

Corporate & Financial Weekly Digest

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CFTC Publishes Fourteenth Series of Dodd-Frank Rules

Co-authored by [Kevin M. Foley](#) and [Vanessa L. Colman](#)

The Commodity Futures Trading Commission has published its fourteenth series of proposed rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act. These proposals include capital requirements for swap dealers (SDs) and major swap participants (MSPs), interpretive guidance regarding various proposed definitions and the regulation of mixed swaps, proposed rules concerning the bankruptcy protection of cleared swaps customer contracts and collateral, and amendments to adapt certain CFTC regulations to Dodd-Frank Act requirements.

- **Proposed Capital Requirements for Swap Dealers and Major Swap Participants:**
The CFTC has proposed minimum capital requirements for those SDs and MSPs that are not subject to prudential regulation by the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration or the Federal Housing Finance Agency (collectively, the Prudential Regulators), as well as SDs and MSPs that are registered as futures commission merchants (FCMs) with the CFTC. SDs and MSPs that are neither FCMs nor bank holding company subsidiaries and that do not have a Prudential Regulator would be required to maintain minimum tangible net equity of at least \$20 million, plus additional amounts for market risk and over-the-counter derivatives credit risk. SDs and MSPs that are not FCMs, but that are nonbank subsidiaries of U.S. bank holding companies (and are not governed by a Prudential Regulator), would be required to meet the same capital requirements applicable to the bank holding company, subject to a minimum requirement of at least \$20 million of Tier 1 capital. Finally, SDs and MSPs that are FCMs would be required to meet existing minimum net capital requirements applicable to FCMs, subject to a minimum adjusted net capital requirement of \$20 million.

The CFTC proposal would permit SDs or MSPs to apply for CFTC approval to use internal models to calculate their capital requirements above the required minimum amounts. The proposal would initially require that such models be subject to ongoing review by the Federal Reserve Board (FRB) or the Securities and Exchange Commission, but would also permit the CFTC, by written order, to accept applications and approve models that are not subject to FRB or SEC review. The proposal also includes financial condition reporting and recordkeeping requirements for SDs and MSPs, similar to those currently applicable to FCMs.

- **Proposed Rules and Interpretive Guidance Concerning Certain Proposed Definitions:** The CFTC and SEC (together, the Commissions) have jointly proposed rules and interpretive guidance in connection with the proposed definitions of certain terms under the Dodd-Frank Act. In response to public comment on the CFTC's and SEC's previously proposed definitions of "swap" and "security-based swap," the Commissions issued proposed rules and interpretive guidance:

(a) provide that certain insurance products, consumer and commercial agreements and loan participations are neither swaps nor security-based swaps;

(b) clarify the scope of the forward contract exclusion from the swap definition for nonfinancial commodities;

(c) make clear that the following products are within the scope of the definitions of swap and, where applicable, security-based swap: foreign exchange (FX) forwards and FX swaps (unless exempted by the Secretary of the Treasury), forward rate agreements and certain FX products that are outside the Treasury's determination (unless otherwise excluded by the Dodd-Frank Act) and options on swaps, forward swaps and certain contracts for differences; and

(d) clarify when a Title VII instrument is a swap, a security-based swap or a mixed swap and propose rules in connection with the Commissions' joint regulation of mixed swaps.

The Commissions' proposed rules and interpretive guidance also: (1) address several issues in the security-based swap definition with respect to the terms "narrow-based security index" and "issuers of securities in a narrow-based security index;" (2) provide direction about what types of products are considered security-based swap agreements (SBSAs); (3) clarify that the Commissions do not intend to propose additional books and records requirements with respect to SBSAs beyond those that the CFTC previously proposed for swaps; (4) set forth a process by which interested persons may request a joint interpretation by the Commissions on whether a particular Title VII instrument is a swap, a security-based swap or a mixed swap (similar to the statutory process for novel derivative products set forth in Section 718 of the Dodd-Frank Act); (5) would define as swaps those transactions that are deliberately structured so as to evade the provisions of Title VII governing the regulation of swaps; and (6) address the potential evasion of Title VII by persons located outside of the United States.

- **Protection of Cleared Swaps Customer Contracts and Collateral and Conforming Amendments to the Commodity Broker Bankruptcy Provisions:** In an advance notice of proposed rulemaking issued on November 19, 2010 (the November Proposal), the CFTC proposed four models for the protection of cleared swaps and associated collateral for FCM customers. Based on comments received in connection with the November Proposal, the CFTC has proposed the "Complete Legal Segregation Model" (referred to in the November Proposal as the "Legal Segregation with Commingling" model). (The current proposal regarding the Complete Legal Segregation Model is not to the exclusion of the three other models set forth in the November Proposal, which the CFTC is still

evaluating.) Under the Complete Legal Segregation Model, an FCM would be permitted to commingle the cleared swap collateral of all cleared swap customers prior to bankruptcy. In the event of a default of both an FCM and one or more of the FCM's cleared swap customers, a derivatives clearing organization (DCO) would have recourse against the collateral of the defaulting customers, but not against the collateral of non-defaulting customers.

The proposed rules do not restrict the types of collateral that a customer would be able to post, but cleared swaps customers' margin deposits could be invested only in accordance with CFTC Regulation 1.25.

Finally, the CFTC also proposed amendments to modify certain of its Part 190 bankruptcy regulations to reflect Dodd-Frank Act requirements.

- Proposed Amendments to Adapt Certain CFTC Regulations to the Dodd-Frank Act Requirements: The CFTC has proposed to amend certain CFTC regulations to comport with the Dodd-Frank Act by:
 - (1) requiring FCMs and introducing brokers (IBs) to comply with recordkeeping rules for swap transactions similar to the rules that currently apply with respect to futures transactions;
 - (2) imposing recordkeeping requirements on members of swap execution facilities (SEFs) that are the same as those that currently apply to members of designated contract markets (DCMs);
 - (3) requiring FCMs, IBs, retail FX dealers, and members of DCMs and SEFs to maintain records of all oral communications that lead to the execution of transactions in a commodity interest or cash commodity;
 - (4) setting forth procedures for the end-of-day allocation of bunched orders for both cleared and uncleared products; and
 - (5) amending certain existing definitions to apply to swaps in addition to futures.

The CFTC has also proposed to amend certain other of its regulations in order to treat swaps similarly to futures and SEFs and swap data repositories analogously to DCMs.

Comments on the proposed rules are due within 60 days from the dates of their respective publication in the *Federal Register*.

Information regarding the fourteenth series of CFTC proposals, including the fact sheets and Q&As for each of the proposals, is available [here](#).

Katten Muchin Rosenman LLP
Charlotte Chicago Irving London Los Angeles New York Washington, DC