

MEMO# 25272

June 13, 2011

Joint Industry Letters Regarding Self-Operative Derivatives Provisions of the Dodd-Frank Act

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 44-11
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 19-11
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 19-11
ETF ADVISORY COMMITTEE No. 37-11
EQUITY MARKETS ADVISORY COMMITTEE No. 33-11
FIXED-INCOME ADVISORY COMMITTEE No. 48-11
SEC RULES MEMBERS No. 68-11
SMALL FUNDS MEMBERS No. 40-11 RE: JOINT INDUSTRY LETTERS REGARDING SELF-OPERATIVE DERIVATIVES PROVISIONS OF THE DODD-FRANK ACT

ICI recently joined a number of trade associations in submitting letters to the Commodity Futures Trading Commission (“CFTC”) and the Securities and Exchange Commission (“SEC”) requesting exemptions and regulatory relief from certain provisions of Title VII of the Dodd-Frank Act (“Act”) that could become effective without rulemaking on July 16, 2011. [\[1\]](#) The letters explain that under Sections 754 and 774 of the Act some provisions in Title VII are scheduled to become effective 360 days after the date of the Dodd-Frank Act’s enactment (“self-operative provisions”) – i.e., July 16 – while other provisions require rulemaking and become effective not less than 60 days after publication of the final rule or regulation implementing the provision. [\[2\]](#) The letters state that compliance, interpretive and operational challenges will arise, in addition to potential market disruption, if the self-operative provisions go into effect on July 16 because of the incomplete status of the CFTC and SEC rulemaking combined with the interdependencies between the self-operative provisions and the provisions that require rulemaking. The letters are briefly summarized below.

Joint CFTC Letter

The Joint CFTC Letter urges the CFTC to use its exemptive authority to ensure a coordinated implementation of the Dodd-Frank Act provisions that are implemented through rulemaking and those that are self-operative but interrelated to CFTC rulemaking. [\[3\]](#) It explains that

many situations exist under Title VII in which a rulemaking is either required to give content to a substantive standard or requirement or defined term used in a self-operative provision, or necessary to avoid compelling an impossible requirement or manifestly inappropriate result. The Joint CFTC Letter states that Section 754 of the Dodd-Frank Act indicates that Congress intended self-operative provisions to come into effect in a coordinated manner and for provisions that would otherwise be effective by their terms to be delayed pending related CFTC rulemaking. It also states that until finalization of a number of critical rulemakings (e.g., those applicable to margin, duties of major swap participants, registration requirements and extraterritorial application of the Act), market participants are unable to complete the analysis necessary to determine how to structure their derivatives activity and how to develop compliance and systems infrastructure to implement the new, evolving regulatory framework.

The Joint CFTC Letter specifically requests that the CFTC issue an order interpreting Section 754 in a manner that allows the CFTC to effectuate the orderly implementation of the Dodd-Frank Act, including the self-operative provisions, through appropriate sequencing to avoid market disruption, uncertainty, non-compliance, and other unintended consequences. To the extent any uncertainty exists with respect to the construction of Section 754, the Joint CFTC Letter requests that through an order the CFTC (1) adopt a non-enforcement policy with respect to non-compliance with self-operative provisions of the Dodd-Frank Act prior to finalization and effectiveness of related rulemakings specified by the CFTC and (2) exempt affected market participants from the private rights of action provisions of the Commodity Exchange Act (“CEA”) with respect to the self-operative provisions of the Dodd-Frank Act prior to finalization and effectiveness of the specified related rulemakings.

The Joint CFTC Letter also requests that the CFTC provide interpretive and exemptive relief with respect to the treatment of swap transactions under the provisions of the CEA applicable to futures contracts. It explains that the Dodd-Frank Act would repeal, on July 16, 2011, certain sections of the CEA that set forth the existing legal distinction between futures contracts and swaps. Without legal certainty and until the CFTC and SEC adopt definitions of the terms “swap” and “security-based swap,” common types of over-the-counter transactions currently regarded as swaps could be considered illegal if such transactions are conducted in accordance with the new regulatory framework for swaps but are subsequently held by the CFTC or a court to be futures contracts. Such a finding could result in rescission, private rights of action or CFTC enforcement cases. Until the CFTC is able to address this issue, the Joint CFTC Letter recommends that the CFTC provide exemptive relief to: (1) eligible contract participants to an agreement, contract or transaction conducted in accordance with the swap provisions of the CEA and CFTC rules from compliance with the provisions of the CEA and CFTC rules applicable to futures contracts (unless previously determined by the CFTC to be subject to such provisions) and (2) market participants engaging in transactions that the CFTC and SEC have proposed to exclude from the definition of swap from compliance with the provisions of the CEA and CFTC rules applicable to swaps.

Joint SEC Letter

Similar to the Joint CFTC Letter, the Joint SEC Letter explains that the self-operative provisions of the Dodd-Frank Act must align with the provisions of the Act that are dependent on rulemaking to ensure an orderly and logical implementation of Title VII without creating inefficient, overbroad and duplicative implementation and compliance efforts. [\[4\]](#) It also states that there is no basis for assuming that Congress intended through

Section 774 of the Dodd-Frank Act for the self-operative provisions to become effective before the rulemaking process is complete. The Joint SEC Letter recognizes the SEC for its recent announcement that it will take a series of actions in the coming weeks to clarify the requirements of the Dodd-Frank Act that will apply to security-based swap transactions as of July 16, 2011, and to provide temporary relief. [5]

The Joint SEC Letter urges the SEC to use its exemptive authority, and any other legal authorities available to it, to exempt, interpret or otherwise provide relief to market participants from the requirements of the self-operative provisions of the Act until key definitional (i.e., the definition of security-based swap and mixed swap) and other related rules (e.g., those applicable to registration requirements, margin, antifraud liability and extraterritorial application of the Act) are effective, and the SEC has specified an implementation plan for Title VII. This relief would not apply to the amendment to the securities definition to include security-based swaps and Section 767 of the Dodd-Frank Act. Instead, the Joint SEC Letter requests that the SEC temporarily exempt market participants from all of the securities laws, except the existing antifraud protections, that would otherwise apply to security-based swaps beginning on July 16 when security-based swaps become securities. [6] This would allow the SEC to maintain its existing antifraud authority over security-based swaps that were previously security-based swap agreements.

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[Attachment](#)

endnotes

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

[2] Section 754 applies to the CFTC and Section 774 applies to the SEC.

[3] See Letter from Futures Industry Association, Institute of International Bankers, International Swaps and Derivatives Association, Investment Company Institute, Securities Industry and Financial Markets Association, and U.S. Chamber of Commerce to Chairman Gary Gensler, Commissioner Michael Dunn, Commissioner Jill E. Sommers, Commissioner Bart Chilton and Commissioner Scott D. O'Malia, CFTC, dated June 10, 2011 ("Joint CFTC Letter").

[4] See Letter from American Bankers Association, Financial Services Roundtable, Futures Industry Association, Institute of International Bankers, International Swaps and Derivatives Association, Investment Company Institute, Securities Industry and Financial Markets Association, and U.S. Chamber of Commerce to Chairman Mary L. Schapiro, Commissioner Kathleen L. Casey, Commissioner Elisse B. Walter, Commissioner Luis A. Aguilar, and Commissioner Troy A. Paredes, SEC, dated June 10, 2011 ("Joint SEC Letter").

[5] See SEC Press Release, SEC Announces Steps to Address One-Year Effective Date of Title VII of Dodd-Frank Act (June 10, 2011), available at <http://www.sec.gov/news/press/2011/2011-125.htm>. The SEC also indicated that, after proposing all of the key rules under Title VII, it intends to consider publishing a detailed implementation plan in order to roll-out the new security-based swap requirements in the

most efficient manner while minimizing unnecessary disruption and costs to the markets.

[\[6\]](#) The Joint SEC Letter also requests that the SEC encourage the Financial Industry Regulatory Authority to file a rule that would defer application of its rules to security-based swaps and to adopt an implementation plan that is aligned with the SEC's schedule.

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