurance Act (FDIA).

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

Section 731 of the Dodd-Frank Act amends the Commodity Exchange Act (CEA) by adding section 4s, which sets forth a number of requirements for swap dealers and major swap participants. This rulemaking is being proposed pursuant to section 4s(i). Section 4s(i)(1) requires swap dealers and major swap participants to "conform with such standards as may be prescribed by the Commission by rule or regulation that relate to the timely and accurate confirmation, processing, netting, documentation, and valuation of all swaps." Section 4s(i)(2) expressly directs the Commission to "adopt rules governing documentation standards for swap dealers and major swap participants."

Proposed Orderly Liquidation Termination Provision Rule

On January 13, 2011, the Commission voted to issue a notice of proposed rulemaking entitled, "Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants." This proposed regulation would supplement that proposal and set forth another element of the swap trading relationship documentation that swap dealers, major swap participants, and their counterparties must include in their documentation.

The proposed regulation would require that swap dealers and major swap participants include in the documentation with each of their counterparties a provision that confirms both parties' understanding of how the new orderly liquidation authority under the Title II of the Dodd-Frank Act and the FDIA may affect their portfolios of uncleared, over-the-counter, bilateral swaps.

As part of the resolution authority in Title II and in the existing provisions of the FDIA for insured depository institutions, the Federal Deposit Insurance Corporation (FDIC) is given a one business day period in which to transfer swaps and certain other contracts to a solvent third party financial institution. For this transfer authority to be effective, a brief stay on the ability of counterparties to terminate, liquidate, or net is necessary.

The proposed regulation would ensure both counterparties to a swap understand that under particular, unique circumstances, if one of the counterparties to a swap defaults, the non-defaulting party's swap positions could be transferred to a new, solvent counterparty by the FDIC, and the non-defaulting party may not be able to terminate its claims against the defaulting counterparty until 5:00 p.m. (U.S. eastern time) on the business day following the day the FDIC is appointed receiver. This stay would facilitate the FDIC's orderly liquidation of the defaulting counterparty's swap positions. This stay also is critical because it would allow the FDIC the requisite time to transfer the defaulter's open swap positions, claims, and collateral with the objective of avoiding widespread market disruption in the form of fire sales and contagion risk. The proposed regulations also would require that each party consent to the transfer of swaps by the FDIC to a performing third party.