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The New Swaps Regulatory Framework under Dodd-Frank

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In an historic piece of legislation reminiscent of the creation of the Securities Exchange Commission and the regulation of securities markets and broker dealers in 1933 and 1934, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act” or the “Act”) will be remembered as the first significant overhaul of US financial markets since the Great Depression.

The Dodd-Frank Act was necessitated by Main Street’s view that the Great Recession of 2007-2008 was either caused or accelerated by the swaps market, primarily credit default swaps, an historically opaque over-the-counter market largely traded in the inter-bank and institutional market. The swaps market had grown so large and created such financial inter-connectedness among US and foreign banks, hedge funds, insurance company affiliates and other financial institutions that its near-failure to efficiently operate without a bailout from Washington and other governments of large financial centers was a sign that a new regulatory framework was needed, one that would provide more transparency and greater margin and capital requirements in order to avoid any future financial contagion of the type experienced during the Great Recession.

The Dodd-Frank Act is 2139 pages long and requires 73 sections covering 445 pages to create a new regulatory infrastructure over swaps and those persons engaged in swap activities, swap markets, swap trading and reporting.

While the historic legislative reforms of the Great Depression took 4 years following the Great Crash of 1929 to be put in place, it took Congress less than 2 years from the beginning of the Great Recession, after much negotiation amongst regulators, government agencies, numerous financial entities including banks, dealers and end-users, coupled with extensive lobbying, to find the political will and necessary Congressional

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votes to advance these historic reforms. President Obama signed the legislation into law on July 21, 2010.

The Act is comprehensive and as a general matter seeks to regulate parties engage in swaps, their dealing and trading activities and attempts to reduce the lack of transparency in the swaps market. It divides the regulatory world into swaps, other than security-based swaps, which are to be regulated by the Commodities Futures Trading Commission (“CFTC”), and security-based swaps which are to be regulated by the Securities Exchange Commission (“SEC”). Participants in the swaps market regulated by the CFTC are swap dealers and major swap participants and in the SEC are security-based swap dealers and major security-based swap participants. Given that the same swaps entity will most likely be engaged in both swaps and security-based swaps and thus regulated at the same time by the CFTC and the SEC, there is an acknowledgement of much joint rule making between the Commissions.

Whether this new regulatory structure will reduce systemic risk concerns and increase the cost of entering into hedging activities for end-users, and whether the push-out rules will make banks and financial institutions much less strong and more at risk, remains to be seen. In the final analysis, the actual effectiveness of the Act and the complete scope of its coverage can only be determined once the more than 100 rules required of the CFTC and SEC are completed.

The Act is extremely complex and the summary below is intended to give you an understanding of the regulatory construct and how it builds a regulatory infrastructure around the swaps market. Each provision is identified in the footnotes so that you may review the exact language. In addition, as there are numerous new key definitional terms, we have provided the exact language and set those out in Appendix A.

For a copy of the Act please go to http://banking.senate.gov/public/files/AYO10H30_xml.pdf.



Regulation of Swap Markets

Among the number of new requirements, the Act provides for the regulation of newly defined swap entities, mandatory clearing and exchange trading, public reporting of swap trading data, new capital and margin requirements, position limits and large trader reporting, and new business conduct rules. These are all summarized below.

Jurisdictional Separation

CFTC Jurisdiction

The Act gives the CFTC exclusive jurisdiction over all swaps except for security-based swaps, which are the exclusive jurisdiction of the SEC.¹ Mixed swaps, those transactions that have elements of both swaps and security-based swaps, are the joint jurisdiction of the CFTC and SEC and subject to certain joint rule making requirements.²

Swaps³ on interest rates, foreign exchange, currencies, commodities, government securities, weather, energy, metal, emissions, credit default and credit spread swaps on issuers in a broad-based securities index, including total return swaps on all the aforementioned and swaps on broad-based securities indices, are regulated by the CFTC.⁴ Options on securities, certain forward and futures contracts, and listed foreign exchange options are not included in the definition of “swap” and thus are not regulated by the Act.⁵

The CFTC has regulatory jurisdiction for foreign exchange swaps and foreign exchange forwards unless the Treasury makes a written determination that either or both types of these transactions should not be regulated as swaps. The determination of the regulatory jurisdiction of foreign exchange swaps and foreign exchange forwards does not affect the CFTC’s regulatory jurisdiction over retail foreign exchange transactions.⁶ (*Also see discussion on “Treatment of Foreign Exchange Forwards and Foreign Exchange Swaps” set forth below.*)

Stable value contracts are not swaps or security-based swaps (see “*SEC Jurisdiction*” below for a discussion on “security-based swaps”) until the CFTC and SEC shall have completed a study on these instruments to determine whether they should be swaps or security-based swaps (*See “Studies - Stable Value Contracts” set forth below*).

SEC Jurisdiction

Swaps that are on (i) a single security or loan, including any interest therein or on the value thereof, (ii) a narrow based security index, or (iii) the occurrence, nonoccurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or



financial obligations of the issuer are considered security-based swaps subject to SEC regulatory jurisdiction. This later provision is designed to give the SEC jurisdiction over single-name CDS or CDS on issuers in a narrow-based security index.⁷

Regulation of Swap Participants in the Market

New Types of Regulated Participants

The Act defines certain active swap participants as swap dealers or major swap participants, and, with respect to security-based activities, as security-based swap dealers and major security-based swap participants. These newly regulated entities will be required to register with their respective Commissions, and be subject to clearing and exchange trading requirements, capital, margin, registration, reporting, recordkeeping and business conduct standards and requirements.

Swap Dealers and Security-Based Swap Dealers

A swap dealer and security-based swap dealer is any person who (i) holds itself out as a dealer in swaps, (ii) makes a market in swaps and regularly enters into swaps with counterparties as an ordinary course of business, but does not include a person who enters into swaps or security-based swaps for its own account, either individually or as a fiduciary, but not as a part of a regular business.⁸ No person will be considered a swap dealer to the extent that it offers to enter into a swap with a customer in connection with originating a loan with that customer.⁹ No similar exclusion exists for security-based swap dealers.

No person is permitted to act as a swap dealer, a major swap participant, a security-based swap dealer or a major security-based swap participant without registering with the appropriate Commission.¹⁰ However, the Commissions must exempt from the swap dealers and security-based swap dealers definition any entity that engages in a *de minimus* quantity of swap or security-based swap dealings in connection with transactions with or on behalf of its customers.¹¹

Major Swap Participants and Major Security-Based Swap Participants

Major swap participants and major security-based swap participants are persons (i) who are not swap dealers or security-based swap dealers, (ii) who maintain a substantial position in swaps or security-based swaps, (iii) whose outstanding swaps or security-based swap create substantial counterparty exposure that could have serious adverse effects on the financial stability of the US banking system or financial markets, or (iv) that are a highly leveraged financial entity relative to the amount of capital held and that are not subject to capital requirements established by an appropriate Federal banking agency and maintain a substantial position in swaps or security-based swaps.¹²



In what is known as the captive finance affiliates for manufacturing entities provision, a major swap participant is not to include any entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company.¹³

The CFTC and SEC are to determine what constitutes a “substantial position” held by a major swap participant and major security-based swap participant at a threshold the Commissions determine to be prudent for the effective monitoring, management and oversight of entities that are systematically important or can significantly impact the US financial system, by considering such persons relative positions of cleared and uncleared swaps and security-based swaps, and by determining the value and quality of collateral held against counterparty exposures.¹⁴ In determining whether an entity maintains a substantial position in swaps or security-based swaps, the Commission is to exclude positions held for hedging or mitigating commercial risk and positions maintained by an employee benefit plan under ERISA for the primary purpose of hedging or mitigating risk directly associated with the operation of the plan.¹⁵

An entity may be designated as a major swap participant or major security-based swap participant for one or more categories of swaps or security-based swaps without being classified as a major swap participant or major security-based swap participant for all classes of swaps.¹⁶

It is quite possible, depending on the rules to be adopted by the Commissions in connection with determining what constitutes a substantial position, that many hedge funds, including individual investment vehicles, may fall within the definition of major swap participant or major security-based swap participant, in which case they will be subject to the mandatory clearing, exchange trade execution, margin and capital requirements.

Mandatory Clearing

General Rule

A swap or security-based swap must be cleared if the relevant Commission determines that it is required to be cleared and a derivatives clearing organization or clearing agency registered with the respective Commission or exempt from such registration accepts the swap or security-based swap for clearing.¹⁷

Commercial End-User Exemption



The major exception to the clearing requirement (and thus to be exempt from exchange trading and margin requirements) is the commercial end-user exemption.

This exemption applies if one of the counterparties to the swap or security-based swap is (i) not a financial entity, (ii) is using the transaction to hedge or mitigate commercial risk and (iii) notifies the relevant Commission, in a manner set forth by such Commission, how it generally meets its financial obligations associated with entering into non-cleared security-based swaps.¹⁸

In order to meet this exemption, one must not be a financial entity which is defined as a swap, dealer, security-based swap dealer, major swap participant, major security-based swap participant, a commodity pool, a private fund, an employment benefit plan or a person predominantly engaged in the business of banking or financial in nature.¹⁹

A commercial end-user who benefits from the clearing exemption may elect to require the swap or security-based swap to be cleared and is permitted to designate the derivatives clearing organization if it is a swap or the clearing agency if it is a security-based swap on which it is to be cleared.^{20 21} Furthermore, in connection with any swap or security-based swap transaction which is required to be cleared, a counterparty who is not a swap dealer, major swap participant, security-based swap dealer or major security-based swap participant shall have the right to designate the clearing entity with respect to such transaction.²²

If one is unable to avail themselves of the commercial end user exemption to the mandatory clearing requirements, they will be required to clear swaps and security-based swaps, post relevant margin to the derivatives clearing organization or clearing agency registered with the respective Commission, and be subject to the mandatory trade execution requirements of the Act.

Open Access Requirement for Clearing Entities

The rules of the derivatives clearing organization and clearing agency are to provide for “open access” so as to (i) allow all swaps and security-based swaps submitted to the them having the same terms and conditions to be treated as economically equivalent so as to be able to be offset with each other and (ii) provide for non-discriminatory clearing of any swap or security-based swap executed on a bilateral basis or in the case of a swap on an unaffiliated designated contract market or swap execution facility and in the case of a security-based swap on an unaffiliated national securities exchange or security-based swap execution facility.²³

Commissions to Determine which Swaps and Security-Based Swaps are to be Cleared



The CFTC and SEC also have the power to mandate whether certain swaps or security-based swaps are required to be cleared, and if a Commission determines that to be the case it must provide a 30-day public comment period.²⁴ Derivatives clearing organizations and clearing agencies are also required to submit to the CFTC and SEC respectively, any swap or security-based swap it plans to accept for clearing, and the CFTC and SEC within 90 days of receiving the submission must determine whether the swap or security-based swap is required to be cleared.²⁵

In determining whether a swap or security-based swap is required to be cleared the appropriate Commission is to take into account, among other things the existence of significant outstanding notional exposures, trading liquidity, adequate pricing data, the availability of rules, operational expertise and resources, and credit support infrastructure to the clear the contract, the effect on the mitigation of systemic risk taking into account the market size of the contract, and the effect on competition, the existence of reasonable certainty in the event of insolvency of the relevant clearing entity or one or more of its clearing members.²⁶

Clearing Requirement Application to which Swaps?

The clearing requirement will only be required once the Commissions have adopted rules that establish and govern the clearing houses. Swaps entered into before the effective date of the clearing requirement (within 360 days from the effective date of the Act) are not required to be cleared so long as they are reported to the respective Commissions within 180 days of the effective date of the clearing requirement. Swaps entered into before the application of the clearing requirement are also exempt if reported no later than 90 days following the effective date of the clearing requirement.²⁷

Mandatory Trade Execution for Cleared Swaps

General Rule

All swaps (including security-based swaps) required to be cleared are now also required to be executed on a board of trade designated as a contract market maker by the CFTC or on a swap execution facility registered or exempt from registration under the CEA. The mandatory trading exemption will not apply if no board of trade or swap execution facility makes the swap available to trade or if the commercial end-user exemption applies.²⁸ The same provisions exist for security-based swaps subject to mandatory clearing that must be traded either on an exchange or on a security-based swap execution facility that is registered with the SEC or exempt from SEC registration.²⁹

All security-based swaps traded with a person who is not an eligible contract participant must be traded on a registered national securities exchange.³⁰



Capital and Margin Requirements

General

In order to ensure the safety and soundness of swap dealers, security-based swap dealers, major swap participants and major security-based swap participants, the Act requires regulators to adopt minimum capital requirements and minimum initial and variation margin requirements.³¹ In addition, those same entities will have initial and variation margin requirements for all uncleared swaps.³²

These capital and uncleared swap margin requirements will be set for entities that are banks by the prudential regulators in consultation with the CFTC and SEC. For entities not regulated by prudential regulators, capital and uncleared swap margin requirements will be set by the CFTC and SEC, respectively.³³

The requirements for determining appropriate capital requirements and margin requirements for uncleared swaps and uncleared securities-based swaps are to be based on helping to ensure the safety and soundness of the entity and to be appropriate for the risk associated with such entity's positions.³⁴

Use of Non-Cash Collateral to Meet Margin Requirements

With respect to swap dealers, security-based swap dealers, major swap participants and major security-based swap participants, the Act requires the respective Commissions, and in the case of those entities which are banks, the prudential regulator, to permit the use of non-cash collateral to meet margin requirements if doing so is consistent with preserving the financial integrity of the swap markets and the stability of the US financial system.³⁵

No Express Grandfathering for Margin

The Act does not expressly grandfather existing swaps from the margin requirements on uncleared swaps. This will obviously have potential significant financial and capital issues for swap entities should existing swaps which are not cleared be subject to these new margining requirements.

Applicability of Margining to Commercial End-Users

In another area of significant concern to the market, there is no express exemption from the uncleared swap margining requirements for commercial end-users. This appears to conflict with the premise that end-users are exempt from the clearing requirements of the Act. However, a June 30, 2010 letter from Sen. Dodd (D-CT) and Sen. Lincoln (D-AR) to Rep. Barney Frank (D-MA) and Rep. Peterson (D-MN) stated that it was not the intention that commercial end-users be subject to the uncleared swaps margin requirements.

Protection of Counterparty Funds and Property



Requirement to Register as a Futures Commission Merchant or Broker-Dealer

The Act requires any person accepting a swap counterparty's money, securities or property that margins, guarantees or secures a swap or security-based swap that is cleared to register in the case of swaps as a registered futures commission merchant ("FCM") or in the case of a security-based swap as a registered broker-dealer.³⁶

Segregation of Swap Counterparty's Funds and Property for Cleared Swaps

The Act, subject to certain exceptions, requires FCMs, broker-dealers and security-based swap dealers to treat swap customers' money, securities and property that is received to margin, guarantee or secure cleared swaps as belonging to the swaps customer and not to commingle such property with their own funds.³⁷ Similar rules apply to clearing houses, clearing agencies and depository institutions as it relates to assets of the FCM, broker, dealer, security-based swap dealer or any other person other than the swaps customer.³⁸

Segregation of Swap Counterparty's Funds and Property for Uncleared Swaps

The Act also requires swap dealers, security-based swap dealers, major swap participants and major security-based swap participants, at the option of a counterparty to an uncleared swap, to segregate initial margin for the counterparty's benefit at a third party custodian.³⁹ If a counterparty to an uncleared swap did not elect segregation of its collateral, the Act requires the swap dealer, security-based swap dealer, major swap participant and major security-based swap participant to report quarterly to the counterparty that the back office procedures of the swap dealer, security-based swap dealer, major swap participant and major security-based swap participant relating to margin and collateral requirements are in compliance with the agreement of the counterparties.⁴⁰



New Business Conduct Rules

Each registered swap dealer and major swap participant are to conform to new business conduct standards to be adopted by the Commission. The Commission is to make rules and regulations regarding fraud, manipulation, and other abusive practices involving swaps (including swaps that are offered but not entered into), the diligent supervision of the business of the registered swap dealer and major swap participant, the adherence to the position limits and such other matters as the Commission determines appropriate.⁴¹

Each registered swap dealer and major swap participant is to maintain daily trading records (including related cash and forward transactions), recorded communication, including electronic mail, instant messaging, and recording of telephone calls, for such periods as required by the Commission by rule or regulation. They will also be required to maintain counterparty trading records, and a complete audit trail for conducting comprehensive and accurate trade reconstructions.⁴²

The Commission is also to adopt rules which are to include (i) duties to verify that each counterparty is an eligible contract participant, (ii) disclosure to counterparties (other than swap dealers and major swap participants) the material risks and characteristics of the swap, any material incentives or conflicts of interest that the swap dealer or major swap participant may have in connection with the swap, (iii) for cleared swaps, upon counterparty request, receipt of the daily mark-to-market of the transaction from the appropriate derivatives clearing organization, (iv) for uncleared swaps, receipt of the daily mark-to-market from the swap dealer or major swap participant, (v) duties for the swap dealer and major swap participant to communicate in a fair and balanced manner based on principles of fair dealing and good faith, and (vi) to establish such other standards and requirements the Commission determines to be in the public interest.⁴³

Similar provisions apply to security-based swap dealers and major security-based swap participants as it relates to their security-based swap activities.⁴⁴

Duties as Advisors to Special Entities

A swap dealer acting as an advisor to a special entity⁴⁵ has a duty to act in the best interests of the special entity and must make reasonable efforts to obtain information as to the financial status, tax status, investment or financing objective of the special entity as is necessary to make a reasonable determination that any swap recommended by the swap dealer is in the best interests of the Special Entity.⁴⁶

Duties as Counterparties to Special Entities

New duties are imposed on swap dealers and major swap participants when acting as counterparties to special entities.



Swap dealers and major swap participants will be required to have a reasonable basis to believe that a counterparty that is a special entity has an independent representative who (i) has sufficient knowledge to evaluate the transaction and the risks, (ii) is not subject to statutory disqualification, (iii) is independent of the swap dealer or major swap participant, (iv) undertakes a duty to act in the best interests of the counterparty it represents, (v) will make appropriate disclosures and (vi) will provide written representations to the special entity as to fair pricing and the appropriateness of the transaction. The swap dealer, but not the major swap participant, will be required before the initiation of the transaction to disclose to the special entity in writing the capacity in which it is acting.⁴⁷

These requirements do not apply to a transaction that is initiated by a special entity on an exchange or swap execution facility or one where the swap dealer or major swap participant does not know the identity of the counterparty to the transaction.⁴⁸

Similar provisions exist for security-based swap dealers and major security-based swap participants as it relates to security-based swaps entered into with special entities.⁴⁹

Public Reporting of Swap Transaction Data

The Act requires the CFTC and the SEC to promulgate rules relating to real-time public data reporting of swap and security-based swap transactions, including data relating to price and volume, in order to make transaction data and pricing available to the public in order to enhance price discovery.⁵⁰ Public reporting of this data is required for both cleared and uncleared swaps but in the case of uncleared swaps real-time public reporting will be required in a manner that does not disclose the business transactions and market position of any person.

Swap data repositories and security-based swap data repositories will be required to be registered.⁵¹ A derivatives clearing organization and a clearing organization can register as a swap data repository and security-based swap data repository.⁵²

Prohibition against Providing Federal Assistance and Federal Government Bailouts to Swap Entities

Subject to the various definitional exclusions, there is an absolute prohibition on providing any Federal assistance to any swaps entity with respect to any swap, security-based swap or other activity of the swaps entity.⁵³ For these purposes, a swaps entity excludes major swap participants or major security-based swap participants that are an insured depository institution.⁵⁴ Thus an insured depository institution is a swaps entity only if it is a swap dealer or security-based swap dealer.

The key exemption from the prohibition on providing Federal assistance applies to swap entities of an insured depository institutions that limits its swap and security-based swap



activities to (i) hedging and other similar risk mitigating activities related to the depository institution's activities and (ii) acting as a swaps entity for swaps and security-based swaps on reference assets that are permissible for investment by a national bank (such as interest rates, foreign exchange, US government and agency securities, certain shares in investment companies as long as the assets held by the investment companies are themselves bank eligible investments, investment-grade CDS that is cleared, gold and silver and certain other precious metals).⁵⁵ Securities-based swaps on equities, non-investment-grade CDS and investment-grade CDS which is not cleared cannot be held in a swap entity that receives any Federal assistance as banks are not permitted to own the actual underlying securities. This effectively allows for no Federal assistance to non-insured depository institutions' swap entities that have been pushed out because they are engaged in swaps on non-bank eligible investments.

This prohibition on Federal assistance to a swaps entity does not apply to, and shall not prevent an insured depository institution from having or establishing, an affiliate which is a swaps entity, as long as the depository institution is part of a bank holding company or savings and loan holding company supervised by the Federal Reserve, and where such swaps entity complies with Sections 23A and 23B of the Federal Reserve Act and with such other requirements as the CFTC, the SEC, as appropriate, and the Board of Governors of the Federal Reserve deem necessary and appropriate.⁵⁶ Changes to Sections 23A and 23B of the Federal Reserve Act are made to treat swaps and derivatives with affiliates as "covered transactions" making them subject to quantitative limits and collateral requirements.⁵⁷

The prohibitions on Federal assistance only apply to swaps or security-based swaps entered into by an insured depository institution after the end of the transition period (discussed below).⁵⁸ The general prohibition against Federal assistance is effective, subject to possible extensions, 2 years following the effective date of the Act.⁵⁹

The appropriate Federal banking agency, after consulting with the CFTC and SEC, shall permit the insured depository institution that has a swaps entity that would be subject to the Federal assistance prohibition, with up to 24 months following the effective date of the Act (which is 360 days following the date the Act becomes law) to divest of such swap entity or to cease the activities that require registration as a swaps entity. It may also extend the transition period for an additional year. In establishing the appropriate transition period, the appropriate Federal banking agency will take into account and make written findings regarding the potential impact of such divestiture or cessation of activities on the insured depository institution's (i) mortgage lending, (ii) small business lending, (iii) job creation, and (4) capital formation versus the potential impact on insured depositors and the FDIC's Deposit Insurance Fund, together with such other factors as it deems appropriate.⁶⁰

In the creation of some large fail-safe authority, the Financial Stability Oversight Council may determine that when provisions established under the Act are insufficient to



effectively mitigate systemic risk and protect taxpayers, that swaps entities may no longer access Federal assistance with respect to any swap, security-based swap or other activity of the swaps entity. This determination must be on an institution by institution basis, shall require not less than 2/3 of the members of the Financial Stability Oversight Board and must include the votes of the Chairman of the Council, the Chairman of the Board of Governors and the Chairperson of the FDIC.⁶¹

Notwithstanding the general rule requirements relating to the push-out requirements, the prudential regulator may not allow a bank or bank holding company to become a swap entity unless it conducts its swap or security-based swaps activity in compliance with minimum standards set by its prudential regulator in order to manage its business in a safe and sound manner and to mitigate systemic risk.⁶² This would allow the prudential regulator to impose additional rules and regulations on the activities of a swap entity beyond those already imposed by Section 23A and 23B of the Federal Reserve Act.

Finally, an insured depository institution must comply with the prohibition on proprietary trading in derivatives as required by section 619 of the Act.⁶³

The effect of these “push-out” rules may require swap dealers, major swap participants, security-based swap dealers and major security-based swap participants (i) to have greater capital costs, (ii) to have higher funding costs in the bank holding company entity and thus potentially higher hedging costs to end-users or a loss of business to non-US regulated banks, and (iii) have fewer nettable positions and thus greater credit exposure due to trading swaps out of two dealer subsidiaries thus creating greater credit risk (and thus greater cost) to an end-user.

Position Limits and Large Swap Trader Reporting

In order to prevent fraud and manipulation, the Commissions are to establish limits (including any hedge exemptions) on the size of any swap or security-based swaps positions. The Commissions may also require that any person aggregate their swaps or security-based swaps with actual cash investments, narrow-based security indexes and any other instruments relating to such underlyings.⁶⁴ The SEC may also direct self-regulatory organizations to adopt similar rules.⁶⁵

The Commissions may also require large trader reporting in any swap, securities-based swap or uncleared security-based swap, which may be aggregated with actual cash or spot investments, futures and any narrow-based security index.⁶⁶

Any position limit established under the Act will not apply to a position acquired in good faith prior to the effective date of any rule, regulation or order under the Act that established the position limit, provided that such trader's position is not increased after the effective date of position limit rule.⁶⁷



Exchange Act Beneficial Ownership Reporting

The Act also amends Sections 13 and 16 of the Securities Exchange Act to allow for security-based swaps to be deemed as beneficial ownership positions in underlying securities if the SEC, by rule, determines after consultation with prudential regulators and the Treasury, that the purchase or sale of the security-based swap provides incidents of ownership comparable to direct ownership of the equity security.⁶⁸

New Eligible Contract Participant Definition

The standards for qualifying as an eligible contract participant is raised for government entities, political subdivisions, multinational or supranational government entities and any instrumentality, agency or department thereof to owning or managing on a discretionary basis at least \$50 million. With respect to individuals, the standard is \$10 million on a discretionary basis or at least \$5 million if the transaction is entered into to manage a risk associated with an asset or liability incurred, or reasonably likely to be incurred by the individual.⁶⁹

New Product Approval

A proposal made by a person to list or trade a novel derivative product that has elements of both securities and contracts for sale of a commodity for future delivery (or options on such contracts or options on commodities) may provide concurrent notice to the CFTC and SEC and state accordingly.⁷⁰ If no concurrent notice has been made, then within 5 business days after determining that a proposal to list or trade a novel derivative product may have elements that are subject to the jurisdiction of the other Commission, the Commission with which the filing had been made shall notify its counterpart.⁷¹ The Commission which has been referred the novel derivative product has 21 days to determine whether the product is under its exclusive jurisdiction.⁷² The CFTC or SEC must determine by order the status of novel derivative products that have both securities and futures-like elements within 120 days of a request by the other Commission to do so.⁷³ The requesting Commission can petition the United States Court of Appeals for the District of Columbia circuit within 60 days after the date of entry of the order and the filing of the petition shall operate as a stay of the order until final determination by the court.^{74 75}

Treatment of Foreign Exchange Forwards and Foreign Exchange Swaps

Foreign exchange swaps and forwards are to be treated as swaps unless the Secretary of the Treasury makes a written determination that either or both should not be regulated as swaps and are not structured to evade any rule promulgated under the Act.⁷⁶ In making such determination the Secretary of the Treasury is to consider (i) whether the required trading and clearing of foreign exchange swaps and foreign exchange forwards would create systemic risk, lower transparency or threaten the financial stability of the US, (ii)



whether they are already subject to a regulatory scheme materially comparable to that established by the Act for other classes of swaps, (iii) the extent by which bank regulators of participants in this market provide adequate supervision, including capital and margin requirements, (iv) the extent of adequate payment and settlement systems, and (v) the potential use of these transactions to evade otherwise applicable regulatory requirements.⁷⁷ This last consideration was in light of certain foreign exchange swaps entered into by the Greek government which became an issue in connection with their financial condition and outstanding international debt obligations.

Notwithstanding a determination that foreign exchange swaps and forwards are to be excluded from the definition of swaps, they are still to be reported to either a swap data repository, or if there is none at such time that would accept such foreign exchange swaps and forwards data, to the CFTC within such time period as the CFTC shall require. Finally, even if foreign exchange swaps or forwards are exempted from the definition of swap, any swap dealer or major swap participant who engages in these transactions are to conform to the business conduct standards of swap dealers or major swap participants. In the event that any foreign exchange swap and foreign exchange forward is listed and traded on or subject to the rules of a designated contract market or a swap execution facility, or is cleared by a derivatives clearing organization, it is not exempt from any provision of the Act or any amendments relating to the Act prohibiting fraud or manipulation.⁷⁸

CFTC Ban on Motion Picture Box Office Receipts

As with onions, the CEA was amended to provide for an outright ban on futures contracts relating to motion picture box office receipts, or on any index, measure, value or data related to such receipts.⁷⁹

Legal Certainty for Long-Term Swaps Entered into Before Enactment of the Act

Unless specifically reserved in the applicable swap, neither the enactment of the Act nor any requirement under the Act or amendment made by the Act shall constitute a termination event, force majeure, illegality, increased costs, regulatory change or similar event under a swap (including any related credit support arrangement) that would permit a party to terminate, renegotiate, modify, amend or supplement one or more transactions under the swap.⁸⁰ This may be of concern to swap dealers, major swap participants, security-based swap dealers and major security-based swap participants who may experience increased capital and collateral requirements from end-users or other swap participants.

Swaps are not Insurance under State law

The Commodity Exchange Act (“CEA”) is amended to provide that swaps are not to be considered as insurance and may not be regulated as an insurance contract under the laws



of any State.⁸¹ This clarifies the treatment of credit default swaps as not constituting insurance.

Act's effect on Structured Products

Since the Hybrid Exemption⁸² exclusion from the CEA remains unchanged, most structured products that contain elements of commodities contracts and securities will fall within this exemption and continue to be regulated as securities and will also not constitute security-based swaps under the Act. The Act does provide a mechanism for the CFTC and the SEC to determine regulatory authority over novel derivative products.⁸³ However numerous aspect of the Act may affect the way financial institutions and banks engage in hedging activities in connection with structured products.

State Law Preemption

The Act prohibits state gaming and bucket shop laws from making illegal any options on securities, any security-based swaps between eligible contract participants or any security-based swap effected on a registered national securities exchange.⁸⁴

Extra-territorial Effect of the Act

The provisions of the Act relating to swaps do not apply to any activities outside of the US unless those activities have a direct and significant connection with activities in, or effect on, commerce in the US or they contravene rules and regulations the CFTC prescribes that are necessary to prevent the evasion of any provision of the Act.⁸⁵

No Exemption from Broker Registration when Dealing in Security-Based Swaps

Interestingly, the Act modifies the Securities Exchange Act's definition of "security" by including security-based swaps and modifies the definition of "dealer" to provide that dealers who engage in security-based swaps with eligible contract participants are not required to register as a broker-dealer. However, there is no similar exemption for persons who act as brokers of security-based swaps with eligible contract participants.⁸⁶



Rule Making

Unless otherwise specified most rulemaking under the Act is to be completed within 360 days following the Act's enactment.⁸⁷

CFTC and SEC to Consult during Rulemaking Process

Before the CFTC or SEC commences any rulemaking or issue an order regarding swaps, security-based swaps, swap dealers, security-based swap dealers, major swap participants, major security-based swap participants, swap data repositories, security-based swap data repositories, derivative clearing organizations with regard to swaps, clearing agencies with regard to security-based swaps, persons associated with a swap dealer, security-based swap dealer, major swap participant or major security-based swap dealer, eligible contract participants, swap execution facilities or security-based swap execution facilities, they shall consult and coordinate to the extent possible with each other and with the prudential regulators for purposes of assuring regulatory consistency and comparability to the extent possible.⁸⁸

CFTC and SEC to Consult with Prudential Regulators and Prescribe Comparable Joint Rules

In developing and promulgating rules and orders, each Commission shall consider the views of the prudential regulators.⁸⁹ In addition, in adopting rules and orders, the CFTC and the SEC are to treat functionally or economically similar products or entities in a similar manner⁹⁰ but they are not required to adopt joint rules or orders in that regard.⁹¹ However, in connection with any rules and regulations prescribed "jointly" under the Act, the CFTC and the SEC shall prescribe comparable rules and regulations to the maximum extent possible, taking into consideration differences in instruments and the applicable statutory requirements.⁹²

CFTC and SEC to Jointly Adopt Key Definitions

The CFTC and the SEC, in consultation with the Board of Governors, shall jointly adopt rules defining the terms swap, security-based swap, swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, eligible contract participant and security-based swap agreement.⁹³ They are also to adopt, in consultation with the Board of Governors, such other rules and definitions as they determine necessary and appropriate, in the public interest, and for the protection of investors.⁹⁴ Any rules prescribed hereunder are to require the maintenance of records of all activities relating to security-based swap agreement transactions that are not cleared.⁹⁵

Rules Regarding Trade Repositories

With respect to trade repositories, the CFTC and the SEC, in consultation with the Board of Governors, are to jointly adopt rules governing the books and records



required to be kept and maintained by persons regulated as swap data repositories under the CEA, including uniform rules that specify the (i) data elements that are to be collected and maintained by each repository⁹⁶ and (ii) books and records requirements regarding security-based swap agreements, including daily trading records, for swap dealers, major swap participants, security-based swap dealers and major security-based swap participants.⁹⁷

Conflicting Jurisdictional Rules

If either Commission determines that a final rule, regulation or order of the other Commission conflicts with their jurisdictional requirements, it may seek review of the final rule, regulation or order in the United States Court of Appeals for the District of Columbia by filing within 60 days from its date of publication.⁹⁸

Mixed Swap, Information Gathering, Foreign Jurisdiction Regulatory Schemes

The CFTC and the SEC after consultation with the Board of Governors, are to jointly prescribe regulations regarding mixed swaps.⁹⁹ The CFTC or the SEC may, individually or jointly, by rule or order collect information concerning the swap and security-based swap market and issue a report with respect to the types of swaps or security-based swaps it determines to be detrimental to the stability of a financial market or to participants in such financial market.¹⁰⁰ In addition, if the CFTC or SEC determine that the regulation of swaps or security-based swaps markets in a foreign jurisdiction undermines the stability of the US financial system, either Commission, in consultation with the Secretary of the Treasury, may prohibit an entity domiciled in the foreign country from participating in the US in any swap or security-based swap activities.¹⁰¹

FSOC to Resolve Disputes when CFTC and SEC Have Joint Rulemaking Requirements

In the event the CFTC and the SEC fail to jointly prescribe the rules and regulations required by Section 712(d)(1) and (2), the Financial Stability Oversight Council shall resolve the dispute within a reasonable time after receiving the request and after considering all the relevant information,¹⁰² and all jointly made rules and regulations will be subject to joint interpretations by the CFTC and the SEC, after consultation with the Board of Governors.¹⁰³

Each Commission has no Jurisdiction over the Other Commission

Finally, as part of a jurisdictional limitation, nothing in the Act confers jurisdiction to the CFTC with respect to security-based swaps or to the activities or functions concerning security-based swaps and the entities involved in security-based swaps¹⁰⁴ or to the SEC with respect to swaps or to the activities or functions concerning swaps and the entities involved in swap activities.¹⁰⁵ A similar limitation applies to futures associations registered under section 17 of the CEA as it relates to any rules, regulations or orders for the oversight or regulation of, or a jurisdictional assertion over, security based swaps, unless it relates to



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compliance with its rules on capital adequacy.¹⁰⁶ A similar limitation applies to national securities associations registered under section 15A of the Securities Exchange Act of 1934 as it relates to swaps.¹⁰⁷



Studies

A number of new studies are required by the Act.

Position Limits Study

The CFTC in consultation with each entity that is a designated contract maker under the CEA is to conduct a study of the effects (if any) of the position limits imposed pursuant to the Act on excessive speculation and on the movement of transactions from US exchanges to offshore trading venues.¹⁰⁸ Such report is to be provided to Congress within 12 months after the imposition of position limits pursuant to the Act.¹⁰⁹

Biennial Reporting on State of Derivatives Markets

The Chairman of the CFTC is to make biennial reports to Congress on the growth or decline of derivatives markets in the US and abroad, including assessments of the causes for such growth or decline, the effectiveness of regulatory regimes in managing systemic risk, a comparison of the costs of compliance at the time of the report with the costs as of December 2008.¹¹⁰ No other Commission is required to make such report.

Feasibility of Requiring Use of Standardized Algorithmic Descriptions for Financial Derivatives

The SEC and the CFTC are to conduct a joint study on the feasibility of requiring the derivatives industry to adopt standardized computer-readable algorithmic descriptions which may be used to describe complex and standardized financial products. These algorithmic descriptions would be used to facilitate computerized analysis of individual derivative contracts to calculate net exposures. They would be used by commercial users and traders of derivatives, derivative clearing houses, exchanges and electronic platforms, trade repositories, regulator investigations of market activities and systemic risk regulators. This would not contemplate disclosure of proprietary models but would be limited to electronic formats for exchange of derivative contract descriptions. This report is required within 8 months of the enactment of the Act.¹¹¹

International Swap Regulation

The CFTC and SEC are to jointly conduct a study relating to swap regulation and clearing house and clearing agency regulation in the US, Asia and Europe that identifies areas of similar regulation and areas that can be harmonized. The report is due within 18 months of the enactment of the Act.¹¹²

Stable Value Contracts

The SEC and CFTC are to jointly conduct a study to determine whether stable value contracts fall within the definition of a swap. The Commissions are to consult with the Department of Labor, the Department of the Treasury and state



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regulators who regulate the issuers of stable value contracts. The report is due within 15 months of the enactment of the Act.¹¹³ If the Commissions determine that stable value contracts fall within the definition of a swap, they are to determine if an exemption therefrom is in the public interest. Until such time, the requirements of the Act are not to apply to stable value contracts and stable value contracts in effect prior to the adoption of any regulations are not to be considered swaps.¹¹⁴



Appendix A

Key Definitions

- “cleared swap”** The term ‘cleared swap’ means any swap that is, directly or indirectly, submitted to and cleared by a derivatives clearing organization registered with the Commission.
- “Federal assistance”** The term ‘Federal assistance’ means the use of any advances from any Federal Reserve credit facility or discount window that is not part of a program or facility with broad based eligibility under section 13(3)(A) of the Federal Reserve Act, Federal Deposit Insurance Corporation insurance or guarantees for the purpose of—
(A) making any loan to, or purchasing any stock, equity interest, or debt obligation of, any swaps entity;
(B) purchasing the assets of any swaps entity;
(C) guaranteeing any loan or debt issuance of any swaps entity; or
(D) entering into any assistance arrangement (including tax breaks), loss sharing, or profit sharing with any swaps entity.
- “financial entity”** (A) IN GENERAL—For the purposes of this subsection, the term ‘financial entity’ means—
(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 section 1a(10) of the Commodity Exchange Act;
(vi) a private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80–b–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);
(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.



(B) EXCLUSION.—The Commission shall consider whether to exempt small banks, savings associations, farm credit system institutions, and credit unions, including—

- (i) depository institutions with total assets of \$10,000,000,000 or less;
- (ii) farm credit system institutions with total assets of \$10,000,000,000 or less; or
- (iii) credit unions with total assets of \$10,000,000,000 or less.

“foreign exchange forward”

The term ‘foreign exchange forward’ means a transaction that solely involves the exchange of 2 different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange.

“foreign exchange swap”

The term ‘foreign exchange swap’ means a transaction that solely involves—

- (A) an exchange of 2 different currencies on a specific date at a fixed rate that is agreed upon on the inception of the contract covering the exchange; and
- (B) a reverse exchange of the currencies described in subparagraph (A) at a later date and at a fixed rate that is agreed upon on the inception of the contract covering the exchange.

“major security-based swap participant”

(A) IN GENERAL.—The term ‘major security-based swap participant’ means any person—

- (i) who is not a security-based swap dealer; and
- (ii)(I) who maintains a substantial position in security-based swaps for any of the major security-based swap categories, as such categories are determined by the Commission, excluding both positions held for hedging or mitigating commercial risk and positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and(32) of section 3 of the Employee Retirement Income Security Act of 1974 (299 U.S.C. 1002) for the primary purpose of hedging or



mitigating any risk directly associated with the operation of the plan;

(II) whose outstanding security based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or

(III) that is a financial entity that—

(aa) is highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and

(bb) maintains a substantial position in outstanding security-based swaps in any major security-based swap category, as such categories are determined by the Commission.

“major swap participant”

(A) IN GENERAL.—The term ‘major swap participant’ means any person who is not a swap dealer, and—

(i) maintains a substantial position in swaps for any of the major swap categories as determined by the Commission, excluding—

(I) positions held for hedging or mitigating commercial risk; and

(II) positions maintained by any employee benefit plan (or any contract held by such a 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) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan;

(ii) whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or

(iii)(I) is a financial entity that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and

(II) maintains a substantial position in outstanding swaps in any major swap category as determined by the Commission.



(B) DEFINITION OF SUBSTANTIAL POSITION.—For purposes of subparagraph (A), the Commission shall define by rule or regulation the term ‘substantial position’ at the threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States. In setting the definition under this subparagraph, the Commission shall consider the person’s relative position in uncleared as opposed to cleared swaps and may take into consideration the value and quality of collateral held against counterparty exposures.

(C) SCOPE OF DESIGNATION—For purposes of subparagraph (A), a person may be designated as a major swap participant for 1 or more categories of swaps without being classified as a major swap participant for all classes of swaps.

(D) EXCLUSIONS.—The definition under this paragraph shall not include an entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company.

“mixed swap”

The term ‘security based swap’ includes any agreement, contract, or transaction that is as described in section 3(a)(68)(A) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(68)(A)) and also is based on the value of 1 or more interest or other rates, currencies, commodities, instruments of indebtedness, indices, quantitative measures, other financial or economic interest or property of any kind (other than a single security or a narrow-based security index), or the occurrence, non-occurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence (other than an event described in subparagraph (A)(iii)).



“security-based swap”

(A) IN GENERAL.—Except as provided in subparagraph (B), the term ‘security-based swap’ means any agreement, contract, or transaction that—

(i) is a swap, as that term is defined under section 1a of the Commodity Exchange Act (without regard to paragraph (47)(B)(x) of such section); and

(ii) is based on—

(I) an index that is a narrow based security index, including any interest therein or on the value thereof;

(II) a single security or loan, including any interest therein or on the value thereof; or

(III) the occurrence, nonoccurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer.

(B) RULE OF CONSTRUCTION REGARDING MASTER AGREEMENTS.—The term ‘security based swap’ shall be construed to include a master agreement that provides for an agreement, contract, or transaction that is a security-based swap pursuant to subparagraph (A), together with all supplements to any such master agreement, without regard to whether the master agreement contains an agreement, contract, or transaction that is not a security-based swap pursuant to subparagraph (A), except that the master agreement shall be considered to be a security-based swap only with respect to each agreement, contract, or transaction under the master agreement that is a security-based swap pursuant to subparagraph (A).

(C) EXCLUSIONS.—The term ‘security-based swap’ does not include any agreement, contract, or transaction that meets the definition of a security-based swap only because such agreement, contract, or transaction references, is based upon, or settles through the transfer, delivery, or receipt of an exempted security under paragraph (12), as in effect on the date of enactment of the Futures Trading Act of 1982 (other than any municipal security as defined in paragraph (29) as in effect on the date of enactment of the Futures Trading Act of 1982), unless such agreement, contract, or⁷ transaction is of the character of, or is commonly known in the trade as, a put, call, or other option.



**“security-based swap
data repository”**

The term ‘security-based swap data repository’ means any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, security-based swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for security-based swaps.

**“security-based swap
execution facility”**

The term ‘security-based swap execution facility’ means a trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that—

- (A) facilitates the execution of security-based swaps between persons; and
- (B) is not a national securities exchange.

**“security-based
swap dealer”**

(A) IN GENERAL.—The term ‘security based swap dealer’ means any person who—

- (i) holds themselves out as a dealer in security-based swaps;
- (ii) makes a market in security-based swaps;
- (iii) regularly enters into security based swaps with counterparties as an ordinary course of business for its own account; or
- (iv) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps.

(B) DESIGNATION BY TYPE OR CLASS.— A person may be designated as a security-based swap dealer for a single type or single class or category of security-based swap or activities and considered not to be a security-based swap dealer for other types, classes, or categories of security-based swaps or activities.

(C) EXCEPTION.—The term ‘security-based swap dealer’ does not include a person that enters into security-based



swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business.

(D) DE MINIMIS EXCEPTION.—The Commission shall exempt from designation as a security-based swap dealer an entity that engages in a de minimis quantity of security-based swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to the making of any determination to exempt.

“special entity”

For purposes of this subsection, the term ‘special entity’ means—

- (i) a Federal agency;
- (ii) a State, State agency, city, county, municipality, or other political subdivision of a State or;
- (iii) any employee benefit plan, as defined in section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002);
- (iv) any governmental plan, as defined in section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002); or
- (v) any endowment, including an endowment that is an organization described in section 501(c)(3) of the Internal Revenue Code of 1986

“stable value contracts”

The term “stable value contract” means any contract, agreement, or transaction that provides a crediting interest rate and guaranty or financial assurance of liquidity at contract or book value prior to maturity offered by a bank, insurance company, or other State or federally regulated financial institution for the benefit of any individual or commingled fund available as an investment in an employee benefit plan (as defined in section 3(3) of the Employee Retirement Income Security Act of 1974, including plans described in section 3(32) of such Act) subject to participant direction, an eligible deferred compensation plan (as defined in section 457(b) of the Internal Revenue Code of 1986) that is maintained by an eligible employer described in section 457(e)(1)(A) of such Code, an arrangement described in section 403(b) of such Code, or a qualified tuition program (as defined in section 529 of such Code).



“substantial position”

For purposes of subparagraph (A), the Commission shall define by rule or regulation the term ‘substantial position’ at the threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States. In setting the definition under this subparagraph, the Commission shall consider the person’s relative position in uncleared as opposed to cleared swaps and may take into consideration the value and quality of collateral held against counterparty exposures.

“swap”

(A) IN GENERAL.—Except as provided in 8 subparagraph (B), the term ‘swap’ means any agreement, contract, or transaction—

(i) that is a put, call, cap, floor, collar, or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind;

(ii) that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence;

(iii) that provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level without also conveying a current or future direct or indirect ownership interest in an asset (including any enterprise or investment pool) or liability that incorporates the financial risk so



transferred, including any agreement, contract, or transaction commonly known as—

- (I) an interest rate swap;
- (II) a rate floor;
- (III) a rate cap;
- (IV) a rate collar;
- (V) a cross-currency rate swap;
- (VI) a basis swap;
- (VII) a currency swap;
- (VIII) a foreign exchange swap;
- (IX) a total return swap;
- (X) an equity index swap;
- (XI) an equity swap;
- (XII) a debt index swap;
- (XIII) a debt swap;
- (XIV) a credit spread;
- (XV) a credit default swap;
- (XVI) a credit swap;
- (XVII) a weather swap;
- (XVIII) an energy swap;
- (XIX) a metal swap;
- (XX) an agricultural swap;
- (XXI) an emissions swap; and
- (XXII) a commodity swap;

(iv) that is an agreement, contract, or transaction that is, or in the future becomes, commonly known to the trade as a swap;

(v) including any security-based swap agreement which meets the definition of 'swap agreement' as defined in section 206A of the Gramm-Leach-Bliley Act (15 1 U.S.C. 78c note) of which a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein; or

(vi) that is any combination or permutation of, or option on, any agreement, contract, or transaction described in any of clauses (i) through (v).

(B) EXCLUSIONS.—The term 'swap' does not include—

(i) any contract of sale of a commodity for future delivery (or option on such a contract), leverage contract authorized under section 19, security futures product, or agreement, contract, or transaction described in section 2(c)(2)(C)(i) or section 2(c)(2)(D)(i);



(ii) any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled;

(iii) any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities, including any interest therein or based on the value thereof, that is subject to—

(I) the Securities Act of 1933 (15 U.S.C. 77a et seq.); and

(II) the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.);

(iv) any put, call, straddle, option, or privilege relating to a foreign currency entered into on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a));

(v) any agreement, contract, or transaction providing for the purchase or sale of 1 or more securities on a fixed basis that is subject to—

(I) the Securities Act of 1933 (15 U.S.C. 77a et seq.); and

(II) the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.);

(vi) any agreement, contract, or transaction providing for the purchase or sale of 1 or more securities on a contingent basis that is subject to the Securities Act of 1933 (15 U.S.C. 77a et seq.) and the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), unless the agreement, contract, or transaction predicates the purchase or sale on the occurrence of a bona fide contingency that might reasonably be expected to affect or be affected by the creditworthiness of a party other than a party to the agreement, contract, or transaction;

(vii) any note, bond, or evidence of indebtedness that is a security, as defined in section 2(a)(1) of the Securities Act of 1933 (15 U.S.C. 77b(a)(1));

(viii) any agreement, contract, or transaction that is—

(I) based on a security; and

(II) entered into directly or through an underwriter (as defined in section 2(a)(11) of the Securities Act of 1933 (15 U.S.C. 77b(a)(11))) by the issuer of such security for the purposes of raising capital, unless the agreement, contract, or transaction is entered into to manage a risk associated with capital raising;



- (ix) any agreement, contract, or transaction a counterparty of which is a Federal Reserve bank, the Federal Government, or a Federal agency that is expressly backed by the full faith and credit of the United States; and
- (x) any security-based swap, other than a security-based swap as described in subparagraph (D).

“swap data repository”

The term ‘swap data repository’ means any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for swaps.

“swap dealer”

(A) IN GENERAL.—The term ‘swap dealer’ means any person who—

- (i) holds itself out as a dealer in swaps;
- (ii) makes a market in swaps;
- (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or
- (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps, provided however, in no event shall an insured depository institution be considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.

(B) INCLUSION.—A person may be designated as a swap dealer for a single type or single class or category of swap or activities and considered not to be a swap dealer for other types, classes, or categories of swaps or activities.

(C) EXCEPTION.—The term ‘swap dealer’ does not include a person that enters into swaps for such person’s own account, either individually or in a fiduciary capacity, but not as a part of a regular business.

(D) DE MINIMIS EXCEPTION.—The Commission shall exempt from designation as a swap dealer an entity that engages in a de minimis quantity of swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations



to establish factors with respect to the making of this determination to exempt.

“swap entity”

(A) IN GENERAL.—The term “swaps entity” means any swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, that is registered under—

(i) the Commodity Exchange Act (7 U.S.C. 1 et seq.); or

(ii) the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

(B) EXCLUSION.—The term “swaps entity” does not include any major swap participant or major security-based swap participant that is an insured depository institution.

“swap execution facility”

The term ‘swap execution facility’ means a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that—

(A) facilitates the execution of swaps between persons; and

(B) is not a designated contract market.



End Notes

References to Sections below, unless otherwise noted, are references to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

¹ Sec. 722(a), p. 801 and Sec. 762(c), p. 1043.

² Sec. 721, p. 762 at p. 791.

³ The definition of a swap is in Sec. 721, p. 762 at p. 784.

⁴ Sec. 722(a), p. 801.

⁵ Sec. 721, p. 762 at p. 787.

⁶ Sec. 721(a), p. 762 at p. 794.

⁷ Sec. 761(a), p. 1029 at p. 1034.

⁸ Sec. 721(a), p. 762 at p. 794-5 and Sec. 761(a), p. 1029 at p. 1038-9.

⁹ Sec. 721(a), p. 762 at p. 794.

¹⁰ Sec. 731, p. 888 and Sec. 764(a), p. 1112.

¹¹ Sec. 721(a), p. 762 at p. 795 and Sec. 761(a), p. 1029 at p. 1039.

¹² Sec. 721(a), p. 762 at p. 776 and Sec. 761, p. 1029 at p. 1031.

¹³ Sec. 721(a), p. 762 at p. 776.

¹⁴ Sec. 721(a), p. 762 at p. 778 and Sec. 761(a), p. 1029 at p. 1033.

¹⁵ Sec. 721(a), p. 762 at p. 776 and Sec. 761, p. 1029 at p. 1031.

¹⁶ Sec. 721(a), p. 762 at p. 778 and Sec. 761(a), p. 1029 at p. 1033.

¹⁷ Sec. 723(a)(3), p. 809 at p. 810 and Sec. 763(a), p. 1049.

¹⁸ Sec. 723(a)(3), p. 809 at p. 820 and Sec. 763(a), p. 1049 at p. 1058.

¹⁹ Sec. 723(a)(3), p. 809 at p. 821 and Sec. 763(a), p. 1049 at p. 1059.

²⁰ Sec. 723(a)(3), p. 809 at p. 820 and Sec. 763(a), p. 1049 at p. 1059.

²¹ Sec. 723(a)(3), p. 809 at 825 and Sec. 763(a), p. 1049 at p. 1063.

²² Sec. 723(a)(3), p. 809 at p. 825 and Sec. 763(a), p. 1049 at p. 1062.

²³ Sec. 723(a)(3), p. 810 and Sec. 763(a), p. 1049.

²⁴ Sec. 723(a)(3), p. 810 at p. 812, Sec. 763(a), p. 1049 at p. 1050.

²⁵ Sec. 723(a)(3), p. 810 at p. 813, Sec. 763(a), p. 1049 at p. 1052.

²⁶ Sec. 723(a)(3), p. 810 at p. 814 and Sec. 763(a), p. 1049 at p. 1052.

²⁷ Sec. 723(a)(3), p. 810 at p. 820 and Sec. 763(a), p. 1049 at p. 1058.

²⁸ Sec. 723(a)(3), p. 809 at p. 826.

²⁹ Sec. 763(a), p. 1049 at p. 1064.

³⁰ Sec. 763(e), p. 1091.

³¹ Sec. 731, p. 888 at p. 891 and Sec. 764(a), p. 1112 at p. 1116.

³² Sec. 731, p. 888 at p. 891 and Sec. 764, p. 1112 at p. 1116.

³³ Sec. 731, p. 888 at p. 892 and Sec. 764(a), p. 1112 at p. 1118.

³⁴ Sec. 731, p. 888 at p. 894 and Sec. 764(a), p. 1112 at p. 1119.

³⁵ Sec. 731, p. 888 at p. 896 and Sec. 764(a), p. 1112 at p. 1120.

³⁶ Sec. 724(a), p. 830 and Sec. 763(a), p. 1049 at p. 1083.

³⁷ Sec. 724(a), p. 830 at p. 831 and Sec. 763(a), p. 1049 at p. 1084.

³⁸ Sec. 724(a), p. 830 at p. 834 and Sec. 763(a), p. 1049 at p. 1086.

³⁹ Sec. 724(a), p. 830 at p. 835 and Sec. 763(a), p. 1049 at p. 1087.

⁴⁰ Sec. 724(a), p. 830 at p. 837 and Sec. 763(a), p. 1049 at p. 1087.

⁴¹ Sec. 731, p. 888 at p. 899.

⁴² Sec. 731, p. 888 at p. 898 and Sec. 764(a), p. 1112 at p. 1123.

⁴³ Sec. 731, p. 888 at p. 901.

⁴⁴ Sec. 764(a), p. 1112 at p. 1122.

⁴⁵ Special entities are Federal agencies, State, State agencies, city, county, municipality, or other political subdivisions of a State, any employment benefit plan, any governmental plan and any endowment.

⁴⁶ Sec. 731, p. 888 at p. 903 and Sec. 764(a), p. 1112 at p. 1125.

⁴⁷ Sec. 731, p. 888, at p. 904.



- ⁴⁸ Sec. 731, p. 888 at p. 906.
- ⁴⁹ Sec. 764(a), p. 1112 at p. 1130 and following.
- ⁵⁰ Sec. 727, p. 867 and Sec. 763(i), p. 1097.
- ⁵¹ Sec. 728, p. 872 and Sec. 763(i), p. 1097 at p. 1102.
- ⁵² Sec. 727, p. 867 at p. 872 and Sec. 763(i), p. 1097 at p. 1101.
- ⁵³ Sec. 716(a), p. 734.
- ⁵⁴ Sec. 716(b)(2)(B)(2), p. 734 at 735.
- ⁵⁵ Sec. 716(d)(1) - (3), p. 736.
- ⁵⁶ Sec. 716(c), p. 735.
- ⁵⁷ Sec. 608, p. 625.
- ⁵⁸ Sec. 716(e), p. 737.
- ⁵⁹ Sec. 716(h), p. 739.
- ⁶⁰ Sec. 716(f), p. 737.
- ⁶¹ Sec. 716(l), p. 742.
- ⁶² Sec. 716(j) - (k), p. 741-742.
- ⁶³ Sec. 716(m), p. 743.
- ⁶⁴ Sec. 737(a), p. 941 and Sec. 763(h), p. 1093.
- ⁶⁵ Sec. 763(h), p. 1093 at p. 1095.
- ⁶⁶ Sec. 730, p. 885 and Sec. 763(h), p. 1093 at p. 1096.
- ⁶⁷ Sec. 739, p. 958 at p. 960.
- ⁶⁸ Sec. 767(b) at p. 1152.
- ⁶⁹ Sec. 721(a), p. 762 at p. 768.
- ⁷⁰ Sec. 718(a)(1)(A), p. 747.
- ⁷¹ Sec. 718(a)(1)(B), p. 748.
- ⁷² Sec. 718(a)(2)(A) and (B), p. 748-749.
- ⁷³ Sec. 718(a)(3), p. 751.
- ⁷⁴ Sec. 718(b)(1), p. 752.
- ⁷⁵ Sec. 718(b)(4), p. 753.
- ⁷⁶ Sec. 721(a), p. 762 at p. 791.
- ⁷⁷ Sec. 722(h), p. 807.
- ⁷⁸ Sec. 721(a), p. 762 at p. 791.
- ⁷⁹ Sec. 721(a)(3), p. 762 at p. 764.
- ⁸⁰ Sec. 739, p. 958 at p. 959.
- ⁸¹ Sec. 722(b), p. 802.
- ⁸² The CFTC's Hybrid Exemption substantively exempts hybrid instruments that are predominantly "securities" from the CEA. For purposes of this exemption, a "hybrid instrument" is considered to be "predominantly a security" if: (i) the issuer of the hybrid instrument receives payment in full of the purchase price of the hybrid instrument, substantially contemporaneously with delivery of the hybrid instrument; (ii) the purchaser or holder of the hybrid instrument is not required to make any payment to the issuer in addition to the purchase price paid under subparagraph (A), whether as margin, settlement payment, or otherwise, during the life of the hybrid instrument or at maturity; (iii) the issuer of the hybrid instrument is not subject by the terms of the instrument to mark-to-market margining requirements; and (iv) the hybrid instrument is not marketed as a contract of sale of a commodity for future delivery (or option on such a contract).
- ⁸³ Sec. 718, p. 747.
- ⁸⁴ Sec. 767, p. 1154 at p. 1155.
- ⁸⁵ Sec. 722(d), p. 803.
- ⁸⁶ Sec. 761(a), p. 1029 at p. 1029-1031.
- ⁸⁷ Sec. 712(a)(3), p. 718.
- ⁸⁸ Sec. 712(a)(1), p. 717 and Sec. 712(a)(2), p. 717.
- ⁸⁹ Sec. 712(a)(6), p. 719.



- ⁹⁰ Sec. 712(a)(7)(A), p. 719.
- ⁹¹ Sec. 712(a)(7)(B), p. 719.
- ⁹² Sec. 712(d), p. 725 at p. 727.
- ⁹³ Sec. 712(d)(1), p. 725.
- ⁹⁴ Sec. 712(d)(2)(A), p. 726.
- ⁹⁵ Sec. 712(d)(2)(E), p. 727.
- ⁹⁶ Sec. 712(d)(2)(B), p. 726.
- ⁹⁷ Sec. 712(d)(2)(C), p. 727.
- ⁹⁸ Sec. 712(c), p. 723.
- ⁹⁹ Sec. 712(a)(8), p. 720.
- ¹⁰⁰ Sec. 714, p. 733.
- ¹⁰¹ Sec. 715, p. 733.
- ¹⁰² Sec. 712 (d)(3), p. 728.
- ¹⁰³ Sec. 712(d)(4), p. 728.
- ¹⁰⁴ Sec. 712(b)(1), p. 720.
- ¹⁰⁵ Sec. 712(b)(2), p. 721.
- ¹⁰⁶ Sec. 712(b)(3), p. 722.
- ¹⁰⁷ Sec. 712(b)(3), p. 722.
- ¹⁰⁸ Sec. 719(a)(1), p. 753.
- ¹⁰⁹ Sec. 719(a)(2), p. 753.
- ¹¹⁰ Sec. 719(a)(4), p. 753 at p. 754.
- ¹¹¹ Sec. 719(b), p. 755.
- ¹¹² Sec. 719(c), p. 757.
- ¹¹³ Sec. 719(d), p. 759.
- ¹¹⁴ Sec. 719(d), p. 759.