

## CFTC Holds First Open Meeting of 2012 and Finalizes Key Rulemakings Under the Dodd-Frank Act

January 13, 2012

On January 11, the Commodity Futures Trading Commission (CFTC) adopted three final rules to implement certain requirements contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), including (1) the protection of cleared swaps customer collateral, (2) external business conduct standards for swap dealers and major swap participants, and (3) the registration of swap dealers and major swap participants. The CFTC also adopted proposed rules to implement the Volcker Rule.

It is expected that all of the above items will be published in the Federal Register in the coming weeks. The discussion below is based on the fact sheets on the CFTC's website and remarks made by CFTC Commissioners and staff at the open meeting.

The next CFTC open meeting is tentatively scheduled for January 25, 2012, at which the CFTC expects to consider final rules pertaining to the further definitions of swap dealer and major swap participant, among other topics. Also, the CFTC has issued a tentative timeline for its issuance of additional final rules and interpretive orders to implement Title VII of the Dodd-Frank Act. The timeline can be accessed [here](#).

### Protection of Cleared Swaps Customer Collateral

In line with proposed rules on the topic, the CFTC adopted a "complete legal segregation" (also known as "legal segregation with operational commingling") (LSOC) model for the segregation of cleared swaps customer collateral. Pursuant to the LSOC model, customer collateral must be individually segregated by customer on a futures commission merchant's (FCM) and derivatives clearing organization's (DCO) books and records but may be commingled with the collateral of other customers of the same FCM in one physical account. The LSOC model is a departure from the collateral segregation model currently used for futures contracts, pursuant to which customer collateral is both legally and operationally commingled. Under the futures model, FCMs may post collateral to DCOs on a net basis for all of their customers, and the DCOs do not keep records for such collateral at the customer level.

CFTC Commissioners and staff emphasized that because of operational and investment risks inherent in the LSOC model and because of certain provisions applicable to FCM insolvencies under the Bankruptcy Code, the LSOC model does not afford complete protection to cleared swaps customer collateral. However, Commissioners and staff also noted that they will continue to analyze what additional protections may be necessary and how to implement any such protections. The CFTC is also expected to analyze how additional protections may be afforded to collateral posted by futures customers.

Compliance with the LSOC final rules will be required by November 8 of this year. A CFTC fact sheet pertaining to the final rules can be accessed [here](#), and a Q&A can be accessed [here](#).

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## External Business Conduct Standards

The business conduct standards adopted by the CFTC govern swap dealers' and major swap participants' relationships with their counterparties (*i.e.*, external business conduct). The final rules are distinct from internal business conduct standards for swap dealers and major swap participants, which the CFTC is expected to finalize later this year.

Generally, the external business conduct rules prohibit certain abusive practices, require swap dealers and major swap participants to disclose material information to their counterparties and require swap dealers and major swap participants to perform due diligence on their counterparties. Additionally, the CFTC's final rules provide guidance with respect to a swap dealer's or major swap participant's dealings with "special entities" which include, among others, federal and state agencies, ERISA plans and endowments.

For additional information, please see the CFTC's fact sheet, which can be accessed [here](#), or the Q&A, which can be accessed [here](#).

## Registration of Swap Dealers and Major Swap Participants

The CFTC also adopted final rules pertaining to the registration of swap dealers and major swap participants. Notably, the CFTC and the Securities and Exchange Commission (the SEC) have not finalized their joint rules further defining "swap dealer" and "major swap participant." Accordingly, the final rules set forth the process that those entities ultimately deemed swap dealers or major swap participants will be required to follow for registration.<sup>1</sup>

The CFTC's final registration rules require entities registering as swap dealers and major swap participants to certify their compliance with all laws and regulations applicable to them as swap dealers or major swap participants. However, the CFTC and other regulators have yet to finalize a number of such regulations. To address this issue, the final rules do not take effect until all such regulations are finalized but permit swap dealers and major swap participants to voluntarily register prior to such time and to update their registration as additional regulations are finalized.

In connection with the final registration rules, the CFTC approved a delegation of authority order pursuant to which the National Futures Association (NFA) will register swap dealers and major swap participants on behalf of the CFTC, including confirming compliance with the myriad of laws and regulations applicable to such entities. In addition, swap dealers and major swap participants will be required to become members of the NFA, and the NFA will have primary oversight responsibility over these entities.

A CFTC fact sheet pertaining to the final registration rules can be accessed [here](#), and a Q&A can be accessed [here](#). Also, a pre-publication draft of the final registration rules can be accessed [here](#).

## Proposed Rules to Implement the Volcker Rule

In addition to the foregoing, on January 11, the CFTC issued proposed rules to implement the so-called Volcker Rule, which are understood to be substantially similar to the rules previously proposed by the

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<sup>1</sup> The SEC issued proposed rules last October pertaining to the registration of security-based swap dealers and major security-based swap participants; such rules have yet to be finalized. The SEC's proposed rules can be accessed [here](#).

SEC, the Board of Governors of the Federal Reserve Board, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency (the Jointly Proposed Rules). The Jointly Proposed Rules are currently open for public comment and can be accessed [here](#).<sup>2</sup> The CFTC's proposal will be subject to a 60-day public comment period, which will commence once it is published in the Federal Register. A fact sheet pertaining to the CFTC's proposed rules can be accessed [here](#).



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<sup>2</sup> The public comment period for the Jointly Proposed Rules was initially set to close on January 13, 2012 but was extended to February 13, 2012.