

CFTC Proposes Schedule for Swap Rules

On September 8, 2011, the U.S. Commodity Futures Trading Commission (the "**CFTC**") issued two proposed rules¹ addressing the timetable for implementation of new regulatory requirements for swaps under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**"). One of these proposals relates to the implementation schedule for clearing and trade execution requirements (the "**Cleared Swaps Implementation Proposal**"); the other relates to the implementation schedule for documentation and margin requirements for uncleared swaps (the "**Uncleared Swaps Implementation Proposal**"). On the same day, CFTC Chairman Gary Gensler also issued a tentative schedule for finalizing various other derivatives-related rules to be promulgated under Dodd-Frank (the "**Final Rules Schedule**").

Cleared Swaps Implementation Proposal

Section 723(a)(3) of Dodd-Frank requires a swap to be submitted for clearing to a derivatives clearing organization ("**DCO**") if the CFTC makes the determination that the relevant type of swap must be cleared (a "**Clearing Determination**").

Mandatory Clearing

In the Cleared Swaps Implementation Proposal, the CFTC proposes to phase in mandatory swap clearing in accordance with a timeline (the "**Compliance Timeline**") that differentiates between types of market participants, as set out in the table below. Exempt end-users are not required to clear swaps under Dodd-Frank, but may do so on a voluntary basis at any time.

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¹ The two proposed rules are titled "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."

Category of Participants	Entity Type	Clearing Compliance Date
Category 1 Entities	Swap Dealer Security Based Swap Dealer Major Swap Participant Major Security-Based Swap Participant Active Fund (as defined below)	90 days after Clearing Determination for trades with other Category 1 Entities
Category 2 Entities	Financial entity that is not an Active Fund or Third-Party Subaccount (as defined below)	180 days after Clearing Determination for trades with Category 1 or other Category 2 Entities
All Other Entities		270 days after Clearing Determination for any trade

Proposed Definitions of "Active Funds," "Third-Party Accounts," and "Financial Entities"

The proposed rule creates a new category of entity, an **"active fund,"** which is defined as any private fund (as defined under the Investment Advisers Act of 1940) that executes twenty or more swaps per month (irrespective of whether such swaps are cleared or uncleared) based on a monthly average over the twelve months preceding the relevant Clearing Determination, unless that fund is a "third-party subaccount". A **"third-party subaccount"** is 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.

The CFTC stated in the proposal that the purpose of distinguishing between "active funds" and "third-party subaccounts," is to balance concerns of investment managers that they require time to educate clients and put in place necessary documentation to permit clients' swaps to be cleared against concerns that liquidity may decrease and spreads increase, if investment managers leave the swap market.

As set out in the CFTC proposal, the definition of "active funds" is intended to capture funds that conduct such a volume of swaps that they are "likely to have (1) sufficient resources to enter into arrangements that comply with the clearing and trade execution requirement earlier than other types of market participants; and (2) sufficient market experience to comply meaningfully to the "buy-side" perspective as industry standards are being developed." However, since many funds that trade in such volumes may also fall within the definition of "third-party subaccounts," it remains to be seen how successfully this balance will work in practice. Further, asset managers should note that the determination of whether a client is a "third-party subaccount" or not may involve careful analysis of their client agreements, and may have unintended implications for their relationships with both clients and counterparties.

A "financial entity" for purposes of Category 2 includes any commodity pool, private fund that is not an "active fund" or a "third-party subaccount", employee benefit plan, or entity predominantly engaged in banking activities or other activities that are financial in nature.

The Compliance Timeline with respect to a swap would begin after the effective date of a Clearing Determination for that type of swap (which the CFTC must make within 90 days of a clearing house making a submission to the CFTC to clear that swap).

Phase-in of Mandatory Exchange Trading

The proposed Compliance Timeline will also apply to Dodd-Frank trade execution provisions, which require that a swap that is subject to mandatory clearing must also be exchange-traded if a swap execution facility ("**SEF**") or designated contract market ("**DCM**") makes the swap available for trading. If a swap is not immediately available for exchange-trading on the relevant Clearing Compliance Date, exchange-trading will become mandatory 30 days after the swap becomes available for trading.

Relationship with Other Rules

The CFTC has acknowledged that it must finalize other swap-related rules before clearing and trading can become mandatory. Those rules include critical definitions including "swap", "security-based swaps", "swap dealer", "major swap participant", "security-based swap dealer" and "major security-based swap participant", rules defining end-users and rules related to the protection of cleared swaps customer contracts and collateral. (We note that a DCO will be presumed to be eligible to clear swaps of a type that it already clears.)² In addition, the CFTC recognized that it needs to adopt rules for DCMs and SEFs before the trade execution requirement becomes final. Consequently, it remains unclear when clearing and trading will become mandatory, but it seems reasonable to assume that swaps entered into between Category 1 Participants are unlikely to be subject to the clearing requirement before the second quarter of 2012 at the earliest.

Uncleared Swap Implementation Proposal

Phase In of Requirements

Earlier in 2011, the CFTC proposed margin rules for uncleared swaps³ and rules related to standard trading documentation for swap dealers and major swap participants.⁴ Under the Uncleared Swap Implementation Proposal, these rules would be subject to a phase-in compliance schedule similar to the Compliance Timeline.

Relationship with Other Rules

The CFTC acknowledged that, before the trading documentation and margin rules becomes final, the CFTC had to finalize rules dealing with the following topics: confirmations; protection of collateral for uncleared swaps; definitions of "swap", "swap dealer" and "major swap participant"; and registration of dealers and major swap participants.

Schedule for Adopting Final Rules

The Final Rules Schedule proposed by Chairman Gensler is set out below. As he noted in his introductory comments, the Final Rules Schedule is indicative and the ultimate timing may slip:

Timeline	Relevant CFTC Rules Subject Matter
Remainder of 2011	<ul style="list-style-type: none">• Clearinghouse Rules• Data Recordkeeping and Reporting• End-User Exception• Entity Definitions/Registration• External Business Conduct• Internal Business Conduct (duties, recordkeeping and chief compliance officers)• Position Limits• Product Definitions/Commodity Options• Real-Time Reporting• Segregation for Cleared Swaps• Trading – Designated Contract Markets and Foreign Boards of Trade

² Proposed CFTC Rule §39.5(a), 76 FR 44 473 (July 26, 2011).

³ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, proposed on April 28, 2011.

⁴ Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, proposed on February 8, 2011.

Timeline	Relevant CFTC Rules Subject Matter
First Quarter 2012	<ul style="list-style-type: none">• Capital and Margin• Client Clearing Documentation and Risk Management• Conforming Rules• Disruptive Trading Practices• Governance and Conflict of Interest• Internal Business Conduct (Documentation)• Investment of Customer Funds• Swap Execution Facilities• Segregation for Uncleared Swaps• Straight-Through Trade Processing

Application of Dodd-Frank to Non-U.S. Swap Activities

Chairman Gensler also stated that the CFTC expects to seek public input on the application of Section 722(d) of Dodd-Frank, which states that Dodd-Frank does not apply to activities outside the United States, unless those activities have a direct and significant connection with activities in, or effect on, commerce of the United States or contravene any of the CFTC rules intended to prevent the evasion of any Dodd-Frank provision. Chairman Gensler did not say when the public consultation request is likely to be released.

This client memorandum does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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