

## **CFTC FINALIZES EXTENSION AND MODIFICATION TO PREVIOUSLY ISSUED EXEMPTIVE RELIEF FROM SWAP REGULATIONS**

July 5, 2012

To Our Clients and Friends:

On July 3, 2012, the Commodity Futures Trading Commission (the “CFTC”) adopted a final order (the “Final Order”) modifying and extending previously granted exemptive relief with respect to certain provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Title VII”).<sup>1</sup> The Final Order, which is effective immediately, is generally consistent with the notice of proposed amendment (the “Proposed Amendment”) issued by the CFTC on May 10, 2012.<sup>2</sup>

### **OVERVIEW**

The Final Order provides a six-month extension to the exemptive relief previously granted by the CFTC in a final order dated July 14, 2011<sup>3</sup> (the “July Order”), which was already amended and extended in December 2011.<sup>4</sup> Without the Final Order, the previously granted exemptive relief would expire on July 16, 2012. In the July Order, the CFTC exercised its exemptive authority under section 4(c) of the Commodity Exchange Act (the “CEA”) and section 712(f) of Title VII to address the concern that final, joint rulemakings from the CFTC and Securities and Exchange Commission (“SEC”) to define the terms “swap,” “security-based swap,” “swap dealer,” “security-based swap dealer,” “major swap participant,” “major security-based swap participant” and “security-based swap agreement” (the “Entities and Products Definitions”) would not be completed by July 16, 2011, Title VII’s general effective date. According to the CFTC, the July Order was intended to mitigate potential market disruptions that could have resulted if various regulatory requirements mandated under Title VII were to be applied to

<sup>1</sup> CFTC, *Second Amendment to July 14, 2011 Order for Swap Regulation (July 3, 2012)*, available at: <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister070312.pdf>.

<sup>2</sup> *Second Amendment to July 14, 2011 Order for Swap Regulation*, 77 Fed. Reg. 28,819 (May 16, 2012).

<sup>3</sup> *Effective Date for Swap Regulation*, 76 Fed. Reg. 42,508 (July 19, 2011).

<sup>4</sup> *Amendment to July 14, 2011 Order for Swap Regulation*, 76 Fed. Reg. 80,233 (Dec. 23, 2011), which had extended the original exemption relief expiration date of the July Order from December 31, 2011 to July 16, 2012.

agreements, contracts and transactions after July 16, 2011 in the absence of final rules for the Entities and Products Definitions.

The Final Order amends the July Order in four significant respects. Each is discussed below.

### **FURTHER EXTENSION OF EXEMPTIVE RELIEF**

First, and most importantly, the Final Order further extends the expiration date of the July Order from July 16, 2012 to December 31, 2012, or such other compliance date as would be determined by the CFTC. Consistent with the July Order and as discussed in the Proposed Amendment and Final Order, this extension intends to “ensure that market practices will not be unduly disrupted during the transition to the new [swaps] regulatory regime.”

### **REMOVAL OF REFERENCES TO ENTITIES DEFINITIONS**

Second, the Final Order clarifies that the exemptive relief provided in the July Order to various Title VII provisions pending the finalization of the definitions of “swap dealer,” “major swap participant” and “eligible contract participant” (“ECP”) is no longer applicable as the CFTC and SEC have since adopted final rules with respect to these terms.<sup>5</sup> With respect to comments that the term “ECP” was inadequately defined and needs further guidance and that the CFTC should therefore delay mandatory compliance with Title VII amendments to section 2(e) of the CEA, which makes it unlawful for non-ECPs to enter into swaps other than on a designated contract market (“DCM”), the CFTC declines to modify the Final Order to delay the effectiveness of section 2(e). However, the CFTC provides guidance that where a person finds it has entered into a swap with a counterparty that the CFTC and the SEC later further define or interpret as not an ECP, absent other material factors, the CFTC will not bring an enforcement action for violation of section 2(e) if the person has implemented and followed reasonably designed policies and procedures to verify the ECP status of a swap counterparty, and notwithstanding good faith compliance with such policies and procedures, the person enters into a swap with a non-ECP counterparty.

### **CLEARING OF AGRICULTURAL SWAPS**

Third, the Final Order amends the July Order to clarify that agricultural swaps, whether entered into bilaterally, on a DCM or on a swap execution facility (“SEF”), may be cleared to the same

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<sup>5</sup> Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant,” 77 Fed. Reg. 30,596 (May 23, 2012).

extent that any other swap would be cleared without the need for further exemptive relief from the CFTC under section 4(c) of the CEA. According to the CFTC, this amendment would harmonize the July Order with the CFTC's already-promulgated final rule ending the pre-Title VII prohibition against the clearing of agricultural swaps.<sup>6</sup> Therefore, the Final Order confirms the CFTC's intention that agricultural swaps may only be entered into or executed bilaterally, on a DCM or on a SEF.

### **REMOVAL OF REFERENCES TO PREVIOUS RELIEF GRANTED TO EXEMPT COMMERCIAL MARKETS AND EXEMPT BOARDS OF TRADE**

Finally, the Final Order amends the July Order to remove any reference to a previous CFTC order (the "ECM/EBOT Grandfather Order") that grandfathered relief from compliance with the general effective date of Title VII for exempt commercial markets ("ECMs") and exempt boards of trade ("EBOTs").<sup>7</sup> After July 16, 2012, ECMs, EBOTs and markets that relied on section 2(d)(2) of the CEA prior to the passage of the Dodd-Frank Act ("2(d)(2) Market Entities") will no longer be able to rely on the ECM/EBOT Grandfather Order. Instead, these entities must rely on relief provided in the Final Order, which will itself expire upon the effective date of final rules relating to DCMs or SEFs, "whichever is later," unless the ECM, EBOT or 2(d)(2) Market Entity files a DCM or SEF application on or prior to the effective date of such final rules (in which case relief would remain in place during the pendency of the application). In response to comments that the Proposed Amendment failed to specify which rules concerning DCMs and SEFs must be finalized before relief is terminated, the CFTC clarifies in the preamble to the Final Order that "final rules relating to DCMs or SEFs" refers to the following rulemakings: (i) Core Principles and other Requirements for Designated Contract Markets;<sup>8</sup> (ii) Core Principles and Other Requirements for Swap Execution Facilities;<sup>9</sup> and (iii) a rulemaking on DCM Core Principle 9.

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<sup>6</sup> *Agricultural Swaps*, 76 Fed. Reg. 49,291 (Aug. 10, 2011).

<sup>7</sup> *Orders Regarding the Treatment of Petitions Seeking Grandfather Relief for Exempt Commercial Markets and Exempt Boards of Trade*, 75 Fed. Reg. 56,513 (Sept. 16, 2010).

<sup>8</sup> *Core Principles and Other Requirements for Designated Contract Markets*, 77 Fed. Reg. 36,612 (June 19, 2012).

<sup>9</sup> *Core Principles and Other Requirements for Swap Execution Facilities*, 76 Fed. Reg. 1,214 (Jan. 7, 2011).

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