

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 37, 38, and 39

RIN 3038-AD60

Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (Commission or CFTC) is proposing regulations that would establish a schedule to phase in compliance with certain new statutory provisions enacted under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). These provisions include the clearing requirement under new section 2(h)(1)(A) of the Commodity Exchange Act (CEA or Act), and the trade execution requirement under new section 2(h)(8)(A) of the CEA. The proposed schedules would provide relief in the form of additional time for compliance with these requirements. This relief is intended to facilitate the transition to the new regulatory regime established by the Dodd-Frank Act in an orderly manner that does not unduly disrupt markets and transactions. The Commission requests comment on the proposed compliance schedules for these clearing and trade execution requirements.

DATES: Submit comments on or before [INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments, identified by RIN number 3038-AD60 and Swap Transaction Compliance and Implementation Schedule: Clearing and Trade

Execution Requirements under Section 2(h) of the CEA, by any of the following methods:

- Agency website, via its Comments Online process at <http://comments.cftc.gov>. Follow the instructions for submitting comments through the website.
- Mail: David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.
- Hand Delivery/Courier: Same as mail above.
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.

Please submit your comments using only one method.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to www.cftc.gov. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that may be exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the established procedures in § 145.9 of the Commission's regulations, 17 CFR 145.9.

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from www.cftc.gov that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as

required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

FOR FURTHER INFORMATION CONTACT: Dhaval Patel, Counsel, Office of the General Counsel, 202-418-5125, dpatel@cftc.gov, or Camden Nunery, Office of the Chief Economist, cnunery@cftc.gov, 202-418-5723, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Background

On July 21, 2010, President Obama signed the Dodd-Frank Act.¹ Title VII of the Dodd-Frank Act amends the CEA² to establish a comprehensive new regulatory framework for swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating robust recordkeeping and real-time reporting regimes; and (4) enhancing the rulemaking and enforcement authorities of the Commission with respect to, among others, all registered entities and intermediaries subject to the Commission's oversight.

To implement the Dodd-Frank Act, the Commission has to-date issued 55 advance notices of proposed rulemaking or notices of proposed rulemaking, two interim final rules, 12 final rules, and one proposed interpretive order. By the beginning of May

¹ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).

² 7 U.S.C. 1 et seq.

2011, the Commission had published in the Federal Register a significant number of notices of proposed rulemaking, which represented a substantially complete mosaic of the Commission's proposed regulatory framework under Title VII of the Dodd-Frank Act. In recognition of that fact and with the goal of giving market participants additional time to comment on the proposed new regulatory framework for swaps, either in part or as a whole, the Commission reopened or extended the comment period of many of its proposed rulemakings through June 3, 2011.³ In total, the Commission has received over 20,000 comments in response to its Dodd-Frank Act rulemaking proposals.

To give the public an opportunity to comment further on implementation phasing, on May 2-3, 2011, the Commission, along with the Securities and Exchange Commission (SEC), held a joint, two-day roundtable on issues related to implementation.⁴ In connection with this roundtable, Commission staff proposed thirteen concepts to be considered regarding implementation phasing, and staff asked a series of questions based on the concepts outlined.⁵ The Commission received numerous comments in response to both its roundtable and the staff concepts and questions.⁶

These comments were submitted by a number of existing and potential market infrastructures, including clearinghouses, trading platforms, and swap data repositories.

³ See Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 FR 25274, May 4, 2011.

⁴ The transcripts from the roundtable are available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/csjac_transcript050311.pdf ("Day 1 Roundtable Tr.") and http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/csjac_transcript050211.pdf ("Day 2 Roundtable Tr.").

⁵ See "CFTC Staff Concepts and Questions Regarding Phased Implementation of Effective Dates for Final Dodd-Frank Rules," available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/staffconcepts050211.pdf>.

⁶ Such comments are available at <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1000>.

Comments also were submitted by entities that may potentially be swap dealers (SDs) or major swap participants (MSPs), as well as those financial entities that may not be required to register with the Commission, but whose swap transactions may be required to comply with the clearing requirement under section 2(h)(1)(A) of the CEA, and a trade execution requirement under section 2(h)(8)(A) of the CEA. The Commission also received many comments from non-financial entities.

One of the key themes to emerge from the comments received by the Commission is that some market participants may require more time to bring their swap transactions into compliance with certain new regulatory requirements.⁷ For example, one commenter requested a “meaningful” period after finalization of the suite of rulemakings that is applicable to it before actual compliance will be required.⁸ Similarly, several trade associations recommended the Commission allow “sufficient” time for infrastructure and business practices to develop before requiring compliance with the new requirements.⁹ A group of international banks commented that the Commission should defer compliance until December 31, 2012, at which point the regulatory timetable as per the September 2009 G20 Pittsburgh statement will have reached a conclusion.¹⁰ Another commenter noted that some entities may be able to comply relatively quickly with certain

⁷ E.g., Letter from Karrie McMillan, Investment Company Institute, dated Jun. 10, 2011 at 8-11; Letter from Financial Services Forum, Futures Industry Association, International Swaps and Derivatives Association, and Securities Industry and Financial Markets Association, dated May 4, 2011 at 7-9; Letter from Jeff Gooch, MarkitSERV, dated Jun. 10, 2011 at 1-2 and 6; Letter from Electric Trade Association, dated May 4, 2011 at 5; Letter from John R. Gidman, Association of Institutional Investors, dated Jun. 10, 2011 at 3.

⁸ Letter from the Coalition of Physical Energy Companies, dated Mar. 14, 2011 at 4.

⁹ Letter from the Futures Industry Association, the Financial Services Forum, the International Swaps and Derivatives Association and the Securities Industry and Financial Markets Association, dated May 4, 2011 at 5.

¹⁰ Letter from the Bank of Tokyo-Mitsubishi UFJ, Ltd., et al., dated May 6, 2011 at 6.

documentation requirements that are largely consistent with current business practices while other requirements may need a longer implementation period.¹¹ Although commenters varied in their recommendations regarding the time it would take to bring their swaps into compliance with the new regulatory requirements,¹² many commenters agreed on phasing in compliance with these requirements by type of market participant based on a variety of factors, including a market participant's experience, resources, and the size and complexity of its transactions.¹³ The Commission has taken these comments into consideration in developing the proposed compliance schedules.

The swap transaction compliance requirements that are the subject of this proposed rulemaking include compliance with the clearing requirement and the corresponding trade execution requirement under sections 2(h)(1)(A) and 2(h)(8)(A) of the CEA, respectively.¹⁴ The Commission's proposed compliance schedules are designed to afford affected market participants a reasonable amount of time to bring their transactions into compliance with such requirements. The proposed schedules also would provide relief in the form of additional time for compliance with these transaction

¹¹ Letter from the Financial Services Roundtable, dated May 12, 2011 at 4.

¹² For example, Javelin stated that it could be open for business and generally be in compliance with the clearing and trade execution requirements within 6 months. Day 1 Roundtable Tr. at 104-105. Citadel suggested moving towards a voluntary clearing launch between day 180 and day 240, and eventually moving towards a mandatory clearing date. Day 1 Roundtable Tr. at 73-74. Moreover, the Swap Financial Group offered a different perspective stating that it generally thought implementation of Dodd-Drank could be accomplished in a year or two. Day 2 Roundtable Tr. at 269.

¹³ These comments are more fully discussed later in the preamble.

¹⁴ The Commission also is proposing Swap Transaction Compliance and Implementation Schedule: Trade Documentation and Margining Requirements under section 4s of the CEA.

compliance requirements and are further explained below.¹⁵ This relief is intended to facilitate the transition to the new regulatory regime established by the Dodd-Frank Act in an orderly manner that does not unduly disrupt markets and transactions.

II. Proposed Regulation

A. Authority to Implement Proposed Regulations

In this Notice of Proposed Rulemaking, the Commission relies on its general authority to establish compliance dates with the rules and regulations enacted pursuant to the Dodd-Frank Act. Section 712(f) also authorizes the Commission to promulgate rules to prepare for the effective dates of the provisions of the Dodd-Frank Act.¹⁶ In addition, the Commission relies on section 8(a)(5) of the CEA, which authorizes the Commission to promulgate such regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of the CEA. In accordance with this authority, the proposed regulations would amend parts 37, 38, and 39 of the Commission's regulations to phase in compliance dates for the clearing and trade execution requirements under section 2(h) of the CEA.

B. Implementation Phasing of the Clearing Requirement under Section 2(h)(1)

1. Background on Mandatory Clearing Determinations

Section 723(a)(3) of the Dodd-Frank Act amended the CEA to provide, under new section 2(h)(1)(A), that "it shall be unlawful for any person to engage in a swap

¹⁵ The proposed compliance schedules do not address the effective dates of the clearing and trade execution requirements in the Dodd-Frank Act, including the application of the Commission's Effective Date Order to such requirements. See Effective Date for Swap Regulation, 76 FR 42508, Jul. 19, 2011.

¹⁶ Section 712(f) of the Dodd-Frank Act states: "Beginning on the date of enactment of this Act and notwithstanding the effective date of any provision of this Act, the [Commission] . . . may, in order to prepare for the effective dates of the provisions of this Act – (1) promulgate rules, regulations, or orders permitted or required by this Act"

unless that person submits such swap for clearing to a derivatives clearing organization that is registered under this Act or a derivatives clearing organization that is exempt from registration under this Act if the swap is required to be cleared.”¹⁷ Section 2(h)(2) charges the Commission with the responsibility for determining whether a swap is required to be cleared, through one of two avenues: (1) pursuant to a Commission-initiated review; or (2) pursuant to a submission from a derivatives clearing organization (DCO) of each swap, or any group, category, type, or class of swaps that the DCO “plans to accept for clearing.”¹⁸

On July 26, 2011, the Commission published in the Federal Register a final rule regarding the process for review of swaps for mandatory clearing.¹⁹ Under § 39.5(b)(6), the Commission will review a DCO’s submission and determine whether the swap, or group, category, type, or class of swaps, described in the submission is required to be cleared. This determination will be made not later than 90 days after a complete submission has been received from a DCO, unless the submitting DCO agrees to an extension. Under § 39.5(c), Commission-initiated reviews of swaps that have not been accepted for clearing by a DCO will take place on an ongoing basis. However, as explained in the preamble to the final rule, the “Commission anticipates that the initial

¹⁷ Section 2(h)(7) of the CEA provides an exception to the clearing requirement (“the end-user exception”) when one of the counterparties to a swap (i) is not a financial entity, (ii) is using the swap to hedge or mitigate commercial risk, and (iii) notifies the Commission how it generally meets its financial obligations associated with entering into a non-cleared swap.

¹⁸ Under section 2(h)(2)(B)(ii), the Commission must consider swaps listed for clearing by a DCO as of the date of enactment of the Dodd-Frank Act.

¹⁹ 76 FR 44464, Jul. 26, 2011.

mandatory clearing determinations would only involve swaps that are already being cleared or that a DCO wants to clear.”²⁰

Because the Commission initially will consider mandatory clearing determinations based on those swaps that DCOs are currently clearing or that a DCO would like to clear, the initial sequence of mandatory clearing determinations will be based on the market’s view of which swaps can be cleared and which asset classes are ready for clearing, as reflected by the fact that a DCO is either currently clearing a group, category, type, or class of swaps or is intending to do so. For example, multiple registered DCOs currently clear interest rate, credit, and commodity swaps. For these swaps, the Commission will begin the review process for issuing mandatory clearing determinations in the near term.

The Commission observes that before market participants could be required to comply with a mandatory clearing determination, the Commission must adopt its final rules related to the end-user exception to mandatory clearing established by section 2(h)(7) of the CEA. In December 2010, the Commission proposed rules governing this elective exception to mandatory clearing.²¹ The proposed rule generally provides that a swap otherwise subject to mandatory clearing is subject to an elective exception from clearing if one party to the swap is not a financial entity, is using swaps to hedge or mitigate commercial risk, and notifies the Commission how it generally meets its financial obligations associated with entering into non-cleared swaps (the “end-user

²⁰ 76 FR at 44469.

²¹ End-User Exception to Mandatory Clearing of Swaps, 75 FR 80747, Dec. 23, 2010.

clearing exception”).²² Because this proposed rule would establish the process by which a non-financial entity would elect not to clear a swap subject to a clearing requirement, this rule would need to be finalized prior to requiring compliance with a mandatory clearing determination.

In addition, the Commission recognizes that the swap transaction compliance schedules that are the subject of this proposal reference terms such as “swap,” “swap dealer,” and “major swap participant” that are the subject of rulemaking under sections 712(d)(1) and 721(c) of the Dodd-Frank Act.²³ The Commission and the SEC have proposed rules that would further define each of these terms.²⁴ As such, and in a manner consistent with the temporary relief provided in the Commission’s Effective Date Order,²⁵ the Commission must adopt its final rules regarding the further definitions in question prior to requiring compliance with a mandatory clearing determination.²⁶

²² 75 FR at 80748.

²³ Section 712(d)(1) provides: “Notwithstanding any other provision of this title and subsections (b) and (c), the Commodity Futures Trading Commission and the Securities and Exchange Commission, in consultation with the Board of Governors [of the Federal Reserve System], shall further 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’ in section 1a(47)(A)(v) of the Commodity Exchange Act (7 U.S.C. 1a(47)(A)(v)) and section 3(a)(78) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(78)).” Section 721(c) provides: “To include transactions and entities that have been structured to evade this subtitle (or an amendment made by this subtitle), the Commodity Futures Trading Commission shall adopt a rule to further define the terms ‘swap’, ‘swap dealer’, ‘major swap participant’, and ‘eligible contract participant’.”

²⁴ Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant,” and “Eligible Contract Participant”; Proposed Rule, 75 FR 80174, Dec. 21, 2010 and Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 76 FR 29818, May 23, 2011.

²⁵ See Effective Date for Swap Regulation, 76 FR 42508, Jul. 19, 2011.

²⁶ Notably, under section 712(f) of the Dodd-Frank Act, these definitions would not have to be finalized for the Commission to review swap submissions from DCOs.

Lastly, the Commission notes that it has yet to adopt final rules relating to the protection of cleared swaps customer contracts and collateral. These rules are essential for establishing the customer protection regime associated with client clearing for swaps through Commission-registered futures commission merchants (FCMs) at DCOs.²⁷ The Commission believes that finalizing the rules regarding the segregation of customer collateral prior to requiring compliance with a mandatory clearing determination is necessary to effectuate the purposes of new section 4d(f) of the CEA.

2. Compliance Schedule for Clearing Requirement - § 39.5(e)

Proposed § 39.5(e) would provide the Commission with the authority to phase in compliance with a clearing requirement upon issuance of a mandatory clearing determination. The proposed compliance schedule is based on the type of market participants entering into the swaps subject to the clearing requirement. The triggering event for the application of this compliance schedule would be the Commission's issuance of a determination that the swap, or group, category, type, or class of swaps, is required to be cleared.²⁸

In proposing phased implementation schedules for the clearing requirement, the Commission seeks to balance several goals. First, the Commission believes that certain market participants may require additional time to bring their swaps into compliance with the new regulatory requirement for mandatory clearing of a swap or class of swaps. This

²⁷ Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 76 FR 33818, Jun. 9, 2011.

²⁸ See discussion below at p. 21 and above at p. 7. It would be possible for the Commission to issue a mandatory clearing determination but postpone the overall compliance date for all market participants for some period of time. Additionally, market participants may begin clearing their swap transactions as soon as a DCO begins accepting such swaps for clearing, regardless of whether the Commission determines that such swaps are required to be cleared.

is particularly true for market participants that may not be registered with the Commission and those market participants that may have hundreds or thousands of managed accounts, referred to as “third-party subaccounts” for the purposes of this proposal. Under this proposal, these parties would be afforded additional time to document new client clearing arrangements, connect to market infrastructure such as DCOs, and prepare themselves and their customers for the new regulatory requirements. As one commenter noted, “[i]n the context of asset managers, the account set up process has to be multiplied over hundreds of subaccounts. Processing all of these subaccounts will take time even for the largest and most technologically advanced asset managers.”²⁹

Moreover, several commenters emphasized the need to have adequate time to educate their clients regarding the new regulatory requirements.³⁰ For instance, market participants not registered with the Commission may not be familiar with the new regulatory requirements. In addition, market participants with third-party subaccounts would have to educate additional clients. Accordingly, both types of participants should be given additional time to prepare for compliance with the new requirements.

Another goal of the proposed compliance schedule is to have adequate representation of market participants involved at the outset of implementing a new mandatory clearing regime for swaps. The Commission believes that having a cross-section of market participants involved at the outset of formulating and designing the

²⁹ Letter from Karrie McMillan, Investment Company Institute, dated Jun. 10, 2011 at 9-10.

³⁰ See Letter from Financial Services Forum, Futures Industry Association, International Swaps and Derivatives Association, and Securities Industry Association, dated May 4, 2011 at 9; Letter from Karrie McMillan, Investment Company Institute, dated Jun. 10, 2011 at 10-11.

rules and infrastructure under which mandatory clearing is implemented will best meet the needs of all market participants.

Several commenters have recommended that the Commission take such an approach. For example, one commenter emphasized the importance of the initiation of so-called “buy-side” clearing access for credit default swaps in 2009 and recommended that “[a]t the time that a class of products is ready for clearing, all market participants (including buy-side participants) should be permitted (but not required) to clear those products....”³¹ In another example, one commenter recommended that in phasing mandatory clearing the Commission should aim for open access to establish an “all to all market” with both sides of the trade involved with the initial implementation.³² In further response to these comments, the Commission notes that market participants can begin (and continue) voluntarily clearing swaps through eligible DCOs at any time.

C. Implementation Phasing of the Trade Execution Requirement under Section 2(h)(8)

1. Background on Trade Execution Requirement

Section 723 of the Dodd Frank Act amended the CEA to provide, under new section 2(h)(8)(A), that with respect to a swap that is subject to the clearing requirement of section 2(h)(1)(A), “counterparties shall (i) execute the transaction on a board of trade designated as a contract market under section 5 [a DCM]; or (ii) execute the transaction on a swap execution facility [SEF] registered under section 5h or a swap execution facility exempt from registration under section 5h(f) of this Act.” Under section 2(h)(8)(B), the only exceptions to the trade execution requirement are if no DCM or SEF

³¹ Letter from Richard H. Baker, Managed Funds Association, dated Mar. 24, 2011 at Appendix 1, page 1 and Appendix 2, page 2.

³² Letter from Chris Koppenheffer, Swaps & Derivatives Market Association, dated Jun. 1, 2011 at 2.

“makes the swap available to trade” or the swap is subject to the clearing exception under section 2(h)(7) (ie., the end-user exception).³³

Based on the natural phasing provided for in the statute, a trade execution requirement is triggered for a swap when (1) the Commission has issued a determination that the swap is required to be cleared and (2) any DCM or SEF has made the swap available to trade.³⁴

The Commission observes that before market participants could be required to comply with a trade execution requirement the Commission must adopt final rules related to SEFs and DCMs. The Commission has proposed rules related to the new core principles for DCMs and the changes to the 18 original DCM core principles.³⁵ While none of the new rules proposed for DCMs relate directly to the trade execution requirement under section 2(h)(8), the Commission believes that it is necessary for DCMs to have their new policies, procedures, and rulebooks in place prior to the DCMs making a swap available for trading.

With regard to SEFs, the Commission also observes that it would have to adopt final rules allowing for SEF registration, including procedures for provisional registration, prior to any SEF making a swap that is required to be cleared available for trading.³⁶ The finalization of these rules would enable SEFs to register with the

³³ Section 2(h)(1)(B).

³⁴ This rulemaking does not address the manner in which it may be determined or established that a DCM or a SEF has made a swap available for trading.

³⁵ Core Principles and Other Requirements for Designated Contract Markets, 75 FR 80572, Dec. 22, 2010.

³⁶ Core Principles and other Requirements for Swap Execution Facilities, 76 FR 1214, Jan. 7, 2011. As part of the SEF rulemaking, the Commission proposed regulation §37.10, which would require each SEF to conduct an annual review of whether it has made a swap available for trading and to provide a report to the Commission regarding its assessment. *Id.* at 1222 and 1241.

Commission and ensure that they have developed their new policies, procedures, and rulebooks.

2. Compliance Schedule for the Trading Execution Requirement – §§ 37.12 and 38.11

Proposed regulations §§ 37.12 and 38.11 provide for the phased implementation of a trade execution requirement by setting forth a compliance schedule tied to the schedule proposed for the clearing requirement.

The proposed compliance schedules for the trade execution requirement would be triggered upon the later of (1) the applicable deadline established under the compliance schedule for the associated clearing mandate; or (2) 30 days after the swap is made available for trading on either a SEF or a DCM. Consequently, market participants always will have at least thirty days after a DCM or SEF has made a swap available for trading to comply with a trade execution requirement. Prior to a Commission-issued mandatory clearing determination, both DCMs and SEFs would be permitted to offer swaps for trading by market participants on a voluntarily basis. However, those swaps would not be required to be traded on a DCM or SEF, pursuant to section 2(h)(8) of the CEA until the associated clearing requirement took effect.

D. Three-part Implementation Phasing

The Commission proposes compliance schedules for phasing implementation that afford relief in the form of additional time for compliance with any clearing requirement or trade execution requirement by category of market participant. The Commission based its proposed categorization of entities on the definition of “financial entity” in

section 2(h)(7)(C) of the CEA.³⁷ Under this statutory provision, Congress identified financial entities that would not be eligible to claim an exception from a clearing requirement under section 2(h)(1) of the CEA.

Phase 1 – Category 1 Entities

The proposed compliance schedule would define “Category 1 Entities” to include a swap dealer, a security-based swap dealer, a major swap participant, a major security-based swap participant, or an active fund.

Category 1 Entities include those dealers and major participants in the swap and security-based swap markets that will be registered with the Commission or the Securities and Exchange Commission (SEC).³⁸ Title VII of the Dodd-Frank Act requires these market participants to register with either the CFTC or SEC as a result of their swaps or security-based swaps activities. Based on their level of market experience and based on their status as registrants with either the CFTC or the SEC, the Commission believes they should be capable of complying with a clearing requirement and a trade execution requirement sooner than other market participants and that 90 days is a reasonable timeframe for these entities to come into compliance with these requirements.

³⁷ CEA section 2(h)(7)(A)(i) limits availability of the end-user clearing exception to counterparties to the swap that are not a financial entity. The term financial entity is defined in CEA section 2(h)(7)(C)(i), and includes the following eight entities: (i) a swap dealer; (ii) a security-based swap dealer; (iii) a major swap participant; (iv) a major security-based swap participant; (v) a commodity pool as defined in CEA section 1a(10); (vi) a private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)); (vii) an employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002); or (viii) a person predominantly engaged in activities that are in the business of banking or financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)).

³⁸ If a security-based swap dealer or a major security-based swap participant is not yet required to register with the SEC at such time as the Commission issues mandatory clearing determination, then the security-based swap dealer or a major security-based swap participant would be treated as a Category 2 Entity.

The Commission also is proposing to include those entities it defines as “active funds” in the first category of market participants. The proposed definition of “active fund” would mean “any private fund as defined in section 202(a) of the Investment Advisors Act of 1940, that is not a third-party subaccount and that executes 20 or more swaps per month based on a monthly average over the 12 months preceding the Commission issuing a mandatory clearing determination under section 2(h)(2) of the Act.”³⁹

The Commission is relying on the definition of private fund from section 2(h)(7)(C) of the CEA, as well as section 402 of the Dodd-Frank Act. However, the Commission is limiting the definition in two ways. First, the definition excludes third-party subaccounts, as discussed further below. Second, the definition is limited to those private funds that execute 20 or more swaps per month based on the average over the 12 months preceding the Commission’s issuance of a mandatory clearing determination.⁴⁰ In choosing this threshold, the Commission’s goal was to ensure the involvement of a cross-section of market participants at the outset of both clearing and trading requirement implementation. The Commission also sought to address some commenters’ concerns regarding adequate “buy-side” representation early in the mandatory clearing process. Based on a preliminary assessment, the Commission believes the proposed numerical threshold for active funds is appropriate because a private fund that conducts this volume of swaps would be likely to have: (1) sufficient resources to enter into arrangements that

³⁹ It should be noted that many commodity pools meet the definition of private fund under section 202(a) of the Investment Advisors Act of 1940. Such a commodity pool would only be a Category 1 Entity if it met the other criteria of an active fund.

⁴⁰ In calculating the numerical threshold, the Commission intends for funds to calculate all swaps it executes not just those that are the subject of a mandatory clearing determination.

comply with the clearing and trade execution requirement earlier than other types of market participants; and (2) sufficient market experience to contribute meaningfully to the “buy-side” perspective as industry standards are being developed.⁴¹ In defining “active fund” accordingly, the Commission believes it has included those market participants that are likely to be among the most experienced participants with expertise and resources needed to come into transaction compliance quickly.

The Commission proposes to phase in compliance with the mandatory clearing requirement for any swap transaction between a Category 1 Entity and another Category 1 Entity, or any other entity that desires to clear the transaction⁴² within the first 90 days after the Commission issues any mandatory clearing determination. With respect to the trade execution requirement, the Commission proposes to phase in compliance with this requirement either at the same time as the clearing requirement or thirty days after the swap is made available for trading, whichever is later. The Commission proposes phasing in all Category 1 Entities first because these market participants are likely to be the most active and experienced market participants whose involvement in the early stages of building and rolling out the clearing and trading requirements is critical. The Commission is attempting to include in this category those market participants with the expertise and resources to implement mandatory clearing and trading most quickly. The Commission also believes Category 1 Entities likely will have the most existing

⁴¹ The Commission is unaware of any position-level or transaction-level data on private fund swap activity in a publicly available form. In order to determine private fund activity levels, the staff consulted with academics focusing their research in this area, with industry participants, and with groups that represent the industry.

⁴² The intent of this clause is to facilitate clearing by counterparties that desire to comply with a clearing mandate earlier than they would otherwise be required to under the compliance schedule. The Commission solicits comment on whether there would be a better way to accomplish this objective.

connectivity to clearinghouses and trading platforms and would be able to come into compliance sooner than other categories of participants.

Phase 2 – Category 2 Entities

The proposed compliance schedule would define “Category 2 Entities” to include a commodity pool; a private fund as defined in section 202(a) of the Investment Advisors Act of 1940 other than an active fund; an employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974; or a person 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 a third-party subaccount.

The Commission proposes to phase in compliance for swap transactions between a Category 2 Entity and Category 1 Entity, another Category 2 Entity, or any other entity that desires to clear the transaction.⁴³ The Commission is proposing to afford swap transactions between these types of market participants 180 days to come into compliance with a clearing requirement. With respect to the trade execution requirement, the Commission proposes to phase in compliance with this requirement either at the same time as the clearing requirement or thirty days after the swap is made available for trading, whichever is later. In providing these market participants an additional 90 days to come into compliance, the Commission took into consideration the fact that Category 2 Entities may not be required to be registered with the Commission and may be less experienced and less frequent users of the swap markets than those in Category 1.

Additionally, Category 2 Entities may not have the same level of expertise and resources to bring their swaps into compliance with a clearing requirement as quickly as

⁴³ See footnote 42.

Category 1 Entities. As defined for purposes of these compliance schedules, Category 2 Entities do not include those financial entities that are third-party subaccounts, as described further below.

Phase 3 – Third-party subaccounts and all other swap transactions

Finally, the Commission proposes to phase in compliance for all other swap transactions not excepted from the mandatory clearing requirement within 270 days after the Commission issues a clearing requirement. The Commission proposes to phase in compliance with the trade execution requirement either at the same time as the clearing requirement or thirty days after the swap is made available for trading, whichever is later.

The Commission proposes to include all entities that are third-party subaccounts in this 270-day period. This approach would give these entities the most time to bring their swaps into compliance because they are likely to require the most time for documentation, coordination, and management. A third-party subaccount is afforded 270 days to bring its swaps into compliance because its portfolio is managed by an asset manager that may have to bring numerous accounts into compliance. The Commission also proposes to include any other swap transaction that would be subject to a clearing requirement into compliance within this proposed 270-day period.

Under the Commission's proposed definition, a third-party subaccount would be a managed account that requires specific approval by the beneficial owner of the account to execute documentation necessary for executing, confirming, margining, or clearing swaps. By way of non-exclusive example, if investment management firm X manages the assets of pension fund Y, and does so in a separate account that requires the approval of pension fund Y to execute necessary documentation, then that account would be

afforded 270 days to come into compliance. On the other hand, if pension fund Y manages its own assets, it would fall within Category 2 and be afforded 180 days to come into compliance. Likewise, if investment management firm X does not manage the assets of third parties, then it would fall within Category 2.

The Commission is proposing to afford third-party subaccounts an additional 90 days beyond the 180 days proposed for Category 2 because such entities may have documentation obligations for hundreds or even thousands of third-party subaccounts, and each such account must meet the mandatory clearing and trading requirements. For example, according to a statement made during the Joint SEC-CFTC Roundtable by Mr. William DeLeon of the firm Pacific Investment Management Company, LLC (PIMCO), PIMCO manages hundreds of third-party subaccounts, as defined above.⁴⁴ The proposed compliance schedules would not prohibit any type of market participant from voluntarily complying sooner than the compliance deadline. Indeed, the Commission would encourage market participants that can come into compliance more quickly to move their swaps into clearing and begin trading on trading platforms as soon as possible in order to facilitate development of infrastructure that takes into account the views of many types of market participants. As one commenter noted, “Smaller entities, for example, may have unique issues that need to be accounted for before systems are hardwired. Many swap market participants are small entities; it is important to ensure that these entities and their liquidity are not squeezed out of the swaps market.”⁴⁵

E. Prospective Application of Compliance Schedules

⁴⁴ Day 2 Roundtable Tr. at 62.

⁴⁵ Investment Company Institute, Jun. 10, 2011 letter, at 12.

The Commission anticipates that it will exercise its authority to trigger the proposed compliance schedules each time it issues a mandatory clearing determination for a new group, category, type, or class of swaps. Under this approach, when a DCO begins offering a new swap for clearing and it is in the same group, category, type, or class of swaps and it meets the requirements imposed under a previously issued mandatory clearing determination, then the proposed compliance schedules would not be triggered. However, if the Commission issues a mandatory clearing determination in any entirely new group, category, type, or class of swaps then the compliance schedules could once again be triggered by the Commission. For example, if the Commission issues a mandatory clearing determination for 5 year credit default swap products and a new 5 year credit default swap product is offered for clearing based on a new 5 year index, then the proposed compliance schedules may not be triggered. If on the other hand, the Commission has not issued a mandatory clearing determination for 10 year credit default swap products and a new 10 year credit default swap product is offered for clearing, then the compliance schedules could be triggered by the Commission.

When issuing a mandatory clearing determination, the Commission would set an effective date by which all market participants would have to comply. In other words, the proposed compliance schedules would be used only when the Commission believes that phasing is necessary based on the considerations outlined in this release. The Commission will provide the public with notice of its intent to rely upon the compliance schedule pursuant to the process outlined in § 39.5(b)(5).

The Commission solicits comment on the ongoing usefulness of the proposed compliance schedules once market participants have established documentation and connectivity to DCOs, DCMs, and SEFs.

F. Comment Requested

The Commission requests comment on all aspects of the proposed compliance schedules, §§ 37.12, 38.11 and 39.5(e). The Commission may consider alternatives to the proposed compliance schedules and is requesting comment on the following questions:

- What, if any, other rules should have been taken into consideration when proposing an implementation schedule regarding the clearing and trade execution requirements? If applicable, how should the implementation requirements of those other rules be taken into consideration?
- Should there be a presumption that the Commission will rely on the compliance schedule for each mandatory clearing determination that it issues, unless the Commission finds that the compliance schedule is not necessary to achieve the benefits set forth herein (e.g., facilitating the transition to the new regulatory requirement established by the Dodd-Frank Act in an orderly manner that does not unduly disrupt markets and transactions)?
- What factors, if any, would prevent an entity in any of the proposed categories from adhering to the compliance schedules proposed by the Commission? How much additional time would be needed to address these factors?
- Are there other considerations that the Commission should have taken into account when designing this tiered implementation schedule? Are the timeframes

outlined in this implementation schedule adequate? If not, what alternative schedule should the Commission consider, and why?

- Assuming a situation where a swap first becomes subject to the clearing requirement and then is made available for trading by a DCM or SEF, is an additional thirty days after the swap becomes made available for trading enough time for DCMs, SEFs, and market participants to come into compliance with the trade execution requirement? For example, would thirty days be sufficient for the needed technological linkages to be established between (i) the DCOs, DCMs, and SEFs and (ii) the DCMs, SEFs, and market participants.

- What other entities, if any, should be included in Category 1 or 2, and why? Should any entities be moved from Category 1 or 2 to a later category? For example, where should the Commission place those entities described in section 2(h)(7)(C)(ii) of the CEA (e.g., small banks, savings associations, farm credit system institutions, and credit unions)?

- What adjustments to the compliance schedule and/or other steps could the Commission take to ensure there is adequate representation from all market participants at the outset of clearing and trade execution requirements?

- In suggesting phasing in transactions between Category 1 or 2 Entities and “any other entity that desires to clear the transaction,” the Commission intended to facilitate clearing by counterparties that desire to comply with a clearing mandate earlier than they would otherwise be required to under the compliance schedule. Is there a better way to achieve this objective?

- Is an entity's average monthly swap transaction activity a useful proxy for that entity's ability to comply with the clearing and trade execution requirements? Or whether an entity is required to be registered with the Commission (rather than whether an entity is already registered with the Commission)?
- Is the Commission's definition of "active fund" overly inclusive or under-inclusive? Should the numerical threshold for number of monthly swap transactions be higher or lower than 20? If so, why? Should the number of monthly swap transactions be linked to swap activity in a particular asset class?
- Should the Commission exclude from the definition of "active fund" any investment advisor of private funds acting solely as an advisor to private funds with assets under management in the United States of less than \$150,000,000, as provided for in the reporting exemption for private funds under section 408 of the Dodd-Frank Act?
- Would it be more appropriate for the Commission to measure a market participant's level of swap activity by measuring notional turnover and/or open exposure, as suggested by some commenters?⁴⁶
- Are there any anticompetitive implications to the proposed compliance schedules? If so, how could the proposed rules be implemented to achieve the purposes of the CEA in a less anticompetitive manner? If so, please quantify those costs, if possible, and provide underlying data sources, assumptions and calculations.
- Are there additional costs or benefits associated with the current proposal that the Commission has not already taken into account? Please discuss any such costs in detail and quantify in dollar terms, if possible.

⁴⁶ Letter from Adam C. Cooper, Citadel, dated June 3, 2011, Appendix B.

- Are there any assumptions, including quantitative assumptions, underlying the Commission's cost benefit analysis that the Commission should consider?
- Should the Commission consider an alternative implementation schedule? Would such an alternative schedule reduce the costs market participants bear? Please describe any such alternative implementation schedule in detail, including how it will reduce costs and the benefits it will likely deliver. If possible, please quantify the cost and benefits associated with any alternative. If providing dollar values, please describe any data sources, assumptions, and calculations used to generate them.

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act requires that agencies consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact.⁴⁷ The rules proposed by the CFTC provide compliance schedules for certain new statutory requirements of the Dodd Frank Act and do not by themselves impose significant new regulatory requirements. Accordingly, the Chairman, on behalf of the CFTC, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed rules will not have a significant economic impact on a substantial number of small entities. The CFTC invites public comment on this determination.

⁴⁷ 5 U.S.C. 601 et seq.

B. Paperwork Reduction Act

The Paperwork Reduction Act (PRA)⁴⁸ imposes certain requirements on federal agencies (including the Commission) in connection with conducting or sponsoring any collection of information as defined by the PRA. This notice of proposed rulemaking, if approved, would not require a new collection of information from any persons or entities.

C. Consideration of Costs and Benefits

Section 15(a) of the CEA⁴⁹ requires the Commission to consider the costs and benefits of its action before promulgating a regulation under the CEA. Section 15(a) of the CEA specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular regulation is necessary or appropriate to protect the public interest or to effectuate any of the provisions or accomplish any of the purposes of the Act.

The purpose of the proposed compliance schedules is to afford market participants adequate time to comply with the clearing requirement under section 2(h)(1)(A) of the CEA and the trade execution requirements under section 2(h)(8). Without the proposed compliance schedules, market participants could be required to comply with the clearing requirement immediately upon issuance of a mandatory clearing determination by the Commission, and market participants could be required to comply

⁴⁸ 44 U.S.C. 3507(d).

⁴⁹ 7 U.S.C. 19(a).

with the trade execution requirement when (1) the Commission has issued a determination that the swap is required to be cleared and (2) any DCM or SEF has made the swap available to trade.

The Commission recognizes that requiring such immediate compliance with the clearing and trade execution requirements may impose costs on market participants, particularly for market participants that may not be registered with the Commission and those market participants that have hundreds or thousands of third-party subaccounts to bring into compliance with the new requirements under section 2(h) of the CEA.⁵⁰ Accordingly, the Commission's proposal provides substantial benefits in that it affords market participants additional time to document new clearing arrangements, connect to market infrastructures, and prepare themselves and their customers for the new regulatory requirements. The Commission believes that such an approach will help protect the public interest by facilitating an orderly transition to a new regulatory environment.

1. Protection of market participants and the public.

In devising the proposed compliance schedules, the Commission sought to balance the goal of protecting the public by bringing market participants into compliance with the clearing and trade execution requirements for swaps as quickly as possible while affording market participants adequate time to come into compliance.

Market participants in Category 1 (e.g., SDs, MSPs, and active funds) are likely to be among the most experienced and active participants with the resources needed to come

⁵⁰ E.g., Letter from Richard H. Baker, Managed Funds Association, dated Mar. 24, 2011 at Appendix 1, page 1.

into compliance with the clearing and trading requirements more quickly.⁵¹ The swaps entered into by these market participants are likely to represent a significant portion of the total swap market volume. As a result, moving these transactions into central clearing and onto trading platforms before those of Category 2 and 3 Entities would provide additional protection for the public by ensuring that the most active participants in the swap market come into compliance as soon as possible, thus mitigating risk and promoting transparency in significant portions of the swap market.

By requiring Category 2 Entities to comply within 180 days, the Commission is seeking to balance the needs of those market participants that are not registered with the Commission and may not be as active in the swap market with the public interest of bringing all market participants into compliance as soon as possible.

The market participants in Category 2 are likely to be less experienced and less active participants than those in Category 1. To the extent these market participants are less active in the swap markets the balance between moving their transactions into central clearing and onto trading platforms and giving them additional time to comply with the new requirements, tips in favor of the latter approach. Additionally, these entities may not have the same level of resources as Category 1 Entities. Therefore, they will benefit from the opportunity to document new clearing arrangements, connect to market infrastructures, and prepare themselves and their customers for the new regulatory requirements by considering examples of how Category 1 Entities have met these requirements.

⁵¹ In a letter from the Financial Services Forum, Futures Industry Association, International Swaps and Derivatives Association, and Securities Industry and Financial Markets Association, dated May 4, 2011, commenters noted that “market participants vary dramatically in their resources, market sophistication and rationale for using Swaps. Swap Entities, in general, have greater resources, access to technology and clearing infrastructure than their end user counterparties.”

It should be noted that Category 2 Entities and other market participants wanting to come into compliance before their respective compliance schedule deadlines in order to take advantage of the risk-mitigating benefits of central clearing and executing swaps on trading platforms are allowed, and encouraged, to do so.

Entities that are third-party subaccounts have the additional challenge of transitioning hundreds, and in some cases, thousands of subaccounts into compliance with the clearing and trade execution requirements. This process may require that these entities negotiate and formalize new agreements with each of their customers. In order to accomplish this they also will need to educate their customers about how clearing and trade execution requirements will affect the costs and processes associated with their accounts. Each of these tasks requires time. By giving third-party subaccounts 270 days to come into compliance, the Commission seeks to balance the need of these entities and their customers for additional time with the benefits of reducing risks in the swap market and protecting the public as quickly as possible.

It may be that the Category 1 Entities that constitute the first phase under the proposed compliance schedules will bear a larger proportion of the “start-up” costs associated with implementing the clearing and trade execution requirements. They are the entities likely to expend the most resources documenting new clearing arrangements, connecting to market infrastructures, and preparing themselves and their customers for the new regulatory requirements. The Commission is aware of these costs and believes that it is appropriate for the entities that are likely to be among the most active participants in these markets to shoulder a larger percentage of these start-up costs.

2. Efficiency, competitiveness, and financial integrity of the markets.

By necessity, the first group of market participants that are required to comply with the clearing and trade execution requirements, along with DCOs, DCMs, and SEFs, are likely to work together to establish methods for compliance that other market participants may later consider. The experience with swaps that the first group of market participants brings to this process should help to ensure the integrity and effectiveness of their solutions. These solutions will likely be helpful to other market participants that comply later. For example, entities that are more experienced in the swap market, such as those in Category 1, are likely to have greater technological expertise and will best be able to develop the necessary technological infrastructure.

It is critical that a cross-section of market participants is involved in developing the solutions that become industry conventions in order to ensure that those approaches promote the efficiency, competitiveness, and integrity of participants on the buy-side and the sell-side. The Commission's proposed compliance schedules address this need. For example, Category 1 includes active funds and MSPs that are likely to have the experience and expertise to represent "buy-side" interests, whereas SDs generally will represent "sell-side" interests.

In providing Category 1 Entities with 90 days to comply with the clearing and trade execution requirements, the Commission would afford these market participants additional time to identify issues and work to develop solutions. This is likely to result in more efficient problem-solving processes, which may reduce the system-wide start-up costs of implementing new regulations. Moreover, it is also likely to foster a greater

degree of compatibility and interoperability among the varied methods of compliance which, in turn, is likely to reduce the cost and complexity of interconnectedness.⁵²

Lastly, in the absence of the proposed compliance schedules, some entities have expressed concern that they would be unable to comply with the clearing and trading requirements and would choose to leave the swap market or avoid the market for some period of time. If this occurred, it could reduce liquidity and increase spreads in the market. By providing additional time for compliance, this rule reduces the chance that these adverse effects will occur in the swap market during the transition period.

3. Price discovery.

The trade execution requirement is expected to facilitate price discovery in the swap market. However, a disorderly implementation may inhibit price discovery by creating confusion about which counterparties are prepared to trade specific swaps and which contracts are fungible. An orderly process, however, promotes good communication between counterparties, which is essential to price discovery during the transition period.

As for costs, to the extent that market participants could comply sooner than the proposed compliance schedule in an effective and efficient manner, this proposed schedule would delay the benefits that would come from increased price transparency that are expected to accompany a trade execution requirement under section 2(h)(8) of the CEA. The Commission's proposed compliance schedule reflects that the Commission anticipates that market participants will need additional time, however, for an orderly implementation process.

⁵² See TABB Group, "Technology and Financial Reform: Data, Derivatives and Decision Making", Aug. 2011 at 12.

4. Sound risk management practices.

To the extent that the proposed compliance schedule for the clearing requirement would delay implementation of mandatory clearing, the swap market could suffer costs in terms of risk management. For example, there are risk management costs associated with not having counterparty credit risk monitored and managed effectively by a DCO. More prompt implementation of mandatory clearing would have the benefit of preventing losses from accumulating over time through the settlement of variation margin between a DCO's clearing members each day. The settlement of variation margin each day reduces both the chance of default and the size of any default should one occur. Delay in implementing mandatory clearing would also postpone the use of initial margin as a performance bond against potential future losses such that if a party fails to meet its obligation to pay variation margin, resulting in a default, the DCO may use the defaulting party's initial margin to cover most or all of any loss based on the need to replace the open position.

On the other hand, the proposed compliance schedule for the clearing requirement would provide an orderly process for implementing mandatory clearing of swaps, and to the extent that it does so successfully, it will lead to overall sounder risk management practices for the swap market and the broader financial system, particularly during the implementation period. As noted above, in the absence of this rule, some entities may choose not to engage in swap transactions while they work to come into compliance with the new requirements. This result could expose those entities to risks they would otherwise have used swaps to mitigate. Therefore, by providing a timetable for orderly transition, this rule encourages continued participation in the swap markets and makes

possible the continued use of swaps during the transition period for risk mitigation purposes.

Moreover, if market participants were concerned that they might not be able to meet the proposed compliance schedule timelines, it is likely that they would incur additional costs associated with the potential lack of regulatory compliance. Providing additional time for compliance may reduce the costs that participants may incur mitigating legal risks during the transition period, and focuses those resources on achieving compliance.

5. Other public interest considerations.

There are public interest benefits to phasing in compliance using the implementation structure proposed in this release. The proposed implementation structure generally allows market participants to comply with the requirements of Dodd-Frank as quickly and efficiently as possible and thereby provides a sound basis for achieving the overarching Dodd-Frank goals of risk reduction and increased market transparency.

In sum, the Commission has considered the costs and benefits as required by section 15(a) and is proposing the compliance schedules discussed herein. The Commission invites public comment on its cost-benefit considerations. Commenters are also invited to submit any data or other information that they may have quantifying or qualifying the costs and benefits of the proposal with their comment letters.

List of Subjects

17 CFR Part 37

Swaps, Swap execution facilities, Registration application, Registered entities, Reporting and recordkeeping requirements.

17 CFR Part 38

Block transaction, Commodity futures, Designated contract markets, Reporting and Recordkeeping requirements, Transactions off the centralized market.

17 CFR Part 39

Business and industry, Commodity futures, Reporting and recordkeeping requirements.

For the reasons stated in the preamble, the Commission proposes to amend 17 CFR parts 37, 38 and 39 as follows:

PART 37 – SWAP EXECUTION FACILITIES

1. The authority citation for part 37 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6c, 7, 7a-2, 7b-3 and 12a, as amended by Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

2. Add § 37.12 to read as follows:

§ 37.12 Trade execution compliance schedule.

(a) A swap transaction shall be subject to the requirements of section 2(h)(8)(A) of the Act upon the later of (1) the applicable deadline established under the compliance schedule provided under § 39.5(e)(2); or (2) 30 days after the swap is first made available for trading on either a swap execution facility registered under section 5h of the Act or a board of trade designated as a contract market under section 5 of the Act.

(b) Nothing in this rule shall prohibit any counterparty from complying voluntarily with the requirements of section 2(h)(8)(A) of the Act sooner than as provided in paragraph (a) of this section.

PART 38 – DESIGNATED CONTRACT MARKETS

3. The authority citation for part 38 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6c, 6d, 6e, 6f, 6g, 6i, 6j, 6k, 6l, 6m, 6n, 7, 7a-2, 7b, 7b-1, 7b-3, 8, 9, 15, and 21, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

4. Add § 38.11 to read as follows:

§ 38.11 Trade execution compliance schedule.

(a) A swap transaction shall be subject to the requirements of section 2(h)(8)(A) of the Act upon the later of (1) the applicable deadline established under the compliance schedule provided under § 39.5(e)(2); or (2) 30 days after the swap is first made available for trading on a swap execution facility registered under section 5h of the Act or a board of trade designated as a contract market under section 5 of the Act.

(b) Nothing in this rule shall prohibit any counterparty from complying voluntarily with the requirements of section 2(h)(8)(A) of the Act sooner than as provided in paragraph (a) of this section.

PART 39 – DERIVATIVES CLEARING ORGANIZATIONS

5. The authority citation for part 39 continues to read as follows:

Authority: 7 U.S.C. 7a-1 as amended by Pub. L. 111-203, 124 Stat. 1376.

6. Amend § 39.5 to add paragraph (e) to read as follows:

§ 39.5 Review of swaps for Commission determination on clearing requirement.

* * * * *

(e) Mandatory clearing compliance schedule. (1) Definitions. For the purposes of this paragraph:

Category 1 Entity means (1) a swap dealer, (2) a security-based swap dealer; (3) a major swap participant; (4) a major security-based swap participant; or (5) an active fund.

Category 2 Entity means (1) a commodity pool; (2) a private fund as defined in section 202(a) of the Investment Advisors Act of 1940 other than an active fund; (3) an employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974; or (4) a person 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, in each case, the entity is not a third-party subaccount.

Active Fund means any private fund as defined in section 202(a) of the Investment Advisors Act of 1940, that is not a third-party subaccount and that executes 20 or more swaps per month based on a monthly average over the 12 months preceding the Commission issuing a mandatory clearing determination under section 2(h)(2) of the Act.

Third-party Subaccount means a managed account that requires specific approval by the beneficial owner of the account to execute documentation necessary for executing, confirming, margining, or clearing swaps.

(2) Upon issuing a mandatory clearing determination under section 2(h)(2) of the Act, the Commission may determine, based on the group, category, type or class of swaps subject to such determination, that the following schedule for compliance with the requirements of section 2(h)(1)(A) of the Act shall apply:

(i) A swap transaction between a Category 1 Entity and another Category 1 Entity, or any other entity that desires to clear the transaction, must comply with the requirements of section 2(h)(1)(A) of the Act no later than ninety (90) days after the effective date set by the Commission for such mandatory clearing determination.

(ii) A swap transaction between a Category 2 Entity and a Category 1 Entity, another Category 2 Entity, or any other entity that desires to clear the transaction, must comply with the requirements of section 2(h)(1)(A) of the Act no later than one hundred and eighty (180) days after the effective date set by the Commission for such mandatory clearing determination.

(iii) All other swap transactions not eligible to claim the exception from mandatory clearing set forth in section 2(h)(7) of the Act and § 39.6, must comply with the requirements of section 2(h)(1)(A) of the Act no later than two hundred and seventy (270) days after the effective date set by the Commission for such mandatory clearing determination.

(3) Nothing in this rule shall be construed to prohibit any person from voluntarily complying with the requirements of section 2(h)(1)(A) of the Act sooner than the implementation schedule provided under paragraph (2).

Issued in Washington, DC, on September 8, 2011, by the Commission.



David A. Stawick,
Secretary of the Commission.

Appendices to Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA—Commissioners Voting Summary and Statements of Commissioners

NOTE: The following appendices will not appear in the Code of Federal Regulations

Appendix 1—Commissioners Voting Summary

On this matter, Chairman Gensler and Commissioners Dunn, Sommers, and Chilton voted in the affirmative; Commissioner O'Malia voted in the negative.

Appendix 2—Statement of Chairman Gary Gensler

I support the proposed rule to establish schedules to phase in compliance with the clearing and trade execution requirement provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposal would provide greater clarity to market participants regarding the timeframe for bringing their swap transactions into compliance with the clearing and trade execution requirements. The rule also would make the market more open and transparent, while giving market participants an adequate amount of time to comply. The proposed rule would help facilitate an orderly transition to a new regulatory environment for swaps.

Appendix 3—Statement of Commissioner Jill Sommers

I support this proposal to establish a schedule to phase in compliance with certain statutory provisions under Title VII of the Dodd-Frank Act because this will give market participants some degree of certainty about implementation deadlines. However, I believe the Commission should have provided a broader implementation plan encompassing all of the rulemakings under Dodd Frank, rather than the much narrower portion covered by today's proposed rulemaking. In addition, the proposed rule fails to

address a critical component of the trade execution requirement in Section 2(h)(8) of the Commodity Exchange Act. That is, what does it mean to “make a swap available to trade?”

I believe the Commission should clarify who makes the determination that a swap is “made available for trading” and how the decision is to be made, just as the Commission has done with respect to the clearing requirement. This would provide the public with an opportunity to comment on a proposed mechanism for such a determination. In a consultation paper published by the European Commission’s Directorate General on Internal Markets and Services on December 8, 2010, the European Commission put forth the idea that the European Securities and Markets Authority, or ESMA, “could assess and decide when a derivative which is eligible for clearing is sufficiently liquid to be traded exclusively” on a trading platform.⁵³ The European Commission noted that ESMA could base its decision on “the frequency of trades in a given derivative and the average size of transactions,” and solicited comments from the public on which criteria could determine whether a derivative is sufficiently liquid to be required to be traded on a platform.

Both the Dodd-Frank Act and proposed regulations in the European Union require consideration of trading liquidity, in addition to other factors, before a determination is made that a swap is required to be cleared. The Commission should address whether any additional factors will be considered as part of a determination on the trade execution requirement.

⁵³ Public Consultation: Review of the Markets in Financial Instruments Directive (MiFID) (December 8, 2010), *available at* http://ec.europa.eu/internal_market/consultations/docs/2010/mifid/consultation_paper_en.pdf.

Though I support today's proposal, I believe the Commission should clarify who makes the determination that a swap is "made available for trading" and how that decision will be made.

Appendix 4— Statement of Commissioner Scott O'Malia

I respectfully dissent from the Commission's decision today to approve for Federal Register publication two rule proposals related to implementation entitled "Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA" and "Swap Transaction Compliance and Implementation Schedule: Trading Documentation and Margining Requirements under Section 4s of the CEA." For quite some time, I have been asking that the Commission publish for notice and comment a comprehensive implementation schedule that addresses the entire mosaic of rule proposals under the Dodd-Frank Act. I believe the Commission should have proposed a comprehensive schedule that detailed, at a minimum:

- for each registered entity (*e.g.*, swap dealer and major swap participants), compliance dates for each of its entity-specific obligations (*e.g.*, all obligations under Section 4s of the Commodity Exchange Act) under Dodd-Frank; and
- for each market-wide obligation (*e.g.*, the clearing and trading mandates), the entities affected (whether registered or unregistered) along with appropriate compliance dates.

Such a schedule would have complemented and informed existing proposals and provided structure to future determinations. Additionally, a proposal regarding such a schedule should have adequately analyzed the costs and benefits of alternatives, including appropriate quantification. Unfortunately, the two rule proposals that the Commission approved today fail to either propose a comprehensive schedule or provide an adequate cost benefit analysis.

The Commission's proposals also fail to request comment on a number of issues that I believe are important considerations in developing an implementation plan. As a result, I am encouraging commenters to submit responses to the questions below as part of their comments on the two rule proposals.

Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA

- Should the Commission provide guidance on how it will make and communicate a mandatory clearing determination prior to considering the first such determination? If so, what information should be included in guidance?
- As section II(E) of the proposal states: "When issuing a mandatory clearing determination, the Commission would set an effective date by which all market participants would have to comply. In other words, the proposed compliance schedules would be used only when the Commission believes that phasing is necessary based on the

considerations outlined in this release. The Commission will provide the public with notice of its intent to rely upon the compliance schedule pursuant to the process outlined in §39.5(b)(5).” To afford more certainty to market participants, should the Commission instead create a presumption that it will rely on the compliance schedule for each mandatory clearing determination that it issues, unless it finds that the compliance schedule is not necessary to achieve the benefits set forth in the proposal (*e.g.*, facilitating the transition to the new regulatory regime established by the Dodd-Frank Act in an orderly manner that does not unduly disrupt markets and transactions)?

- What, if any, other issues not addressed in current proposed or final rulemakings should the Commission have taken into consideration when proposing the compliance schedule? For example, should the Commission have considered the extent to which its clearing and trade execution requirements apply to entities and transactions located outside the United States? Also, should the Commission have considered the extent to which such requirements apply to transactions between affiliates (whether domestic or cross-border)? If applicable, how should the Commission adjust the proposed compliance schedule to account for such issues?

- What, if any, adjustments should the Commission make to the proposed compliance schedule for trade execution requirements if the Commission makes a determination that a group, category, type, or class of swaps, rather than a specific swap, is subject to mandatory clearing? Would such adjustments vary depending on the manner in which the Commission defines group, category, type, or class?

Swap Transaction Compliance and Implementation Schedule: Trading Documentation and Margining Requirements under Section 4s of the CEA

- What, if any, other issues not addressed in current proposed or final rulemakings should the Commission have taken into consideration when proposing the compliance schedule? For example, should the Commission have considered the extent to which its documentation and margin requirements apply to entities and transactions located outside the United States? Also, should the Commission have considered the extent to which such requirements apply to transactions between affiliates (whether domestic or cross-border)? If applicable, how should the Commission adjust the proposed compliance schedule to account for such issues?

Finally, I want to be clear that I support completing the final Dodd-Frank rulemakings in a reasonable time frame. I believe that the timely implementation of such rulemakings is important. Knowing when and how the markets are required to do what is vital to the success of implementing the new market structure required under the Dodd-Frank Act. When billions of dollars are at stake, you simply do not rely on guesses and estimates based on vague conditions.