

Dodd-Frank: SEC Policy Statement on the Sequencing of Compliance Dates for the Final Rules Applicable to Security-Based Swaps

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act¹ (“Dodd-Frank”), and the Securities Exchange Act of 1934 as amended by Dodd-Frank (the “Exchange Act”), establish the basis for the regulation of security-based swaps (“SB swaps”) and SB swap market participants in order to make that market more transparent, efficient, fair, and competitive.² In a release dated June 11, 2012,³ the Securities and Exchange Commission (“SEC”) proposed a general policy on the sequencing of compliance dates for the final rules applicable to SB swaps and SB swap market participants under Subtitle B of Title VII of Dodd-Frank (“Subtitle B”). The SEC divided the compliance dates for those final rules into five interconnected categories:

- (i) definitional and cross-border SB swap transaction rules;
- (ii) rules pertaining to security-based swap data repositories, and the reporting and public dissemination of data related thereto;
- (iii) rules pertaining to mandatory clearing of SB swap transactions, the end-user exception for mandatory clearing, and clearing agencies;
- (iv) rules pertaining to security-based swap dealers and major security-based swap participants; and
- (v) rules pertaining to mandatory trading of SB swap transactions and security-based swap execution facilities.

The SEC did not propose any compliance dates for any rule or category of rules, but instead proposed a possible, not conclusive, sequence in which compliance with the final rules will be required. A summary of the SEC’s sequencing proposal follows.

I. Rules Regarding the Scope of Dodd-Frank with Respect to SB Swaps

Definitional Rules

Since the definitional rules affect all of the other categories of rules, the SEC believes these rules should be implemented the earliest of the final rules for Subtitle B. The SEC will further define “security-based swap,” “security-based swap agreement,” “mixed swap,” “security-based swap dealer,” “major security-based swap participant,” and “eligible contract participant” in these rules.⁴ Standing alone, the definitional rules will not impose any of the new requirements to be adopted under Subtitle B. However, upon the compliance date of the

¹ The Dodd-Frank Act is available at <http://www.govtrack.us/congress/billtext.xpd?bill=h111-4173>.

² Title VII of Dodd-Frank provides that the Commodity Futures Trading Commission (the “CFTC”) will regulate “swaps,” the SEC will regulate “security-based swaps,” and the two agencies will jointly regulate “mixed swaps.” See Title VII Section 712 of Dodd-Frank.

³ *Statement of General Policy on the Sequencing of the Compliance Dates for Final Rules Applicable to Security-Based Swaps Adopted Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act*, Release No. 34-67177, (June 11, 2012) is available at <http://www.sec.gov/rules/policy/2012/34-67177.pdf>.

⁴ The rules further defining the terms “swap dealer,” “major swap participant,” “security-based swap dealer,” “major security-based swap participant,” and “eligible contract participant” were adopted (but not implemented) by the SEC, jointly with the CFTC, on April 27, 2012 and published in the Federal Register on May 23, 2012. *Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”*, Release No. 34-66868, (April 27, 2012), 77 FR 30596 (May 23, 2012), available at <http://www.sec.gov/rules/final/2012/34-66868.pdf>.

final rules further defining “security-based swap” and “eligible contract participant” several prior temporary exemptions will automatically expire, unless the SEC modifies or extends those exemptions, or adopts other exemptions.⁵

Cross-Border Rules

The SEC expects to define the scope of Subtitle B with respect to cross-border SB swap transactions prior to adopting any rules other than definitional rules because those rules will potentially affect all other rules made under Subtitle B. This would not independently impose additional requirements on SB swap market participants, but would further clarify which participants and what transactions will be subject to the requirements of Subtitle B going forward.

II. SB Swap Reporting and Security-Based Data Repositories (“SDRs”)

The SEC believes that SDRs should be required to register as soon as practicable following the effectiveness of definitional rules and the proposal of cross-border rules. Registering the SDRs will facilitate the subsequent implementation of reporting requirements for SB swap transactions. On November 19, 2010 the SEC published two releases which set forth proposed rules for reporting SB swap transactions and registering SDRs, respectively.⁶ Exemptions for SDRs from a number of provisions of Exchange Act Section 13(n), which was itself added to the Exchange Act by Dodd-Frank, will expire upon the earlier of (i) the date the SEC grants registration to SDRs, and (ii) the earliest compliance date in any of the final rules regarding the registration of SDRs.⁷ As soon as practicable following the registration of SDRs, the SEC will implement SB swap reporting requirements and begin disseminating SB swap transaction data to the public.⁸

⁵ Upon the compliance date for the final rules defining “security-based swap” and “eligible contract participant” two exemptions from certain provisions of the Exchange Act granted pursuant to *Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of ‘Security’ to Encompass Security-Based Swaps and Request for Comment*,” Release No. 34-64795, (July 1, 2011), will expire, absent further action by the SEC: the exemption for persons meeting the definition of “eligible contract participant” that was in effect prior to Dodd-Frank in connection with activities involving SB swaps and the exemption for broker-dealers registered under Section 15(b) of the Exchange Act from certain provisions of the Exchange Act and the rules and regulations thereunder with respect to SB swaps. Release available at <http://www.sec.gov/rules/exorders/2011/34-64795.pdf>. The SEC has received a comment pertaining to and is considering making certain temporary exemptions from that Exchange Act Exemptive Order permanent. See *SIFMA SBS Exemptive Relief Request*, (Dec. 5, 2011), <http://www.sec.gov/comments/s7-27-11/s72711-10.pdf>. The interim exemptions granted pursuant to *Exemptions for Security-Based Swaps*, SEC Release No. 33-9231, (July 1, 2011), will also expire at that time. Release available at <http://www.sec.gov/rules/interim/2011/33-9231.pdf>. These exemptions include the exemptions from provisions of the Exchange Act for SB swaps that meet the pre-Dodd-Frank definition of “security-based swap agreements,” pursuant to Securities Act Rule 240, and for SB swaps offered and sold in reliance on Rule 240, as well as the exemption from the Trust Indenture Act for SB swaps offered and sold in reliance on Rule 240. Additionally, Section 6(1) of the Exchange Act, which currently applies the definition of “eligible contract participant” set forth in Section 1a(12) of the Commodity Exchange Act pursuant to SEC Release No. 33-9231, will begin to apply the definition of “eligible contract participant” under Dodd-Frank after the compliance date for that final rule.

⁶ *Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information*, Release No. 34-63346, (Nov. 19, 2010), is available at <http://www.sec.gov/rules/proposed/2010/34-63346.pdf>. *Security-Based Swap Data Repository Registration, Duties, and Core Principles*, Release No. 34-63347, (Nov. 19, 2010), is available at <http://www.sec.gov/rules/proposed/2010/34-63347.pdf>.

⁷ The SEC intends to keep in place an exception granted pursuant to Release No. 34-64678 for reporting SB swaps entered into prior to the enactment of Dodd-Frank on July 21, 2010, which were unexpired as of that date, until six months after a SDR capable of accepting the asset class of such SB swap is registered. *Order Pursuant to Sections 15F(b)(6) and 36 of*

III. Mandatory SB Swap Clearing, Clearing Agencies, and the End-User Exception

The SEC believes that at least some clearing agency standards should be established prior to requiring any SB swaps to be cleared. Specifically, the SEC anticipates the final rules resulting from proposed rule 17Ad-22,⁹ which would address clearing agency governance, operation, participation standards, and risk management, will be the first set of final rules relating to clearing agencies for which compliance will be required. The SEC believes that compliance with those rules would be necessary before any SB swaps could be required to be cleared.¹⁰ Also, the SEC believes compliance with the proposed final rules regarding end-user exceptions from mandatory clearing, which provide that a SB swap counterparty may elect the end-user exception by notifying the SEC of how it meets its financial obligations with respect to non-cleared SB swaps,¹¹ should be required prior to requiring SB swaps to be cleared. The SEC is considering allowing for a period of voluntary clearing to ensure that SB swap market participants have adequate notice of the categories of SB swaps which are subject to mandatory clearing.¹²

IV. Security-Based Swap Dealers (“SBSDs”) and Major Security-Based Swap Participants (“MSBSPs”)

The SEC has proposed adopting a conditional registration system for SBSBs and MSBSPs which would entail a period of “conditional registration” that could then be converted to “ongoing registration” prior to the compliance date for the rules requiring the registration.¹³ As an alternative, the SEC has asked for comments on a system that would only require registration after the compliance date, without a conditional registration period.

the Securities Exchange Act of 1934 Granting Temporary Exemptions and Other Temporary Relief, Together With Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, and Request for Comment, Release No. 34-64678, (June 15, 2011) is available at <http://www.sec.gov/rules/exorders/2011/34-64678.pdf>.

⁸ The SEC is continuing to look at the issue of how to establish block trade thresholds for SB swaps, particularly in light of the limited information available on SB swap markets under the current reporting regime. To address this, the SEC is considering an initial reporting period allowing parties an extended timeframe for reporting SB swap transactions.

⁹ Rule 17Ad-22 was proposed by *Clearing Agency Standards for Operation and Governance*, Release No. 34-64017, (Mar. 3, 2011), available at <http://www.sec.gov/rules/policy/2012/34-67177.pdf>.

¹⁰ Because of the interaction between Titles VII and VIII of Dodd-Frank and a sixty-day advanced notice requirement under Title VIII for rules pertaining to “financial market utilities,” which may include clearing agencies, it may be necessary for the SEC to adopt clearing agency standards before the definitional and cross-border rules discussed above in order to provide for an orderly, synchronized implementation of clearing procedures under Title VII.

¹¹ *End-User Exception to Mandatory Clearing of Security-Based Swaps*, Release No. 34-63556, (Dec. 15, 2010), is available at <http://www.sec.gov/rules/proposed/2010/34-63556.pdf>.

¹² Release No. 34-64678, *supra* n.7, provides an exception to Exchange Act Section 3C(g)(5)(B), which would have allowed an SB swap counterparty to elect that the SB swap transaction be cleared in certain circumstances because that would not be possible prior to establishing registered clearing agencies. That exception will expire at the earliest compliance date for final rules regarding Exchange Act Section 3C(b), which pertains to the clearing process. Release No. 34-64678 also provides a temporary exception to Section 3C(j), which provides for the designation and duties of chief compliance officers at registered clearing agencies. That exception will expire at the earliest compliance date for final rules regarding Exchange Act Section 3C(j)(2), which lays out the duties of a chief compliance officer.

¹³ If the conditional registration system is adopted, the SEC will determine whether exemptions from segregation requirements that would then automatically expire should be extended until the later of (i) the date upon which SBSBs and MSBSPs are required to register; and (ii) the last compliance date of any of the final rules under Exchange Act

The sequencing of rules regarding SBSDs and MSBSPs is reliant on the amount of time the SEC believes it will take those market participants to adopt the changes required by such rules. The SEC believes, based on comments received, that a relatively short amount of time would be needed to comply with certain recordkeeping rules that may rely on internal resources because these rules would not require significant changes to the business practices of SBSDs and MSBSPs. By contrast, the SEC believes more time will be needed to comply with rules that would have a greater effect on SBSDs' and MSBSPs' business practices. That includes rules requiring certain disclosures to and fair dealing with counterparties¹⁴ as well as rules relating to newly required SB swap transaction documentation.¹⁵ New capital and margin requirements as well as segregation requirements under Title VII of Dodd-Frank could dictate the most significant changes in the financial arrangements and internal procedures for SBSDs and MSBSPs, so the SEC believes ample time will be needed to comply with those provisions.

V. Mandatory Trade Execution and Security-Based Swap Execution Facilities (“SB SEFs”)

Many of the issues concerning sequencing the rules for SB SEFs were addressed with proposals in a prior release.¹⁶ That proposed Regulation SB SEF provided for a period of temporary registration of SB SEFs, ending July 31, 2014, to facilitate organized trading of SB swaps. Under that proposed system, SB SEF registration would be temporarily granted with reduced requirements while the SEC reviewed the application in detail.

Section 3C(h) of the Exchange Act requires that SB swap transactions that are subject to the clearing requirement in Section 3C(a)(1) are also required to be executed on either a registered SB SEF or an exchange (the mandatory trade execution requirement). This construction means that the mandatory trade execution requirement will not take effect until after the rules for the clearing requirement discussed above. Additionally, SB swaps that are subject to the clearing requirement but which have not been “made available to trade” are exempted from mandatory trade execution.¹⁷ After further review and information gathering, the SEC anticipates setting a standard for what constitutes a SB swap “made available to trade” and expects that SB swaps will not be subject to mandatory trade execution, and thus may still be traded over-the-counter, until such standard has been made effective.

VI. Conclusion

The SEC did not propose any dates for the final rules applicable to SB swaps and SB swap market participants and there are still a number of steps in the final rule adoption process before compliance will be required for the SB swap provisions in Subtitle B of Title VII of Dodd-Frank. The SEC envisions enacting

Sections 3E and 15F.

¹⁴ These rules were proposed in “*Business Conduct Standards for Security-Based Swaps Dealer and Major Security-Based Swap Participants*,” Release No. 34-64766, (June 29, 2011), which is available at <http://www.sec.gov/rules/proposed/2011/34-64766.pdf>.

¹⁵ These rules were proposed in *Trade Acknowledgment and Verification on Security-Based Swap Transactions*, Release No. 34-63727, (Jan. 14, 2011), which is available at <http://www.sec.gov/rules/proposed/2011/34-63727.pdf>. The SEC indicated it believed some documentation standards would require less time to implement than others would.

¹⁶ *Registration and Regulation of Security-Based Swap Execution Facilities*, Release No. 34-63825, (February 2, 2011) available at <http://www.sec.gov/rules/proposed/2011/34-63825.pdf>.

¹⁷ Exchange Act Section 3C(h)(2), 15 U.S.C. 78c-3(h)(2).

CAHILL

definitions for critical terms and clarifying the scope of Subtitle B with respect to cross-border transactions and participants before imposing further regulatory obligations under Subtitle B. Because of notice requirements, it is possible that some clearing standards may be adopted ahead of the definitions and cross-border rules, but it is unlikely those will become effective before the definitions and cross-border rules. The adoption of other rules arising from Subtitle B is likely to be staggered, with provisions that the SEC believes will require the least adjustment on the part of SB swap market participants being adopted earlier than those provisions that will have a more significant effect on the business practices of market participants.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; or John Schuster at 212.701.3323 or jschuster@cahill.com.

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