

## CFTC To Subject Agricultural Swaps to the Same Regulatory Regime as Other Swaps, Creates a Whistleblower Program and Sets Rules and Registration Requirements for Swap Data Repositories

August 15, 2011

On August 4, 2011, the Commodity Futures Trading Commission (CFTC) issued three final rules to implement Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act): (1) a rule that will repeal Part 35 of the CFTC's existing regulations, making swaps in agricultural commodities (agricultural swaps) subject to the same regulatory regime imposed by the Dodd-Frank Act on other types of swaps;<sup>1</sup> (2) a rule to implement a whistleblower program, as mandated by Section 748 of the Dodd-Frank Act; and (3) rules pertaining to the core principles, duties and registration of swap data repositories.

### The Agricultural Swaps Rule

Section 723(c)(3) of the Dodd-Frank Act prohibits agricultural swaps absent an exemption issued by the CFTC.<sup>2</sup> The agricultural swaps final rule, which takes effect on December 31, 2011, will repeal and replace Part 35 of the CFTC's regulations. New Part 35 will permit agricultural swaps, subject to all provisions of the Commodity Exchange Act (CEA) and CFTC regulations promulgated thereunder that are applicable to non-agricultural swaps.<sup>3</sup>

Existing Part 35 was adopted in 1993 pursuant to Sections 4(c) and 4c(b) of the CEA and served as the exemptive authority for bilateral swaps prior to the Commodity Futures Modernization Act of 2000 (CFMA). The CFMA amended the CEA to include several statutorily based exemptions for bilateral swaps. Agricultural swaps were excluded from the CFMA's general exemptions for bilateral swaps,

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<sup>1</sup> The CFTC recently issued a final rule that defines the term "agricultural commodity." See Agricultural Commodity Definition, 76 Fed. Reg. 41,048 (July 13, 2011) (to be codified at 17 C.F.R. pt. 1).

<sup>2</sup> § 723(c)(3) of the Dodd-Frank Act reads:

AGRICULTURAL SWAPS. –

(A) IN GENERAL. – Except as provided in subparagraph (B), no person shall offer to enter into, enter into, or confirm the execution of, any swap in an agricultural commodity (as defined by the Commodity Futures Trading Commission).

(B) EXCEPTION. – Notwithstanding subparagraph (A), a person may offer to enter into, enter into, or confirm the execution of, any swap in an agricultural commodity pursuant to section 4(c) of the Commodity Exchange Act (7 U.S.C. 6(c)) or any rule, regulation, or order issued thereunder (including any rule, regulation, or order in effect as of the date of enactment of this Act) by the Commodity Futures Trading Commission to allow swaps under such terms and conditions as the Commission shall prescribe.

<sup>3</sup> Existing Part 35 requires counterparties to an agricultural swap to be "eligible swap participants," as defined therein. As a result, counterparties to agricultural swaps, to address the "eligible swap participant" definition, often included additional representations in their swap documentation as to their total assets, net worth and purpose for entering into the swap (among others). With Part 35's repeal and replacement, such representations will no longer be necessary.

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however, and as a result, after the CFMA, Part 35 of the CFTC's regulations was only relevant for agricultural swaps.

The agricultural swaps final rule does not address commodity options, which were addressed in a previously issued Advanced Notice of Proposed Rulemaking and Proposed Rules pertaining to agricultural swaps. CFTC staff explained that commodity options present complex issues requiring additional consideration and that, as such, they will be addressed in a separate final rulemaking.

### The Agricultural Swaps Final Rule's Effects on Market Participants

The CFTC's agricultural swaps final rule will allow market participants currently investing in, or wishing to invest in, agricultural swaps to continue to do so. Such transactions will be subject to the Dodd-Frank Act's new requirements for swaps, which will include, among others:

- *Mandatory clearing.* Title VII of the Dodd-Frank Act generally requires the central clearing of swaps.<sup>4</sup> Clearing is intended to reduce counterparty credit risk by mutualizing such risk among the members of a clearinghouse. Central clearing will require market participants to put new legal documentation in place for cleared swaps, namely a futures account agreement, cleared derivatives transactions addendum and possibly a cleared derivatives execution agreement. To the extent a swap is unclearable or not accepted for clearing, such swaps may be entered into on a bilateral basis via entry into an ISDA Master Agreement or other agreement, subject to CFTC-imposed documentation requirements.<sup>5</sup>
- *Margin requirements.* Market participants will be required to comply with margin requirements in connection with cleared swaps transactions, as set by the relevant clearinghouse. To the extent that a market participant engages in bilateral swap transactions, such transactions will be subject to CFTC or federal banking regulator margin requirements, depending on the counterparty.<sup>6</sup>
- *Position limits.* Earlier this year, the CFTC proposed rules that impose position limits on 28 exchange-traded commodity futures (including metals, agricultural and energy commodities) and economically equivalent derivatives that may include certain agricultural swaps.<sup>7</sup> At the August 4 meeting, CFTC Chairman Gary Gensler indicated that the proposed position limit rules will likely be finalized early this fall.

### Other Considerations

The repeal of Part 35 also affects a CFTC temporary order, issued in July, that exempts swap market participants from certain provisions of Title VII of the Dodd-Frank Act that became effective on July 16, 2011, until the earlier of (a) December 31, 2011 or (b) the publication of final rules pertaining to the

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<sup>4</sup> Non-financial end-users will be exempt from the mandatory clearing requirement.

<sup>5</sup> At the August 4 meeting, CFTC Chairman Gary Gensler indicated that clearing may become mandatory as early as December 2011. The new documentation requirements for uncleared swaps, which will apply to swap dealers and major swap participants, will impact market participants. See Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 6,715 (Feb. 8, 2011) (to be codified at 17 C.F.R. pt. 23) and Orderly Liquidation Termination Provision in Swap Trading Relationship Documentation for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 6,708 (Feb. 8, 2011) (to be codified at 17 C.F.R. pt. 23).

<sup>6</sup> See Sutherland's Legal Alert, dated April 13, 2011, available [here](#).

<sup>7</sup> Position Limits for Derivatives, 76 Fed. Reg. 4,752 (Jan. 26, 2011) (to be codified at 17 C.F.R. pts. 1, 150 and 151).

“swap,” “swap dealer” and “major swap participant” definitions.<sup>8</sup> The temporary order partially relies on existing Part 35 of the CFTC’s regulations. To the extent that the temporary order requires extension past December 31, 2011, those portions of the temporary order that rely on Part 35 will no longer be effective because Part 35 will be repealed and replaced on that date. At the August 4 meeting, CFTC staff indicated that, to the extent needed, CFTC staff will recommend that the temporary order be expanded to cover those transactions that rely on existing Part 35.

## Whistleblower Rule

Section 748 of the Dodd-Frank Act requires the CFTC to develop and implement a whistleblower incentives and protection program to encourage individuals to provide the CFTC with information that leads to successful CFTC enforcement actions. The final whistleblower rule provides that a whistleblower will be paid a monetary award, as determined by the CFTC, that will be between 10% to 30% of the sanctions collected in a CFTC enforcement action (or a related action) that is based on information provided by the whistleblower. Awards will only be available where the CFTC enforcement action (or other related action) results in sanctions exceeding \$1,000,000.

The final whistleblower rule will become effective 60 days after publication in the Federal Register and is substantially similar to the CFTC’s proposed rule that was issued last December. CFTC staff did note, however, that the final whistleblower rule includes changes to harmonize with whistleblower rules adopted by the Securities and Exchange Commission.

## Swap Data Repositories

Title VII of the Dodd-Frank Act created swap data repositories (SDRs) as new registered entities under the CEA. SDRs are intended to bring transparency to the swaps market by collecting and maintaining data related to swap transactions and making such data readily available to domestic and foreign regulators, including the CFTC. The final rules dictate the procedures and substantive requirements for registration as an SDR and implement the Dodd-Frank Act’s statutory duties and core principles for SDRs.<sup>9</sup>

The SDR final rules will become effective 60 days after publication in the Federal Register. However, compliance will not be required until the CFTC has finalized rules pertaining to the definition of a “swap” and swap data reporting requirements.

The Federal Register version of the agricultural swaps final rule is available [here](#). Federal Register versions of the whistleblower and SDR final rules are not yet available, but fact sheets and Q&As pertaining to the final rules are available [here](#). The CFTC will hold open meetings in September, October and November to consider additional final rules pertaining to Title VII of the Dodd-Frank Act.

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<sup>8</sup> For additional information about the temporary exemptive relief order, see Sutherland’s Legal Alert, dated July 15, 2011, available [here](#).

<sup>9</sup> See § 728 of the Dodd-Frank Act.



*If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*

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