

## CFTC Proposes Temporary Exemptions From Certain New OTC Swap Laws

The *Dodd-Frank Wall Street Reform and Consumer Protection Act* (“Dodd-Frank Act”) put many over-the-counter (“OTC”) derivatives under federal regulation and directed regulators to finish implementing regulations by July 16, 2011, the Dodd-Frank Act’s general effective date. The Commodity Futures Trading Commission (“CFTC”) and the Securities and Exchange Commission (“SEC”) have announced, however, that many rules will not be in place by this date, raising concern about which parts of the Dodd-Frank Act will take effect on July 16, 2011.

Yesterday the CFTC took the following steps to address this concern:

### Temporary exemptions from certain CEA provisions

#### **Exemption for parties from CEA provisions referencing “swap,” “swap dealer,” “major swap participant,” or “eligible contract participant”**

The CFTC proposed an order that temporarily exempts parties from complying with CEA provisions that reference certain terms, including the terms “swap,” “swap dealer,” “major swap participant,” or “eligible contract participant,” which the Dodd-Frank Act requires the CFTC and SEC to define further. The exemption extends until the earlier of the effective date of the rules defining such terms or December 31, 2011. Although the proposed order will expire on December 31, 2011, the CFTC notes that such expiration will not affect its ability to provide further relief.

Beneficiaries of this temporary exemption include the general partner (or similar entity) and investment adviser of a pooled investment vehicle that trades, or may trade, swaps, who could be a commodity pool operator (“CPO”) or commodity trading advisor (“CTA”), respectively, under the CEA. Under current law, such definitions only apply with respect to pooled investment vehicles or other clients that trade, or may trade, futures, options on futures or commodities, or certain foreign currency transactions. When the expanded definitions of CPO and CTA become effective, the general partner and investment adviser of a pooled investment vehicle or other client that invests in any interest rate derivatives, commodity derivatives, derivatives over a broad-based securities index or broad-based credit default index, or most types of currency derivatives, for example, will become a CPO or CTA, respectively.

Commodity pool operators and commodity trading advisors must be registered with the CFTC and be members of the National Futures Association (NFA), unless an exemption is available. The CFTC proposed order gives a reprieve to general partners or investment advisers to pools and other clients that invest in swaps who might otherwise have needed to register with the CFTC, or take steps to comply with an applicable exemption, by July 16, 2011.

Also, the CFTC proposed order notes that the CFTC does not have authority under the CEA to grant a temporary exemption with respect to certain Dodd-Frank Act provisions that do not require a rulemaking

but that reference terms requiring further definition, such as section 724 that obligates a swap dealer to offer customers an opportunity to have their derivatives collateral held in a segregated account at an independent custodian. The CFTC staff is considering whether to issue a no-action letter recommending that the CFTC not commence an enforcement action against swap dealers for failure to comply with this and other similar self-effectuating Dodd-Frank Act provisions.

### **Exemption for certain transactions in exempt or excluded commodities (including financial and energy commodities)**

The CFTC proposed order also temporarily exempts certain transactions in exempt or excluded commodities (including financial and energy commodities) from CEA provisions added or amended by the Dodd-Frank Act. Prior to giving effect to the Dodd-Frank Act, individually negotiated transactions between “eligible contract participants” were generally exempt from the provisions of the CEA, including the requirement that all futures contracts be traded on an exchange. The Dodd-Frank Act repealed these exemptions, effective as of July 16, 2011. As a result, despite another provision of the Dodd-Frank Act that states that only certain provisions of the CEA apply to “swaps” (which provisions do not include the requirement to trade futures on an exchange), concern was expressed by some market participants that certain OTC derivatives transactions would become illegal off-exchange futures on July 16, 2011. In particular, this was a concern with respect to transactions that did not clearly meet the Dodd-Frank Act statutory definition of “swap.”

The CFTC proposed order addresses this concern by clarifying that such transactions will remain exempt from certain CEA provisions until the earlier of the repeal or replacement of certain existing CFTC rules or December 31, 2011. In granting this temporary exemption, the CFTC relies on Part 35 of its regulations, indicating Part 35’s continuing viability after July 15, 2011 as a safe-harbor exemption from the CEA. Part 35 was issued in 1993 and provides a broad exemption from the CEA for many OTC derivatives transactions, although some of its terms are narrower than the exemptions added to the CEA by the *Commodity Futures Modernization Act of 2000*.

### **Clarification of Dodd-Frank Act provisions that require a rulemaking**

In general, the Dodd-Frank Act provides that its derivatives provisions become effective upon the later of (i) July 16, 2011 or (ii) to the extent a provision requires a rulemaking, not less than 60 days after publication of the applicable final rule. As a result, no provision that “requires a rulemaking” will become effective until at least 60 days after publication of the final rule. The CFTC has addressed uncertainty as to which provisions “require a rulemaking” by posting a list of these provisions on its website.

This list includes section 731 of the Dodd-Frank Act, which imposes business conduct standards on swap dealers and major swap participants, including certain additional requirements with respect to acting as an advisor or counterparty to “special entities” (such as certain employee benefit plans and endowments). As a result, these provisions should not become effective until at least 60 days after the final rules with respect to such business conduct standards are published.

## Clarification of Dodd-Frank Act provisions that will become effective on July 16, 2011

The CFTC proposed order also explains that some provisions of the Dodd-Frank Act that do not require a rulemaking are not covered by the temporary exemptions. As a result, these provisions will become effective on July 16, 2011. The CFTC has also posted a list of these provisions on its website.

### General

The CFTC cautions that its proposed order covers the effective date for Dodd-Frank Act provisions regarding only swaps and not provisions for futures, options on futures, or transactions with retail customers in foreign currency. Moreover, the CFTC notes that its temporary exemptive relief does not limit its ability to pursue fraud and manipulation with respect to transactions under its jurisdiction other than “swaps” (including futures contracts, options on futures contracts, and transactions with retail customers in foreign currency).

The text of the CFTC proposed order, fact sheet and Q&A’s can be found by clicking [here](#).

The comment period on the proposed order will be open only for 14 days after the proposed order is published in the Federal Register.

If you have questions about the CFTC proposed order or its impact on your business, please contact your usual contact at the firm.