

CFTC Begins Implementation of Mandatory Clearing of Swaps

On July 24, 2012, the CFTC finalized a rule establishing a schedule for compliance with the mandatory clearing requirements for swaps under Title VII of the Dodd-Frank Act. On the same day, the CFTC proposed the first determination of classes of swaps that will be subject to mandatory clearing. Together, these actions bring the mandatory swap clearing requirement a step closer to realization.

Clearing Phase-In Final Rule

The CFTC's final clearing phase-in rule specifies the time periods between final mandatory clearing determinations and the related compliance dates for swaps entered into between various combinations of counterparty types as follows:

Combinations of Counterparty Types	Swap Clearing Requirement Timing
Swap dealers, security-based swap dealers, major swap participants, major security-based swap participants, and "active funds" ¹ (" Category 1 entities ").	Transactions between a Category 1 entity and (i) another Category 1 entity or (ii) any other entity that wishes to clear will become subject to mandatory clearing starting 90 days after publication of a final clearing determination.
Commodity pools, private funds, and persons predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature according to section 4(k) of the Bank Holding Company Act, provided that such participants are not third-party subaccounts ² (" Category 2 entities ").	Transactions between a Category 2 entity and (i) a Category 1 entity; (ii) a Category 2 entity; or (iii) any other entity that wishes to clear will become subject to mandatory clearing starting 180 days after publication of a final clearing determination.
Other combinations of counterparty types (e.g., transactions between Category 1 entities and third party subaccounts or nonfinancial end users that are not eligible for or do not elect the end-user exemption).	All swap transactions not listed above will become subject to mandatory clearing starting 270 days after publication of a final clearing determination.

While the phase-in rule, as proposed, included an implementation schedule for Title VII's trade execution requirements, the final rule does not address this issue. A final rule on the trade execution requirement is expected this fall.

Proposed Required Clearing Determination

As anticipated, the CFTC's first proposed clearing determinations apply to certain classes of index credit default swaps ("**CDS**") and interest rate swaps ("**IRS**") (together, the "**Proposed Swaps**"), some of which are already cleared by designated clearing organizations ("**DCOs**"). In particular, the Proposed Swaps would include North American untranching CDS index contracts and European untranching CDS index contracts, as well as to fixed-to-floating rate swaps, basis swaps, overnight index swaps and forward rate agreements on certain common indices. The specific criteria for the Proposed Swaps are set forth in a chart contained in the proposed rules, which can be accessed [here](#).

A Proposed Swap that meets the specifications of the CFTC but that is not offered for clearing by any DCO would not be subject to mandatory clearing. The CFTC and DCOs will maintain lists on their websites of swaps that are required to be cleared, and each DCO will also make publicly available a list of swaps that it accepts for clearing.

In its proposal, the CFTC delegates to the Director of the Division of Clearing and Risk (and his or her designees) authority to make determinations concerning whether swaps submitted by a DCO fall within a class of swaps that are subject to mandatory clearing.

Finally, the CFTC proposal includes a broad anti-evasion rule that makes it unlawful for any person to knowingly or recklessly evade, or abuse any exception to, the clearing requirements.

Comments on the CFTC's proposal are due within 30 days of publication in the Federal Register, which is expected shortly.

Timeline

Taken together, the CFTC's actions suggest a possible timeline for mandatory clearing of CDS and IRS that are Proposed Swaps. For example, if the CFTC were to publish its clearing proposal in the Federal Register on August 1, 2012 and finalize its clearing determination 90 days later, the following schedule would result:

August 1, 2012	CFTC publishes proposed clearing determination for the Proposed Swaps.
October 30, 2012	CFTC publishes final clearing determination for the Proposed Swaps.
January 28, 2013	Transactions between Category 1 entities in the Proposed Swaps must be cleared.
April 28, 2013	Transactions between Category 1 and Category 2 entities in the Proposed Swaps must be cleared.
July 27, 2013	All other transactions in the Proposed Swaps must be cleared, unless the end-user clearing exemption applies and is elected.

However, it is possible that the clearing proposal could be published later than August 1, 2012 or that the CFTC will wait until later than October 30, 2012 to publish its final clearing determination, which could delay this schedule.

¹ An "active fund" is defined as any private fund under section 202(a) of the Investment Advisors Act of 1940 that is not a third-party subaccount and which executes 200 or more swaps per month on average over the course of the 12 months preceding a final clearing determination by the CFTC. Notably, the CFTC increased the threshold for a private fund to be considered an "active fund" from 20 swaps per month in the proposed rule to 200 swaps per month in the final rule.

² The final rule defines a third-party subaccount as a managed account where the manager is unaffiliated with the account's beneficial owner and is responsible for the documentation necessary for the account's beneficial owner to clear swaps.

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