

## U.S. Federal Regulators Provide Temporary Relief from Certain Dodd-Frank Act Derivatives Provisions

The Commodity Futures Trading Commission (“CFTC”) has provided a notice of proposed order, and the Securities and Exchange Commission (“SEC”) has provided an order, each to provide temporary relief from certain Title VII requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Title VII”) that pertain to swaps. Subsequently, the CFTC has issued a Draft Staff No-Action Letter recommending that the CFTC not commence certain related enforcement actions, and the SEC has provided an additional order to provide temporary relief from certain other Title VII requirements and also has adopted interim final rules regarding security-based swaps. Additionally, the Financial Industry Regulatory Authority (“FINRA”) has proposed to temporarily exempt security-based swaps from certain of its rules. These actions are intended to provide legal certainty to market participants as to certain over-the-counter derivatives that were to be transacted and regulated differently on and after July 16, 2011 pursuant to Title VII.

### CFTC Proposed Order and Draft Staff No-Action Letter

#### CFTC Proposed Order

The CFTC issued a notice on June 14, 2011 (“Notice”)<sup>1</sup> proposing temporary exemptive relief in two parts with respect to various requirements of the Commodity Exchange Act as amended (“CEA”) that would otherwise take effect on July 16, 2011:

- Part 1: Relief from CEA provisions that specifically reference terms that Title VII

<sup>1</sup> CFTC, Notice of Proposed Order and Request for Comment on Effective Date for Swap Regulation, 76 Fed. Reg. 35372 (June 17, 2011), available at: <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-15195a.pdf>.

requires to be further defined, such as “swap,” “swap dealer,” “major swap participant,” and “eligible contract participant,” but only with respect to those requirements or portions of such provisions that specifically relate to such referenced terms.<sup>2</sup> The proposed relief would expire upon the earlier of: (1) the effective date of the applicable final rule further defining the relevant term; and (2) December 31, 2011.

<sup>2</sup> The proposed exemptive relief would not affect the CEA’s applicability to futures contracts or options on futures contracts. For example, should a CEA provision reference both futures and one of the terms that requires further definition (such as swaps), the CFTC relief would not affect the provision’s applicability to the extent it refers to futures or options.

- Part 2: For certain transactions that fall outside of existing CFTC Regulations Part 32 or Part 35, exemptive relief from the repeal of the following currently existing CEA Sections:
  - Certain transactions in excluded commodities—CEA Section 2(d);
  - Electronic trading facilities for certain exempted transactions—CEA Section 2(e);
  - Certain individually negotiated swap transactions—CEA Section 2(g);
  - Certain transactions in exempt commodities—CEA Section 2(h); and
  - Certain transactions traded on exempt boards of trade—CEA Section 5d.

The exemptive relief would also apply to those transactions that fall outside of CFTC Regulations Part 32 or Part 35 but within the scope of the “line of business provision.” The proposed relief would expire upon the earlier of (1) the repeal or replacement of Part 32 or Part 35, as applicable, and (2) December 31, 2011.

The Notice cites as reasons for the temporary relief: (i) the fact that definitional rulemaking regarding the terms listed in Part 1 above will not be in place by July 16; and (ii) requests from market participants for greater clarity regarding the applicability of various regulatory requirements to certain transactions.

### Draft Staff No-Action Letter

On June 30, 2011, the CFTC released a Draft Staff No-Action Letter (“Letter”)<sup>3</sup> which would supplement the Notice. The Letter acknowledges that the CFTC may not have authority to provide the Notice’s proposed exemptive relief from certain provisions of Title VII and the CEA as discussed in Part 1 above, and therefore recommends that the CFTC not commence an enforcement action against any person failing to comply with such provisions. The provisions at issue include: (1) CEA Section 4s(l), “which imposes upon swap dealers and major swap participants certain segrega-

<sup>3</sup> CFTC, Staff No-Action Relief: Application of certain CEA provisions after July 16, 2011 – the general effective date of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act; staff working draft; yet unpublished and for discussion purposes only, available at: <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/noaction061411.pdf>.

tion requirements with respect to collateral for uncleared swaps;” (2) CEA Section 5b(a), “which requires a derivatives clearing organization to register with the CFTC in order to clear swaps;” and (3) CEA Section 4s(k), “which provides for the duties and designation of a chief compliance officer for swap dealers and major swap participants.”<sup>4</sup> The Letter states that the no-action relief will not impact the CFTC’s anti-fraud and anti-manipulation authority, and such relief will automatically expire upon the earlier of (i) the effective date of the applicable final rule defining the relevant term, and (ii) December 31, 2011.

## SEC Orders and Interim Final Rules

### June SEC Order

Through guidance issued on June 15, 2011 (“June Order”),<sup>5</sup> the SEC granted temporary relief from “substantially all” of Title VII’s requirements applicable to “security-based swaps” that would have become effective on July 16, 2011, and also provided temporary relief from compliance with most of the new Securities Exchange Act of 1934 as amended (“Exchange Act”) requirements that would have applied on July 16. Importantly, the SEC granted an exemption to persons who meet the current definition of “eligible contract participant” and may be excluded from this definition by Title VII—to continue to rely on the pre-Title VII definition until the term is further defined in final rulemaking. Additionally, the SEC provided a temporary exemption to allow entities not currently registered as a national securities exchange or that cannot currently register as a security-based swap execution facility, because final rules for such registration have not been adopted, to continue trading security-based swaps without so registering, until the earliest compliance date set forth in final rules regarding registration of security-based swap execution facilities. Additionally,

<sup>4</sup> CFTC, Press Release: PR6062-11 (June 30, 2011), available at: <http://www.cftc.gov/PressRoom/PressReleases/pr6062-11.html>.

<sup>5</sup> SEC, Order Pursuant to Sections 15F(b)(6) and 36 of the Securities Exchange Act of 1934 Granting 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, and Request for Comment, Release No. 34-64678; File No. S7-24-11 (June 15, 2011), as yet unpublished in the Federal Register, available at: <http://www.sec.gov/rules/exorders/2011/34-64678.pdf>.

with the goal of providing assurance to market participants, the SEC granted temporary exemptive relief from Section 29 of the Exchange Act, which generally states that contracts made in violation of any provision of the Exchange Act shall be void regarding the rights of any person who is in violation of such provision.

The SEC stated, as reasons for relief, its understanding that: (i) market participants need additional time to modify current systems and practices and implement necessary policies and procedures in order to comply with Title VII; and (ii) some of these alterations cannot be completed until certain rules are effective.

### July SEC Order

The SEC issued additional guidance, effective July 1, 2011, regarding “security-based swaps” (“July Order”),<sup>6</sup> which provides that certain Exchange Act requirements applicable to securities will not apply to security-based swaps when Title VII’s new definition of “security” (which includes security-based swaps) becomes effective on July 16, 2011, in order to provide additional time to analyze the impact of the new definition on the industry. Specifically, the July Order provides a temporary exemption from the provisions of the Exchange Act and the regulations thereunder in connection with activities involving security-based swaps to (1) any person who meets the current “eligible contract participant” definition and (2) registered brokers and dealers, except as otherwise provided in the July Order. Such temporary exemptions will remain effective until the compliance date for the final rules that the SEC may adopt regarding the definitions of the terms security-based swap and eligible contract participant. Additionally, the July Order provides certain temporary exemptions from Sections 5 and 6 of the Exchange Act until compliance is required by the final rules regarding registration of security-based swap execution facilities. Finally, the July Order sets forth exemptive relief from Section 29 of the Exchange Act for persons party to a contract that violates a provision of the Exchange Act for which the SEC provided exemptive relief in the July Order. There are certain exclusions from the July Order, such as the anti-fraud

<sup>6</sup> SEC, Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of “Security” to Encompass Security-Based Swaps, and Request for Comment, Release No. 34-64795; File No. S7-27-11 (July 1, 2011), as yet unpublished in the Federal Register, available at: <http://www.sec.gov/rules/exorders/2011/34-64795.pdf>.

and anti-manipulation provisions of the Exchange Act. The SEC is soliciting public comment on all aspects of these exemptions which are due on July 15, 2011.

### SEC Interim Final Rules

On July 1, 2011, the SEC adopted interim final rules<sup>7</sup> in response to comments received from market participants who requested more time to consider the implications of including “security-based swaps” in the definition of “security.” By providing exemptions “from all provisions of the Securities Act [of 1933 as amended] (other than the Section 17(a) antifraud provisions), the registration requirements of the Exchange Act relating to classes of securities, and the indenture provisions of the Trust Indenture Act [of 1939 as amended] for those security-based swaps,” the SEC is allowing certain security-based swaps to continue to trade and be cleared, unimpeded by the new requirements of Title VII. Such interim relief will continue until the SEC adopts rules clarifying the definitions of security-based swap and “eligible contract participant.” While these interim final rules have been approved, the SEC is soliciting public comment on such rules which are due on August 15, 2011.

### FINRA Proposed Rule

On July 8, 2011, FINRA filed a proposed rule change with the SEC to adopt FINRA Rule 0180 (“FINRA Rule”)<sup>8</sup> which addresses the application of the FINRA rules to “security-based swaps.” Specifically, the FINRA Rule provides “that FINRA rules shall not apply to members’ activities and positions with respect to security-based swaps,” except for certain conduct rules, such as those relating to standards of commercial honor and principles of trade, the use of manipulative, deceptive or other fraudulent devices, anti-money laundering compliance programs, and margin requirements for credit default swaps.<sup>9</sup> For purposes of the

<sup>7</sup> SEC, Exemptions for Security-based Swaps, Release No. 33-9231; File No: S7-26-11 (July 1, 2011), as yet unpublished in the Federal Register, available at: <http://www.sec.gov/rules/interim/2011/33-9231.pdf>.

<sup>8</sup> FINRA, Proposed Rule Change to Adopt FINRA Rule 0180 (Application of Rules to Security-Based Swaps), SR-FINRA-2011-033 (July 8, 2011), available at: <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p123872.pdf>.

<sup>9</sup> See FINRA Rule 2010; FINRA Rule 2020; FINRA Rule 3310; and FINRA Rule 4240.

FINRA Rule, security-based swaps shall be defined pursuant to the Exchange Act and the rules and guidance of the SEC or its staff. FINRA has requested to implement the FINRA Rule immediately and has provided that it would expire on January 17, 2012, with the qualification that FINRA will amend the expiration date in subsequent filings as necessary, such that the FINRA Rule will expire at the same time as relevant SEC provisions.

Similar to the SEC, FINRA states as reasoning for the FINRA Rule its concern that, absent additional time to

understand the potential implications of including security-based swaps in the definition of “security” and absent final rules and guidance providing clarity on the revised definition’s nuances, the definition change may lead to unnecessary uncertainty for market participants.



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