



Commodity Futures Trading Commission

Office of Public Affairs

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Q & A – Proposed Rules and Interpretive Guidance Further Defining “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Regarding “Mixed Swaps”; and, Governing Books and Records for “Security-Based Swap Agreements”

What is the goal of the proposed rulemaking?

To: i) further define certain terms; ii) provide for the regulation of mixed swaps; and iii) adopt specified books and records rules. The notice of proposed rulemaking includes proposed rules and interpretive guidance regarding the terms “swap,” “security-based swap,” and “security-based swap agreement,” which the Dodd-Frank Act requires the Commission and the SEC, in consultation with the Federal Reserve Board, to jointly further define. In addition, the statute provides that the Commissions shall jointly prescribe regulations regarding “mixed swaps” as are necessary to carry out the purposes of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), and to jointly adopt rules governing books and records requirements for “security-based swap agreements.”

What is included in the “swap” definition?

The statutory definition of “swap” is detailed and comprehensive. It includes, for example, interest rate swaps, commodity swaps, currency swaps, equity swaps and credit default swaps. To avoid confusion in certain areas, the Commissions are proposing rules and guidance to clarify that a few types of transactions in particular are swaps. These include foreign exchange swaps and forwards (for further information, see questions about foreign exchange forwards and swaps below), foreign currency options (other than foreign currency options traded on a national securities exchange), commodity options, non-deliverable forwards in foreign exchange, cross-currency swaps, forward rate agreements, contracts for differences, options to enter into swaps and forward swaps.

What is not included in the swap definition?

The Commissions are clarifying in their proposed rules and interpretive guidance that certain types of products or transactions that could be covered by an expansive reading of the swap definition, but that traditionally have not been considered to be swaps, are not swaps. These products and transactions include insurance products that meet certain criteria, certain consumer and commercial arrangements, and certain loan participations.

How is the CFTC proposing to interpret the forward exclusion from the swap definition and to treat commodity options embedded in forward contracts?

The swap definition in the Dodd-Frank Act excludes forward contracts in nonfinancial commodities. The CFTC is proposing that this forward exclusion be interpreted in a manner that is consistent with the CFTC’s historical interpretation of the existing forward contract exclusion with respect to futures contracts. The CFTC also is proposing to treat commodity options embedded in forward contracts under the Dodd-Frank Act consistently with its prior interpretations regarding such embedded options.

Do transactions that are “booked out” qualify for the forward exclusion from the swap definition?

The proposal provides that the CFTC’s “Brent Interpretation” regarding “booked-out” transactions also would apply to the forward exclusion from the swap definition for nonfinancial commodities. Market participants that regularly make or take delivery of the referenced commodity in the ordinary course of their business, where the book-out transactions are effectuated through a subsequent, separately-negotiated agreement, would qualify for the forward exclusion from the swap definition.

Are loan participations swaps?

Under the proposal, the Commissions do not interpret the swap definition to include loan participations in which the purchaser is acquiring a current or future direct or indirect ownership interest in the related loan and the loan participations are “true participations” (the participant acquires a beneficial ownership interest in the underlying loans). Depending on the facts and circumstances, a loan participation may be a security regulated by the SEC, and may be an identified banking product subject to the jurisdiction of the Federal bank regulatory agencies.

If the Treasury Secretary determines to exempt Foreign Exchange Forwards and Swaps from the swap definition, are there any regulatory requirements applicable to them under the Commodity Exchange Act (CEA)?

Yes. Under the Dodd-Frank Act, even if the Secretary of the Treasury determines that foreign exchange forwards or foreign exchange swaps should not be regulated as swaps, they still would be subject to swap reporting requirements (to a swap data repository, if available, or to the CFTC otherwise). Also, swap dealers and major swap participants engaging in such transactions still would be subject to certain business conduct standards with respect to the transactions.

Are there other foreign exchange products that remain subject to the CEA?

Yes. All foreign exchange products that meet the swap definition, and are not foreign exchange forwards or foreign exchange swaps, remain subject to the CEA even if the Treasury Secretary exempts foreign exchange swaps and foreign exchange forwards. These include foreign currency options (other than foreign currency options traded on a national securities exchange) (including those on foreign exchange forwards or foreign exchange swaps), non-deliverable forward contracts involving foreign exchange, currency swaps and cross-currency swaps.

How are transactions in regional transmission organizations (“RTOs”) and independent system operators (“ISOs”) treated?

Section 722 of the Dodd-Frank Act specifically addresses how the CFTC should approach products regulated by the Federal Energy Regulatory Commission (“FERC”) that also may be subject to CFTC jurisdiction. It permits the CFTC to exempt certain FERC-regulated instruments or other specified electricity transactions if the CFTC finds that such an exemption would be in the public interest. The proposal states that the treatment of these products should be considered under this public interest waiver process, rather than through this joint rulemaking to further define the term “swap.”

Have the Commissions distinguished between transactions that would be swaps regulated by the CFTC and transactions that would be security-based swaps regulated by the SEC?

Yes. The proposal refers to swaps and security-based swap collectively as “Title VII instruments.” The classification of a Title VII instrument as a swap or a security-based swap generally is to be made at the inception of the transaction. The proposal identifies Title VII instruments based on a variety of specific types of interest and other monetary rates as swaps regulated by the CFTC, and Title VII instruments based on the “yield” of a debt

security, loan, or narrow-based security index in the sense where the term “yield” is used as a proxy for price, as security-based swaps regulated by the SEC. It also addresses the appropriate classification of Title VII instruments based on government debt obligations and futures contracts.

Are Total Return Swaps (“TRS”) based on securities security-based swaps?

A TRS based on a single security or loan or on a narrow-based security index generally would be a security-based swap regulated by the SEC. However, if the TRS embeds interest-rate optionality (e.g., a cap, collar, call, or put) to shift or limit interest rate exposure, the inclusion of these terms would cause the TRS to be a mixed swap. Similarly, if a TRS also is based on non-security-based components (such as the price of oil, or a currency), it would be a mixed swap. Under the Dodd-Frank Act, a TRS based on a broad-based security index would be a swap regulated by the CFTC.

Who regulates credit default swaps (CDS)?

The SEC regulates CDS on single names, loans and narrow-based security indexes. The CFTC regulates CDS based on broad-based security indexes. The Commissions are proposing detailed and objective rules to distinguish broad from narrow-based security indexes for purposes of CDS. These rules are similar to rules that the Commissions previously have issued with respect to debt security indexes, but tailored to index CDS in particular. The proposed rules also address circumstances in which indexes migrate from broad-based to narrow-based, or vice versa.

What is a “mixed swap” and how will it be regulated?

A mixed swap is a transaction that is both a swap and a mixed swap. In order to facilitate the trading of these instruments in appropriate circumstances, the proposed rules provide that bilateral, uncleared mixed swaps, where one of the counterparties is dually registered as a dealer or major participant with both the CFTC and also with the SEC, would be subject to certain key provisions of the CEA and related CFTC rules as well as the requirements of the federal securities laws. For all other mixed swaps, the Commissions are proposing a process where a person who desires or intends to list, trade, or clear such a mixed swap (or class thereof) can ask the agencies for a joint order permitting the requesting person (and any other person or persons that subsequently lists, trades, or clears that mixed swap) to comply, as to parallel provisions only, with specified parallel provisions of either the CEA or the Securities Exchange Act of 1934 (“Exchange Act”), and the rules and regulations under the relevant statute, rather than being required to comply with parallel provisions of both the CEA and the Exchange Act.

If I don’t know whether a particular transaction is a swap, security-based swap, or mixed swap, is there a process by which I may request an interpretation from the Commissions?

Yes. Under the proposed rules, any person may submit a request to the CFTC and the SEC to provide a joint interpretation of whether a particular agreement, contract, or transaction (or class thereof) is a swap, security-based swap or mixed swap. In making a request, the requesting party must provide: all material information; a statement of the economic characteristics and purpose of the transaction; the requesting party’s determination as to whether the transaction should be characterized as a swap, a security-based swap, or a mixed swap and the basis for such determination; and any other information requested by either agency.

How long will it take to obtain such an interpretation?

If the Commissions determine to issue a joint interpretation, under the proposed rules it must be issued within 120 days after receipt of a complete submission requesting a joint interpretation. The Commissions may seek public comment with respect to such a joint interpretation; if they do, the 120-day deadline will be stayed during the comment period, but will recommence the business day after the public comment period ends. If the Commissions

do not issue a joint interpretation within the prescribed time period, the proposed rules would require each Commission to publicly provide the reasons for not having done so.

What is a "security-based swap agreement" ("SBSA")?

SBSAs are a type of swap related to securities over which the CFTC has full regulatory and enforcement authority under the Dodd-Frank Act, and where the SEC also has certain authority, including antifraud authority, and access to information from certain CFTC regulated entities. SBSAs include swaps based on broad-based security indexes and certain exempted securities, such as U.S. Treasuries.

What books and records requirements apply to SBSAs?

The CFTC and SEC are proposing rules stating that none of the following CFTC registrants would be required to keep additional books and records, including daily trading records, regarding SBSAs beyond the books and records that the CFTC is already requiring regarding swaps: swap dealers; major swap participants; security-based swap dealers; and major security-based swap participants. Similarly, swap data repositories would not be required to collect additional data or keep additional data or books and records regarding SBSAs beyond the books and records, and data, that the CFTC is requiring regarding swaps.

Does the proposal discuss the statutory provisions that address efforts to evade the swap-related requirements of the Dodd-Frank Act?

Yes. The CFTC is proposing rules to exercise the anti-evasion authority provided under the Dodd-Frank Act. The proposed rules do not attempt to draw a bright line regarding what constitutes evasion, but rather provides that transactions that are willfully structured to evade the requirements of the Dodd-Frank Act will be treated as swaps. Proposed interpretive guidance also is provided with respect to certain types of circumstances that may, and may not, constitute evasion.