Commodity Futures Trading Commission Clarifies Which Provisions of the Dodd-Frank Act are Now Effective; Delays Effective Date of Others

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In an action that will affect virtually all participants in the over-the-counter swaps market, as well as futures exchanges and derivatives clearing organizations, the Commodity Futures Trading Commission ("CFTC" or "Commission") recently extended, by way of a December Order,[1] the effective date of major provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

Revisiting its earlier deadline of December 31, 2011,[2] the CFTC confirmed that certain self-effectuating provisions of the Commodity Exchange Act ("CEA"), as amended by the Dodd-Frank Act, will not now become effective until the earlier of the CFTC's issuance of final definitions for key terms, such as "swap," "swap dealer" and other product and entity-related definitions. Significantly, the Commission reaffirmed that despite the repeal of various CEA statutory and regulatory exemptions and exclusions, the Order's relief, together with prior CFTC staff no-action letters relating to other specified provisions of the Dodd-Frank Act, effectively preserves the status quo with respect to trading over-the-counter swaps and options pending further implementation of the Dodd-Frank Act's provisions.

Why did the CFTC issue this extension?

The Commission issued an Order extending the effective date for two reasons. First, the CFTC, by way of a July Order, had issued an earlier extension of the effectiveness of the Dodd-Frank Act provisions until December 31, 2011. With the first extension set to expire and the rules not yet fully implemented, a follow-up extension was required. Second, Part 35 of the Commission's regulations, which was the backbone for maintaining the status quo for trading over-the-counter swaps and options, was repealed on December 31, 2011.[3] The Commission therefore temporarily extended the effectiveness of the provisions of Part 35, as in force prior to December 31, 2011, despite its repeal.

How does the CFTC categorize the various Dodd-Frank Act provisions with respect to their

effectiveness?

The Commission's action affects four different categories of Dodd-Frank Act provisions and CFTC rules under those provisions. These four categories are:

Category 1: Provisions of the Dodd-Frank Act that, on their face, do not become effective until the CFTC issues implementing rules;

Category 2: Provisions of the Dodd-Frank Act that would be effective, but for their dependence on pivotal terms that the CFTC must finalize through rulemaking;

Category 3: Provisions of the Dodd-Frank Act that repeal exemptions or exclusions in current law; and

Category 4: Provisions of the Dodd-Frank Act that are effective, and should remain so, because the Commission believes their effectiveness will not disrupt the swaps markets.

Which Dodd-Frank Act provisions require CFTC action to become effective?

Category 1

The CFTC identified in the Appendix to its July Order a significant number of provisions of the Dodd-Frank Act that need Commission action to become effective (Category 1). This Appendix was incorporated by reference into the CFTC's December Order.

Although these provisions may rely on the pivotal definitions that remain undefined, they are not self-effectuating and cannot become effective without specific CFTC action. These provisions include, among others, provisions authorizing a large swaps trader reporting system, authorization for adopting swap data recordkeeping and reporting rules, authorization for adopting real-time reporting rules, provisions governing the business conduct and registration of swap dealers, the capital and margin provisions that will apply to swaps, and provisions on the registration of swap execution facilities and swap data repositories.

The CFTC has used different strategies for issuing final rules under Category 1 Dodd-Frank Act provisions without having definitions for the pivotal terms finalized. For example, in the Commission's large swaps trader rulemaking, the Commission is temporarily relying on the Part 35 definition of "swap agreement" to identify reportable positions.[4] In contrast, the CFTC has explicitly delayed compliance (not effectiveness) with other rulemakings until the CFTC issues a final definition for the term "swap."[5]

Category 2

The CFTC's Order temporarily exempts market participants and others from most of the self-effectuating provisions of the Dodd-Frank Act that rely on the terms "swap," "swap dealer," "major swap participant," or "eligible contract participant" until the CFTC issues final rules further defining these terms. Among the requirements that are subject to this exemption are the Dodd-Frank Act provisions relating to the mandatory clearing and trade execution of swap transactions.

How do the CFTC's Orders affect over-the-counter trading of swaps?

Category 3

In addition to addressing Category 2 provisions, the CFTC's relief also specifically accounts for the effect of the Dodd-Frank Act's repeal of certain exemptions and exclusions used widely by swaps market participants to reduce or eliminate regulatory exposure. The CFTC's Order provides that contracts, agreements or transactions in excluded and exempt commodities and agricultural swaps and options for the time being may continue to be transacted in reliance on Part 35 of the CFTC's rules (as in force prior to December 31, 2011) relating to swaps or Part 32 of its rules relating to over-the-counter options.

Who is covered by the temporary exemptions?

The CFTC's transaction relief applies to all eligible swap participants ("ESPs") under Part 35 of the CFTC's rules, all persons offering or entering into the transaction that are eligible contract participants ("ECPs") as that term was defined in the CEA prior to July 16, 2011, and a party entering into the transaction in conjunction with its line of business that is not marketed to the public.

Which Dodd-Frank Act provisions are effective now?

Category 4

The exact provisions of the Dodd-Frank Act that are now effective and operational are listed in the Appendix to the CFTC's July Order. Among these are Dodd-Frank Act amendments addressing the bankruptcy treatment of cleared swaps, foreign boards of trade, private rights of action for swaps, whistleblower incentives and protections, Core Principles by which derivatives clearing organizations ("DCOs") and designated contract markets must operate, and the requirement that DCOs appoint a chief compliance officer.

When will the relief expire for Category 2 and 3 provisions?

The CFTC's December Order and related staff no-action relief will expire the earlier of July 16, 2012 or, in the case of definition-dependent provisions and rules (Category 2), no sooner than 60 days following adoption of the relevant definitions. In the case of repealed exclusions from the CEA, (Category 3), the exemptive relief will expire the earlier of July 16, 2012, or such other compliance date set by the Commission. For exempt commercial market and exempt board of trade transactions that are cleared, however, the December Order's relief will expire no earlier than July 16, 2012.

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[1]*Amendment to July 14, 2011 Order for Swap Regulation, 76 Fed. Reg.* 80233 (December 23, 2011) ("Order" or "December Order").

[2]*76 Fed. Reg.* 42508 (July 19, 2011)("July Order").

[3]*76 Fed. Reg.* 49291 (August 10, 2011).

[4]*See Large Trader Reporting for Physical Commodity Swaps, 76 Fed. Reg.* 43851 (July 22, 2011).

[5]*See Swap Data Recordkeeping and Reporting Requirements, available at*www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_17_Recordkeeping/index.htm (December 20, 2011).

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