

June 28, 2011

CFTC and SEC Relief with respect to Dodd-Frank Effective Dates for Derivatives Regulation

I. OVERVIEW

On June 14, 2011, the Commodity Futures Trading Commission (“CFTC”) proposed an order to grant temporary relief with respect to most of the new requirements regulating swaps in the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) due to take effect on July 16, 2011 (“Proposed CFTC Order”). The following day, the Securities and Exchange Commission (“SEC”) released an order granting temporary relief from compliance with new Dodd-Frank requirements relating to security-based swaps (“SBS”) also due to take effect July 16, 2011 (“SEC Order”). The CFTC and SEC (collectively, the “Commissions”) explained that these actions serve to allow the Commissions additional time to implement the new regulatory framework for swaps and SBS mandated by Dodd-Frank in a clear and efficient manner while providing market participants with some degree of certainty as to what requirements will become effective on July 16, 2011. The orders also respond to significant concern among market participants that the legal status of OTC derivatives as of July 16, 2011, would be uncertain. While the SEC’s action takes effect immediately, the CFTC will take final action following a July 1, 2011 deadline for public comments.

II. BACKGROUND

Title VII of Dodd-Frank amends the Commodity Exchange Act (“CEA”) and Securities Exchange Act of 1934 (“Exchange Act”) to establish a new comprehensive regulatory regime for swaps and SBS. The new regulatory regime will, among other things, require the registration and regulation of swap dealers and major swap participants, impose clearing and trade execution requirements on standardized products, and create a record keeping and real-time price and trade data reporting regime with respect to swaps and SBS. Under Sections 754 and 774 of Dodd-Frank, the provisions of Title VII that do not have an explicit effective date will come into effect on the later of (i) July 16, 2011, or (ii) not less than 60 days after publication of the relevant final rule if the provision requires rulemaking for implementation. Some requirements of Title VII are self-effectuating meaning that they do not require an implementing rule or regulation in order to become effective. Others, however, require rulemaking in order to become effective, and Dodd-Frank generally requires that the Commissions finalize such rules by July 16, 2011. While the Commissions have proposed many rules, most rules required under Title VII are not finalized, including final rules defining key Dodd-Frank terms, such as “swap,” “security-based swap,” “swap dealer,” “security-based swap dealer,” “major swap participant,” “major security-based swap participant” and “eligible contract participant.” Both Commissions have indicated that they will miss the statutory deadline and, at the urging of market participants, have been considering their statutory authority to provide some form of exemptive relief from having to comply with the new requirements as of the general effective date of July 16, 2011.

III. THE PROPOSED CFTC ORDER

In the Proposed CFTC Order, the CFTC noted four categories of Dodd-Frank requirements: (1) provisions that require a rulemaking (for which relief is not being proposed); (2) self-effectuating provisions that reference terms that require further definition; (3) self-effectuating provisions that do not reference terms that require further definition and that repeal provisions of current law; and (4) self-effectuating provisions for which relief is not being proposed. The CFTC's temporary relief would be limited to categories (2) and (3) above.

Category 1: Provisions that Require Rulemaking; CFTC Not Providing Relief

Dodd-Frank provisions in Category 1 will require final rules in order to become effective. The CFTC is not providing relief with respect to Category 1 provisions since they are not self-effectuating as of July 16, 2011. Examples of Category 1 provisions include registration of swap dealers and major swap participants as well as capital, margin, and business conduct requirements for swap dealers and major swap participants. The CFTC staff has prepared a list of these provisions, which is available [here](#).

Category 2: Provisions that Reference Terms Requiring Further Definition; CFTC Delaying Effectiveness

Dodd-Frank provisions in Category 2 make specific reference to the terms "swap," "swap dealer," "major swap participant" or "eligible contract participant" and would otherwise become effective on July 16, 2011. The Proposed CFTC Order would exempt market participants from the new requirements under Dodd-Frank under these provisions insofar as they relate to the terms subject to further definition by the CFTC. Two noteworthy examples of Category 2 provisions include new section 4d(f) under the CEA requiring persons holding collateral for margin customer cleared swaps to be registered with the CFTC as futures commission merchants and to hold such collateral in segregated accounts, and the requirement that non-eligible contract participants must only trade swaps on exchanges. The proposed relief, however, would not limit the CFTC's anti-fraud or anti-manipulation authority under the CEA. The relief in the Proposed CFTC Order would expire on the earlier of the effective date of the final rule defining the relevant term or December 31, 2011.

The Proposed CFTC Order notes that the CFTC's authority to provide exemptive relief under the CEA may not extend to certain Category 2 provisions, including swap dealer segregation requirements for uncleared swaps and the duties and appointment of a chief compliance officer for swap dealers and major swap participants. While these provisions will take effect on July 16, 2011, the release notes that CFTC staff is separately considering whether to issue no-action relief in which the staff would state that it would not recommend that the CFTC commence an enforcement action for failure to comply with such provisions over a similar time period for which relief is being provided for other Category 2 provisions. The form and scope of any such no-action relief has not yet been proposed.

Category 3: Provisions that Repeal Provisions of Current Law; CFTC Providing Temporary Relief

Dodd-Frank provisions in Category 3 repeal sections of the CEA that were added by the Commodity Futures Modernization Act of 2000. These sections exempted certain swap transactions, including swaps in excluded or exempt commodities, from the CEA, including the exchange trading requirement applicable to futures contracts. Under Dodd-Frank, these exemptions or exclusions will all be removed from the CEA as of July 16, 2011. There has been some concern expressed by market participants that given the removal of these exemptions and the lack of full implementation of the new framework governing swaps, transactions widely entered into in the swap market today that have been exempted or excluded from the requirements of the CEA may be viewed as illegal, off-exchange futures contracts after July 16, 2011.

To address this concern, the Proposed CFTC Order notes that Part 35 of the CFTC Regulations, which currently provides exemptions for certain non-standardized, non-cleared, and non-exchange traded transactions, and Part 32 of the CFTC Regulations, which includes a similar exemption for commodity options transactions, remain in effect. Furthermore, the Proposed CFTC Order temporarily exempts transactions that would not technically satisfy such exemptions but would have been within the scope of sections 2(d), 2(e), 2(g), 2(h) and 5d of the CEA, as in effect prior to July 16, 2011. Such exemptive relief does not, however, restrict the CFTC's enforcement power regarding these transactions pursuant to its anti-fraud and anti-manipulation authority. The temporary exemptive relief would expire upon the earlier of December 31, 2011, or the repeal or replacement of Part 35 or Part 32, as applicable.

Category 4: Self-Effectuating Provisions Effective July 16, 2011; CFTC Not Providing Relief

Certain Dodd-Frank provisions are self-effectuating and will be effective July 16, 2011. The CFTC is not providing relief for these Category 4 provisions. A list of these provisions may be found [here](#).

As a practical matter, some Category 4 requirements may present challenges for market participants since the contours of the requirements will be largely shaped by guidance contained in the CFTC's rulemakings on the topic. This includes provisions relating to new definitions and enforcement authorities. Another such requirement is included in newly added CEA section 5b(c)(2), which contains the new core principles for derivatives clearing organizations. These new core principles will take effect on July 16, 2011. The CFTC's proposed guidance and rulemaking implementing the core principles, however, will only come into effect once the rules have been finalized. This may make compliance more difficult in the interim period.

IV. SEC EXEMPTIVE RELIEF

The SEC issued guidance on which Dodd-Frank requirements will be effective on July 16, 2011, and those for which temporary relief would be granted effective immediately. The SEC Order discusses each provision of Dodd-Frank relating to SBS and identifies those provisions for which relief is being provided, those for which relief is not necessary because they pertain to SEC action that is yet to be finalized and those provisions that will take effect on July 16, 2011. The SEC Order does not provide relief to SBS provisions requiring publication of final rules or those which apply only to registered entities for whom the registration process has not yet been finalized. These provisions will only become effective upon the effectiveness of the final rules.

Guidance on Temporary Relief for Self-Effectuating Provisions Requiring Further SEC Action

The SEC Order provides immediate temporary relief for key Dodd-Frank provisions intended to augment SEC supervision of the SBS market. For instance, the obligation to report SBS executed prior to the enactment of Dodd-Frank is deferred until the date that is six months after the registration with the SEC of a Security-Based Swap Data Repository ("SDR") capable of accepting data for the asset class of such pre-enactment SBS. Prior to the SEC Order, Dodd-Frank provided that this requirement to report pre-enactment SBS would take effect on January 12, 2012. Similarly, the SEC order grants temporary relief from the requirements of Dodd-Frank for SDRs themselves.

Other new mandates in Dodd-Frank are deferred until the requisite rules take effect. Notably, market participants are temporarily exempt from the Dodd-Frank prohibition on the involvement of an associated person subject to a statutory disqualification in an entity's SBS transactions. The restriction on non-eligible contract participants to effect SBS only on a national securities exchange is also delayed until the effective date for the final rules defining the term "eligible contract participant." Requirements relating to the segregation of collateral in connection with uncleared SBS are also deferred.

Provisions Outside the Scope of Relief Provided by SEC Order

The Dodd-Frank provisions related to the regulation of SBS that become effective on July 16, 2011, generally include measures for which a final rule has taken effect or which relates to SBS not yet cleared or cleared on a voluntary basis. For instance, the relief in the SEC Order does not apply to reporting requirements for beneficial ownership because the SEC has issued a final rule on this topic. Also, the SEC chose not to exempt market participants from the restriction permitting only registered broker-dealers or swap dealers to collect or hold customer margin, or the obligation to segregate initial margin amounts delivered with respect to cleared SBS. The SEC justified this decision on the grounds that no central counterparties are currently offering to clear SBS for customers. However, the SEC stated that it will review individual requests for relief from these provisions.

Moreover, institutional investment managers will not be exempt from the requirement to file reports with the SEC regarding the purchase or sale of SBS under section 13(f)(1) of the Exchange Act.

V. VALIDITY OF SBS CONTRACTS

The SEC Order makes clear that SBS executed after July 16, 2011, would not be rendered invalid or unenforceable as a result of failure to comply with the Dodd-Frank requirements that have not yet been implemented. Concerns had arisen as a result of Section 29(b) of the Exchange Act, which provides that contracts made in violation of the Exchange Act, and any rights created under such contracts, are invalid. However, the SEC maintains that those Dodd-Frank provisions requiring final rulemaking do not become operative until adoption of final rules by the SEC. Accordingly, the SEC Order exempts SBS contracts executed on or after the Dodd-Frank effective date from invalidation under Section 29 of the Exchange Act as a result of those provisions. The SEC justifies this action citing the need for investor certainty as to the validity of SBS contracts during the time between July 16, 2011, and the effective date for the final rule for each relevant provision of Dodd-Frank.

VI. SBS AS SECURITIES

Title VII of Dodd-Frank amends the Securities Act of 1933 and the Exchange Act to include SBS in the definition of “security.” As a result, SBS are subject to the provisions of the securities laws and the rules thereunder with respect to “securities,” including the SEC’s anti-fraud and anti-manipulation authority. This definitional change will go into effect on July 16, 2011, and the SEC Order is not currently proposing any relief from this change. The SEC Order makes note, however, that the SEC will provide guidance and, where appropriate, temporary relief from various pre-Dodd-Frank provisions of the securities laws that would otherwise apply to SBS on July 16, 2011.¹

¹ For instance, in a recent release proposing permanent exemptions for SBS issued by certain clearing agencies from the Securities Act of 1933, Exchange Act and Trust Indenture Act of 1939, the SEC indicated that it would extend temporary exemptions for cleared credit default swaps beyond the current July 16, 2011 expiration date. Exemption for Security-Based Swaps Issued by Certain Clearing Agencies published by SEC on June 10, 2011, available [here](#).

VII. LOOKING AHEAD

In their recent actions, the Commissions provided some degree of certainty to the market ahead of the July 16, 2011 general effective date. However, the implementation of Dodd-Frank requirements continues to present challenges for all market participants given the amount of necessary action yet to be taken by the regulatory bodies and the lack of interpretive guidance on a number of provisions coming into effect on July 16, 2011, for which the Commissions have not provided relief. The Commissions have indicated plans to hold additional open meetings over the coming months on these topics and we will continue to monitor all developments.

This publication is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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