

ClientAlert

Capital Markets/Derivatives

December 2012

The CFTC Issues Interim Final Rules Extending the Time for Compliance for Certain Business Conduct and Documentation Requirements for Swap Dealers and Major Swap Participants



On December 18, 2012, the US Commodity Futures Trading Commission's (the "Commission") approved interim final rules (the "Interim Final Rules")¹ for swap dealers ("SDs") and major swap participants ("MSPs") that delay compliance with certain business conduct and documentation requirements under Part 23 of the Commission's Regulations until May 1, 2013 and July 1, 2013 (as discussed below).

SDs and MSPs have not only received some relief in the meantime from such requirements, but this also likely gives market participants a little more time to adhere to the ISDA August 2012 Dodd-Frank Protocol (the "Protocol").

The Commission has requested comments (to be received no later than 30 days after the date of publication of the Interim Final Rules in the Federal Register) and notes that it will revise the Interim Final Rules, if warranted.

Background

Since the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the Commission has issued final rules to implement Title VII of the Dodd-Frank Act, including with respect to business conduct standards, documentation standards, and reporting and recordkeeping requirements.

Subsequent to the issuance of the rules with respect to business conduct standards, documentation standards, and reporting and recordkeeping requirements, the Commission received requests from various market participants for additional time to achieve compliance. According to ISDA's comments to the Commission, despite extensive counterparty outreach and education efforts by its members, only 175 percent of counterparties of prospective SDs and MSPs had submitted an adherence letter for Protocol and less than 1 percent had submitted the completed questionnaires necessary for SDs and MSPs to make use of the protocol and integrate necessary counterparty information into their compliance systems. The commenters represented that more time was needed for the counterparties to understand the Commission's requirements, to understand the legal consequences of adhering to the Protocol and to gather information needed to complete the questionnaire. Further, among other delays, commenters noted that Hurricane Sandy and IT freezes have hampered the ability of SDs, MSPs and counterparties to complete the documentation necessary for compliance. In order to avoid violating Commission regulations, many SDs and MSPs warned that they would stop

Ian Cuillerier
Partner, New York
+ 1 212 819 8713
icuillerier@whitecase.com

Claire Hall
Associate, Los Angeles
+ 1 213 620 7852
chall@whitecase.com

Yvette Valdez
Associate, New York
+ 1 212 819 8788
yvaldez@whitecase.com

¹ The Interim Final Rules are available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister121812.pdf>.

entering into swaps with counterparties that had not completed the Protocol process by December 31, 2012. Such a reaction could result in a sudden and dramatic drop in the number of participants in swap markets, which would damage all market participants as well as the economy as a whole. For these reasons, the Commission has issued Interim Final Rules deferring the compliance dates as set forth below.

Interim Final Rule—Delay in Compliance

Compliance with the following Commission regulations is deferred until **May 1, 2013**:

- **23.201(b)(3)(ii)** of Subpart F of Part 23, which requires SDs and MSPs to keep records indicating that each counterparty has been provided with a notice containing the physical address, email or other widely available electronic address, and telephone number of the department of the SD or MSP to which any complaints may be directed
- **23.402** of Subpart H of Part 23, which requires SDs and MSPs to: have policies and procedures designed to ensure compliance and monitor compliance with such policies and procedures; implement “Know Your Counterparty” policies and procedures, which are designed to obtain and retain a record of essential facts concerning each counterparty; obtain and retain a record showing the true name and address of each counterparty whose identity is known, its principal occupation or business and the name and address or any other person guaranteeing the performance of such counterparty and any person exercising any control with respect to positions of such counterparty; create a record of compliance, retain records and make such records available to prudential regulators upon request
- **23.410(c)** of Subpart H of Part 23, which requires confidential treatment of certain counterparty information
- **23.430** of Subpart H of Part 23, which requires SDs and MSPs to take certain measures to verify the eligibility of any counterparty before offering to enter into or entering into a swap with that counterparty, subject to a reasonable reliance safe harbor
- **23.431(a)-(c)** of Subpart H of Part 23, which requires SDs and MSPs to: disclose to any counterparty certain material information concerning the swap; notify the counterparty that it can request and consult on the design of a scenario analysis, upon request, provide a scenario analysis, and disclosure assumptions and methodologies used in the scenario analysis. Such subsections are subject to certain exceptions, including: with respect to counterparties that are SDs, MSPs, security-based swap dealers or major security-based swap participants; transactions initiated on a designated contract market or swap execution facility; and transactions in which the SD or MSP does not know the identity of the counterparty prior to execution

- **23.432** of Subpart H of Part 23, which requires SDs and MSPs to: with respect to swaps required to be cleared, notify certain counterparties that such counterparties have the sole right to select the derivatives clearing organization; with respect to swaps not required to be cleared, notify certain counterparties that such counterparties may elect to require clearing of the swap and shall have the sole right to select the derivatives clearing organization at which the swap will be cleared
- **23.434(a)(2), (b), and (c)** of Subpart H of Part 23, which require SDs that recommend certain swaps or trading strategies to have a reasonable basis to believe such recommendations are suitable for the counterparty
- **23.440** of Subpart H of Part 23, which sets out certain requirements for SDs acting as advisors to Special Entities
- **23.450** of Subpart H of Part 23, which sets out certain requirements for SDs and MSPs acting as counterparties to Special Entities
- **23.505** of Subpart I of Part 23, which requires: for swaps excepted from a mandatory clearing requirement, SDs and MSPs to obtain documentation to provide a reasonable basis that their counterparties meet the statutory conditions required for such exception; and SDs and MSPs to maintain all documents obtained pursuant to this section and make them available upon regulators’ request

Compliance with the following Commission regulations is deferred until **July 1, 2013**:

- **23.502** of Subpart I of Part 23, which sets out the requirements for portfolio reconciliation
- **23.504** of Subpart I of Part 23, which sets out, for those swaps not excepted from the section, the requirements for swap-trading relationship documentation; the requirement that each SD and MSP shall have an independent internal or external auditor conduct periodic audits and retain a record of the results of such audits; and the requirement that SDs and MSPs maintain all documents created pursuant to this section and make them available upon regulators’ request

Compliance dates for all other provisions of Subpart F, Subpart H, and Subpart I of Part 23 remain unchanged. These other rules address fair dealing, product suitability, post-trade marks, political contributions and general anti-fraud, manipulation and abusive practices requirements. All market participants are subject to the new compliance dates regardless of whether they participate in the Protocol.

Effect on the Protocol and Timing of Adherence

This compliance relief with respect to business conduct and documentation under the Interim Final Rules is similar in scope to the relief which had been previously given until December 31, 2012 pursuant to the rule release accompanying the Commission's *Final Rule for Confirmation, Portfolio Reconciliation, Portfolio Compression and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants* issued in August of this year. As a result of this delay in compliance dates for the business conduct standards discussed herein, we would expect SDs and MSPs to similarly give their counterparties more time to adhere to the Protocol given that they will not need to comply with these requirements until May 1, 2013.

This Client Alert is provided for your convenience and does not constitute legal advice. It is prepared for the general information of our clients and other interested persons. This Client Alert should not be acted upon in any specific situation without appropriate legal advice and it may include links to websites other than the White & Case website.

White & Case has no responsibility for any websites other than its own and does not endorse the information, content, presentation or accuracy, or make any warranty, express or implied, regarding any other website.

This Client Alert is protected by copyright. Material appearing herein may be reproduced or translated with appropriate credit.