

MEMO# 24502

August 19, 2010

SEC and CFTC Seek Comment on Definitions Related to Regulation of Swaps

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 44-10
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 25-10
ETF ADVISORY COMMITTEE No. 36-10
EQUITY MARKETS ADVISORY COMMITTEE No. 33-10
SEC RULES MEMBERS No. 83-10 RE: SEC AND CFTC SEEK COMMENT ON DEFINITIONS
RELATED TO REGULATION OF SWAPS

The Securities and Exchange Commission and the Commodity Futures Trading Commission are jointly seeking comment on the definitions of certain key terms in the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to the regulation of swaps and security-based swaps. [\[1\]](#) Specifically, the Commissions are seeking comment on the following terms: swap, security-based swap, swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, eligible contract participant, and security-based swap agreement. [\[2\]](#) The Dodd-Frank legislation provides that the swap rules and regulations promulgated by the Commissions should be comparable to the maximum extent possible, taking into consideration differences in instruments and in the applicable statutory requirements. The Commissions also are seeking comment on the regulation of “mixed swaps” as may be necessary to carry out the purposes of the Dodd-Frank legislation.

Major Swap Participants

Under the legislation, it is questionable whether investment advisers or funds would be treated as swap dealers; [\[3\]](#) it is more likely that investment advisers and funds would be treated as “major swap participants.” The legislation defines major swap participant to be a person that is not a swap dealer and either (1) maintains a substantial position in swaps, other than positions held for hedging or mitigating commercial risk and positions maintained by ERISA plans, whose swaps create substantial counterparty exposure that

could have serious adverse effects on the financial stability of the United States banking system or financial markets or (2) is a financial entity that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements and maintains a substantial position in outstanding swaps.

The Dodd-Frank legislation provides that the Commissions will define the term “substantial position.” The definition must include a threshold amount that is prudent for effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States. Further, the definition must consider a person’s relative position in cleared as opposed to uncleared swaps and may consider the value and quality of collateral held against counterparty exposures.

Classification as a major swap participant would result in registration with one or both of the Commissions, ongoing recordkeeping and reporting requirements, and capital and margin requirements. Major swap participants also could face limitations on their swap activities depending on the rules adopted by the Commissions to fulfill the Dodd-Frank legislative mandate.

Eligible Contract Participant

The Dodd-Frank legislation defines “eligible contract participant” to include an investment company subject to regulation under the Investment Company Act of 1940, acting for its own account, regardless of whether each investor in the investment company is itself an eligible contract participant. The definition also would include an investment adviser, subject to regulation under the Investment Advisers Act of 1940, acting as investment manager or fiduciary for another eligible contract participant and who is authorized by the other participant to commit the swap transaction.

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endnotes

[1] See SEC Release No. 62717 (August 13, 2010), available at <http://www.sec.gov/rules/concept/2010/34-62717.pdf>. Comments must be filed with the Commission no later than 30 days after the release is published in the Federal Register.

[2] These terms are defined in Sections 721 and 761 of the Dodd-Frank legislation, and with respect to the term “eligible contract participant,” in Section 1a(18) of the Commodity Exchange Act. The legislation tasks the Commissions with further defining the terms.

[3] The Dodd-Frank legislation defines swap dealer as a person who holds itself out as a dealer, makes a market in swaps, and regularly enters into swaps for its own account or engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps.