

MEMO# 25286

June 20, 2011

CFTC and SEC Grant Temporary Relief from Self-Effectuating Provisions of Dodd-Frank Act

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 47-11
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 21-11
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 21-11
ETF ADVISORY COMMITTEE No. 39-11
EQUITY MARKETS ADVISORY COMMITTEE No. 35-11
FIXED-INCOME ADVISORY COMMITTEE No. 49-11
SEC RULES MEMBERS No. 74-11
SMALL FUNDS MEMBERS No. 43-11 RE: CFTC AND SEC GRANT TEMPORARY RELIEF FROM SELF-EFFECTUATING PROVISIONS OF DODD-FRANK ACT

The Securities and Exchange Commission ("SEC") has granted and the Commodities Futures Trading Commission ("CFTC") has proposed temporary exemptions and other relief from certain of the Title VII Dodd-Frank Act [\[1\]](#) requirements that become effective on July 16, 2011 (i.e., the general effective date for provisions of Title VII that do not require rulemaking or otherwise specify an effective date). In both cases, the relief is designed to provide legal certainty regarding the applicability of various regulatory requirements to certain transactions after July 16, 2011. Provisions of Title VII that require rulemaking would not be implicated by the orders because, pursuant to the Dodd-Frank Act, such provisions do not become effective until at least 60 days after publication of a final rule. The orders are briefly summarized below.

Proposed CFTC Order

The CFTC Order [\[2\]](#) is designed to provide temporary relief to market participants regarding the transition to the new swap regulatory regime. The relief is divided into two parts. The first part of the CFTC Order would exempt persons or entities from complying with requirements of the Commodity Exchange Act ("CEA") that would go into effect on July 16 but that reference the terms "swap," "swap dealer," "major swap participant," or "eligible contract participant." The proposed relief would apply only with respect to those requirements or portions of such provisions that specifically relate to the referenced terms.

It would be granted until the effective date of the definitional rulemaking for these terms or December 31, 2011, whichever is earlier.

The CFTC Order notes that the CFTC does not have authority under the CEA to grant an exemption for certain Dodd-Frank Act provisions that do not require a rulemaking and do not amend the CEA but that do reference terms requiring further definition and are self-effectuating on July 16, 2011. The CFTC staff is considering whether to issue a no-action letter(s) with respect to these provisions.

The second part of the CFTC Order would temporarily exempt certain transactions in exempt or excluded commodities from various CEA provisions that will or may apply to certain agreements, contracts and transactions as a result of the repeal of certain CEA exemptions and exclusions as of July 16, 2011. These transactions include:

- Section 2(d)(1), transactions in excluded commodities between eligible contract participants and not executed or traded on a trading facility;
- Section 2(d)(2), principal-to-principal transactions in excluded commodities between certain eligible contract participants and executed or traded on an electronic trading facility;
- Section 2(g), transactions subject to individual negotiation between eligible contract participants in commodities other than agricultural commodities and not executed or traded on a trading facility;
- Sections 2(h)(1)-(2), transactions in exempt commodities between eligible contract participants and not entered into on a trading facility;
- Sections 2(h)(3)-(7), principal-to-principal transactions in exempt commodities between eligible commercial entities and executed or traded on an electronic trading facility (called exempt commercial markets);
- Section 5d, transactions in commodities, among other things, having a nearly inexhaustible deliverable supply or no cash market, between eligible contract participants and traded on an electronic board of trade; and
- Section 2(e), which generally provides that nothing in the CEA governs or is applicable to an electronic trading facility that limits transactions authorized to be conducted on its facilities to those satisfying the requirements of sections 2(d)(2), 2(g) or 2(h)(3).

The CFTC Order would temporarily exempt such transactions until the repeal or replacement of certain of the CFTC's regulations or December 31, 2011, whichever is earlier. The CFTC relies on Part 35 of its regulations for providing the proposed temporary relief. [\[3\]](#) It states that Part 35 will continue to be an option for providing relief to eligible transactions until such time as it is withdrawn, amended or replaced. [\[4\]](#)

The CFTC has posted lists of the provisions that would not be subject to the relief in the CFTC Order. [\[5\]](#) These provisions fall into two categories: those that require rulemaking and those that are self-effectuating and will become effective on July 16. Further, the CFTC Order would not apply to futures contracts, options on futures or transactions by retail customers in foreign currency or other commodities. It would not apply to any provision of Title VII that has already become effective and it would not affect any implementing regulations that the CFTC has already issued or may promulgate under the Dodd-Frank Act, including any related implementation dates. The CFTC Order would not limit the CFTC's ability to pursue fraud and manipulation.

SEC Order

The SEC Order is designed to provide temporary exemptions and other temporary relief, together with information on compliance dates for various Dodd-Frank Act provisions that would otherwise apply to security-based swaps (“SB swaps”) on July 16, 2011, as well as extend existing temporary rules under the Securities Act of 1933 (“Securities Act”), the Securities Exchange Act of 1934 (“Exchange Act”) and the Trust Indenture Act of 1939 (“Trust Indenture Act”) for certain SB swaps. [6] The SEC Order provides guidance on a provision-by-provision basis. It states that the Title VII provisions that apply to “registered persons” cannot become effective until such persons have become registered. Similarly, provisions that impose requirements that require compliance by market participants in response to, or as a result of, SEC action in other rulemaking do not impose a compliance obligation in the absence of such SEC action – even in those cases where the provisions become effective on July 16. [7] The SEC Order explains that these two categories of provisions are independent of a third category of Dodd-Frank Act provisions, those that require rulemaking and cannot become effective until such rulemaking is completed.

In addition, the SEC Order identifies a number of provisions that will become effective and require compliance beginning on July 16, 2011. It notes that the SEC will consider individual requests for relief from certain of these provisions. Further, it states that any relief provided by the SEC will expire upon the adoption of related final rules and the compliance dates specified in those related final rules.

In line with the guidance provided above, a SB swap does not need to be cleared through a registered clearing agency or a clearing agency that is exempt from registration unless and until the SEC makes a determination that a SB swap is required to be cleared. Also, SB swap dealers and MSPs are exempt from restrictions on association with persons subject to a statutory disqualification and from the collateral segregation requirements for uncleared SB swaps until the registration rules are effective. In addition, market participants are temporarily exempted from the requirement to report pre-enactment SB swaps by January 12, 2010. Instead, the SEC Order provides that SB swaps will need to be reported six months after the date that an SB swap data repository that is capable of accepting the asset class of such SB swap registers with the Commission.

The SEC Order states that SB swaps will become “securities” on July 16, 2011, subject to the SEC’s antifraud and anti-manipulation rules and regulations. It explains, however, that the SEC intends to separately address requests for relief from certain provisions of the federal securities laws that will impose new obligations on counterparties to SB swaps in light of the expansion of the definition of security. Further, the SEC has proposed exemptions under the Securities Act, Exchange Act and Trust Indenture Act for SB swaps issued by certain clearing agencies satisfying certain conditions. The SEC Order also provides legal certainty for SB swaps contracts by granting temporary relief under Section 29(b) of the Exchange Act to exempt any SB swap contract entered into on or after July 16, 2011 from being void or considered voidable because any person that is a counterparty of the SB swap contract violated a provision of the Dodd-Frank Act that is not effective on July 16.

endnotes

[1] Title VII is the section of the Dodd-Frank Act that establishes a comprehensive framework for regulating over-the-counter derivatives.

[2] Effective Date for Swap Regulation, CFTC Notice of Proposed Order and Request for Comment, June 14, 2011 (“CFTC Order”), available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister061411.pdf>. Comments on the CFTC Order must be submitted to the CFTC by July 1.

[3] Issued in 1993, Part 35 of the CFTC regulations generally provides a broad exemption from the CEA for “swap agreements” if: (1) they are entered into by eligible swap participants; (2) they are not part of a fungible class of agreements standardized as to their material economic terms; (3) the creditworthiness of any party having an actual or potential obligation under the swap agreement would be a material consideration in entering into or determining the terms of the swap agreement, including pricing, cost, or credit enhancement terms; and (4) they are not entered into or traded on a multilateral transaction execution facility.

[4] During the public meeting to discuss the CFTC Order, it was noted that the CFTC has proposed in a rulemaking earlier this year to eliminate the Part 35 safe-harbor provisions. The CFTC commented that it would coordinate any action on the proposed rulemaking and the proposed CFTC Order.

[5] The lists are available at: <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cat1requiredrulemaking061411.pdf> and <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cat4requiredrulemaking061411.pdf>.

[6] SEC Release No. 64678 (June 15, 2011) (“SEC Order”), available at <http://www.sec.gov/rules/exorders/2011/34-64678.pdf>. Comments on the SEC Order must be submitted to the SEC by July 6.

[7] As with the CFTC Order, these provisions would include provisions in which a term (e.g., eligible contract participants) has yet to be defined by the SEC.