

Credit Default Swaps

Interim Pilot Program on Margin Requirements for Credit Default Swaps

Effective Date: July 16, 2011

Executive Summary

FINRA Rule 4240 established an interim pilot program (the Interim Pilot Program) with respect to margin requirements for certain transactions in credit default swaps (CDS). This *Notice* addresses FINRA approval of margin methodologies used by clearing agencies or derivatives clearing organizations for purposes of Rule 4240.

FINRA has extended the Interim Pilot Program to January 17, 2012.

The text of FINRA Rule 4240 is available in the online [FINRA Manual](#).

Questions concerning this *Notice* should be directed to:

- ▶ Rudolph R. Verra, Managing Director, Risk Oversight and Operational Regulation, at (646) 315-8811;
- ▶ Glen Garofalo, Director, Credit Regulation, at (646) 315-8464;
- ▶ Steve Yannolo, Project Manager, Credit Regulation, at (646) 315-8621; or
- ▶ Adam H. Arkel, Assistant General Counsel, Office of General Counsel, at (202) 728-6961.

Background & Discussion

In May 2009, the SEC approved FINRA Rule 4240, which established the Interim Pilot Program with respect to margin requirements for CDS and addresses related risk monitoring procedures and guidelines.¹ FINRA has extended the implementation of Rule 4240 so that the rule will expire on January 17, 2012.²

July 2011

Notice Type

- ▶ Rule Amendment

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Margin Department
- ▶ Operations
- ▶ Regulatory Reporting
- ▶ Risk Management
- ▶ Senior Management

Key Topics

- ▶ Approved Margin Methodology
- ▶ Credit Default Swaps
- ▶ Margin Requirements

Referenced Rules & Notices

- ▶ FINRA Rule 4240

FINRA Rule 4240(a), as revised effective July 16, 2011,³ provides in part that the Interim Pilot Program applies with respect to margin requirements for any transactions in CDS executed by a member (regardless of the type of account in which the transaction is booked).⁴ The rule's scope includes certain transactions that are cleared through a clearing agency or derivatives clearing organization that provides central counterparty clearing services using a margin methodology approved by FINRA as announced in a *Regulatory Notice* (referred to in the rule as an "approved margin methodology"). Paragraph (c)(1) of the rule addresses margin requirements that apply to CDS cleared through a clearing agency or derivatives clearing organization using such an approved margin methodology.⁵

Currently, FINRA has approved the use of the margin methodology of the central counterparty clearing facilities of the Chicago Mercantile Exchange (CME) for purposes of FINRA Rule 4240. Further, FINRA has approved the use of the margin methodology of ICE Trust (ICE) for purposes of the rule on an interim basis, pending further review by FINRA. FINRA will consider margin methodology proposals from other clearing agencies or derivatives clearing organizations that provide central counterparty clearing services,⁶ and will announce the approval of the use of any such margin methodologies in future *Regulatory Notice(s)* as appropriate. FINRA expects to consider in the future whether to supersede the Interim Pilot Program with a permanent comprehensive rule governing margin requirements for all swap and security-based swap transactions effected by a member.

Endnotes

1. See Securities Exchange Act Release No. 59955 (May 22, 2009), 74 FR 25586 (May 28, 2009) (Notice of Approval of Proposed Rule Change; File No. SR-FINRA-2009-012) ("Approval Order"). See also *Regulatory Notice 09-30* (June 2009) (Credit Default Swaps).
2. See SR-FINRA-2011-034.
3. See note 2.
4. The rule provides that the term CDS includes any product that is commonly known to the trade as a credit default swap and is a swap or security-based swap as defined pursuant to Section 1a(47) of the Commodity Exchange Act and Section 3(a)(68) of the Securities Exchange Act, respectively, or the joint rules and guidance of the CFTC and the SEC and their staff.
5. Paragraph (c)(2) of the rule addresses margin requirements that apply to CDS that are cleared on central counterparty clearing facilities that do not use an approved margin methodology or that settle over-the-counter.
6. See the Approval Order at 74 FR 25589.

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