

CFTC Proposes Rules to Continue to Allow Agricultural Swaps and Commodity Options and to Supplement Previously Proposed Swap Documentation Requirements

January 21, 2011

The Commodity Futures Trading Commission (CFTC) issued two proposed rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) at an open meeting held yesterday, January 20, 2011. The first proposed rule would permit agricultural swaps and commodity options and subject them to the same regulatory regime that the Dodd-Frank Act establishes for other types of swaps. The second proposed rule requires swap dealers and major swap participants to include an "Orderly Liquidation Termination" provision in their swap trading relationship documentation.

The proposed rules have not yet been published in the Federal Register. This discussion is based on statements made at the CFTC's open meeting as well as Fact Sheets and Q&As made available by the CFTC. Once published in the Federal Register, both of the proposed rules will be subject to a 60-day public comment period.

Proposed Rule Regarding Agricultural Swaps and Commodity Options

The Dodd-Frank Act explicitly prohibits agricultural swaps absent a CFTC rule, regulation or order granted under Section 4(c) of the Commodity Exchange Act (CEA).¹ The Dodd-Frank Act also explicitly includes options of any kind, other than options on a futures contract, within the swap definition.² The proposed rule makes agricultural swaps and commodity options, which are currently regulated separately and distinctly from other types of swaps, subject to the same CEA provisions and CFTC rules as any other swap. The CFTC's decision to treat agricultural swaps and commodity options the same as other types of swaps is due, in large part, to public comments received by the CFTC in response to an advanced notice of proposed rulemaking (ANPR) issued last September.³ According to the CFTC, nearly all of the comments supported treating agricultural swaps like other types of swaps.

The proposed rule, promulgated under Section 4(c) of the CEA, repeals Part 35 of the CFTC's regulations, which pertains to agricultural swaps, and replaces it with a provision stating that agricultural swaps are subject to the same provisions of the CEA (and any rule, regulation, or order thereunder) that are applicable to all other swaps. The existing eligible swap participant safe harbor for agricultural swap transactions would thus be replaced with the eligible contract participant requirements applicable to all swaps that are not traded on a designated contract market under the Dodd-Frank Act. The proposed rule also revises Parts 32 and 33 of the CFTC's regulations to permit the transaction of commodity options (other than options on a future) and to make clear that Part 33 only applies to options on a future.

For more information, see the CFTC's [Fact Sheet](#) and [Q&A](#).

¹ Dodd-Frank Section 723(c)(3).

² Dodd-Frank Section 721(a).

³ See Sutherland's [Legal Alert](#) pertaining to the ANPR.

Proposed Rule Requiring Swap Dealers and Major Swap Participants to Include an Orderly Termination Provision in Their Swap Trading Relationship Documentation

The second proposed rule issued at yesterday's meeting supplements a proposed rule that the CFTC issued on January 13, 2011 establishing swap trading documentation requirements for swap dealers and major swap participants.⁴ Under yesterday's proposed rule, swap dealers and major swap participants entering into bilateral uncleared swaps must include an "Orderly Liquidation Termination" provision in their swap trading relationship documentation with each of their counterparties.

Under Title II of the Dodd-Frank Act and the Federal Deposit Insurance Act, the Federal Deposit Insurance Corporation (FDIC) may transfer the positions of an insolvent "covered financial company" (as defined in Title II) to a solvent third-party financial institution. To effectuate such a transfer, a one business day stay is imposed on the non-defaulting counterparty's ability to terminate, liquidate, or net its positions.

The "Orderly Liquidation Termination" provision confirms that both counterparties understand that under certain specified circumstances, if one of the counterparties to a swap is a covered financial company and defaults, the non-defaulting party's swap positions could be transferred to a new, solvent counterparty by the FDIC, and that the non-defaulting party may not terminate, transfer or net its positions until 5 p.m. on the business day following the day the FDIC is appointed receiver.

For more information, see the CFTC's [Fact Sheet](#) and [Q&A](#).



The CFTC's next open meeting is scheduled for Wednesday, January 26, 2011. At this meeting the CFTC will consider two proposed rulemakings: one to establish reporting requirements for investment advisors dealing with private funds and certain commodity pool operators (CPOs) and commodity trading advisors (CTAs), and a second to amend existing CPO and CTA compliance obligations.

The CFTC will also hold open meetings to consider proposed rulemakings under the Dodd-Frank Act on February 11 and February 24. Agendas for these meetings will be made public a week in advance of each meeting.



If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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⁴ See Sutherland's [Legal Alert](#).

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