

## Title VII of the Dodd-Frank Act One Year Later: Piecing Together the Dodd-Frank 'Mosaic' for Derivatives Regulation

### Introduction

Today marks the one-year anniversary of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).<sup>1</sup> Among the major changes the 846-page statute contemplates, Title VII's 161 pages provide a statutory framework for comprehensive regulation of swaps by the Commodity Futures Trading Commission (CFTC) and security-based swaps (SB swaps) by the Securities and Exchange Commission (SEC). Swaps touch nearly every facet of our economy. Yet before the Dodd-Frank Act, regulation of swap markets and trading activities was modest and uneven at best.

The Dodd-Frank Act overhauls today's piecemeal approach by requiring 1) reports of all swap transactions, including public reports of swap prices and volumes; 2) clearing of many swaps to remove counterparty credit risk and ameliorate systemic risk; 3) trading on regulated platforms of most cleared swaps; and 4) registration and regulation of swap dealers (SDs) and major swap participants (MSPs). To promote hedging and risk management, the Dodd-Frank Act also allows commercial businesses to elect whether to clear and trade their swaps on a platform. This new statutory framework has presented the CFTC and the SEC with an ambitious and historic challenge: to develop for an ongoing, massive and international financial market a completely new and far-reaching set of regulatory guideposts and systems.

While the Dodd-Frank Act embodied the congressional goal that the CFTC and the SEC could complete their work in 360 days, the agencies' best-intentioned best efforts fell short. To date, most of the Dodd-Frank Act rules that are needed to implement the new regulatory structure have not been adopted. Some of those rules have not even been proposed. Nonetheless, the image of what CFTC Chairman Gensler calls the Dodd-Frank "mosaic" is becoming easier to see almost daily. In the past year, this mosaic has emerged through the CFTC's issuance of 52 advanced and regular notices of proposed rulemaking, two interim final rules, 10 final rules and a proposed interpretive order. For its part, the SEC has issued 46 advanced and regular notices of proposed rulemaking, two interim final rules, nine final rules and two proposed interpretations (one in the form of an order, the other an interpretive guidance).

Public input has been plentiful. Tens of thousands of public comment letters have been filed. Countless meetings have been held. The agencies also have conducted jointly seven roundtable discussions with members of the public on issues of special interest.<sup>2</sup> And the process goes on as the CFTC and the SEC continue to make judgments about how best to implement the statutory directives Congress has adopted and to fill in the blanks when Congress has left gaps for the exercise of informed discretion.

*If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.*

**Mark D. Young**  
Washington, D.C.  
202.371.7680  
mark.d.young@skadden.com

**Maureen A. Donley**  
Washington, D.C.  
202.371.7570  
maureen.donley@skadden.com

**Brian M. Duncan**  
Washington, D.C.  
202.371.7396  
brian.duncan@skadden.com

**Prashina J. Gagoomal**  
Washington, D.C.  
202.371.7522  
prashina.gagoomal@skadden.com

**George M. Gilbert**  
Washington, D.C.  
202.371.7516  
george.gilbert@skadden.com

**Timothy S. Kearns**  
Washington, D.C.  
202.371.7244  
timothy.kearns@skadden.com

**Daniel S. Konar II**  
Washington, D.C.  
202.371.7102  
daniel.konar@skadden.com

**Rachel Kaplan Reicher**  
Washington, D.C.  
202.371.7042  
rachel.reicher@skadden.com

**Grey A. Tanzi**  
Chicago  
312.407.0891  
grey.tanzi@skadden.com

\* \* \*

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Four Times Square, New York, NY 10036  
Telephone: 212.735.3000

[WWW.SKADDEN.COM](http://WWW.SKADDEN.COM)

<sup>1</sup> Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>2</sup> Additional information about the roundtables can be found on the CFTC's website at: <http://www.cftc.gov/PressRoom/Events/OtherEvents/index.htm>. CFTC and SEC Staff Roundtable to Discuss Governance and Conflicts of Interest in the Clearing and Listing of Swaps (Aug. 20, 2010); CFTC and SEC Staff Roundtable to Discuss Swap Data, Swap Data Repositories and Real Time Reporting (Sept. 14, 2010); CFTC and SEC Staff Roundtable on Swap Execution Facilities and Security-Based Swap Execution Facilities (Sept. 15, 2010); CFTC and SEC Staff Roundtable on Credit Default Swaps (Oct. 22, 2010); CFTC and SEC Staff Roundtable to Discuss Issues Related to Capital and Margin for Swaps and Security-Based Swaps (Dec. 10, 2010); Day 1-2 CFTC and SEC Staff Roundtable Discussion on Dodd-Frank Implementation (May 2-3, 2011); and CFTC and SEC Staff Roundtable Discussion on Proposed Dealer and Major Participant Definitions under Dodd-Frank Act (June 16, 2011).

Although much about the final Dodd-Frank Act structures remains unknown today, we are hoping a summary at the one-year anniversary date of the color and shape of the major “tiles” being considered for the regulatory mosaic will help market participants and observers to gauge better what the derivatives market regulatory structures will look like when the agencies complete their work. Please let us know if you have any comments or questions on the matters we discuss, or if you would like additional information on any of the topics covered.

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## I. Jurisdiction and Products

### A. Product Definitions – Swaps, Security-Based Swaps, Mixed Swaps

Under Title VII, the CFTC regulates all swaps except “security-based swaps,” which are regulated by the SEC. But the Dodd-Frank Act requires the CFTC and the SEC to jointly further define the terms “swap,” “security-based swap,” “mixed swap” and “security-based swap agreement.”<sup>3</sup> Further definition is warranted because the statutory definition of a “swap” is both expansive and accompanied by major categories of exclusions from that expansive definition.

In April 2011, the CFTC and the SEC issued a joint rulemaking proposal that would further define these terms.<sup>4</sup> The proposal would classify a number of contracts and agreements as outside the swap/SB swap definition, including specified insurance products, forward contracts in non-financial commodities, specified consumer and commercial transactions, and certain loan participations. The proposal espouses an overarching principle that the economic reality and substance of a transaction, as opposed to its form or label, determines whether that transaction is a swap or not. The public comment period for the Commissions’ product proposal ends on July 22, 2011.

The joint proposal offers a number of criteria by which the CFTC and the SEC would classify swaps and SB swaps. In general, an instrument based on a single security or loan or narrow-based security index (nine or fewer securities) would be treated as a SB swap and subject to SEC regulation. Conversely, most instruments based on broad-based security indices (10 or more securities) would be classified as swaps and subject to CFTC regulation. The Commissions’ proposal also would characterize mixed swaps as a narrow product category that includes, among others, instruments with references that have a mixed portfolio of securities and commodities.<sup>5</sup>

The Commissions’ proposal clarifies that the exclusion of non-financial commodity forward contracts from the “swap” definition is to be interpreted consistently with the forward contract exclusion from futures contracts. According to the proposal, the distinguishing feature of an excluded forward contract is the “intent to deliver” the underlying commodity, which has historically been, and should continue to be, inferred from the “facts and circumstances” of a given situation. The Commissions’ proposal fails to provide guidance on how to distinguish swaps from futures contracts, although the statute expressly excludes futures from the swap definition.

### B. Agricultural Commodities

The Dodd-Frank Act gives the CFTC discretion to treat swaps on agricultural commodities differently from other swaps.<sup>6</sup> Although certain provisions of the pre-Dodd-Frank Act CEA reference agricultural commodities, the term “agricultural commodity” historically has been undefined for purposes of the CEA and CFTC regulations.<sup>7</sup> On July 7, 2011, the CFTC issued final rules defining this heretofore

3 Dodd-Frank Act § 712(a)(8).

4 Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, *76 Fed. Reg. 29818* (May 23, 2011). Additional information about the meetings at which this proposed rule was issued can be found on the CFTC’s website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank042711.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank042711.html) and on the SEC’s website at <http://sec.gov/news/press/2011/2011-99.htm>.

5 Bilateral uncleared mixed swaps where one party is registered with both the CFTC and the SEC as a SD or security-based swap dealer (SB SD) or as a MSP or major security-based swap participant (MSBSP) will be required to comply with parallel provisions of the CEA and Exchange Act while being required to comply with the remaining provisions of either the Commodity Exchange Act (CEA) or Exchange Act.

6 Dodd-Frank Act § 723(c)(3)(B).

7 However, certain provisions of the pre-Dodd-Frank Act CEA reference agricultural commodities. The Dodd-Frank Act deleted two of these provisions, Sections 2(g) and 5a(b)(2)(F) of the CEA.

undefined term.<sup>8</sup> The final rules, effective on September 12, 2011, set out four categories of agricultural commodities:

- The items specifically enumerated in the “commodity” definition found in Section 1a of the CEA (for example, wheat, corn and soybeans);<sup>9</sup>
- All other commodities that are, or once were, or are derived from, living organisms, including plant, animal and aquatic life, which generally are fungible, within their respective classes, and are used primarily for human food, shelter, animal feed or natural fiber;
- Tobacco, products of horticulture and such other commodities used or consumed by animals or humans as the CFTC may designate by rule, regulation or order; and
- Commodity-based indexes based wholly or principally on underlying agricultural commodities.

Once the CFTC adopts its swaps regulatory framework, the agricultural commodity definition may have little substantive impact. Although the Dodd-Frank Act gives the CFTC discretion to treat swaps on agricultural commodities differently from other swaps, the CFTC has proposed rules to treat agricultural swaps the same as all other swaps.<sup>10</sup> Most commenters have supported the proposal.

### C. Foreign Exchange Products

The Dodd-Frank Act modifies the regulation of institutional and retail foreign exchange (forex) markets. Many foreign currency derivatives would qualify as swaps under Section 1a(47) of the amended CEA. However, the Dodd-Frank Act permits the Secretary of the Treasury to determine that foreign exchange forwards and foreign exchange swaps should be exempted from the swap definition.<sup>11</sup> In late April 2011, the Treasury Department proposed to issue such a determination and invited comment on the proposal.<sup>12</sup> The bulk of comments filed supported the Treasury’s proposal.

Under Section 2(c)(2) of the amended CEA, only certain counterparties are eligible to engage in off-exchange forex transactions with retail customers.<sup>13</sup> Eligible counterparties include U.S. financial

8 Agricultural Commodity Definition, [76 Fed. Reg. 41048](#) (July 13, 2011). The CFTC issued its proposed agricultural commodity definition in October 2010. See Agricultural Commodity Definition, [75 Fed. Reg. 65586](#) (Oct. 26, 2010). Additional information about the meeting at which this proposed rule was issued can be found on the CFTC’s website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank101910.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank101910.html).

9 Notably, onions are the only agricultural product specifically excluded from the list of enumerated commodities in Section 1a of the CEA. However, the CFTC notes that the definition of swap in Section 1a(47) of the amended CEA is not limited to transactions based upon “commodities,” and concludes on that basis that onion swaps would be permissible. The same logic would seem to apply to motion picture box office receipts which were not addressed by the CFTC’s proposal, but like onions, are specifically excluded from the definition of “commodity.”

10 Commodity Options and Agricultural Swaps, [76 Fed. Reg. 6095](#) (Feb. 3, 2011). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC’s website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank012011.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank012011.html).

11 Dodd-Frank Act § 721(a)(21) (adding new CEA § 1a(47)).

12 Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act, [76 Fed. Reg. 25744](#) (May 5, 2011). Even if exempted, foreign exchange swaps and forwards would still remain subject to the Dodd-Frank Act’s trade reporting requirements, anti-evasion requirements and strengthened business conduct standards. The determination would not apply to any foreign exchange swap or forward executed on a designated contract market (DCM) or swap execution facility (SEF), or that is cleared by a derivatives clearing organization (DCO). In its proposed determination, Treasury notes that physical delivery is the defining feature of foreign exchange swaps and forward. Other currency derivatives, including non-deliverable forwards, would not be covered by the proposed Treasury determination and likely will be considered swaps subject to full CFTC regulation.

13 See Dodd-Frank Act § 742 (amending CEA § 2(c)(2)). A retail counterparty is any counterparty who is not an eligible contract participant.

institutions, broker-dealers, futures commission merchants (FCMs), financial holding companies and retail foreign exchange dealers. Another provision in Section 2(c)(2) prohibits eligible counterparties who are subject to a federal regulatory agency from entering into a retail forex transaction except pursuant to a rule or regulation of that federal regulatory agency.<sup>14</sup> Several regulatory agencies, including the CFTC, the SEC, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (FDIC), have adopted rules to permit the eligible counterparties they supervise to engage in the retail forex business.<sup>15</sup>

## II. New Registration Categories

### A. Swap Dealers, Security-Based Swap Dealers, Major Swap Participants and Major Security-Based Swap Participants

To ensure that the swap exposure of a single, interconnected counterparty does not threaten the United States financial system, the Dodd-Frank Act creates new registration categories for systemically-important swaps entities: SDs, security-based swap dealers (SB SDs), MSPs and major security-based swap participants (MSBSPs).<sup>16</sup> The CFTC and the SEC have proposed rules to implement statutory directives regarding the definition, registration, and regulation of these entities.

#### *i. Proposed Definitions of SD, SB SD, MSP and MSBSP*

Under the Dodd-Frank Act, dealers would generally be entities that hold themselves out as dealers in swaps, make a market in swaps, or engage in activities causing them to be known as a dealer or market maker.<sup>17</sup> Put differently, dealer regulation will cover the liquidity providers in the swap and SB swap market. The Dodd-Frank Act excludes from the dealer category entities that engage in only a *de minimis* amount of swap dealing activity or that enter into swaps or SB swaps for their own account, but not as part of a regular business.

Major participants are those non-dealer entities who engage in systemically important swap or SB swap activity. The Dodd-Frank Act specifies that major participants maintain “substantial” swap positions, create “substantial counterparty exposure” that could affect the stability of the U.S. banking system or financial markets, or highly leveraged entities that maintain “substantial position[s]” in swaps.<sup>18</sup> The Dodd-Frank Act requires the CFTC and the SEC to adopt regulations to further define key terms of major participant definitions.

On August 13, 2010, the CFTC and the SEC jointly issued an advance notice of proposed rulemaking (ANPR) soliciting comments on the definitions of key terms, including SD, SB SD, MSP and MSBSP.<sup>19</sup> In December 2010, the Commissions jointly proposed rules further

<sup>14</sup> CEA § 2(c)(2), as amended by the Dodd-Frank Act.

<sup>15</sup> The CFTC adopted regulations concerning retail foreign exchange transactions in the fall of 2010. See Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries, [75 Fed. Reg. 55410](#) (Sep. 10, 2010). The SEC has adopted an interim final temporary rule permitting SEC-regulated eligible counterparties to operate a retail forex business. The SEC’s interim final temporary rule will remain in effect until July 16, 2012. Retail Foreign Exchange Transactions, [76 Fed. Reg. 41676](#) (July 15, 2011). Two bank regulators, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation, also have adopted final retail forex rules. Retail Foreign Exchange Transactions, [76 Fed. Reg. 41375](#) (July 14, 2011) (OCC’s Rule); See Retail Foreign Exchange Transactions, [76 Fed. Reg. 40779](#) (July 12, 2011) (FDIC’s Rule). Other bank regulators have not yet acted.

<sup>16</sup> The term “Dealers” refers to SDs and SB SDs together. The term “Major Participants” refers to MSPs and MSBSPs together.

<sup>17</sup> Dodd-Frank Act §§ 721(a)(21) (adding new CEA § 1a(49)), 761(a)(6) (adding new Exchange Act § 3(a)(71)).

<sup>18</sup> Dodd-Frank Act §§ 721(a)(16) (adding new CEA § 1a(33)), 761(a)(6) (adding new Exchange Act § 3(a)(67)).

<sup>19</sup> Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, [75 Fed. Reg. 51429](#) (Aug. 20, 2010).



defining SD, SB SD, MSP and MSBSP.<sup>20</sup> With respect to SDs and SB SDs, the proposals look to whether a market participant serves the function of a Dealer and propose a *de minimis* threshold. The focus of the major participant proposals is on the entity who bears the risk of a swap position (so asset managers will not be major participants based on the positions they enter into on behalf of clients). To determine whether an entity is a major participant, the proposed rules create threshold exposures in the major swap and SB swap categories (rate, credit, equity and other for swaps; credit and other for SB swaps). The CFTC and SEC have not finalized the definitions.

## *ii. Registration and Regulation of SDs, SB SDs, MSPs and MSBSPs*

The Dodd-Frank Act directs the CFTC and the SEC to establish registration requirements and rules governing dealer and major participant activities including business conduct standards and margin and capital requirements. Accordingly, the CFTC and the SEC have proposed rules for the registration and regulation of Dealers and Major Participants. Notably, the proposed rules treat Dealers and Major Participants identically for most purposes, even though they play very different roles in the swap markets.

### (1) Registration Requirements

The Dodd-Frank Act forbids any person from acting as a dealer or major participant unless that person is appropriately registered with the CFTC or the SEC and requires the CFTC and the SEC to establish registration requirements.<sup>21</sup>

On November 10, 2010, the CFTC proposed rules regarding registration of SDs and MSPs.<sup>22</sup> The proposed rules generally would require SDs and MSPs to become full members of the National Futures Association (NFA) and register through NFA, generally following the procedures used for registering FCMs, introducing brokers (IBs), retail foreign exchange dealers, commodity pool operators (CPOs) and commodity trading advisors (CTAs). The CFTC has not issued final registration rules. The SEC has not yet proposed registration rules for SB SDs and MSBSPs.<sup>23</sup>

### (2) Internal Business Conduct Standards

The Dodd-Frank Act creates additional requirements for Dealers and Major Participants including reporting and recordkeeping, designation of a chief compliance officer, conflicts of interest, governing rules, trading records and documentation. The CFTC has proposed six separate rules to implement these requirements, none of which have been finalized, while the SEC has yet to propose internal business conduct standards.

20 Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant,” Joint Proposed Rule, [75 Fed. Reg. 80174](#) (Dec. 21, 2010). The CFTC voted to propose this rule on December 1, 2010 and the SEC voted to propose the rule on December 7, 2010. Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC’s website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank120110.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank120110.html).

21 Dodd-Frank Act §§ 731 (adding new CEA § 4s), 764(a) (adding new Exchange Act § 15F).

22 Registration of Swap Dealers and Major Swap Participants, [75 Fed. Reg. 71379](#) (Nov. 23, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC’s website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank111010.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank111010.html)

23 It is notable that the CFTC proposed many substantive requirements for SDs and MSPs before it proposed definitions. Many commenters noted that by sequencing rulemakings in this manner, the CFTC put some market participants in the awkward position of commenting without knowing whether they likely would be MSPs or SDs.

On December 1, 2010, the CFTC proposed reporting and recordkeeping rules for SDs and MSPs.<sup>24</sup> The proposal prescribes records SDs and MSPs must maintain including full and complete swap transaction information as well as general business records. The rules would require SDs and MSPs to retain daily trading records, including pre-execution, execution and post-execution data. Pre-execution records would include records of all oral and written communications that led to the execution of a swap, including recordings of telephone calls and other communications created in the normal course of business (but would not establish a new requirement to record all telephone conversations so long as the complete audit trail requirement can be met through other means).

On November 10, 2010, the CFTC proposed:

- rules requiring each SD and MSP to appoint a chief compliance officer (CCO) and prescribing the qualifications and duties of a CCO.<sup>25</sup> Among their duties, CCOs would be required to prepare, certify, and provide the CFTC with an annual compliance report;
- rules relating to conflicts of interest.<sup>26</sup> The proposed rules relate primarily to research reports, internal walls and the decision to accept a customer for clearing; and
- rules relating to establishing and governing the duties of SDs and MSPs.<sup>27</sup> The proposed rules address risk management procedures, monitoring of trading to prevent position limit violations, diligent supervision, business continuity and disaster recovery, disclosure and the ability of regulators to obtain information, and anti-trust considerations.

On December 16, 2010, the CFTC proposed confirmation, portfolio reconciliation and portfolio compression requirements.<sup>28</sup> SDs and MSPs entering into a swap with another SD or MSP would have to obtain a confirmation the same day as the transaction, while transactions between a SD or MSP and a non-SD or non-MSP would have to be confirmed no later than the day following the transaction. More stringent requirements would apply to transactions executed electronically. For uncleared swaps, SDs and MSPs would have to reconcile swap portfolios with other SDs and MSPs periodically (ranging from daily to quarterly depending upon the number of swaps); reconciliation would be left to the discretion of the SD or MSP for transactions with a non-SD or non-MSP.

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24 Reporting, Recordkeeping, and Daily Trading Records Requirements for Swap Dealers and Major Swap Participants, **75 Fed. Reg. 76666** (Dec. 9, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank120110.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank120110.html).

25 Designation of a Chief Compliance Officer; Required Compliance Policies; and Annual Report of a Futures Commission Merchant, Swap Dealer, or Major Swap Participant, **75 Fed. Reg. 70881** (Nov. 19, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank111010.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank111010.html).

26 Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants, **75 Fed. Reg. 71391** (Nov. 23, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank111010.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank111010.html).

27 Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, **75 Fed. Reg. 71397** (Nov. 23, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank111010.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank111010.html).

28 Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, **75 Fed. Reg. 81519** (Dec. 28, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank121610.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank121610.html).

On January 13, 2011, the CFTC proposed rules relating to swap trading relationship documentation for SDs and MSPs.<sup>29</sup> The proposed rules would specify that such documentation must include a written agreement by the parties relating to payment obligations, netting of payments, events of default or other termination events, netting of obligations upon termination, transfer of rights and obligations, governing law, valuation, and dispute resolution procedures. Documentation requirements also would include credit support agreements that impose initial and variation margin requirements at least as high as those set by the CFTC and Prudential Regulators.<sup>30</sup> If a swap counterparty is relying on the commercial end-user exemption to the clearing mandate, SDs and MSPs would have to obtain documentation sufficient to provide a reasonable basis to believe that the counterparty satisfies the clearing exemption.

### (3) Business Conduct Standards With Counterparties

The Dodd-Frank Act also creates external business conduct standards for Dealers and Major Participants – *i.e.* business conduct standards that apply when dealing with counterparties.<sup>31</sup> The statute sets forth required standards that the CFTC and the SEC must adopt and permissive standards that the CFTC and the SEC may adopt. Under the required standards, Dealers and Major Participants must verify a counterparty’s status as an ECP, make certain disclosures of material information about swaps and SB swaps to counterparties, and communicate with counterparties in a fair and balanced manner. The permissive standards allow the CFTC and SEC to establish rules relating to fraud, manipulation, abusive practices, diligence supervision, adherence to position limits and other matters the Commissions deem appropriate. Dealers and Major Participants have additional duties when dealing with special entities such as governmental entities and ERISA plans.

On December 9, 2010, the CFTC proposed business conduct standards for SDs and MSPs when dealing with counterparties, including prospective counterparties.<sup>32</sup> In addition to the rules required by the Dodd-Frank Act, the CFTC proposed know-your-customer requirements for SDs and MSPs that could require a counterparty to make reasonably detailed representations. Notably, such requirements apply equally to SDs and MSPs even though MSPs, as buy-side market participants, are technically the “customers” in a given transaction. In effect, the CFTC’s proposed rules could require MSPs to protect the best interests of their dealers. The proposal also would prohibit fraud, manipulation and other abusive practices such as trading ahead and front-running.

The proposed rules also would address business conduct standards for SDs and MSPs when dealing with special entities. SDs and MSPs would be required to have a reasonable basis to believe that any counterparty who is a special entity has a qualified representative that is independent of the SD or MSP. Another controversial provision could inadvertently make SDs advisers to special entities, which would require SDs to take a special entity’s best interests into

29 Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, **76 Fed. Reg. 6715** (Feb. 8, 2011). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC’s website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank011311.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank011311.html).

30 The Prudential Regulators are the Office of the Comptroller of Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration and Federal Housing Finance Agency.

31 Dodd-Frank Act §§ 731 (adding new CEA § 4s(h)), 764(a) (adding new Exchange Act § 15F(h)).

32 Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, **75 Fed. Reg. 80638** (Dec. 22, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC’s website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank120910.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank120910.html).



account and could preclude a SD in effect from both recommending swaps to, and entering into swaps with, a counterparty. The CFTC has not issued final business conduct standards.

On June 29, 2011, the SEC proposed business conduct standards for SB SDs' and MSBSPs' dealings with counterparties.<sup>33</sup> While there are common elements between the SEC's and CFTC's proposal, a key difference is that the SEC takes a more permissive approach in permitting SB SDs and MSBSPs to rely on representations of their counterparties, including permitting special entities to represent in writing that they are not relying on the SB SD or MSBSP counterparty and are relying on an independent, qualified advisor. The comment period for the SEC's proposed rule ends on August 29, 2011.

#### (4) Margin Rules for Uncleared Swaps

The Dodd-Frank Act requires the CFTC and the SEC to establish minimum initial and variation margin requirements with respect to uncleared swaps and SB swaps for Dealers and Major Participants that are not regulated by a Prudential Regulator.<sup>34</sup> The Prudential Regulators must establish minimum margin requirements for uncleared swaps and SB swaps for Dealers and Major Participants they regulate.<sup>35</sup> The statute directs the CFTC, the SEC and the Prudential Regulators to create comparable requirements and to consult at least annually.

On April 12, 2011, the CFTC proposed margin requirements for uncleared swaps.<sup>36</sup> The proposal would generally require SDs and MSPs to collect initial and variation margin from swap counterparties. The proposal would impose initial margin requirements that are significantly higher than those for cleared swaps. Where both parties to a swap are SDs or MSPs, each party would be required to collect margin from the other (without reductions for off-setting obligations) and segregate the collateral with an independent custodian. For a limited universe of financial entities that have limited swap exposure and are subject to regulatory capital requirements (including those imposed by an insurance regulator), SDs and MSPs would not have to collect initial and variation margin below a negotiated threshold that would be subject to a maximum limit set by the CFTC. SDs and MSPs would not be required to collect margin from counterparties that are not financial entities (generally those entities eligible for the end-user exemption from the clearing mandate), but would be required to have a credit support agreement with those counterparties. Where margin is required, the proposal would limit eligible collateral to cash, U.S. Treasuries, and senior obligations of certain government-sponsored entities. For non-financial entities, to the extent the parties agree that initial margin is required, the non-financial entity could post any form of collateral whose value is reasonably ascertainable.

Extensive public comments have been filed on the CFTC's proposal. The CFTC is reviewing those comments and will issue final margin rules in the coming months.

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33 Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, **76 Fed. Reg. 42396** (July 18, 2011). Additional information about the meeting at which this proposed rule was issued can be found on the SEC's website at: <http://sec.gov/news/press/2011/2011-137.htm>.

34 Dodd-Frank Act §§ 731 (adding new CEA § 4s(e)), 764(a) (adding new Exchange Act § 15F(e)).

35 Dodd-Frank Act §§ 731 (adding new CEA § 4s(e)), 764(a) (adding new Exchange Act § 15F(e)).

36 Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, **76 Fed. Reg. 23732** (Apr. 28, 2011). Additional information about the meeting at which this proposed rule was issued can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank041211.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank041211.html).

On April 12, 2011, the Prudential Regulators jointly proposed corollary uncleared margin rules very similar to those proposed by the CFTC.<sup>37</sup> However, the Prudential Regulators would by default impose margin requirements on non-financial entities, but permit Dealers and Major Participants to provide non-financial counterparties with credit-based margin thresholds that could be unlimited. Also, under the Prudential Regulators' proposal, to the extent a non-financial entity exceeds its margin threshold, it would have to post collateral in the form of cash, U.S. Treasuries or senior obligations of certain government-sponsored entities. In extensive public comment letters, market participants have asked the Prudential Regulators to adopt the CFTC's approach with respect to non-financial entities. The Prudential Regulators have not issued final rules.

The express purpose driving both the CFTC's and the Prudential Regulators' proposals is to establish "margin requirements for uncleared swaps that are at least as stringent as those for cleared swaps" because the regulators conclude that uncleared swaps are riskier than cleared swaps.<sup>38</sup>

The SEC has not proposed margin rules for SB SDs and MSBSPs.

#### (5) Capital Requirements for Dealers and Major Participants

The Dodd-Frank Act requires the CFTC and the SEC to establish minimum capital requirements for Dealers and Major Participants that are not regulated by a Prudential Regulator.<sup>39</sup> The Prudential Regulators must establish minimum capital requirements for Dealers and Major Participants they regulate.<sup>40</sup> The statute directs the CFTC, the SEC and the Prudential Regulators to create comparable requirements and to consult with one another at least annually.

On April 27, 2011, the CFTC proposed capital requirements for SDs and MSPs.<sup>41</sup> The proposal would generally require SDs and MSPs to maintain tangible net equity of at least \$20 million, plus adjustments for market risk and derivatives credit risk that are generally based upon the Basel II requirements. In general, SDs and MSPs that are registered FCMs, subject to regulation by a Prudential Regulator, or designated as systemically important financial institutions would already be subject to separate capital requirements and would not be subject to the proposed capital requirements for SDs and MSPs. The CFTC is reviewing comments on the proposal and will issue final capital rules in the coming months.

The Prudential Regulators have not proposed separate capital requirements, but instead will rely on their existing regulatory capital rules, which are being modified under separate rulemakings.<sup>42</sup>

The SEC has not proposed capital requirements for SB SDs and MSBSPs.

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37 Margin and Capital Requirements for Covered Swap Entities, *76 Fed. Reg. 27564* (May 11, 2011).

38 See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, *76 Fed. Reg. at 23734*.

39 Dodd-Frank Act §§ 731 (adding new CEA § 4s(e)), 764(a) (adding new Exchange Act § 15F(e)).

40 Dodd-Frank Act §§ 731 (adding new CEA § 4s(e)), 764(a) (adding new Exchange Act § 15F(e)).

41 Capital Requirements of Swap Dealers and Major Swap Participants, *76 Fed. Reg. 27802* (May 12, 2011). Additional information about the meeting at which this proposed rule was issued can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank042711.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank042711.html).

42 See Margin and Capital Requirements for Covered Swap Entities, *76 Fed. Reg. at 27568-69*.

## B. Swap Execution Facilities and Security-Based Swap Execution Facilities

The Dodd-Frank Act creates swap execution facilities (SEFs) and security-based swap execution facilities (SB SEFs), new electronic execution venues for swaps and SB swaps, respectively. The statute prohibits any person from operating a facility for trading swaps or SB swaps unless the facility is registered appropriately with the CFTC or SEC.<sup>43</sup>

On December 16, 2010, the CFTC proposed SEF rules.<sup>44</sup> The proposed SEF rules create a comprehensive framework for the operation of SEFs, including registration requirements, permitted execution methods and detailed rules for compliance with the 15 statutory core principles. The most notable of the proposed rules are that SEFs would be required to operate electronic trading platforms that permit multiple participants to interact with multiple other participants and would be required to provide all ECPs with impartial access. Under the CFTC's proposal, single-dealer platforms and voice brokers would not qualify as SEFs. Moreover, SEFs operating a request for quote system would have to require requests be sent to a minimum of five other market participants. The CFTC has received extensive comment on its SEF rules and is expected to issue final rules by year-end.

On February 2, 2011, the SEC issued proposed rules regarding the registration and regulation of SB SEFs.<sup>45</sup> The proposed rules provide the same type of comprehensive framework for the operation of SB SEFs that the CFTC proposed for SEFs. One notable difference is that, for request for quote systems, the SEC would permit market participant requests to be sent to as few as one other participant. The SEC received many comments on these proposals and has not issued final rules.

In addition, the Commissions held a joint roundtable involving SEFs and the CFTC hosted a SEF demonstration.<sup>46</sup> Market participants have asked the CFTC and SEC to better harmonize their rules in order to, among other things, facilitate dual registration of SEFs and SB SEFs and prevent market fragmentation. Virtually all market participants that have participated in the public comment process have urged the CFTC to adopt the SEC's approach with respect to request for quote systems and have urged both Commissions to create flexible rules that will allow markets to innovate as swap and SB swap trading transitions into a regulated environment.

## C. Swap Data Repositories

Another pair of newly regulated entities under the Dodd-Frank Act are swap data repositories (SDRs) and security-based swap data repositories (SB SDRs), which generally will be responsible for receiving, processing and maintaining swap and SB swap transaction data.<sup>47</sup> The CFTC and the SEC will then use the SDR and SB SDR data as a warehouse for swap market information generally. The absence

43 Dodd-Frank Act §§ 733 (adding new CEA § 5h(a)(1)), 763(c) (adding new Exchange Act § 3D(a)(1)). The statute also requires that swaps and SB swaps subject to mandatory clearing be executed on a SEF or SB SEF, if a SEF or SB SEF makes that swap or SB swap available to trade. See Dodd-Frank Act §§ 723(a)(3) (adding new CEA § 2(h)(8)), 763(a) (adding new Exchange Act § 3C(h)).

44 Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1214 (Jan. 7, 2011). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank121610.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank121610.html).

45 Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10948 (Feb. 28, 2011). Additional information about the meeting at which this proposed rule was issued can be found on the SEC's website at: <http://sec.gov/news/press/2011/2011-35.htm>.

46 Joint CFTC-SEC Staff Roundtable on Implementation Phasing for Final Rules for Swaps and Security-Based Swaps under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (May 2, 2011) available at [http://cftc.gov/ucm/groups/public/@newsroom/documents/file/csjac\\_transcript050211.pdf](http://cftc.gov/ucm/groups/public/@newsroom/documents/file/csjac_transcript050211.pdf). Information regarding the SEF demonstration, including a summary of the meeting is available on the CFTC website at [http://cftc.gov/PressRoom/Events/opaevent\\_omalia033111.html](http://cftc.gov/PressRoom/Events/opaevent_omalia033111.html).

47 Dodd-Frank Act §§ 728 (adding new CEA § 21), 763(i) (adding new Exchange Act § 13(n)).

of this kind of repository was one of the regulatory deficiencies cited by the Financial Crisis Inquiry Commission.<sup>48</sup> The statute requires SDRs and SB SDRs to have a CCO and creates four core principles relating to antitrust considerations, governance arrangements, conflicts of interest and other duties imposed by the CFTC or the SEC.

On November 19, 2010, the CFTC proposed comprehensive regulations for SDRs.<sup>49</sup> The CFTC envisions only one or two SDRs being created for each swap category. In that vein, the CFTC proposes that if a SDR accepts swap data for a particular asset class, it must accept swap data for all swaps in that asset class. The proposal also requires SDRs to confirm with the counterparties the accuracy of the data received, but would generally prohibit a swap from being invalidated or modified through that confirmation process. The CFTC has not issued final rules but has indicated that the SDR rules will be among the first to be finalized, perhaps as early as August 2011.

The SEC proposed rules relating to SB SDRs on November 19, 2010.<sup>50</sup> The SEC's proposed rules are generally similar to the CFTC's proposal. No timetable is available for SEC consideration of final rules.

### III. New Regulation of Existing Entities

In addition to creating new entities, the Dodd-Frank Act imposes new regulations and requirements for entities that were previously recognized under the CEA. The following are examples of the regulatory changes affecting these existing entities.

#### A. Designated Contract Markets

All futures contracts must be traded on self-regulatory bodies called designated contract markets (DCM) under Section 4(a) of the CEA, unless exempted. The Dodd-Frank Act amends existing and establishes new core self-regulatory principles for DCMs to meet. Core principles are designed to give DCMs flexibility in achieving important regulatory objectives.

On December 1, 2010, the CFTC proposed rules implementing these new core principles.<sup>51</sup> At times, the proposed rules depart substantially from the core principles as Congress adopted them. Perhaps the most significant instance is Core Principle 9,<sup>52</sup> which statutorily requires that the DCM "shall provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market." Pursuant to this principle, the CFTC has proposed a centralized market trading requirement that would require a DCM to de-list contracts when at least 85 percent of trading in that contract does not occur on the central market. This 85 percent test has drawn considerable criticism from commenters as limiting the availability of block trades on DCMs and discouraging DCMs from introducing novel products.

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48 Fin. Crisis Inquiry Comm'n, *The Financial Crisis Inquiry Report*, 363-64 & n. 56 (2011).

49 Swap Data Repositories, *75 Fed. Reg.* 80898 (Dec. 23, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank111910.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank111910.html).

50 Security-Based Swap Data Repository Registration, Duties, and Core Principles, *75 Fed. Reg.* 77306 (Dec. 10, 2010). Additional information about the meeting at which this proposed rule was issued can be found on the SEC's website at: <http://sec.gov/news/press/2010/2010-229.htm>.

51 Core Principles and Other Requirements for Designated Contract Markets; *75 Fed. Reg.* 80572 (Dec. 22, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank120110.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank120110.html).

52 CEA § 5(d)(9)(a), as amended by Dodd-Frank Act § 735(b).

## B. Futures Commission Merchants and Introducing Brokers

The Dodd-Frank Act prescribes that FCMs and IBs must institute informational partitions separating the activities of commodity researchers and analysts from those in the firm whose involvement in trading or clearing could bias the analyst's judgment. The CFTC's proposed rules<sup>53</sup> would limit the partition requirement to those involved in disseminating public research reports. The proposed rules also would prohibit FCMs and IBs from retaliating against research analysts for negative reports or compensating research analysts based on their issuing favorable research or contributing to the trading business.

As part of its amendments to incorporate swaps into existing regulations, the CFTC has proposed rules that would require IBs, FCMs and members of DCMs to maintain keep full records of all trades executed on DCMs and SEFs.<sup>54</sup> The recordkeeping requirements would include all communications, including oral and electronic communications. Under the proposal, account managers would not need to provide specific customer account identifiers in confirmations or acknowledgements. Thus, certain account managers would be permitted to bunch orders for trades executed bilaterally.

## C. Commodity Pool Operators and Commodity Trading Advisors

The CFTC also has used the Dodd-Frank Act as an impetus to amend its regulations of CPOs and CTAs. The CFTC has proposed amendments to CPO and CTA registration with the stated purpose of bringing CPO/CTA regulation into alignment with the goals of the Dodd-Frank Act, while acknowledging that the Dodd-Frank Act did not require such amendments.<sup>55</sup> The CFTC's proposed rules would repeal the registration exemption in CFTC Rules 4.13(a)(3) and (a)(4) for privately offered funds. The CFTC also proposed rules that would substantially restrict the eligibility of parties to meet the Rule 4.5 exemption that applies to registered investment companies. These proposed repeals potentially would subject tens of thousands of currently exempt parties to registration obligations.

## D. Eligible Contract Participants

The Dodd-Frank Act provides that only "eligible contract participants" (ECPs) may engage in swap transaction in private, bilateral, off-exchange transactions. The Dodd-Frank Act also amended and restricted the statutory definition of ECP in certain ways. One aspect of the new definition that has been subject to considerable discussion is Section 741(b)(10) of the Dodd-Frank Act, which will change the criteria used to determine whether a commodity pool is a non-ECP for purposes of foreign exchange trading. Specifically, once the Dodd-Frank Act amended definition of ECP takes effect, a pool may need to look through to its individual investors to determine whether the pool is a non-ECP in certain circumstances. The CFTC's proposed rules further defining ECP<sup>56</sup> would reinforce this restriction by preventing such pools from relying upon other clauses of the ECP definition to sidestep

53 Implementation of Conflicts of Interest Policies and Procedures by Futures Commission Merchants and Introducing Brokers, *75 Fed. Reg. 70152* (Nov. 17, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank111010.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank111010.html).

54 Adaptation of Regulations to Incorporate Swaps, *76 Fed. Reg. 33066* (June 7, 2011). Additional information about the meeting at which this proposed rule was issued can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank042711.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank042711.html).

55 Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, *76 Fed. Reg. 7976* (Feb. 11, 2011). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_doddfrank012611.html](http://cftc.gov/PressRoom/Events/opaevent_doddfrank012611.html).

56 Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant", *75 Fed. Reg. 80174* (Dec. 21, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank120110.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank120110.html).



the limitation in the Dodd-Frank Act. The look-through restriction may not apply, however, when a pool is engaged in an FX transaction with a U.S. financial institution.

### E. Derivatives Clearing Organizations<sup>57</sup>

The CFTC has proposed several new rules that would regulate DCOs, along with several new enhancements to its existing regulation of DCOs.<sup>58</sup> Among these are proposed rules that would require compliance with DCO core principles in the Dodd-Frank Act.<sup>59</sup> These proposed rules would ensure that DCOs adopt participation and membership requirements that provide for fair and open access to the DCO and adopt rules that would permit nondiscriminatory clearing of swaps that have been executed bilaterally or subject to the rules of an unaffiliated DCM or SEF.<sup>60</sup> The proposed rules also would charge DCOs with prescribing contract unit sizes that maximize liquidity, open-access and risk management.<sup>61</sup>

### IV. Conflicts of Interest

The Dodd-Frank Act requires the CFTC and the SEC to adopt governance requirements, including rules relating to conflicts of interest, for existing entities and new registrants that fall within their respective jurisdictions.<sup>62</sup> The Commissions have separately proposed rules to effectuate this mandate.

57 One particular subset of DCOs is systemically important DCOs (SIDCOs). Section 804 of the Dodd-Frank Act authorizes the Financial Stability Oversight Council (FSOC) to designate certain DCOs as SIDCOs based on factors such as the aggregate exposure of the DCO and the effect that the failure of or a disruption to the DCO would have on the broader financial system. SIDCOs would be subject to additional regulation under the CFTC's proposed rules relating to DCOs. See, e.g., Financial Resources Requirements for Derivatives Clearing Organizations, 75 Fed. Reg. 63113 (Oct. 14, 2010). The CFTC's Part 40 final rulemaking also appears to subject SIDCOs to additional procedural requirements by requiring a SIDCO to provide the CFTC with a 60-day advance notice of any proposed change to its rules or procedures that could materially affect the nature or level of risks presented by the SIDCO. At the time of this publication, the CFTC's Part 40 final rulemaking had not yet been published in the Federal Register. For additional information about the Part 40 final rulemaking, including a copy of the rulemaking when it becomes available, see the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank071911.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank071911.html).

58 See Financial Resources Requirements for Derivatives Clearing Organizations, 75 Fed. Reg. 63113 (Oct. 14, 2010) (for more information, see the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank100110.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank100110.html)); General Regulations and Derivatives Clearing Organizations, 75 Fed. Reg. 77576 (Dec. 13, 2010) (for more information, see the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank120110.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank120110.html)); Information Management Requirements for Derivative Clearing Organizations, 75 Fed. Reg. 78185 (Dec. 15, 2010) (for more information, see the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank120110.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank120110.html)); Risk Management Requirements for Derivatives Clearing Organizations, 76 Fed. Reg. 3698 (Jan. 20, 2011) (for more information, see the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank121610.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank121610.html)); Requirements for Processing, Clearing, and Transfer of Customer Positions, 76 Fed. Reg. 13101 (Mar. 10, 2011) (for more information, see the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank022411.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank022411.html)). The SEC has similarly proposed new rules that would regulate clearing agencies with respect to SB swaps. These proposed rules would impose limits on the ownership of and voting interests in SB swap clearing agencies, SB SEFs and national securities exchanges that make SB swaps available for trading. See Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Security Exchanges with Respect to Security-Based Swaps Under Regulation MC, 75 Fed. Reg. 65882 (Oct. 26, 2010); Clearing Agency Standards for Operation and Governance, 76 Fed. Reg. 14472 (Mar. 16, 2011).

59 See Dodd-Frank Act § 725(c) (*amending* CEA § 5b(c)).

60 Dodd-Frank Act § 723(a)(3) (adding new CEA § 2(h)); Risk Management Requirements for Derivatives Clearing Organizations, 76 Fed. Reg. at 3702 (Jan. 20, 2011).

61 Requirements for Processing, Clearing, and Transfer of Customer Positions, 76 Fed. Reg. at 13105. In addition to proposing risk management requirements for DCOs, the CFTC has proposed rules concerning clearing member risk management. Those rules, proposed on July 19, 2011, would require SDs, MSPs and FCMs that are clearing members to engage in certain risk management practices, such as establishing and monitoring credit and market risk-based limits, stress testing of positions, monitoring liquidation costs and testing lines of credit. At the time of this publication, the proposed rules for clearing member risk management had not yet been published in the Federal Register. For additional information about this rule proposal, including a copy of the rules when they become available, see the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank071911.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank071911.html).

62 Dodd-Frank Act §§ 726, 765.

The CFTC's proposed rules address how SEFs, DCMs and DCOs should balance their commercial interests with their self-regulatory obligations.<sup>63</sup> In particular, the rules would limit the ownership and voting rights of SEF, DCM, and DCO members and would impose composition requirements on the board of directors and certain committees of SEFs, DCMs and DCOs. The proposed rules also would require SEFs, DCMs, and DCOs to make public certain information about their governance procedures.

The SEC's proposal would apply to clearing agencies that clear SB swaps, SB SEFs and national securities exchanges that post or make available for trading SB swaps.<sup>64</sup> Although the SEC's proposal is not perfectly analogous to the CFTC's, the proposals are generally similar. The SEC, like the CFTC, would impose ownership and voting limitations and board and committee composition requirements for these enumerated entities.

In late December 2010, the U.S. Department of Justice (DOJ) submitted comments urging the CFTC and SEC to adopt a more robust conflict of interest regime than had been proposed. Specifically, the DOJ recommended stricter ownership limitations and board composition requirements that would guarantee that directors who are unaffiliated with the entity comprise a majority of the board.<sup>65</sup> These comment letters have caused the CFTC and the SEC to reassess their proposals, and it is unclear when final rules will be adopted.

## V. Clearing and Exchange-Trading Requirements

### A. The Clearing Mandate

Subject to limited exemptions, Sections 723 and 763 of the Dodd-Frank Act require swaps to be cleared by a DCO and SB swaps to be cleared by a clearing agency if they are of a group or type that the CFTC or the SEC, as applicable, determine must be cleared.<sup>66</sup> The CFTC and the SEC are required to review swaps and SB swaps, respectively, on an ongoing basis to determine whether they should be required to be cleared.

The CFTC and the SEC have proposed rules that would outline the process by which a DCO or clearing agency would submit a swap or SB swap to be approved for clearing.<sup>67</sup> Under such rules, the

63 See Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, *75 Fed. Reg. 63732* (Oct. 18, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank100110.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank100110.html); Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest, *76 Fed. Reg. 722* (Jan. 6, 2011). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank120910.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank120910.html).

64 See Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Security Exchanges With Respect to Security-Based Swaps Under Regulation MC, *75 Fed. Reg. 65,882* (Oct. 26, 2010). Additional information about the meeting at which this proposed rule was issued can be found on the SEC's website at: <http://sec.gov/news/press/2010/2010-190.htm>.

65 *Comments of the U.S. Dep't of Justice in Response to the Request of the CFTC for Comments Regarding the Mitigation of Conflicts of Interest* (Dec. 28, 2010); *Comments of the U.S. Dep't of Justice in Response to the Request of the SEC for Comments Regarding Regulation MC* (Dec. 28, 2010).

66 Dodd-Frank Act §§ 723(a)(3), 763(a).

67 Process for Review of Swaps for Mandatory Clearing, *75 Fed. Reg. 67277* (Nov. 2, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank102610.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank102610.html); Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendment to Rule 196-4 and Form 196-4 Applicable to All Self-Regulatory Organizations, *75 Fed. Reg. 82490* (Dec. 30, 2010). Additional information about the meeting at which this proposed rule was issued can be found on the SEC's website at: <http://sec.gov/news/press/2010/2010-244.htm>. On July 19, 2011, the CFTC approved its final rule on the process for review of swaps for mandatory clearing, but at the time of this publication, the rule had not yet been published in the

CFTC and the SEC would require any such submissions: (1) to justify the DCO's or clearing agency's eligibility to clear the swap or SB swap, and (2) to provide information that would allow the regulators to review five statutorily prescribed factors.<sup>68</sup> The particular swaps and SB swaps that will be subject to the clearing mandate cannot be identified until these rules become final and the CFTC and the SEC make their determinations under the final rules. Swaps and SB swaps that are already being cleared may be considered for mandatory clearing without further submissions.

## B. The Exchange-Trading Mandate

Swaps and SB swaps that are required by the Dodd-Frank Act to be cleared also must be executed on a DCM or SEF (for swaps) or on a national securities exchange or SB SEF (for SB swaps), unless no such facility makes such a swap or SB swap available to trade.<sup>69</sup> In separate proposals, the CFTC and the SEC have discussed what it means for a SEF or an SB SEF to make swaps and SB swaps "available to trade."<sup>70</sup> The CFTC has proposed that SEFs would make periodic assessments to determine whether a swap has been made available to trade, whereas the SEC has suggested that the determination of when an SB SEF has made an SB swap available to trade should be made pursuant to SEC-prescribed objective criteria.<sup>71</sup> Neither the CFTC nor the SEC has yet explained what it would mean for a swap or an SB swap to be made available to trade on a DCM or a national securities exchange.<sup>72</sup>

## C. End-User Clearing Exception

Swaps and SB swaps of certain non-financial end-users (commercial end-users) would be excepted from the clearing and exchange-trading mandates.<sup>73</sup> To qualify for this exception, Section 723(a)(3) of the Dodd-Frank Act requires that the commercial end-user must use such swaps or SB swaps to hedge or mitigate commercial risk and must notify the CFTC or the SEC that it is claiming such exception. The CFTC and the SEC each have proposed rules specifying the manner by which a commercial end-user would notify the agencies of an exception from the clearing requirement.<sup>74</sup> Under the proposals, every time a commercial end-user elects to use the clearing exception, certain information about the swap or SB swap must be reported to the SDR or SB SDR, as applicable (or if none is available, to the CFTC or SEC, respectively).

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Federal Register. For additional information about this final rule, including a copy of the rule when it becomes available, see the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank071911.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank071911.html).

68 Dodd-Frank Act §§ 723(a)(3), 763(a).

69 Dodd-Frank Act §§ 723(a)(3), 763(a).

70 Core Principles and Other Requirements for Swap Execution Facilities, *76 Fed. Reg.* 1,214 (Jan. 7, 2011); Registration and Regulation of Security-Based Swap Execution Facilities, *76 Fed. Reg.* 10948 (Feb. 28, 2011). Additional information about the meeting at which this proposed rule was issued can be found on the SEC's website at: <http://sec.gov/news/press/2011/2011-35.htm>.

71 Core Principles and Other Requirements for Swap Execution Facilities, *76 Fed. Reg.* at 1222; Registration and Regulation of Security-Based Swap Execution Facilities, *76 Fed. Reg.* at 10969.

72 The CFTC has stated that its amended core principles for DCMs would apply to all "contracts," including the swaps that must be made available for trading. *75 Fed. Reg.* at 80574.

73 Dodd-Frank Act §§ 723(a)(3), 763(a).

74 End-User Exception to Mandatory Clearing of Swaps, *75 Fed. Reg.* 80747 (Dec. 23, 2010) (additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank120910.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank120910.html)); End-User Exception to Mandatory Clearing of Security-Based Swaps, *75 Fed. Reg.* 79992 (Dec. 21, 2010). Additional information about the meeting at which this proposed rule was issued can be found on the SEC's website at: <http://sec.gov/news/press/2010/2010-244.htm>.

## D. Segregation and Margin

The Dodd-Frank Act calls for FCMs to segregate collateral margining or guaranteeing a customer's position in cleared swaps and allows for a swaps counterparty to an MSP or SD to require the MSP or SD to segregate collateral margining or guaranteeing the counterparty's position in uncleared swaps.<sup>75</sup> With respect to cleared swaps, the CFTC has proposed that FCMs segregate margin in accordance with the "Complete Legal Segregation Model," which would allow operational commingling of customer margin prior to default, but would provide a DCO with recourse against only the defaulting customer's collateral after a default.<sup>76</sup> The CFTC has separately proposed rules that would govern segregation of uncleared swaps collateral by MSPs and SDs and the permitted investment of such collateral.<sup>77</sup>

## VI. Recordkeeping and Reporting

The Dodd-Frank Act imposes various recordkeeping and reporting requirements with respect to swaps and SB swaps. The recordkeeping rules are largely straightforward and consistent with standard business practices. The reporting requirements, however, are novel. They will require each swap transaction to be reported to SDRs or SB SDRs.<sup>78</sup> Parties to swaps will be subject to a different reporting regime as well for public reporting of swap transaction data, including pricing and volume data. This is called the "real-time public reporting" requirement.<sup>79</sup> In addition, the CFTC has finalized rules to bring physical commodity swaps (agricultural, energy and metals) into its large-trader reporting system.

### A. Recordkeeping

Soon after the Dodd-Frank Act was enacted, the CFTC and SEC each adopted interim final rules requiring market participants to retain records for swaps and SB swaps already executed that have not yet expired.<sup>80</sup> The CFTC has since proposed a new interim final rule to replace the prior interim final rules.<sup>81</sup> Last December, the CFTC proposed, but has not yet adopted, swap recordkeeping rules for transactions entered into in the future.<sup>82</sup> These rules would require all persons subject to the CFTC's

<sup>75</sup> Dodd-Frank Act §§ 724(a), 724(c).

<sup>76</sup> Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, **76 Fed. Reg. 33818** (June 9, 2011). Additional information about the meeting at which this proposed rule was issued can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank042711.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank042711.html).

<sup>77</sup> Protection of Collateral Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy, **75 Fed. Reg. 75432** (Dec. 3, 2010).

<sup>78</sup> Dodd-Frank Act §§ 727 (adding new CEA § 2(a)(13)(G)), 763(i) (adding new Exchange Act § 13(m)(1)(G)).

<sup>79</sup> Dodd-Frank Act §§ 727 (adding new CEA § 2(a)(13)), 763(i) (adding new Exchange Act § 13(m)(1)).

<sup>80</sup> Interim Final Rule for Reporting Pre-Enactment Swaps, **75 Fed. Reg. 63080** (Oct. 14, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank100110.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank100110.html); Reporting Certain Post-Enactment Swap Transactions, **75 Fed. Reg. 78892** (Dec. 17, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank120910.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank120910.html); Reporting of Security-Based Swap Transaction Data, **75 Fed. Reg. 64643** (Oct. 20, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the SEC's website at: <http://sec.gov/news/press/2010/2010-191.htm>.

<sup>81</sup> Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps, **76 Fed. Reg. 22833** (Apr. 25, 2011). Additional information about the meeting at which this proposed rule was issued can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank041211.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank041211.html).

<sup>82</sup> Swap Data Recordkeeping and Reporting Requirements, **75 Fed. Reg. 76574** (Dec. 8, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank111910.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank111910.html); Reporting, Recordkeeping, and Daily Trading

jurisdiction that enter into swaps to maintain “full, complete, and systematic records, together with all pertinent data and memoranda” of their swap transactions.<sup>83</sup>

## B. Reporting of Transaction and Counterparty Data to Repositories

The Dodd-Frank Act requires data on every swap and SB swap transaction to be reported to an SDR or an SB SDR. Last year, the CFTC and SEC proposed, but have not yet adopted, rules to implement this reporting requirement.<sup>84</sup> Under these rules, reports to the repositories would include the identities of the counterparties, the nature of the swap, the price, the notional amount and the payment terms.<sup>85</sup> The SDR or SB SDR must not disclose to the public the identity of any party to a swap or SB swap.<sup>86</sup> The CFTC and SEC will each develop systems to obtain the data warehoused at the SDRs and SB SDRs as needed for their regulatory purposes.

The Dodd-Frank Act requires one of the counterparties (called the “reporting counterparty”) to each uncleared swap and SB swap to report terms of the transaction to the SDR or SB SDR. Under both CFTC and SEC proposals, so long as both counterparties are U.S. persons, the reporting counterparty would be:

- The dealer counterparty for any swap or SB swap with only one dealer counterparty;
- The major participant counterparty for any swap or SB swap with only one major participant (and no dealer) counterparty; and
- The counterparty selected by the parties to the swap or SB swap for any swap or SB swap with only dealer counterparties, only major participant counterparties, or only end-user counterparties.<sup>87</sup>

However, if a U.S. business (end user) enters into a swap or SB swap with any counterparty that is not a U.S. person, even if the counterparty is a foreign swap dealer, CFTC Proposed Rule 45.5(d) and SEC Proposed Rule 242.901(a)(1) would designate the U.S. end user as the reporting counterparty. If adopted as proposed, these rules would contradict the Dodd-Frank Act, which explicitly states that the Dealer or Major Participant would be the reporting counterparty for an uncleared swap or SB swap entered into by an end user with a dealer or major participant as its counterparty.<sup>88</sup> Regardless of which party is the reporting counterparty, the SDR or SB SDR will verify with both counterparties to the swap or SB swap the terms reported to the SDR or SB SDR.

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Records Requirements for Swap Dealers and Major Swap Participants [75 Fed. Reg. 76666](#) (Dec. 9, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC’s website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank120110.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank120110.html).

83 See [75 Fed. Reg. at 76599-600](#) (Dec. 8, 2010); [75 Fed. Reg. at 76674-75](#) (Dec. 9, 2010).

84 Swap Data Recordkeeping and Reporting Requirements, [75 Fed. Reg. 76574](#) (Dec. 8, 2010); Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information [75 Fed. Reg. 75208](#) (Dec. 2, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC’s website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank111910.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank111910.html).

85 See [75 Fed. Reg. at 76600-01](#) (Dec. 8, 2010)(CFTC); [75 Fed. Reg. at 75284-85](#) (Dec. 2, 2010)(SEC).

86 See [75 Fed. Reg. at 80931](#) (Dec. 23, 2010)(CFTC); [75 Fed. Reg. at 75286](#) (Dec. 2, 2010)(SEC).

87 See [75 Fed. Reg. at 76604](#) (Dec. 8, 2010)(CFTC); [75 Fed. Reg. at 75284](#) (Dec. 2, 2010)(SEC).

88 Dodd-Frank Act §§ 729 (adding new CEA § 4r(a)(3)), 766 (adding new Exchange Act § 13A(a)(3)). CFTC Proposed Rule 45.5(d) and SEC Proposed Rule 242.901(a)(1) would apply to all swaps and SB swaps — whether cleared or uncleared — to the degree that data would be required to be reported by the reporting counterparty.



### C. Real-time Public Reporting of Price and Volume Data

The Dodd-Frank Act's real-time public reporting requirements will require data on swaps and SB swaps to be reported to the public as soon as technologically practicable after the swap or SB swap is executed, except for transactions that exceed a certain size ("block trades") which may be delayed before being reported publicly.<sup>89</sup> Last December, the CFTC and the SEC proposed, but have not yet adopted, rules to govern real-time public reporting.<sup>90</sup> These rules would require SDRs (or third-party service providers) and SB SDRs to publicly disseminate transaction and pricing data on swaps and SB swaps that are not block trades as soon as technologically practical.

To qualify as a block trade, the CFTC proposal would require a swap to satisfy the greater of two tests.<sup>91</sup> The distribution test would require the notional or principal amount to be greater than 95 percent of transaction sizes in that swap instrument. The multiple test would multiply by a factor of five the greatest of the mean, median and mode transaction sizes for all swaps in the category of swap instrument. The CFTC received numerous comments that its proposed minimum block size is too restrictive and must be a rational formula based upon sufficient swap data once such data becomes available. Instead of proposing a formula to determine the appropriate minimum block size, the SEC's proposal would require SB SDRs to establish and maintain written policies and procedures for calculating and publicizing block trade thresholds for SB swap instruments reported to the SB SDR.<sup>92</sup>

### D. Large Trader Reporting

On July 7, 2011, the CFTC adopted final large trader reporting rules for physical commodity swaps and swaptions.<sup>93</sup> The rules apply to swaps and swaptions that are directly or indirectly linked, or priced at a differential, to either the price of any of the 46 physical commodity futures contracts enumerated in CFTC Rule 20.2 ("Covered Futures Contracts") or the price of the physical commodity at the delivery location of any of the Covered Futures Contracts. The rules require regular position reporting and recordkeeping by clearing organizations, clearing members, and swap dealers for any principal or counterparty accounts containing these swaps or swaptions that meet or exceed the "reportable position" threshold.<sup>94</sup> This threshold is 50 economically equivalent futures contracts in any single month.<sup>95</sup> Recordkeeping and special call reporting requirements also apply to persons with positions in these swaps or swaptions that exceed a minimum threshold that is lower than the "reportable position" threshold.

For purposes of these rules, until the CFTC issues a final definition of the term "swap," the CFTC defines "swap" by restating a portion of the existing definition of "swap agreement" in CFTC Rule 35.1(b)

89 Dodd-Frank Act §§ 727 (adding new CEA § 2(a)(13)), 763(i) (adding new Exchange Act § 13(m)(1)).

90 Real-Time Public Reporting of Swap Transaction Data, 75 Fed. Reg. 76140 (Dec. 7, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank111910.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank111910.html); Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75208 (Dec. 2, 2010). Additional information about the meeting at which this proposed rule was issued can be found on the SEC's website at: <http://sec.gov/news/press/2010/2010-230.htm>.

91 75 Fed. Reg. at 76174-76 (Dec. 7, 2010)(CFTC).

92 75 Fed. Reg. at 75287 (Dec. 2, 2010)(SEC).

93 Large Trader Reporting for Physical Commodity Swaps, 76 Fed. Reg. \_\_\_\_ (Meeting on July 7, 2011). Additional information about the meeting at which this rule was issued, including a copy of the unofficial version of the rule, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank070711.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank070711.html).

94 The content of the information that must be reported is detailed in the rules and Appendix B of the rules provides explanatory guidance on the content and layout of the required reports.

95 Appendix A of the rules provides guidelines and illustrative examples for determining futures equivalency of swap and swaption positions.

(1).<sup>96</sup> Once the CFTC's definition of swap in the CFTC-SEC product definition proposal is finalized and effective, that definition will supersede the CFTC's reliance on Rule 35.1(b)(1) in the Final Rules.

These special reporting rules will take effect in 60 days after publication in the Federal Register. At that time, the rules will impose routine reporting obligations on clearing organizations for cleared swaps and on clearing members (including positions of affiliates that are commonly understood to be swap dealers) for both cleared and uncleared swaps. The rules will not take effect for SDs that are not clearing members until the CFTC finalizes the definition, registration requirements and applicable regulations for SDs. However, the CFTC may phase in the full requirements during the first 6 months for which the rules are effective for clearinghouses, clearing members, and certain SDs. These rules also contains a sunset provision that allows the CFTC to make the rules ineffective by order once SDRs are processing swap positional data in a way that enables the CFTC to effectively surveil trading.

### E. Reporting by Commodity Pool Operators and Commodity Trading Advisors

The CFTC and SEC have jointly proposed reporting rules for investment advisers to private funds and certain CPOs and CTAs on Form PF.<sup>97</sup> Although not expressly required by the Dodd-Frank Act, the CFTC separately proposed reporting requirements for CPOs on Form CPO-PQR and CTAs on Form CTA-PR.<sup>98</sup> As proposed, Forms PF, CPO-PQR and CTA-PR would require private fund investment advisers, CPOs and/or CTAs (as appropriate) to report periodically certain metrics about the funds they operate or advise. The reporting requirements for each of these forms would be tiered to require more information with increased frequency from private fund investment advisers, CPOs and CTAs as the amount of aggregate assets under their management increases.

### VII. Position Limits

Section 4a(a) of the CEA empowers the CFTC to prescribe speculative position limits "as [it] finds are necessary to diminish, eliminate or prevent" the burden on interstate commerce caused by excessive speculation. The Dodd-Frank Act expands the CFTC's position limit authority beyond futures and options contracts to include swaps traded on registered entities and bilateral, privately negotiated swaps that perform a significant price discovery function.<sup>99</sup> The CFTC has proposed rules to establish position limits for futures contracts in agricultural, energy and metals commodities and swaps that are "economically equivalent" to such contracts.<sup>100</sup>

96 As restated in the large trader reporting rules, the term "swap" means "an agreement (including terms and conditions incorporated by reference therein) which is a commodity swap (including any option to enter into such swap) within the meaning of 'swap agreement' under [Rule 35.1(b)(1)], or a master agreement for a commodity swap together with all supplements thereto."

97 Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, **76 Fed. Reg. 8068** (Feb. 11, 2011). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_doddfrank012611.html](http://cftc.gov/PressRoom/Events/opaevent_doddfrank012611.html).

98 Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, **76 Fed. Reg. 7976** (Feb. 11, 2011). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_doddfrank012611.html](http://cftc.gov/PressRoom/Events/opaevent_doddfrank012611.html).

99 Dodd-Frank Act § 737(a) (*amending CEA § 4a(a)*).

100 Position Limits for Derivatives, **76 Fed. Reg. 4752** (Jan. 26, 2011). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank011311.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank011311.html). In 2010, prior to the enactment of the Dodd-Frank Act, the CFTC proposed position limits for certain energy contracts. See Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, **75 Fed. Reg. 4144** (Jan. 26, 2010).

The CFTC’s proposal calls for establishing position limits in two phases. During the first phase, spot-month limits would be implemented. The CFTC proposes that limits would be set for the last three days of trading in the delivery month at 25 percent of estimated deliverable supply for the referenced contracts’ underlying commodity. During the second phase, non-spot-month limits would be adopted. Limits would be set at 10 percent of the average all-months combined aggregated open interest up to the first 25,000 contracts and 2.5 percent thereafter.<sup>101</sup> The proposal would provide exemptions from position limits for bona fide hedging transactions and pre-existing positions.

The proposal would require aggregation of 1) all positions in accounts in which any trader has an ownership or equity interest of 10 percent or greater or controls trading; and 2) positions held by two or more traders acting pursuant to an express or implied agreement or understanding. The proposal would limit disaggregation relief through eliminating the CFTC’s long-standing independent account controller exception and modifying other aspects of the CFTC’s current aggregation regime. The CFTC’s proposed aggregation exemptions are narrow and are not self-executing, meaning that they must be sought through application to the CFTC. This aspect of the proposal has been the subject to considerable adverse public comment.

Section 763(h) of the Dodd-Frank Act permits the SEC, for the purpose of preventing fraud and manipulation, to limit the size of positions in any SB swap that may be held by any person. Section 763(h) further empowers the SEC to require self-regulatory organizations to adopt position limit rules. The SEC has not proposed position limit rules and has not indicated that it plans to exercise its authority at this time.

## **VIII. Restrictions on Depository Institutions and Their Affiliates**

### **A. The Volcker Rule**

The Volcker Rule amends the Bank Holding Company Act of 1956 (BHC Act) to prohibit insured depository institutions and their affiliates (collectively, “banking entities”) from engaging in a set of activities defined as “proprietary trading” (including in derivatives), acquiring or retaining certain interests in “hedge funds” or “private equity funds”, and “sponsoring” hedge funds or private equity funds.<sup>102</sup> Certain permitted activities have been carved out of the prohibitions of the Volcker Rule and are expressly allowed to continue within banking entities.<sup>103</sup> These permitted activities include, among other activities, underwriting and market making-related activities, risk-mitigating hedging related to individual or aggregated positions, trading on behalf of customers, and organizing and offering activities for private equity or hedge funds structured to satisfy a set of safe-harbor conditions.<sup>104</sup> However, no banking entity may engage in any activity that would otherwise be permitted if such activity would: 1) involve or result in a material conflict of interest between a banking entity and its clients or counterparties; 2) result directly or indirectly in material exposure by the banking entity to high-risk assets or high-risk trading strategies; 3) pose a threat to the safety and soundness of the banking entity; or 4) pose a threat to the financial stability of the United States.

<sup>101</sup> Aggregated open interest would be defined as the sum of futures and swaps open interest for referenced contracts in a given commodity.

<sup>102</sup> Dodd-Frank Act § 619 (adding new BHC Act § 13(a)(1)).

<sup>103</sup> Dodd-Frank Act § 619 (adding new BHC Act § 13(d)(1)).

<sup>104</sup> Dodd-Frank Act § 619 (adding new BHC Act § 13(d)(1)).

Within six months of the enactment of the Dodd-Frank Act, FSOC was required to study and make recommendations about the implementation of the Volcker Rule.<sup>105</sup> In January 2011, FSOC released its study (Study).<sup>106</sup> The Study made recommendations that regulators implement the proprietary trading ban by requiring banking entities to implement programmatic compliance regimes (with public attestations by an entity's CEO as to the effectiveness of the regime), to report certain prescribed quantitative metrics to the regulators, and to be subjected to supervisory examinations or reviews. The Study recommended a similar programmatic compliance regime to prevent banking entities from making investments in or sponsoring private equity and hedge funds.

For the last several months, staff from the Department of Treasury, Board of Governors of the Federal Reserve System, OCC, FDIC, SEC and CFTC have held twice-weekly meetings to draft proposed rules by which each agency would implement the Volcker Rule. While timelines surrounding Dodd-Frank Act implementation are difficult to predict, the Federal Reserve, along with the other federal financial regulatory agencies, expects to issue a request for comment before October of this year on a proposed interagency rule to implement the Volcker Rule requirements. Although there is a transition period for banking entities to come into compliance, the general Volcker Rule statutory prohibitions become effective two years after enactment (or July 15, 2012).<sup>107</sup>

## B. The Swaps Push-Out Rule

Section 716 of the Dodd-Frank Act, commonly referred to as the "Lincoln Amendment" or the "push-out rule," prohibits "federal assistance" to any swaps entity.<sup>108</sup> A "swaps entity" includes any registered SD, SB SD, MSP or MSBSP, but excludes an insured depository institution that is an MSP or MSBSP.<sup>109</sup>

The practical effect of the push-out rule will be that an insured depository institution with access to Federal Reserve credit facilities or FDIC assistance (effectively all insured depository institutions), whose activities constitute acting as an SD or SB SD, will be forced to "push" those swap activities out of the insured depository institution. However, unlike the Volcker Rule, the push-out rule does not require that these swap activities be pushed out of the bank holding company group altogether. While those activities would no longer be able to be conducted through the insured depository institution, the swaps activities could be transferred to an affiliate that does not have access to federal assistance. In addition, the push-out rule specifically permits certain uses of swaps, including activities in interest rate and currency swaps, cleared credit derivatives on investment grade securities, and hedging activities directly related to the conduct of the insured depository institution.

<sup>105</sup> Dodd-Frank Act § 619 (adding new BHC Act § 13(b)(1)). FSOC is composed of 15 persons (most of whom head a state or federal financial regulatory agency). Dodd-Frank Act § 111(b).

<sup>106</sup> FSOC, Study & Recommendation on Proprietary Trading of Certain Relationships with Hedge Funds & Private Equity Funds (2011), available at: <http://www.treasury.gov/initiatives/Documents/Volcker%20sec%20%20619%20study%20final%201%2018%2011%20rg.pdf>.

<sup>107</sup> The Volcker Rule becomes effective upon the earlier of two years after its enactment or 12 months after issuance of the final rules. However, as the regulators have not yet proposed rules at the time of this publication, the earlier date will be two years from the Rule's enactment. Once the Volcker Rule becomes effective, insured depository institutions and their affiliates would be required to divest or discontinue prohibited activities within two years, subject to regulators' authority to grant limited extensions. Dodd-Frank Act § 619(c) (adding new BHC Act § 13(c)).

<sup>108</sup> Dodd-Frank Act § 716(a). "Federal assistance" means the use of any advance from any Federal Reserve credit facility or discount window (unless the facility is part of a program with broad-based eligibility) or FDIC insurance or guarantees. Dodd-Frank Act § 716(b)(1).

<sup>109</sup> Dodd-Frank Act § 716(b)(2). The CFTC and the SEC have jointly proposed definitions of "swap dealer," "security-based swap dealer," "major swap participant," and "major security-based swap participant." Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant," 75 Fed. Reg. 80174 (Dec. 21, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank120110.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank120110.html).

It remains unclear whether the agencies will extend the exemptions for insured depository institutions to the uninsured U.S. branches of foreign banks, which are ineligible for federal deposit insurance but have access to the Federal Reserve discount window.

The push-out rule becomes effective on July 15, 2013. Neither the CFTC nor the SEC has yet indicated whether it will engage in rulemaking pursuant to the push-out rule.

## IX. New Enforcement Powers

The Dodd-Frank Act adds broad, new statutory prohibitions on manipulation, fraud, and disruptive trading practices in the futures, swap, physical commodity, and securities markets. The Dodd-Frank Act also seeks to encourage enforcement of the CEA and securities laws by instituting parallel whistleblower programs with heightened financial incentives and protections for qualifying whistleblowers. The CFTC and SEC have proposed rules – and in certain areas adopted final rules – to implement the Dodd-Frank Act’s expansion of their enforcement powers.

### A. Anti-Manipulation and Anti-Fraud

The Dodd-Frank Act (through the “Cantwell Amendment” in Section 753) grants the CFTC new enforcement authority that resembles the anti-fraud/anti-manipulation authority found in Section 10(b) of the Exchange Act. Specifically, the Dodd-Frank Act makes it unlawful “to use or employ, or attempt to use or employ, in connection with any swap or contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative or deceptive device or contrivance.”<sup>110</sup> The Dodd-Frank Act also preserves the CFTC’s authority to combat price manipulation even in the absence of fraud and extends such authority to swaps.<sup>111</sup> Furthermore, the Dodd-Frank Act includes provisions prohibiting false statements to the CFTC and a special provision prohibiting manipulation by false reporting (with an exception for good-faith mistakes).<sup>112</sup>

On November 3, 2010, the CFTC officially released its proposed rules implementing its new anti-manipulation and anti-fraud authority under the Dodd-Frank Act.<sup>113</sup> The CFTC adopted the proposed rules, with one minor modification to the proposed regulatory text, as final rules on July 7, 2011. The effective date of the rules is August 15, 2011.<sup>114</sup>

Final CFTC Rule 180.1 is modeled on SEC Rule 10b-5, which broadly prohibits manipulative and deceptive devices and contrivances, employed intentionally or recklessly, regardless of whether the conduct in question was intended to create or did create an artificial price. CFTC Chairman Gensler commented that the extension of anti-manipulation reach to prohibit reckless fraud-based manipulation schemes “closes a significant gap, as it will broaden the types of cases we can pursue and improve the chances of prevailing over wrongdoers.”<sup>115</sup>

<sup>110</sup> Dodd-Frank Act § 753(a) (adding new CEA § 6(c)(1)).

<sup>111</sup> Dodd-Frank Act § 753(a) (adding new CEA § 6(c)(3)).

<sup>112</sup> Dodd-Frank Act § 753(a) (adding new CEA §§ 6(c)(2) (“Prohibition Regarding False Information”), CEA § 6(c)(1)(A) (“Special Provision for Manipulation by False Reporting”)).

<sup>113</sup> Prohibition of Market Manipulation, *75 Fed. Reg. 67657* (Nov. 3, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC’s website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank102610.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank102610.html).

<sup>114</sup> Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, *76 Fed. Reg. 41398* (July 14, 2011). Additional information about the meeting at which this proposed rule was issued can be found on the CFTC’s website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank070711.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank070711.html).

<sup>115</sup> Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, *76 Fed. Reg. at 41410* (July 14, 2011).



The CFTC made several clarifications in finalizing Rule 180.1 in the preamble to its final rule proposal. First, trading on the basis of material nonpublic information may violate Rule 180.1 if it that trading is in breach of a pre-existing legal duty or the information involved was obtained through fraud or deception. Second, good-faith mistakes or negligence will not satisfy the intentional or recklessness scienter requirement of Rule 180.1. Third, the “in connection with” requirement in CEA Section 6(c)(1) — the statutory basis for final Rule 180.1 — is meant to be read broadly and not technically or restrictively. Fourth, unlike the CFTC’s existing anti-fraud authority in CEA Section 4b, new CEA Section 6(c)(1) and final Rule 180.1 do not require that that the alleged wrongdoer’s fraud be in connection with a future or swap “made, or to be made, for or on behalf of, or with,” the defrauded person. And, like the statute, Rule 180.1 prohibits attempts to engage in misconduct as well as the misconduct itself.

Final Rule 180.2 codifies the CFTC’s long-standing authority to prohibit price manipulation by making it “unlawful for any person, directly or indirectly, to manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity.” The rule’s application will be guided by the traditional four-part test for manipulation that has developed in case law arising under old CEA Section 6(c) and CEA Section 9(a)(2): 1) that the accused had the ability to influence market prices; 2) that the accused specifically intended to create or effect a price or price trend that does not reflect legitimate forces of supply and demand; 3) that artificial prices existed; and 4) that the accused caused the artificial prices. Recklessness will not suffice to establish a violation of Rule 180.2 as it will under final Rule 180.1.

Section 763(g) of the Dodd-Frank Act expands the anti-manipulation provisions of Section 9 of the Exchange Act<sup>116</sup> and authorizes the SEC to adopt rules to prevent fraud, manipulation, and deception in connection with SB swaps. On November 3, 2010, the SEC proposed a new anti-fraud and anti-manipulation rule that would apply to offers, purchases, and sales of SB swaps in the same way that the general antifraud provisions apply to all securities, but also would also explicitly apply to the cash flows, payments, deliveries, and other ongoing obligations and rights that are specific to SB swaps.<sup>117</sup>

## B. Antidisruptive Practices

The Dodd-Frank Act grants the CFTC authority to prosecute disruptive practices in its regulated markets. Specifically, Section 747 of the Dodd-Frank Act amends Section 4c(a) of the CEA to make it unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity that:

- i) violates bids or offers;
- ii) demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or
- iii) is of the character of, or is commonly known to the trade as, “spoofing” (bidding or offering with the intent to cancel the bid or offer before execution).<sup>118</sup>

<sup>116</sup> Specifically, Section 763(g) adds new subparagraph (j) to Section 9 of the Exchange Act to make it unlawful for “any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange, to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security-based swap, in connection with which such person engages in any fraudulent, deceptive, or manipulative act or practice, makes any fictitious quotation, or engages in any transaction, practice, or course of business which operates as a fraud or deceit upon any person.”

<sup>117</sup> Prohibition Against Fraud, Manipulation, and Deception in Connection With Security-Based Swaps, [75 Fed. Reg. 68560](#) (Nov. 8, 2010).

<sup>118</sup> Dodd-Frank Act § 747 (adding new CEA § 4c(a)(5)).

Section 747 also explicitly grants the CFTC authority to promulgate such “rules and regulations as, in the judgment of the Commission, are reasonably necessary to prohibit the [enumerated] trading practices,” “and any other trading practice that is disruptive of fair and equitable trading.”<sup>119</sup>

On November 2, 2010, the CFTC published an ANPR in the Federal Register to solicit comments on its authority under Section 747 and to assist it in promulgating rules to implement that authority.<sup>120</sup> On March 18, 2011, the CFTC terminated its ANPR<sup>121</sup> and proposed an interpretive order that, among other things, stated that new CEA Section 4c(a) — which by its terms is limited to conduct “on or subject to the rules of a registered entity” — would not apply to 1) a trade solely because it is reported on a swap data repository; 2) block trades or exchange for related positions transacted in accordance with the rules of a DCM or SEF; and 3) bilaterally negotiated OTC derivatives.<sup>122</sup>

As for the three enumerated statutory disruptive practices, the CFTC provided some interpretive guidance with respect to each one:

- i) “Violating a bid or offer” — The CFTC interpreted this phrase to mean buying at a price that is higher than the lowest available offer price or selling at a price that is lower than the highest available bid price, without regard to the intent of the trader.
- ii) “Orderly Execution of Transactions During the Closing Period” — The CFTC emphasized that a market participant must act recklessly at a minimum and, absent an intentional or reckless disregard, will not be liable upon executing an order during the closing period simply because the transaction had a substantial effect on settlement price.
- iii) “Spoofing” — The CFTC noted that specific intent is required for spoofing and therefore that legitimate, good-faith cancellations of orders will not violate the spoofing prohibition. Additionally, the CFTC provided four specific examples of prohibited spoofing.

Although the CFTC’s interpretive order clarifies certain fact patterns related to the statutorily enumerated disruptive trading practices, it ultimately leaves unanswered how new CEA Section 4c(a) may be applied in other contexts.

### C. Whistleblowers

The Dodd-Frank Act creates parallel whistleblower incentives and protections to promote enforcement of the CEA and the securities laws. In particular, the Dodd-Frank Act provides that the CFTC and the SEC must award whistleblower bounties where “original information” provided by an eligible whistleblower results in enforcement actions (including settled actions) that yield monetary remedies of more than \$1 million.<sup>123</sup> Such whistleblowers will be entitled to recover between 10 and 30 percent of the total monetary sanctions collected by the relevant regulatory or law enforcement authority.<sup>124</sup> In terms of statutory protections, whistleblowers’ identities will generally be kept

119 Dodd-Frank Act § 747 (adding new CEA § 4c(A)(6)). A separate provision in Section 747 of the Dodd-Frank Act makes it unlawful for any person to enter into a swap knowing, or recklessly disregarding, that its counterparty will use the swap as part of a device, scheme, or artifice to defraud a third party. Dodd-Frank Act § 747 (adding new CEA § 4c(a)(7)).

120 Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act, [75 Fed. Reg. 67301](#) (Nov. 2, 2010).

121 Antidisruptive Practices Authority, [76 Fed. Reg. 14826](#) (Mar. 18, 2011).

122 Antidisruptive Practices Authority, [76 Fed. Reg. 14943](#) (Mar. 18, 2011).

123 Dodd-Frank Act §§ 748 (adding new CEA § 23(a)(1),(b)(1)), 922(a) (adding new Exchange Act § 21F(a)(1),(b)(1)).

124 Dodd-Frank Act §§ 748 (adding new CEA § 23(b)(1)), 922(a) (adding new Exchange Act § 21F(b)(1)).

confidential by the CFTC and the SEC<sup>125</sup> and whistleblowers will have a private remedy (i.e. reinstatement and back pay plus interest) against retaliation by their employers.<sup>126</sup>

Both the CFTC and the SEC proposed programs that would implement the statutory whistleblower incentives and protections. The CFTC proposal (published December 6, 2010)<sup>127</sup> and the SEC proposal (published November 3, 2010)<sup>128</sup> defined certain terms critical to the operation of the whistleblower program, outlined the procedures for applying for awards and the procedures for making decisions on claims, and generally explained the scope of the whistleblower program to the public and to potential whistleblowers. The SEC adopted final whistleblower rules on May 25, 2011.<sup>129</sup> The CFTC has not yet adopted final rules.

Critics of the CFTC's and the SEC's whistleblower programs have expressed concern that the programs will dissuade employees from first reporting potential violations through applicable internal compliance systems. Although the CFTC and the SEC programs do not require that an individual first make an internal report to be considered an eligible whistleblower, the agencies' rules (particularly the SEC's) create some incentives for employees first to report their concerns to the company. For example, one of the criterion for determining a whistleblower award under the SEC regime (but not under the CFTC's proposed regime) is "[w]hether, and the extent to which, a whistleblower reported the initial violation through effective internal whistleblower, legal, or compliance procedures before reporting the violation to the Commission." Under the CFTC's proposed rules, an employee who reports a CEA violation internally to a compliance officer could still be considered the "original source" of information (and hence eligible for whistleblower status) even where the CFTC receives that information from the compliance officer.

## X. Extraterritoriality Issues

The Dodd-Frank Act provides that its provisions relating to swaps will not apply to activities outside the United States unless those activities have a direct and significant connection with commerce of the United States or contravene the anti-evasion rules and regulations prescribed by the CFTC.<sup>130</sup> While the CFTC has proposed anti-evasion rules as a part of its product definitions,<sup>131</sup> the CFTC has said that it intends to assess "each individual case on a case-by-case basis."<sup>132</sup> The CFTC's proposed rules would give market participants only a general sense of the Dodd-Frank Act's potential extraterritorial scope.

The CFTC's proposed anti-evasion rules would subject to CFTC jurisdiction those activities that are conducted outside of the United States to willfully evade or attempt to evade any CEA provision. The CFTC would determine whether a transaction or conduct constitutes evasion by assessing the extent to which a person has a legitimate business purpose for structuring its activity in a particular

125 Dodd-Frank Act §§ 748 (adding new CEA § 23(h)(2)(A)), 922(a) (adding new Exchange Act § 21F(h)(2)(A)).

126 Dodd-Frank Act §§ 748 (adding new CEA § 23(h)(1)(C)), 922(a) (adding new Exchange Act § 21F(h)(1)(C)).

127 Implementing the Whistleblower Provisions of Section 23 of the Commodity Exchange Act, **75 Fed. Reg. 75728** (Dec. 6, 2010). Additional information about the meeting at which this proposed rule was issued, including a transcript, can be found on the CFTC's website at: [http://cftc.gov/PressRoom/Events/opaevent\\_cftcdoddfrank111010.html](http://cftc.gov/PressRoom/Events/opaevent_cftcdoddfrank111010.html).

128 Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, **75 Fed. Reg. 70488** (Nov. 17, 2010).

129 Securities Whistleblower Incentives and Protections, **76 Fed. Reg. 34300** (June 13, 2011).

130 Dodd-Frank Act § 722(d) (adding new CEA § 2(i)).

131 Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, **76 Fed. Reg. 29818** (May 23, 2011).

132 See **76 Fed. Reg. at 29867** (May 23, 2011).

manner and the extent to which the conduct involves deceit, deception or other unlawful or illegitimate action. The CFTC proposal does not discuss whether the decreased costs of regulatory compliance in other jurisdictions would represent a legitimate business purpose or attempted evasion.

## XI. Effective Date and Implementation Issues

The Dodd-Frank Act set an ambitious goal of 360 days after enactment (July 16, 2011) for the CFTC and the SEC to complete their work on a new regulatory framework for swaps and security-based swaps, respectively. Despite the best efforts of the CFTC and the SEC, the Commissions have not completed their rulemakings. To avoid market disruption, the CFTC and the SEC each have issued orders that identify which Title VII provisions took effect on July 16, defer the effective date of other provisions, and provide appropriate exemptive relief under their statutory authority.<sup>133</sup>

The CFTC issued an order on July 14, 2011, setting out four categories of Dodd-Frank Act provisions. The CFTC has attached appendices to its final order identifying the category of each provision. Under the final order, Category 1 provisions did not take effect on July 16 because they require a rulemaking; instead, these provisions will take effect at least 60 days after publication of such final rules. Category 2 provisions technically became effective on July 16 but, to the extent they rely on the terms to be further defined under Category 1, have no legal effect until the appropriate Category 1 provisions take effect.<sup>134</sup> Category 3 provisions are statutory exemptions that were repealed on July 16; the CFTC order replaces the repealed exemptions with temporary, comparable administrative exemptions.<sup>135</sup> Category 4 provisions became effective on July 16. While complicated, the bottom line is that most Title VII provisions administered by the CFTC have no legal effect on July 16.

The SEC's order, issued on June 15, 2011, sorts the SEC's Dodd-Frank Act provisions into three categories.<sup>136</sup> The provisions in the first category took effect on July 16.<sup>137</sup> The provisions in the second category cannot take effect until the SEC publishes final rules or takes other action required to implement those provisions and, in some cases, will not require compliance until a person registers with the SEC.<sup>138</sup> The provisions in the third category address the SEC, the CFTC and/or other government agencies and direct or authorize such agency/agencies to take a specified action which may impose obligations on market participants. Although these provisions took effect on July 16, they do not require compliance by market participants on that date unless the relevant agency action has been undertaken. The SEC's bottom line is similar to the CFTC's: Few Title VII amendments to the securities laws had legal effect on July 16; most will take effect in the future as rules are finalized.

<sup>133</sup> Temporary Exemptions and Other Temporary Relief, Together With Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, [76 Fed. Reg. 36287](#) (June 22, 2011) (SEC Order); Effective Date for Swap Regulation, [76 Fed. Reg. 42508](#) (July 19, 2011) (CFTC Order).

<sup>134</sup> The CFTC also has granted no-action relief with respect to certain Category 2 provisions that it may lack authority to delay.

<sup>135</sup> The provisions being repealed are Sections 2(d), 2(e), 2(g), 2(h) and 5d of the current CEA.

<sup>136</sup> See Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, [76 Fed. Reg. 36287](#) (June 22, 2011). Additional information about the meeting at which this exemptive order was issued can be found on the SEC's website at <http://sec.gov/news/press/2011/2011-130.htm>.

<sup>137</sup> Notably, the first category includes provisions specifying that SB swaps will become securities on July 16 under new Securities Act § 2(a). SB swaps also will be subject to certain SEC rules and regulations that apply to securities on July 16, 2011.

<sup>138</sup> Examples of requirements that did not require compliance as of July 16 include: reporting data on SB swaps to an SB SDR and the public; the mandated clearing of SB swaps on a clearing agency; and the mandated execution of SB swaps on a national securities exchange or an SB SEF. To promote legal certainty, the SEC Order exempts any post-enactment SB swaps from becoming void under Section 29(b) of the Exchange Act because of a violation of an Exchange Act provision that Dodd-Frank added or amended and for which the SEC has either provided an exception or exemptive relief or taken the view that compliance will be triggered by registration or final rulemaking.

The CFTC and SEC still need to determine the proper sequence in which final rules will be considered and should take effect. On May 2 and 3, 2011, the CFTC and SEC held a joint roundtable to discuss the sequencing of Dodd-Frank Act rulemakings, addressing a wide range of topics, including registration, exchange-trading and reporting requirements, and whether the swap clearing requirement should be phased in or whether all clearing should begin at the same time.<sup>139</sup>

## **XII. Conclusion**

Title VII of the Dodd-Frank Act sets out an ambitious new structure for regulating swap market participants, intermediaries, trading platforms and clearing entities. The CFTC and the SEC, in turn, have worked diligently to promulgate rules to implement this new statutory structure for derivatives regulation. Yet, at the one-year anniversary of the Dodd-Frank Act, the questions of most market observers remain open: Will the new rules make swaps safer, fairer, and more efficient, or not? Will they increase or decrease the costs for hedgers? Will they promote or avoid regulatory arbitrage? Will they encourage trading in the U.S. or encourage trading overseas? The answers to these questions will emerge as the CFTC and SEC design and place the final tiles into the regulatory mosaic. We will continue to keep you apprised of how the pieces come together.

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139 Joint CFTC-SEC Staff Roundtable on Implementation Phasing for Final Rules for Swaps and Security-Based Swaps under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (May 2-3, 2011) *available at* <http://www.cftc.gov/PressRoom/Events/2011/index.htm> (follow "Transcript hyperlinks for days 1 and 2).