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July 1, 2011

Submitted electronically

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549–1090

Re: *CFTC Notice of Proposed Order: Effective Date for Swap Regulation (76 Fed. Reg. 35372 (June 17, 2011)); SEC Exemptive Order: Temporary Exemptions and Other Temporary Relief (Release No. 34-64678) (76 Fed. Reg. 36287 (June 22, 2011))*

Ladies and Gentlemen:

Covington & Burling LLP is pleased to submit this letter in response to the notice of proposed order and request for comment (the "*CFTC Proposed Order*")[1] issued by the Commodity Futures Trading Commission (the "*CFTC*") and the exemptive order (the "*SEC Exemptive Order*" and, together with the CFTC Proposed Order, the "*Orders*")[2] issued by the Securities and Exchange Commission (the "*SEC*" and, together with the CFTC, the

[1] Effective Date for Swap Regulation, 76 Fed. Reg. 35372 (proposed June 17, 2011).

[2] 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, 76 Fed. Reg. 36287 (June 22, 2011).

"*Commissions*") regarding the effective date of derivatives provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "*Dodd-Frank Act*").[3]

We fully support the Commissions' decisions to provide exemptive relief from the effective date of certain derivatives provisions in the Dodd-Frank Act. With respect to the CFTC Proposed Order, we support the proposal to exempt market participants temporarily from new provisions of the Commodity Exchange Act (the "*CEA*") that reference entities (such as "swap dealers") or products (such as "swaps") that require further definition that is not yet final.[4] We also support the CFTC's proposal to grant temporary relief from certain provisions of the Dodd-Frank Act that repeal various CEA exemptions that may apply to exempt or excluded commodities. With respect to the SEC Exemptive Order, we support the grant of exemptive and other temporary relief from compliance with certain provisions added to the Securities Exchange Act of 1934 (the "*Exchange Act*") by the Dodd-Frank Act concerning security-based swaps. We further agree that "compliance with Title VII [is] a substantial undertaking" and that "market participants will need additional time to acquire and configure necessary systems or to modify existing practices and systems, engage and train necessary staff, and develop and implement necessary policies and procedures."[5]

For the reasons discussed below, we respectfully request that the Commissions clarify two issues as they finalize rulemakings under the Dodd-Frank Act. First, in issuing final entity definitions, the Commissions should clarify that the 12-month look-back period in the *de minimis* exception to the definitions of "swap dealer" and "security-based swap dealer" (each, a "*dealer*") should commence on the effective date of the last-adopted final definition rules; this period should not reach back to any period of time predating effectiveness of the final entity or product definition rules. Many market participants may not engage in sufficient quantities of swap dealing to justify the costs of new regulation. They may therefore decide to limit or cease dealing activity if necessary to meet the *de minimis* exception. Requiring these entities to register as dealers only to deregister soon thereafter would result in substantial market disruption and waste scarce regulatory resources. Further, we think market participants should not be asked to anticipate final rules and chill current swap dealing activity that might well ultimately qualify as *de minimis*.

Second, with respect to proposed CFTC rulemakings required by amendments to intermediary definitions in the CEA, we respectfully request additional guidance regarding requirements applicable to futures commission merchants ("*FCMs*"), introducing brokers ("*IBs*"), and commodity trading advisors ("*CTAs*") that transact in uncleared swaps.

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3 Pub. L. No. 111-203, 124 Stat. 1376 (2010).

4 This letter occasionally uses the term "swap" generally to refer to both "swaps" and "security-based swaps."

5 SEC Exemptive Order, 76 Fed. Reg. at 36289; *see also* CFTC Proposed Order, 76 Fed. Reg. at 35373 & n.6 (discussing potential phased implementation of the Dodd-Frank Act).

Specifically, we ask that the CFTC confirm our view, based on the language in the CFTC Proposed Order, that although the registration requirement for these intermediaries is already effective, the proposed temporary exemptive relief applies to the Dodd-Frank Act's amendments to intermediary definitions because those amendments refer to "swaps" -- a term that is currently undefined. Registration requirements should therefore not become effective with respect to swaps intermediaries until the final product definitions are effective. We further ask the CFTC to provide more detailed guidance as to how it will adapt existing regulation relating to FCMs, IBs, and CTAs to the OTC swaps market in the relevant rulemakings. Because FCMs, IBs, and CTAs currently exist primarily for cleared, exchange-traded transactions, we do not believe the existing rules and underlying interpretations can simply be applied unchanged (save for the insertion of references to "swaps," oftentimes without more, into existing rules) to the different market environment of uncleared transactions.[6]

Swap Dealer Registration and the* De Minimis *Exception. The Orders do not provide relief from the registration requirements for dealers, major swap participants, and major security-based swap participants because the amendments to the CEA and the Exchange Act requiring such registration will not become effective until the Commissions issue final rules.[7] We appreciate, however, that the CFTC's proposed rules regarding registration of swap dealers and major swap participants recognize that entities will not be required to register in these capacities before the effective date of definitional rulemakings.[8] It is essential that definitions are finalized before registration is required. Entities must know what products will be defined as "swaps" or "security-based swaps," and what amount of dealing activity will require registration

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[6] We recognize that FCMs may currently transact, for example, in off-exchange retail foreign exchange transactions. *See* Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries, 75 Fed. Reg. 55410, 55410-11 (Sept. 10, 2010) (to be codified at 17 C.F.R. pts. 1, 3, 4, 5, 10, 140, 145, 147, 160 & 166). We believe that these transactions comprise a small component of the business of most FCMs. We also believe that this market is materially different from the institutional OTC derivatives market, and thus is not necessarily a useful analogue for expansion of FCM obligations (or IB or CTA obligations) to OTC derivatives.

[7] CFTC Proposed Order, 76 Fed. Reg. at 35373; SEC Exemptive Order, 76 Fed. Reg. at 36299-02.

[8] Registration of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71379, 71381 (proposed Nov. 23, 2010) (to be codified at 17 C.F.R. pts. 3, 23 & 170) ("SDs and MSPs who had not applied for registration by July 21 would be required to apply for registration not later than the effective date of the applicable Definitional Rulemaking.") (hereinafter "*CFTC Proposed Registration Rules*"). Although the CFTC suggested that the term "Definitional Rulemakings" referred to "regulations to implement the new 'swap dealer' and 'major swap participant' definitions," *id.* at 71379, the Commission's citation to section 721(c) of the Dodd-Frank Act suggests that this phrase also refers to regulations implementing the definition of "swap." Because the definition of "swap dealer" will depend on the definition of the term "swap," we think it is important that both terms are defined before entities are required to register with the CFTC as swap dealers or major swap participants. The SEC has not yet proposed rules regarding registration of security-based swap dealers and major security-based swap participants.

as a "swap dealer" or "security-based swap dealer," before they can make decisions about how to structure their businesses.

The CFTC has proposed to implement swap dealer registration in phases, starting with a transitional period during which swap dealers could register provisionally before the effective date of relevant new rules. As the CFTC explained in its proposed rules, "This approach is intended to ensure continuity of the business operations of existing swaps entities, and to avoid undue market disruption."[9] Phased implementation makes sense for entities that wish to continue dealing swaps after the effective date of new regulations. Other market participants may, however, choose to scale back or cease dealing, rather than to become subject to comprehensive regulation.

The Dodd-Frank Act requires the CFTC to "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."[10] Similarly, the SEC must "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."[11] In a joint rulemaking, the Commissions proposed to implement these *de minimis* exceptions by providing that an entity will not be deemed to be a dealer as a result of dealing activity that meets certain conditions regarding aggregate effective gross notional amount, number of counterparties, and number of swaps "over the course of the immediately preceding 12 months."[12] Neither the proposed definitions nor the proposing release specifically discuss whether swaps or security-based swaps entered into before the effective date of the final definitions will be included in this 12-month look-back period. This is important because, among other things, the CFTC's proposed registration rules contemplate that entities will register as swap dealers or major swap participants either provisionally before definitional rules become effective or, at the latest, when applicable definitional rules become effective.[13]

Market participants do not currently know the notional amount of swaps, number of counterparties, or number of swaps they may enter into in reliance upon the *de minimis* exception without triggering the swap dealer definition. This leaves market participants with two disruptive options. On the one hand, a market participant could register as a dealer and thereafter, armed with knowledge of the precise *de minimis* thresholds, manage its dealings in

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9 CFTC Proposed Registration Rules, 75 Fed. Reg. at 71381.

10 Pub. L. No. 111-203, § 721(a)(21), 124 Stat. at 1670 (to be codified at 7 U.S.C. § 1a(49)(D)).

11 *Id.* § 761(a)(6), 124 Stat. at 1758 (to be codified at 15 U.S.C. § 78c(a)(71)(D)).

12 Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 75 Fed. Reg. 80174, 80212, 80218 (proposed Dec. 21, 2010) (to be codified at 17 C.F.R. §§ 1.3(ppp)(4), 240.3a71-2).

13 *See* CFTC Proposed Registration Rules, 75 Fed. Reg. at 71381.

derivatives so as to fall below those thresholds, so that it may deregister once its dealing activity falls below the *de minimis* thresholds. On the other hand, it could limit dealing activities now in anticipation of final rules, the precise thresholds of which are currently unknown. The former would impose unnecessary burdens on regulators and on businesses that must adapt to new regulations that ultimately will not apply to them. The latter, we believe, would disrupt the market by chilling beneficial dealing activity that might well qualify as *de minimis* under the Commissions' final rules. This result would deprive swap markets and their participants of necessary liquidity before final rules are adopted.

Accordingly, we urge the Commissions to clarify that the 12-month look-back period in the *de minimis* exception will not commence until the last-adopted relevant final regulations are effective. This will protect entities that currently deal in swaps, but reasonably plan to limit future dealing activities to comply with the *de minimis* exception to either dealer definition, from being required to register as a dealer based solely on swaps entered into as a dealer before the final definitions are effective.

Registration as an FCM, IB, or CTA for Swap Activity. The Dodd-Frank Act redefines "futures commission merchant," "introducing broker," and "commodity trading advisor" so that those terms apply to entities that intermediate "swaps," as well as entities that intermediate exchange-traded futures and options.[14] Because these intermediaries currently exist for cleared, exchange-traded transactions, we do not believe the existing rules and underlying interpretations can simply be applied unchanged to the different market environment of uncleared transactions. Market participants will therefore need time and additional guidance to comply with new regulations.

First, many participants in the OTC swaps market are not currently registered as FCMs, IBs, or CTAs, but may need to register as such after the CFTC's final rules under the Dodd-Frank Act become effective. The CFTC should clarify that these entities will not be required to register in these capacities based solely on their swap activity until after the last-adopted final product definition rules become effective. The new definitions of FCM, IB, and CTA are self-effectuating, but they reference the term "swap," which requires further definition that is not final. The registration requirement for FCMs, IBs, and CTAs is, however, already effective.[15] We therefore request that the CFTC clarify in its final order that, insofar as they relate to swaps, the new definitions of FCM, IB, and CTA will be considered "Category 2" provisions and, as such, will be subject to exemptive relief until the earlier of the effective date of applicable final rules or December 31, 2011.

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[14] *See* Pub. L. No. 111-203, § 721(a)(7), 124 Stat. at 1660 (to be codified at 7 U.S.C. § 1a(12)) (commodity trading advisor); *id.* § 721(a)(13), 124 Stat. at 1661-62 (to be codified at 7 U.S.C. § 1a(28)) (futures commission merchant); *id.* § 721(a)(15), 124 Stat. at 1662-63 (to be codified at 7 U.S.C. § 1a(31)) (introducing broker).

[15] *See* 7 U.S.C. §§ 6d, 6m.

Second, we urge the CFTC to provide further guidance about how existing regulation of FCMs, IBs, and CTAs with respect to exchange-traded, cleared products will be adapted to fit the OTC swaps market. We appreciate that the CFTC has proposed rules clarifying some of these new requirements.[16] We are concerned, however, that existing regulation applicable to futures markets cannot simply be applied, substantively unchanged, to swaps markets. We will not know for some time how the OTC swaps market will adapt to new regulation, or how entities will intermediate off-exchange, uncleared swaps after the Dodd-Frank Act.[17] We therefore urge the CFTC to provide additional guidance about how existing regulation of intermediaries will apply to entities that trade uncleared, off-exchange swaps.

Accordingly, we respectfully request that the CFTC clarify that it will not require registration in an intermediary capacity based on swap activity until the final definition of "swap" becomes effective. We further request that the CFTC provide guidance to assist swap market participants in understanding how regulations that currently apply to FCMs, IBs, or CTAs with respect to cleared, exchange-traded futures will be translated to apply to uncleared, off-exchange swaps.

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16 *See* Adaptation of Regulations to Incorporate Swaps, 76 Fed. Reg. 33066 (proposed June 7, 2011) (to be codified at 17 C.F.R. pts. 1, 5, 7, 8, 15, 18, 21, 36, 41, 140, 145, 155 & 166); Registration of Intermediaries, 76 Fed. Reg. 12888 (proposed March 9, 2011) (to be codified at 17 C.F.R. pt. 3).

17 For example, market participants do not yet know what account structure will be required for cleared swaps customer collateral held by FCMs. *See* Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 76 Fed. Reg. 33818 (proposed June 9, 2011) (to be codified at 17 C.F.R. pts. 22 & 190).

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We appreciate the opportunity to comment on the Orders and related issues noted above. If we can be of any further assistance regarding these matters, please feel free to contact the undersigned at 212-841-1060 or at bbennett@cov.com.

Very truly yours,

Bruce C. Bennett

cc: Honorable Gary Gensler, Chairman
Honorable Bart Chilton, Commissioner
Honorable Michael Dunn, Commissioner
Honorable Scott D. O'Malia, Commissioner
Honorable Jill E. Sommers, Commissioner
Terry Arbit, Deputy General Counsel
Harold Hardman, Deputy General Counsel
Steven Kane, Consultant, Office of the Chief Economist
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Honorable Mary L. Schapiro, Chairman
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Honorable Kathleen L. Casey, Commissioner
Honorable Troy A. Paredes, Commissioner
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