
On July 24, CFTC Proposes Mandatory Clearing Determination for Credit Default and Interest Rate Swaps and Approves Regulations to Phase in Compliance with Mandatory Clearing Requirements

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The Commodity Futures Trading Commission (Commission or CFTC) took two actions on July 24, 2012 to further implement the mandatory swaps clearing requirement under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). First, the Commission proposed the inaugural determination of classes of swaps that are required to be cleared by a derivatives clearing organization (DCO). Second, the Commission approved a three-part phased-in implementation schedule for compliance with the requirement to have swaps cleared by a DCO. In addition to a summary of the rules, anticipated effective dates are discussed below.

In its proposed determination, the Commission identifies six classes of credit default and interest rate swaps that should be subject to mandatory clearing on a DCO.¹ The proposal is a product of eight submissions by DCOs that had been received as of February 1, 2012 pursuant to Commission Regulation 39.5.² The Commission stated that the proposal covers swaps which are largely already being cleared by DCOs and that market participants supported this proposal. The proposal has a 30-day comment period.

In a related rulemaking, the Commission also approved a phased-in compliance schedule in new Commission Regulation 50.25. This schedule divides swap participants into three categories, which will be required to comply with clearing rules either 90, 180 or 270 days after the Commission publishes in the *Federal Register* a determination that a swap or class of swaps must be cleared by a DCO.³

Category 1 entities, which must comply with the clearing requirement 90 days after a CFTC mandatory clearing determination, include swap dealers, security-based swap dealers, major swap participants, major security-based swap participants, and active funds.⁴ The Commission reasoned that these entities should be provided the least amount of time to comply with the clearing requirement because of their level of activity, market experience, resources, and status as a CFTC or SEC registrant.

Category 2 entities include commodity pools; private funds as defined in Section 202(a) of the Investment Advisors Act of 1940, other than active funds; or persons predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature as defined in Section 4(k) of the Bank Holding Company Act of 1956, provided that the entity is not clearing for a third-party subaccount. Category 2 entities must comply with the clearing requirement 180 days after a CFTC mandatory clearing determination.

Category 3 entities, which must comply with the clearing requirement 270 days after a CFTC mandatory clearing determination, are all other market participants not eligible to be excepted from the mandatory clearing requirement (with respect to a particular swap), including commercial firms and those with third-party subaccounts. The Commission reasoned that these entities should be provided the most amount of time to comply with the clearing requirement because of their resources and unregistered status with the CFTC or SEC. Commercial firms that are “eligible” to use the end-user clearing exception for particular swaps are outside the framework of the compliance schedule with respect to such swaps.

Effective Dates

The compliance schedule has been transmitted to the Federal Register, so its publication is imminent. It will become effective 60 days after publication, meaning early October 2012. In contrast, the proposed effective date of the inaugural clearing determination, once finalized, is immediately upon publication in the *Federal Register*, which can precede the effective date of the compliance schedule. In order to avoid confusion, however, the Commission may consider publishing the determination no earlier than the effective date of the compliance schedule (early October 2012). As a result, the Commission is likely targeting early January 2013 (90 days after early October 2012) for the initial phase of mandatory clearing under the Dodd-Frank Act. In addition, although further clarification is required, the Commission indicated in the preamble to the proposed determination that credit default swaps with tenors such that the swap’s expiration is scheduled to occur prior to July 1, 2013, will not be subject to the mandatory clearing requirement.

¹ The identified classes are: Fixed-to-Floating Swap Class, Basis Swap Class, Forward Rate Agreement Class, Overnight Index Swap Class, North American Untranch CDS Indices Class, and European Untranch CDS Indices Class.

² The Commission promulgated Regulation 39.5 in connection with an amendment to the Commodity Exchange Act in the Dodd-Frank Act, establishing the regulatory framework for determining a swap is required to be cleared by a DCO.

³ The compliance schedule itself will be effective 60 days after it is published in the *Federal Register*.

⁴ An “active fund” is any private fund as defined in section 202(a) of the Investment Advisers Act of 1940, that is not a third-party subaccount and that executes 200 or more swaps per month. “Third-party subaccount” is defined as an account that is managed by an investment manager that (1) is

independent of and unaffiliated with the account's beneficial owner or sponsor, and (2) is responsible for the documentation necessary for the account's beneficial owner to clear swaps.

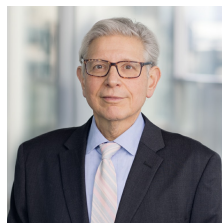
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