



## U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre  
1155 21st Street, NW, Washington, DC 20581  
Telephone: (202) 418-5430  
Facsimile: (202) 418-5536

Division of Clearing  
and Risk

CFTC Letter No. 12-09  
No-Action  
September 26, 2012  
Division of Clearing and Risk

Walter L. Lukken  
President and CEO  
Futures Industry Association  
2001 Pennsylvania Ave. N.W., Suite 600  
Washington, DC 20006-1823

### **Extension for Compliance with Regulation 1.73(a)(1) for Small Exchanges and Regulation 1.73(a)(2)(iv)-(v) - Automated Screening of Give-up and Bunched Orders**

Dear Mr. Lukken:

On April 9, 2012, the Commission published clearing member risk management rules.<sup>1</sup> The Rules are codified in Part 1 of the Commission's regulations and become effective on October 1, 2012. Section 1.73 requires a clearing futures commission merchant ("FCM") of a registered derivatives clearing organization ("DCO") to establish risk-based limits and screen orders for compliance with those limits. Section 1.73 applies to FCMs clearing those products for which the clearing organization is registered with the Commission as a DCO. Section 1.73(a)(2)(iv) requires that a clearing FCM accepting give-up trades establish limits for each customer and enter into an agreement in advance with the executing firm to enforce those limits.

As discussed in the April 9, 2012 release, the Commission does not intend to prescribe the manner of risk limits a clearing FCM must use.<sup>2</sup> Clearing FCMs retain the flexibility to satisfy Section 1.73(a)(1)-(2) with "simple numerical limits on order or position size, or through more complex margin-based limit[s]," or "price limits that would reject orders that are too far away from the market, or limits on the number of orders that could be placed in a short time."<sup>3</sup>

The Division would like to re-iterate that 1.73(a)(2) does not require full portfolio-based pre-trade screening. As stated above, clearing FCMs may choose to implement other limits, which may be less sophisticated than full portfolio-based margining. Such alternatives include limits based on order size, position size, price limits, volume limits, or other risk-based factors.

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<sup>1</sup> 77 FR 21278.

<sup>2</sup> 77 FR 21288.

<sup>3</sup> Id.

The Division disagrees that “subparagraph (a)(2) should be read in the context of the several provisions of the rule and viewed as one aspect of the clearing member FCM’s risk management program, to be implemented flexibly.” The flexibility in Section 1.73(a)(1)-(2) pertains to the manner of evaluating risk, not when the risk should be evaluated. The rule requires a pre-execution limit check only for orders that are subject to automated execution or automated order routing. As noted in the April 9, 2012 release, risk controls reasonably designed to ensure compliance are sufficient for non-automated order execution, such as open outcry and voice brokers. The Commission wrote, it “is not practicable at this time to use automated means to screen such orders. A clearing member, however, can actively monitor a trader’s activities and be in communication if the trader approaches a limit.”<sup>4</sup>

The Division understands that several firms are prepared to comply with all of Section 1.73 on October 1, 2012. In a letter dated July 2, 2012, the Futures Industry Association (“FIA”) acknowledged that Globex and WebICE permit limits to be set on a net initial margin basis.<sup>5</sup> These systems, as well as a number of other systems currently in use in the industry, also provide for other compliant types of limits such as lot size. However, the Division also understands that several small designated contract markets (“DCMs”) currently do not have systems that permit FCMs to set pre-execution limits. The Division hereby grants an extension for compliance with 1.73(a)(2)(i), if necessary, with respect to those transactions executed on DCMs that do not have a system permitting FCMs to set pre-execution limits, until the earlier of the date on which the DCM implements such a system, or June 1, 2013, unless FIA is notified otherwise.

FIA also raised concerns that certain clearing FCMs will be unable to produce fully compliant risk management systems for give-up trades for futures under Section 1.73(a)(2)(iv) by the compliance date. FIA requested that the Division of Clearing and Risk defer the effective date for a period of not less than six months.<sup>6</sup>

In light of these circumstances, the Division herein grants the requested extension thereby requiring compliance with Regulation 1.73(a)(2)(iv) (give-ups) no later than June 1, 2013, unless FIA is notified otherwise. The Division recognizes that similar considerations apply to bunched orders. Accordingly, the Division herein also grants an extension thereby requiring compliance with Regulation 1.73(a)(2)(v) (bunched orders) no later than June 1, 2013, unless FIA is notified otherwise.

This extension is granted by the Division in reliance on the representations contained in your request, and any different, changed, or omitted material facts or circumstances may require termination of the extension and immediate action by clearing member FCMs to facilitate compliance. The Division retains the authority to condition further, modify, suspend, or otherwise restrict the extension granted herein.

Notwithstanding the extension granted herein, the Division reminds clearing member FCMs that they remain responsible for the other risk management requirements of Sections

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<sup>4</sup> Id. at 21288.

<sup>5</sup> FIA letter at 5, n.11 (July 2, 2012).

<sup>6</sup> Id. at 2.

1.73(a)(1), (a)(2)(i)-(iii), (a)(3)-(a)(8), and (b), and that reliance on other entities, including third-party vendors, does not excuse a failure to comply with such requirements. Finally, the Division reminds the public that other applicable provisions of Parts 1, 23, and 37-39, still become effective on October 1, 2012 for both futures and swaps.

This letter represents the position of the Division only and does not necessarily represent the views of the Commission or those of any other division or office of the Commission.

If you have any questions concerning this correspondence, please contact John C. Lawton, Deputy Director, at 202-418-5480, or [jlawton@cftc.gov](mailto:jlawton@cftc.gov), or Christopher Hower, Attorney-Advisor, at 202-418-6703 or [chower@cftc.gov](mailto:chower@cftc.gov).

Sincerely,

Ananda Radhakrishnan  
Director