



DODD-FRANK ESSENTIALS FOR END USERS OF OTC DERIVATIVES - UPDATE 2

Inter-Agency Request for Comments on “Key Definitions” of Title VII

The Commodity Futures Trading Commission (“CFTC”) and the Securities and Exchange Commission (“SEC”) on August 20, 2010 published a joint “[Advance notice of proposed rulemaking; request for comments](#)” (“RFC”) in the Federal Register, soliciting public comments on certain “Key Definitions” contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). *Comments must be submitted in writing by any of the methods provided in the RFC and must be received by September 20, 2010 at 5:00 p.m. Eastern Time.*

This is the second in a series of Sidley updates, “Dodd-Frank Essentials for End Users of OTC Derivatives,” aimed at our end-user or buy-side clients to discuss the implications of Dodd-Frank in their day-to-day activities.¹

Key Definitions of Title VII

Title VII of Dodd-Frank mandates comprehensive regulation of the U.S. over-the-counter (“OTC”) derivatives market. Under Title VII, the CFTC and the SEC, jointly, are required, in consultation with the Federal Reserve, to further define certain key terms that underpin the regulatory framework provided by Dodd-Frank. These “Key Definitions” (as defined in the RFC) are the following:

- Swap
- Security-based swap
- Swap dealer
- Security-based swap dealer
- Major swap participant
- Major security-based swap participant
- Eligible contract participant
- Security-based swap agreement

¹ Our first installment in this series, titled “[What Is a ‘Swap?’](#)” provided an overview of the statutory definitions of “swap,” “security-based swap” and “mixed swap” as set forth in Title VII.

The RFC also seeks comment regarding the regulation of “mixed swaps,” which are to be subject to regulations jointly prescribed by the CFTC and the SEC.

Significance of this Forthcoming Rulemaking

The importance of the Key Definitions cannot be overstated, as they will determine the scope of transactions implicating regulation under Title VII and certain types of entities to be regulated pursuant to Title VII. The definition of “swap” in Title VII is extremely broad, and may capture many transactions that would not ordinarily be thought of as swaps by market participants.² In addition, the CFTC and SEC are required to further define certain Key Definitions for the purpose of including transactions and entities that have been structured to evade Title VII.³

Among the Key Definitions covered by the RFC are “major swap participant” and “major security-based swap participant.”⁴ These definitions will have a significant impact on OTC market participants. An end user captured under one or both of these definitions will be subject to a rigorous compliance regime, including reporting and registration requirements, minimum capital and variation margin requirements, business conduct standards, and recordkeeping.⁵

The RFC has already elicited several comments, and we expect that market participants and industry groups will contribute many more before the end of the comment period.⁶ The agencies are encouraging commenters to address the extent to which the Key Definitions should be based on qualitative or quantitative factors and what those factors should be, including factors specific to the commenter’s experience, as well as relevant areas of law, economics, or industry practice. The CFTC and the SEC are also currently inviting public submissions with respect to other major regulatory topics related to Dodd-Frank, including regulation of hedge fund advisors, business conduct standards, capital and margin for non-banks, recordkeeping and reporting requirements, anti-manipulation, end-user exception, and portfolio margining procedures.⁷

Next Steps

As mentioned above, the deadline for responding to the RFC is September 20, 2010. At some point following this date, the agencies will issue proposed rules defining the Key Definitions. These will be subject to further public

² For example, options to purchase or sell non-security loans or loan participations, contracts with embedded derivatives, letters of credit with payments contingent upon the occurrence of a credit event or default or that provide for settlement by physical delivery of an asset, certain insurance and re-insurance contracts, etc.

³ The CFTC must adopt anti-evasion rules with respect to the Key Definitions within its jurisdiction under Title VII and the SEC must adopt anti-evasion rules with respect to the Key Definitions within its jurisdiction under Title VII. These rulemakings need not be conducted jointly between the agencies.

⁴ In section 721(a)(16) of Dodd-Frank, the definition of a major swap participant is predicated on, among other criteria, the person maintaining a “substantial position” in swaps, excluding swaps held for hedging or mitigating “commercial risk,” or maintaining outstanding swaps that create “substantial counterparty exposure.” Similar wording is used in the definition of a major security-based swap participant. These terms are not defined in Dodd-Frank, but their meanings will help determine which end users will be captured by the definition of major swap participant or major security-based swap participant. Although comments on these key terms are not specifically requested in the RFC, commenters should consider addressing these crucial issues in their responses to the agencies.

⁵ Under Dodd-Frank, determinations of whether end users are thus captured are expressly contemplated to be made *not* across all OTC derivative product areas, but rather having regard to particular transactions or product types. Comments to the Key Definitions might include recommendations regarding the granularity of such determinations.

⁶ Comments may be viewed on the SEC website at: <http://sec.gov/comments/df-title-vii/definitions/definitions.shtml> and on the CFTC website at: <http://www.cftc.gov/LawRegulation/FederalRegister/CommentFiles/10-012.html>. Note that comments are not redacted to mask identifying information, so one should submit only information that is suitable for public disclosure and for attribution to oneself.

⁷ The link to the CFTC public submissions page is <http://www.cftc.gov/LawRegulation/FederalRegister/FinalRules/2010-21269.html> and the link to the SEC public submissions page is <http://www.sec.gov/spotlight/regreformcomments.shtml>.

comment before being promulgated as final rules. We cannot be certain of precisely when the proposed rulemaking will occur or when the final rules will be issued, however all Key Definitions will need to be finalized by July 16, 2011.

If you have any questions regarding this update, please contact the Sidley lawyer with whom you usually work.

For additional information on Sidley's end-user derivatives practice, click [here](#).

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