

August 13, 2012

SEC, CFTC Finalize Definition of “Swap”, “Security-Based Swap”, “Security-Based Swap Agreement” and “Mixed-Swap”, Triggering Effectiveness of Swap Regulations

Today, the Securities and Exchange Commission (“SEC”) and the Commodity Futures Trading Commission (“CFTC”, and together with the SEC, the “Commissions”) jointly published final rules further defining the terms “swap,” “security-based swap,” “mixed swap” and “security-based swap agreement” and providing interpretive guidance with respect to particular products (the “Final Product Definitions”).¹ Publication of the Final Product Definitions triggers the implementation of various regulatory requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) with respect to “swaps” regulated by the CFTC. The CFTC has proposed phased-in compliance schedules for many of these rules to provide additional time for market participants to adapt to the new regime so as not to unduly disrupt markets and existing custom. The publication of the Final Product Definitions does not trigger the implementation of regulatory requirements with respect to “security-based swaps” regulated by the SEC as the SEC will sequence implementation of regulations relating to security-based swaps in accordance with a previously issued policy statement.²

Definition of “Swap”

Sections 721(a) and 761(a) of the Dodd-Frank Act outline the definitions of “swap,” “security-based swap,” “mixed-swap” and “security-based swap agreements” and provide that the Commissions may further define such terms. The final definitions of “swap” and “security-based swap” follow the statutory definitions inserted into the Commodity Exchange Act (“CEA”) and Securities Exchange Act of 1934 by the Dodd-Frank Act. The Final Product Definitions provide further clarity as to which derivatives products fall under each definition and thus delineate the regulatory and enforcement jurisdictions of the CFTC and the SEC.

¹ 77 FR 48208 (August 13, 2012) (17 CFR Parts 1 and 240 – Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping), available at <http://www.gpo.gov/fdsys/pkg/FR-2012-08-13/pdf/2012-18003.pdf>.

² See *Statement of General Policy on the Sequencing of the Compliance Dates for Final Rules Applicable to Security-Based Swaps Adopted Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 77 F.R. 35625 (June 14, 2012).

They also clarify the regulatory treatment of insurance products, certain commercial and consumer agreements and loan participations.

Insurance

The Final Product Definitions provide a safe harbor from the definitions of “swaps” and “security-based swaps” for insurance products that fit within certain product and provider criteria.

LSTA and LMA-Style Participations

Similarly, neither LMA-style nor LSTA-style loan participations fall within the definition of “swaps” or “security-based swaps” if the purchaser is acquiring a current or future direct or indirect ownership interest in the related loan or commitment and if certain other conditions are met.³

FX Swaps and FX Forwards

The Final Product Definitions confirm that certain physically settled foreign exchange swaps and foreign exchange forwards will be excluded from the definition of “swap” if the Secretary of the Treasury makes such a determination in accordance with authority granted to him under the Dodd-Frank Act.⁴ The Secretary currently proposes to exempt these foreign exchange products but has not yet finalized such determination. Reporting requirements and business conduct standards, however, will still apply to foreign exchange swaps and foreign exchange forwards even if they are excluded from the definition of “swap”.

Effectiveness of CFTC Rules Referencing the Term “Swap”

On July 13, 2012, the CFTC issued an order further extending the temporary exemptive relief granted to swap market participants from rules referencing the term “swap” (including

³ See Part 1.II.B.3 of the Final Product Definitions. Loan participations where (i) the grantor of the loan participation is a lender under, or a participant or sub-participant in, the loan or commitment, (ii) the aggregate participation does not exceed the principal amount of the loan or commitment and does not grant to the participant a greater interest in the loan or commitment than that held by the grantor, (iii) the entire purchase price of the participation is paid in full when acquired (no financing or leverage) and (iv) the participant bears all of the economic benefit and risk of the loan or commitment are indicative of loan participations that fall outside the definition of “swap” and “security-based swap”.

⁴ For a complete discussion of the proposal by the Secretary of the Treasury to exclude foreign exchange swaps and foreign exchange forwards from the definition of “swap”, see Client Memorandum entitled “*Department of Treasury Proposes to Exempt FX Swaps and FX Forwards from the definition of “swap” under the Commodity Exchange Act*”, available at <http://www.paulweiss.com/media/102549/18May11FX.pdf>.

reporting and clearing requirements, swap dealer and major swap participant registration and business conduct standards, among others) until December 31, 2012 or until such earlier time at which the Final Product Definitions becomes effective. With the effectiveness of the Final Product Definitions 60 days from today's publication date, the temporary exemptive relief granted by the CFTC to market participants from various regulatory requirements of the Dodd-Frank Act will expire.

Compliance Schedules

The CFTC has issued compliance schedules for reporting, clearing, registration and business conduct rules, which phase in compliance dates so as to avoid undue disruption to the markets.⁵ A chart at the end of this client memorandum illustrates the applicable compliance dates for key rules the CFTC has finalized to date.

Reporting

The recordkeeping and reporting rules promulgated by the CFTC became effective on March 9 and March 13, 2012.⁶ The CFTC adopted a three-phased compliance schedule to address anticipated technological challenges and build familiarity with the process:

- Interest rate and credit swaps entered into on a designated contract market or swap execution facility, or with a swap dealer or major swap participant, must be reported to a swap data repository within 60 days following publication of the Final Product Definitions.
- Foreign exchange, equity and other commodity swaps entered into on a designated contract market or swap execution facility, or with a swap dealer or major swap participant, must be reported to a swap data repository within 150 days following publication of the Final Product Definitions.
- Swaps not entered into on a designated contract market or swap execution facility, or entered into between parties that are not swap dealers or major swap participants, must be reported to a swap data repository within 240 days following publication of the Final Product Definitions.
- The same compliance dates apply to all swaps in existence prior to the enactment of the Dodd-Frank Act (July 21, 2010) whose terms had not expired as of that date and all swaps entered into after the enactment of the Dodd-Frank Act but before the compliance dates take effect.⁷

⁵ A list of compliance dates for CFTC regulations under the Dodd-Frank Act is available at <http://www.cftc.gov/LawRegulation/DoddFrankAct/ComplianceDates/index.htm>.

⁶ For a summary of the recordkeeping and reporting requirements see Client Memorandum entitled "CFTC Adopts Swap Data Recordkeeping and Reporting Requirements", available at http://www.paulweiss.com/media/103326/7Feb12_CDS.pdf.

⁷ 75 FR 63080 (October 14, 2010) (17 CFR Part 44 – Interim Final Rule for Reporting Pre-Enactment Swap Transactions), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010->

Clearing

The CFTC has to make an affirmative clearing determination before any specific swap product must be cleared. On August 7, 2012, the CFTC solicited public comment regarding a proposed clearing mandate for certain interest rate and credit default swaps. The CFTC will make a determination as to whether these categories of swaps will be required to be cleared within 60 days following the end of a 30 day public comment period.

Concurrently with the proposed clearing mandate, the CFTC adopted regulations to phase-in compliance with a clearing requirement to provide additional time for compliance and facilitate the transition to the new regulatory regime:⁸

- Swap dealers, major swap participants and active funds⁹ will be required to clear swaps within 90 days following a determination by the CFTC that a category of swaps will be required to be cleared.
- Commodity pools, private funds that are not active funds and entities primarily engaged in the business of banking will be required to clear swaps within 180 days following a determination by the CFTC that a category of swaps will be required to be cleared.
- All other swap counterparties will be required to clear swaps within 270 days following a determination by the CFTC that a category of swaps will be required to be cleared.

Swap Dealer and Major Swap Participant Registration

Swap dealers and major swap participants will need to register with the CFTC and become members of a registered futures association.¹⁰ The rule defining “swap dealer” and “major swap participant” became effective on March 19, 2012. Upon effectiveness of the Final Product Definitions, swap dealers and major swap participants will be required to have registered with the CFTC.

[25325a.pdf](#) and 77 FR 35200 (June 12, 2012) (17 CFR Part 46 – Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-12531a.pdf>.

⁸ 77 FR 44441 (July 30, 2012) (17 CFR Part 50 – Swap Transaction Compliance and Implementation Schedule: Clearing Requirement under Section 2(h) of the CEA), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-18383a.pdf>.

⁹ Private funds that execute 200 or more swaps per month based on a monthly average over the 12 preceding months are deemed to be “active funds”. See 17 CFR Part 50.25.

¹⁰ 77 FR 2613 (January 19, 2012) (17 CFR Parts 1, 3, 23, and 170 – Registration of Swap Dealers and Major Swap Participants), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-792a.pdf>.

Business Conduct Rules

External business conduct standards applicable to swap dealers and major swap participants in their dealings with swap counterparties became effective on April 17, 2012.¹¹ Swap dealers and major swap participants are required to comply with this rule on or before October 14, 2012. Compliance with this rule may require swap dealers and major swap participants to collect additional information from counterparties and/or amend existing documentation. To facilitate compliance with the external business conduct rule and other Dodd-Frank regulatory requirements, ISDA today launched the ISDA August 2012 Dodd-Frank Protocol. The Protocol allows adhering market participants to deliver required information to their counterparties and to amend their existing ISDA documentation to comply with certain Dodd-Frank requirements.

Compliance Dates for Key CFTC Regulations Under the Dodd-Frank Act	
Rule	Compliance Date
Reporting Rules <ul style="list-style-type: none"> Credit and interest rate swaps entered into on a designated contract market or swap execution facility or with a swap dealer or major swap participant Foreign exchange, equity and other commodity swaps entered into with a swap dealer or major swap participant Swaps where the counterparty is not a swap dealer or major swap participant 	<ul style="list-style-type: none"> 60 days following publication of the Final Product Definitions 150 days following publication of the Final Product Definitions 240 days following publication of the Final Product Definitions
Clearing Mandate – Certain Credit and Interest Rate Swaps <ul style="list-style-type: none"> Swap dealers, major swap participants, active funds 	<ul style="list-style-type: none"> 90 days following the determination that a category of swaps is required to be

¹¹ 77 FR 9734 (February 17, 2012) (17 CFR Parts 4 and 23 – Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-1244a.pdf>.

Compliance Dates for Key CFTC Regulations Under the Dodd-Frank Act

Rule	Compliance Date
<ul style="list-style-type: none">Commodity pools, private funds, entities primarily engaged in the business of bankingAll others	<p>cleared</p> <ul style="list-style-type: none">180 days following the determination that a category of swaps is required to be cleared270 days following the determination that a category of swaps is required to be cleared
Swap Dealer and Major Swap Participant Registration	60 days following publication of the Final Product Definitions
Business Conduct Rules	October 14, 2012

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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