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Dodd-Frank End-User Derivatives Update

June 6, 2011

Nearly ten months have elapsed since the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (the "Dodd-Frank Act") was enacted.[1] Title VII of the Act, entitled the "Wall Street Transparency and Accountability Act of 2010" ("Title VII"), provides for new Federal regulation of the swaps market and sweeping changes to its structure.[2] By its terms, those provisions of Title VII that do not require implementing regulations will automatically become effective on July 16, 2011. Those provisions that require regulation will not become effective until at least 60 days after final rules are published. Because of delays in finalizing necessary rulemaking, the provisions of Title VII that will have the most fundamental impact on the way swaps are traded, cleared and reported are not likely to become effective until the second half of 2011 at the earliest. As a result, companies that participate in the swaps market as "end users" for hedging purposes (and are not "swap dealers" or "major swap participants") may not see dramatic changes in the functioning of the swaps market immediately after the July 16 effective date. Nevertheless, both in the near term and over time, corporate end-users will be affected by the new regulatory framework imposed under Title VII. Set forth below is a summary of recent developments and current status of areas of particular interest to "end users" of swaps and other "over the counter" derivatives that may be impacted by Title VII.

TIMING

Effective Dates of Key Provisions Delayed

At this time, the many Commodity Futures Trading Commission ("CFTC") and Securities and Exchange Commission[3] ("SEC") rulemakings necessary to make effective the sweeping changes to the swaps market contemplated by Title VII, including mandatory central clearing, exchange trading and real-time reporting of swaps, are not expected to be completed until late summer or early fall at the very earliest.[4] At this time, neither the CFTC nor the SEC has finalized any of the rules implementing Title VII.

The SEC and the CFTC have now completed and published for comment all proposed rules that the agencies consider necessary to implement Title VII.[5] On May 2, at a joint CFTC/SEC

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1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010).

2 See our previous memorandum "Reform of the Swaps Market Under the Dodd-Frank Act," July 22, 2010, available at http://www.cravath.com/files/Uploads/Documents/Publications/Dodd-Frank%20(Reform%20of%20the%20Swaps%20Market).pdf.

3 Title VII charges the CFTC with regulation of swaps generally, including interest rate swaps, currency swaps, commodity swaps, weather swaps and swaps on broad-based indices of securities; the SEC is charged with regulation of "security based swaps," defined to include any swap or credit default swap based on one or more issuers, securities or loans, other than broad based indices of securities. In this memorandum, the term swaps includes security-based swaps unless the context indicates otherwise.

4 The effective date for most provisions of Title VII is the later of (a) July 16, 2011 or (b) 60 days after publication of final rules implementing that provision, if rulemaking is required.

5 In response to concerns about the "piecemeal" release of proposed rules, the CFTC has re-opened the comment period for previously published proposed rules to June 3, so that market participants may consider the proposals as a whole.

roundtable regarding the timing of rulemaking and implementation, senior CFTC and SEC staff indicated that effective dates for final rules and required compliance dates will be phased in over time.[6] CFTC staff recently published a list of 13 concepts they will consider in recommending the scheduling of rule effective dates; included as number eight is "it may be appropriate to provide more time for any new regulatory requirements that may apply to transactions with non-financial end users."[7]

Legislative Proposal To Postpone Effectiveness

On May 24, the House Financial Services Committee passed H.R. 1573, which would postpone the effective date of most provisions of Title VII and rules thereunder to the later of September 30, 2012, or 90 days after final rules are published.[8] The House Agriculture Committee also passed H.R. 1573 in April. However, no date has been set for a vote on the bill by the full House of Representatives. At this time, swaps industry trade groups believe that passage of H.R. 1573 by both Houses and signature by the President is unlikely. On June 2, CFTC Chairman Gary Gensler told reporters that he believes legislative action is unnecessary, as the CFTC already has sufficient authority to address any uncertainties of derivatives users arising as a result of the July 16 effective date and the lack of final implementing rules.[9]

PROVISIONS OF TITLE VII CURRENTLY IN EFFECT

Retention of Swap Transaction Records

Section 729 and Section 766 of the Dodd-Frank Act require reporting and recordkeeping for all swaps not accepted for clearing by any derivatives clearing organization, including swaps entered into prior to the enactment of the Dodd-Frank Act on July 21, 2010 that had not expired as of that date ("pre-enactment swaps"). Section 729 and Section 766, both of which became effective upon enactment of the Dodd-Frank Act on July 21, 2010, also require the CFTC and the SEC to promulgate interim final rules within 90 days of the Act's enactment date providing for the reporting of pre-enactment swaps information by a date not later than 30 days after issuance of an interim final rule or "such other period as the [CFTC or SEC] determines to be appropriate."

As of now, the CFTC and the SEC have together produced a number of interim final rules and proposed rules regarding recordkeeping and reporting of swaps, including pre-enactment swaps, swaps entered into after the enactment date but prior to the effective date of final rules and swaps entered into after the effective date of final rules.[10] The net effect of these, from an end-user perspective, is to require the maintenance and preservation of existing records with respect to swaps to which the end-user was a party at any time after the July 21, 2010 enactment date and prior to the effective date of final rules for swap recordkeeping and reporting. None of the rules require any information to be reported until after the final compliance date specified in the final rule.

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[6] Rick Shilts, CFTC Director of Market Oversight, and Robert Cook, SEC Director of Trading and Markets, Opening Remarks at Joint CFTC-SEC Staff Roundtable on Implementation Phasing for Final Rules for Swaps and Security-Based Swaps under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act 8, 16 (May 2, 2011) (transcript available at http://www.sec.gov/news/press/2011/2011-90-transcript.pdf).

[7] Among the concepts CFTC staff have included are phase in of implementation by type of swap and type of swap counterparty, and phase in based on development of market infrastructure, technology, and "natural sequencing" implicit in the new processes required by Title VII. *CFTC Staff Concepts and Questions Regarding Phased Implementation of Effective Dates for Final Dodd-Frank Rules*, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/staffconcepts050211.pdf.

[8] If a particular provision of Title VII already includes an effective date after September 30, 2012, H.R. 1573 would have no effect.

[9] See, *e.g.*, Jonathan Spicer, "CFTC Aims For Certainty Over July 16 Rule Deadline," Reuters, June 2, 2011, http://www.reuters.com/article/2011/06/02/financial-regulation-cftc-idUSN0228261220110602. See also BNA Daily Report for Executives, June 3, 2011.

[10] 76 Fed. Reg. 29818 (May 23, 2011) (CFTC proposed rule); 76 Fed. Reg. 22833 (April 25, 2011) (CFTC proposed rule); 75 Fed. Reg. 78892 (Dec. 17, 2010) (CFTC interim final rule); 75 Fed. Reg. 75208 (Dec. 10, 2010) (SEC proposed rule); 75 Fed. Reg. 76754 (Dec. 8, 2010) (CFTC proposed rule); 75 Fed. Reg. 64643 (Oct. 20, 2010) (SEC interim final rule); 75 Fed. Reg. 63080 (Oct. 14, 2010) (CFTC interim final rule).

As a general matter, even after reporting becomes mandatory, corporate end-users of derivatives that transact with U.S. swap dealers are unlikely to find themselves required to act as the reporting party with respect to any swap transaction, since the reporting rules generally require that swaps be reported by the counterparty that is a swap dealer or major swap participant. There are, however, two exceptions of note for end-users:

- First, where both counterparties to a swap are not swap dealers or major swap participants, the two counterparties must appoint one of them to be the reporting party, Under the proposed rules, transactions between corporate affiliates would be included in this category;

- Second, under the proposed rules, where only one counterparty to a swap transaction is a "U.S. person," that counterparty would be the reporting party.[11]

In addition, it is possible that some end-user reporting may be required under the end-user exception discussed below.

The CFTC and SEC have received numerous comments on the proposed reporting and recordkeeping rules and the final rules may differ substantially from the proposals.

PROVISIONS EFFECTIVE JULY 16, 2011

At the present time, it is not entirely clear which provisions of Title VII will actually become effective on July 16. Numerous provisions of Title VII do not themselves explicitly require rulemaking, but are highly interconnected to other provisions or areas that do require rulemaking, creating uncertainty and concerns about required compliance with provisions that will become effective on July 16. On June 2, 2011, CFTC Chairman Gary Gensler announced that the CFTC is planning to provide some form of interim relief to address market participants' concerns in these areas, noting that the SEC is also very aware of these concerns.[12]

Possible Requirement for Board Approval for Reliance on End-User Exception

Title VII includes a broad requirement for the central clearing of all swaps that are "required to be cleared" and further requires all swaps subject to the clearing requirement to be traded on an exchange or central execution facility, subject in each case to certain exceptions. One important exception for so-called "end-users" of swaps is an exception for transactions that hedge or mitigate commercial risk so long as, in the case of SEC reporting companies, an "appropriate committee" of the board of directors approves "the decision to enter into swaps that are subject to [the end-user exception]."[13] The effect of this provision is to mandate board committee oversight of a public company's use of non-cleared swaps to address risk.

The requirement for board committee approval set out above does not specifically require implementing regulation, and so, arguably, will become effective on July 16, 2011. However, Title VII's mandatory clearing and exchange trading requirements will not become effective until the CFTC or the SEC make the determination that a particular category of swaps is "required to be cleared."[14] As a practical matter, in order for the CFTC to require that a particular swap or class of swaps be centrally cleared as of a particular date, a number of other legal and practical conditions would need to be satisfied prior to that date,

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[11] Theoretically, under the proposed rules, a U.S. end-user could be the reporting party for a swap transaction previously entered into with a foreign bank that is no longer a U.S. swap dealer subject to U.S. swap reporting requirements by the time reporting becomes mandatory (*e.g.* the foreign bank forms a separate subsidiary for its U.S. swaps business).

[12] See Jonathan Spicer, "CFTC Aims For Certainty Over July 16 Rule Deadline," supra note 9.

[13] See our previous memorandum "Proposed Rules for End-User Exception to Clearing of Swaps," December 28, 2010, available at http://www.cravath.com/files/Uploads/Documents/Publications/3258872_1.pdf.

[14] The proposed rule regarding the process by which swaps will be reviewed for mandatory clearing is among those reopened for comment until June 3 by the CFTC. See "Process for Review of Swaps for Mandatory Clearing," 75 Fed. Reg. 67277 (Dec. 23, 2010). The SEC proposed rule on the same topic was published in the Federal Register on December 30, 2010, but has not yet been finalized. See "Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing," 75 Fed. Reg. 82490 (Dec. 30, 2010). However, under the Act, swaps that are currently being centrally cleared are considered to have been submitted to the CFTC for consideration.

including the registration of one or more derivatives clearing corporations capable of and willing to clear that class of swaps.[15] As a result, end-users should be able to continue to enter into non-cleared swaps as they have in the past, without reliance on the end-user exception, until the requirement for clearing and exchange trading becomes effective.

Nevertheless, given the current uncertainty and the fact that some provisions of the Dodd-Frank Act will become effective on July 16, 2011, it is possible that some dealers and others may soon begin asking their end-user customers to provide assurance that they meet the requirements of the end-user exception, even before the mandatory clearing rules become effective. Moreover, at some point it will be necessary for end-users to comply with the requirements of the exception if they intend to continue to enter into off-exchange swaps. Set out below is a summary of the statutory requirements for the end-user exception. Companies may wish to begin to review existing corporate authorities to evaluate how best to address these statutory requirements and implement the mandate for board oversight of swap market activities. Companies should understand, however, that the final scope of the end-user exemption, including mandatory reporting requirements applicable to non-cleared swaps, will be shaped by regulations that are yet to be adopted. The SEC and the CFTC have issued proposals but the final rules may differ substantially from the proposals.[16]

In addition to the requirement for appropriate board or committee approvals for end-users that file periodic reports with the SEC, availability of the end-user exception requires that one of the counterparties to the swap:

- *is not a "financial entity"* -- The term "financial entity" includes banking institutions, swap dealers, major swap participants, pension plans and hedge funds;

- *is using swaps to "hedge or mitigate commercial risk"* -- The CFTC and SEC have proposed complex rules to determine when a transaction qualifies as hedging or mitigating commercial risk. The rules are intended to distinguish risk relating to commercial and treasury operations from speculation or trading (or in some cases investing). Notably, under the current proposals, it would appear that hedging one's own stock price may not qualify as "hedging or mitigating commercial risk";[17] and

- *notifies the relevant Commission that it meets the financial obligations of entering into a non-cleared swap transaction* -- The proposed "reporting" rules rely on dealer reporting of both transaction and counterparty details to satisfy this requirement. However, since Title VII requires end-users to provide this notice, we would expect end-users to be responsible for the content of dealer reports pertaining to this requirement.

We expect that the decision to use the end-user exception will be driven by a number of considerations including (i) the increased liquidity that should be provided by cleared swaps over non-cleared swaps, (ii) the greater ability to customize non-cleared swaps, when compared to cleared swaps, and (iii) the relative costs of cleared swaps versus non-cleared swaps, including margining or collateral requirements, which are expected to be higher for cleared swaps than non-cleared swaps.

Securities-Based Swaps

Among the provisions of Title VII that will become effective on July 16, 2011 without additional rulemaking is the inclusion of security-based swaps in the definition of "security" under the Securities Act of 1933, as amended (the "1933 Act") and the Securities Exchange Act of 1934, as amended (the "1934 Act"). Among other things, the effect of this change is to subject the "offer and sale" of security-based swaps to the registration, prospectus delivery, civil liability, antifraud and antimanipulation provisions of the 1933 Act and the 1934 Act to include swaps. For many corporate end-users, the primary practical impact of this change will be to cause companies to structure total return swaps and similar derivatives on their own stock, as well as credit default swaps on single issuers or securities or small groups thereof, to be treated as private placements, and therefore subject to Securities Act compliance and potential liability issues.

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[15] The CFTC proposed rule setting forth the standards for registration as a "designated clearing organization" under Title VII has also been reopened for comment until June 3. Reopening and Extension of Comment Period for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act , 76 Fed. Reg. 25274 (May 4, 2011).

[16] See "End-User Exception to Mandatory Clearing of Swaps," 75 Fed. Reg. 80747 (Dec. 23, 2010) (CFTC proposed rule). See also "End-User Exception to Mandatory Clearing of Security-Based Swaps," 75 Fed. Reg. 79992 (Dec. 21,2010) (SEC proposed rule).

[17] It is also possible that inter-affiliate swaps may be subject to some swap regulation. See Cravath, Swaine, & Moore LLP comment letter, Feb. 4, 2011, available at http://www.sec.gov/comments/s7-43-10/s74310-6.pdf.

Subjecting securities-based swaps to regulation as securities may lead to a number of unintended consequences not necessarily consistent with the objectives of Title VII to promote transparency and legal certainty for swaps.[18] In particular, both the 1933 Act and the 1934 Act contain provisions that make transactions in violation of the respective Acts void or voidable. Yet 1934 Act Section 15F(a)(1), created as part of Title VII, provides that it is unlawful to act as a security based swap dealer unless registered. This requirement is, on its face, effective on July 16, 2011. However, as a result of the absence of final regulations, it may not be possible for a swap dealer to satisfy the statutory requirement for registration as a swap dealer under the 1934 Act. As a result, from the standpoint of the securities-based swap dealer, the effective date of Title VII introduces enforceability risk that did not exist prior to that date. At this point it is difficult to predict the degree to which the market for securities-based swaps will be affected by these uncertainties.

Notice of Segregation of Collateral

Sections 724(c) and 763(d) require that entities acting as swap dealers or security-based swap dealers notify counterparties to uncleared swaps at the beginning of a swap transaction that the counterparty has the right to require segregation, in an account at a third-party bank, of any initial collateral[19] provided by the counterparty to secure performance under the swap transaction. This requirement does not explicitly require rulemaking and therefore would appear to be effective on July 16, 2011, notwithstanding the absence of final rules setting forth exclusions to the definition of "swap dealer" and "security-based swap dealer" or otherwise providing guidance. For example, it is not clear whether a dealer that is required to segregate collateral on behalf of a counterparty may impose additional costs on that counterparty.

Increased Duties for Counterparties to "Special Entities"

Sections 731 and 764 of the Dodd-Frank Act impose considerably heightened standards of care on swap dealers and major swap participants when they act as counterparty to "special entities", which are defined to include public and private pension plans, governmental entities, Federal agencies and charitable organizations. The "special requirements for swap dealers as counterparties to special entities" are not on their face subject to rulemaking (though rulemaking is required generally to set forth business conduct standards for swap dealers), and therefore are effective on July 16, 2011. The near-term effect of these requirements on the availability and cost of uncleared swap transactions for entities that are "special entities" is difficult to assess. The long term effect may be to create significant disincentives for dealers to engage in uncleared swaps with special entities.

PROPOSED RULES AND OTHER DEVELOPMENTS

Margin Rule Proposals Applicable to Swaps with End Users

As required under Title VII, both the Prudential Regulators[20] and the CFTC have proposed margin and capital rules for swap dealers and major swap participants as defined under Title VII.[21] In general, the Prudential Regulators' margin and capital rules will apply to swap dealers and major swap participants that are insured depositary institutions, and the CFTC rules will apply to all swap dealers and major swap participants that are not banks, including non-bank subsidiaries of bank holding companies regulated by the Federal Reserve Board.[22] From the end user perspective, a key difference between the two sets of margin

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[18] As an example, it may be difficult to reconcile the Act's goal of promoting "transparency" in the swaps market with the requirements for a private placement under 1933 Act Section 4(2).

[19] This requirement applies only to collateral provided at the start of a swap transaction, also known as initial margin or an "independent amount" that is not adjusted or returned based on the performance of the swap, and not to variation margin or "mark to market" collateral. Historically, collateral arrangements requiring initial margin deposits from end-user counterparties have been unusual. See infra, Part IV.A.

[20] The term "Prudential Regulator" is defined in the Dodd-Frank Act to include the Federal Reserve Board , the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency.

[21] "Margin and Capital Requirements for Covered Swap Entities," Apr. 12, 2011, available at http://www.fdic.gov/news/board/Apr11no4.pdf (Prudential Regulators rules); "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants," 76 Fed. Reg. 23732 (Apr. 28, 2011) (CFTC rules). The SEC has not yet proposed margin rules for security-based swap transactions entered into by entities not regulated by the Prudential Regulators.

[22] It is difficult to assess at this time the proportion of the current swap market that would be subject to the Prudential Regulators' margin rules versus the CFTC's, for a number of reasons, including that certain swap activities currently engaged in by banks (and therefore subject to the margin and capital requirements of the Prudential Regulators) may ultimately be "pushed out" to nonbank subsidiaries and affiliates subject to the CFTC's margin and capital requirements for swap dealers and major swap participants as a result of the Act's prohibition on Federal assistance to swap entities.

proposals is the treatment of margin requirements applicable to transactions with "non-financial" end users.[23] The Prudential Regulator proposal would require swap dealers to set margin requirements, based on a standardized table in the proposal or, a swap dealer's approved internal model, for all categories of counterparties, including non-financial end users. However, for counterparties that are non-financial end-users, a swap dealer would be permitted to establish a threshold unsecured exposure limit for each counterparty and collect margin (at least weekly) only when the established threshold is exceeded.[24]

The CFTC proposal, on the other hand, does not require regulated entities to create any specific minimum margin requirement for uncleared swap transactions with non-financial end-users. Instead, swap dealers and major swap participants, at their own discretion, are to agree on margin requirements and thresholds with each of their counterparties that are non-financial entities, and must document those requirements.[25] The CFTC proposal also requires swap dealers and major swap participants to calculate hypothetical initial and variation margin requirements daily for each transaction with a non-financial end user (a) for use as a risk management tool, and (b) because those hypothetical margin calculations "would likely be necessary … in computing applicable capital requirements." (These requirements had not yet been proposed by the CFTC as of the date of the margin rule proposals.)[26] Given the competitive pressures in the swap market, the legislative history of Title VII, and the consistent political support for non-financial end-user exemptions, it is difficult to predict how the inconsistency between the two proposals as regards end-users will ultimately be resolved.

H.R. 1610 and S.947--Legislative End-User Protection

On April 15, 2011, three days after initial release of the Prudential Regulator margin proposal, Representative Michael Grimm introduced H.R. 1610, the "Business Risk Mitigation and Price Stabilization Act of 2011" in the House of Representatives. On May 4, 2011, H.R. 1610 was passed by the Capital Markets Subcommittee to be considered by the full House Financial Services Committee, where it was scheduled for initial consideration on May 24. H.R. 1610 creates an explicit statutory exemption from Title VII's margin requirements for an expanded group of end-users, both non-financial and financial.[27] On May 11, 2011, Senator Mike Johanns of Nebraska introduced S. 947, which is virtually identical to H.R. 1610, in the Senate. The Senate bill was referred to the Committee on Banking, Housing and Urban Affairs. At this time, it is not clear that either bill has sufficient legislative support to be enacted.

Proposed Exemption for Foreign Exchange Swaps and Forwards

Under Title VII, foreign exchange swaps and forwards are considered swaps subject to the execution, clearing, margining and various other requirements applicable to swaps, unless the Secretary of the Department of the Treasury makes a written determination otherwise. On April 29, 2011 the Department of the Treasury issued a Notice of Proposed Determination[28] providing that foreign exchange swaps and forwards, narrowly defined, should be excluded from the definition of "swap" under Title VII and the Commodity Exchange Act. Under the terms of the Notice, foreign exchange swaps and forwards would be exempt

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[23] Both the Prudential Regulators margin proposal and the CFTC margin proposal distinguish between a financial end-user and a non-financial end-user (called, respectively, "financial entity" and "non-financial entity" in the CFTC proposal). In both proposals, financial end-user is defined as a commodity pool, a hedge fund, an employee benefit plan, any entity predominantly engaged in the business of banking or other financial activities as defined in Section 4(k) of the Bank Holding Company Act of 1956, any entity that would be any of the foregoing if it were organized in the U.S., and any foreign governmental entity. The Prudential Regulators proposal also distinguishes between "low risk financial end users" (generally, regulated entities such as insurance companies that use swaps predominantly to hedge having total swap exposures below defined thresholds) and "high risk financial end users" (all other financial end-users).

[24] Under the Prudential Regulator proposal and the CFTC proposal, swap dealers and major swap participants must use a threshold of *zero* for uncleared swap transactions with each other, and must ensure that any initial margin posted by those entities is segregated, held by a third party custodian, and not available for rehypothecation.

[25] See "Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants," 76 Fed. Reg. 6715 (Feb. 8, 2011). See also "Orderly Liquidation Termination Provision in Swap Trading Relationship Documentation for Swap Dealers and Major Swap Participants," 76 Fed. Reg. 6708 (Feb. 8, 2011).

[26] The CFTC proposed rule, "Capital Requirements of Swap Dealers and Major Swap Participants," was published in the Federal Register on May 12, 2011 (76 Fed. Reg. 27802). The CFTC proposal requires swap dealers and major swap participants not using models specifically approved by the CFTC to determine their uncleared OTC derivative credit risk charges to maintain additional net equity equal to 8% of uncollateralized exposures (current mark to market and potential future exposure) times a percentage of 20, 50 or 150, based on the internal credit rating assigned by the swap dealer or major swap participant to the counterparty, and to apply concentration charges to uncollateralized exposures to any single counterparty that exceed 5% of tangible net equity.

[27] Under both bills, any entity that is not a swap dealer, a major swap participant (based on net exposure), a hedge fund with more than five investors or a commodity pool would be exempt from requirements to post margin on uncleared swap transactions. Both H.R. 1610 and S.947 also include provisions clarifying that *net* counterparty exposure should be used in determining whether an entity is a major swap participant or a major security-based swap participant.

[28] "Notice of Proposed Determination of Foreign Exchange Swaps and Foreign Exchange Forwards under the Commodity Exchange Act," 76 Fed. Reg. 25774 (May 5, 2011).

from the clearing and exchange trading requirements of Title VII but would still be subject to its trade reporting requirements, business conduct standards and prohibitions on fraud and manipulation. The Secretary's proposed determination is limited to foreign exchange swaps and forwards,[29] each as narrowly defined in the Commodity Exchange Act, and predicated on the distinct characteristics of those transactions. In particular, they require full physical delivery of predetermined amounts in specific currencies on fixed dates. As a result, the Notice does not apply to foreign exchange options, currency swaps or non-deliverable currency forwards, each of which would remain within the definition of "swaps" subject to Title VII. Comments on the Notice are due by June 6, 2011.

As stated in earlier Firm memoranda[30], it remains to be seen how effectively the new "regulated" swaps market will function in the long term, how competitive it will be with other markets (primarily non-U.S.) and how important the off-exchange market will remain once Title VII's market structure changes are fully implemented. In the near term, swap dealers and active swaps traders that are not end-users face uncertainty and risk resulting from of a lack of clarity as to effective dates for various requirements in the Dodd-Frank Act itself, the absence of final rules in any area under Title VII, and the need for technical correction in a number of areas. At this time it is difficult to determine the impact, if any, of such uncertainty on the overall functioning of the swaps marketplace and the cost and availability of risk reduction transactions to end-users during the coming period of transition.

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[29] A "foreign exchange swap" for purposes of the Commodity Exchange Act means "a transaction that solely involves (A) an exchange of 2 different currencies on a specific date at a fixed rate that is agreed upon on the inception of the contract covering the exchange" and "(B) a reverse exchange of [those two currencies] at a later date and at a fixed rate that is agreed upon on the inception of the contract covering the exchange." Similarly, a "foreign exchange forward" is a "transaction that solely involves the exchange of 2 different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange." "Determination of Foreign Exchange Swaps and Foreign Exchange Forwards under the Commodity Exchange Act," 76 Fed. Reg. 25776 (May 5, 2011) (citing 7 U.S.C. 1(a)(24)-(25)).

[30] See "Reform of the Swaps Market Under the Dodd-Frank Act" and "Proposed Rules for End-User Exception to Clearing of Swaps, " referenced at notes 2 and 13 of this Memorandum.