

# ClientAlert

## Capital Markets/Derivatives

January 2013

### The CFTC Issues Interim Final Rules Extending the Time for Compliance with Certain Business Conduct and Documentation Requirements for Swap Dealers and Major Swap Participants



On December 18, 2012, the US Commodity Futures Trading Commission's (the "Commission") approved interim final rules (the "Interim Final Rules")<sup>1</sup> for swap dealers ("SDs") and major swap participants ("MSPs") that delay compliance with certain business conduct and documentation requirements under Part 23 of the Commission's Regulations until May 1, 2013 and July 1, 2013 (as discussed below).

SDs and MSPs have not only received some relief in the meantime from such requirements, but this also likely gives market participants a little more time to adhere to the ISDA August 2012 Dodd-Frank Protocol (the "Protocol"), as SDs and MSPs will likely not stop trading with a counterparty for failure to adhere to the Protocol by December 31, 2012 since most requirements addressed in the Protocol were extended until July 1, 2013.

The Commission requests comments (to be received no later than 30 days after the date of publication of the Interim Final Rules in the Federal Register) and notes that it will revise the Interim Final Rules, if warranted.

#### Background

Since the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the Commission has issued final rules to implement Title VII of the Dodd-Frank Act, including with respect to business conduct standards, documentation standards, and reporting and recordkeeping requirements. SDs and MSPs would have been required to comply with these rules beginning on December 31, 2012.

Subsequent to the issuance of the rules with respect to business conduct standards, documentation standards, and reporting and recordkeeping requirements, the Commission received requests from various market participants for additional time to achieve compliance. According to ISDA's comments to the Commission, despite extensive counterparty outreach and education efforts by its members, only 17.5 percent of counterparties of prospective SDs and MSPs had submitted an adherence letter for the Protocol and less than 1 percent had submitted the completed questionnaires necessary for SDs and MSPs to make use of the Protocol and integrate necessary counterparty information into their compliance systems. The commenters represented that more time was needed for the counterparties to understand the Commission's requirements, to understand the legal consequences of adhering to the Protocol and to gather information needed to complete the questionnaire. Further, among other delays, commenters noted that Hurricane Sandy and IT freezes have

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<sup>1</sup> The Interim Final Rules are available at:  
<http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister121812.pdf>.

hampered the ability of SDs, MSPs and counterparties to complete the documentation necessary for compliance. In order to avoid violating Commission regulations, many SDs and MSPs warned that they would stop entering into swaps with counterparties that had not completed the Protocol process by December 31, 2012. Such a reaction could result in a sudden and dramatic drop in the number of participants in swap markets, which would damage all market participants as well as the economy on the whole. For these reasons, the Commission has issued Interim Final Rules deferring the compliance dates as set forth below.

### Interim Final Rule—Delay in Compliance

Compliance with the following Commission regulations is deferred until **May 1, 2013**:

- **23.201(b)(3)(ii)** of Subpart F of Part 23, which requires SDs and MSPs to keep records indicating that each counterparty has been provided with a notice containing the physical address, email or other widely available electronic address, and telephone number of the department of the SD or MSP to which any complaints may be directed
  - **23.402** of Subpart H of Part 23, which requires SDs and MSPs to: have policies and procedures designed to ensure compliance and monitor compliance with such policies and procedures; implement “Know Your Counterparty” policies and procedures, which are designed to obtain and retain a record of essential facts concerning each counterparty; obtain and retain a record showing the true name and address of each counterparty whose identity is known, its principal occupation or business, and the name and address or any other person guaranteeing the performance of such counterparty and any person exercising any control with respect to positions of such counterparty; create a record of compliance, retain records and make such records available to prudential regulators upon request
  - **23.410(c)** of Subpart H of Part 23, which requires confidential treatment of certain counterparty information
  - **23.430** of Subpart H of Part 23, which requires SDs and MSPs to take certain measures to verify the eligibility of any counterparty before offering to enter into or entering into a swap with that counterparty, subject to a reasonable reliance safe harbor
  - **23.431(a)-(c)** of Subpart H of Part 23, which requires SDs and MSPs to: disclose to any counterparty certain material information concerning the swap; notify the counterparty that it can request and consult on the design of a scenario analysis, upon request, provide a scenario analysis, and disclosure assumptions and methodologies used in the scenario analysis. Such subsections are subject to certain exceptions, including: with respect to counterparties that are SDs, MSPs, security-based swap dealers or major security-based swap participants; transactions initiated on a designated contract market or swap execution facility; and transactions in which the SD or MSP does not know the identity of the counterparty prior to execution
- **23.432** of Subpart H of Part 23, which requires SDs and MSPs to: with respect to swaps required to be cleared, notify certain counterparties that such counterparties have the sole right to select the derivatives clearing organization; with respect to swaps not required to be cleared, notify certain counterparties that such counterparties may elect to require clearing of the swap and shall have the sole right to select the derivatives clearing organization at which the swap will be cleared
  - **23.434(a)(2), (b), and (c)** of Subpart H of Part 23, which require SDs that recommend certain swaps or trading strategies to have a reasonable basis to believe such recommendations are suitable for the counterparty
  - **23.440** of Subpart H of Part 23, which sets out certain requirements for SDs acting as advisors to Special Entities
  - **23.450** of Subpart H of Part 23, which sets out certain requirements for SDs and MSPs acting as counterparties to Special Entities
  - **23.505** of Subpart I of Part 23, which requires: for swaps excepted from a mandatory clearing requirement, SDs and MSPs to obtain documentation to provide a reasonable basis that their counterparties meet the statutory conditions required for such exception; and SDs and MSPs to maintain all documents obtained pursuant to this section and make them available upon regulators’ request

Compliance with the following Commission regulations is deferred until **July 1, 2013**:

- **23.502** of Subpart I of Part 23, which sets out the requirements for portfolio reconciliation
- **23.504** of Subpart I of Part 23, which sets out, for those swaps not excepted from the section, the requirements for swap-trading relationship documentation; the requirement that each SD and MSP shall have an independent internal or external auditor conduct periodic audits and retain a record of the results of such audits; and the requirement that SDs and MSPs maintain all documents created pursuant to this section and make them available upon regulators’ request

Compliance dates for all other provisions of Subpart F, Subpart H and Subpart I of Part 23 remain unchanged. All market participants are subject to the new compliance dates regardless of whether they participate in the Protocol.

## Effect on the Protocol and Timing of Adherence

The business conduct and documentation requirements, the compliance with which was further delayed under the Interim Final Rules, are similar in scope to the requirements that were previously extended until December 31, 2012 under the Commission's *Final Rule for Confirmation, Portfolio Reconciliation, Portfolio Compression and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants* issued in August of this year. As a result of this delay in compliance dates for the business conducts standards discussed herein, we would expect SDs and MSPs to similarly give their counterparties more time to adhere to the Protocol given that they will not need to comply with these requirements until May 1, 2013. Because the Protocol assists SDs and MSPs in satisfying their business conduct and documentation requirements under Dodd-Frank and given that the Interim Final Rules delayed compliance with most of these requirements covered under the Protocol, we would expect that SDs and MSPs will not stop trading with counterparties that had not adhered to the Protocol by December 31, 2012.

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