

# **Over-the-Counter Derivatives Markets Act of 2009**

## **Financial Services Committee Discussion Draft**

### **Section-by-Section**

#### **Subtitle A- Regulation of Swap Markets**

##### **Definitions- Sec. 111**

This section adds new definitions to the Commodity Exchange Act and directs the Commodity Futures Trading Commission (“CFTC”) and Securities and Exchange Commission (“SEC”) to further define these terms jointly. The defined terms include “swap,” “security based swap,” “swap dealer,” “security-based swap dealer,” “major swap participant,” “major security-based swap participant,” and “eligible contract participant.” Additionally, the CFTC and SEC are authorized to further define “swap” and “security-based swap” to include transactions designed to evade this Act.

More specifically, a “swap dealer” is any person engaged in the business of buying and selling swaps for their own account; a “major swap participant” is any person who is not a swap dealer and maintains a substantial net position in outstanding swaps, excluding positions held primarily for hedging or risk management purposes. “Security-based swap dealer” and “security-based swap participant” are similar, except that such dealers or participants buy and sell security-based swaps or maintain substantial net positions in security-based swaps, respectively. The definition of “substantial net position” is to be jointly determined by the SEC and CFTC at a threshold that is effective for the oversight of the financial system.

This section also establishes guidelines for joint CFTC and SEC rulemaking authority under this Act. Specifically, rules and regulations prescribed jointly shall be uniform and such rules shall treat functionally or economically equivalent products similarly. This stipulation does not, however, require that the SEC and CFTC adopt joint rules treating functionally or economically different product identically. Additionally, such joint rules are to be prescribed in a timely manner. If the SEC and CFTC fail to meet statutory deadlines, this section authorizes the Secretary of the Treasury to prescribe rules.

##### **Jurisdiction- Sec. 112**

This section removes limitations on the CFTC’s jurisdiction with respect to certain derivatives transactions, including swap transactions between “eligible contract participants.”

##### **Clearing- Sec. 113**

###### **Subsection (a). Clearing Requirement**

This subsection directs the CFTC to identify specific swap contracts that it determines should be cleared, based on specific criteria; requires the CFTC to issue rules or regulations defining the scope of clearing functions necessary to clear identified swap contracts; and authorizes the CFTC and SEC jointly to prescribe rules or issue interpretations as necessary to prevent evasions.

Swaps not accepted for clearing are to be reported to a swap repository or the CFTC. Counterparties in a transaction may agree which one will report the trade. If only one of the counterparties is a swap dealer, the swap dealer will report the transaction.

This subsection requires that transactions in standardized swaps between swap dealers and major swap participants be executed on a designated contract market, a registered swap execution facility, or a regulated foreign swap execution facility. If the trade is not made on one of those platforms the transacting entity must comply with any recordkeeping or end-of-day transaction reporting requirements that are stipulated by the appropriate regulator. The CFTC is to work towards eliminating unnecessary impediments to exchange trading.

This subsection clarifies that the clearing requirement shall not apply to a swap if a registered derivatives clearing organization does not accept the swap or one of the counterparties is not a swap dealer or major swap participant.

#### Subsection (b). Derivatives Clearing Organizations

This subsection requires derivatives clearing organizations (DCO) that clear swaps to register with the CFTC. Additionally, this subsection provides for voluntary registration as a DCO and dual CFTC-SEC registration in applicable cases. The CFTC may exempt DCO from dual registration, if it finds that the DCO is subject to comparable regulation from the SEC, a Prudential Regulator, or relevant foreign authority.

This subsection also requires that the SEC and CFTC (in consultation with the prudential regulator) jointly adopt uniform rules and regulations governing DCOs for swaps and clearing agencies for security-based swaps.

Additionally, this subsection specifies core regulatory principles for derivatives clearing organizations, including standards for minimum financial resources, participant and product eligibility, risk management, settlement procedures, safety of member or participant funds and assets, rules and procedures for defaults, rule enforcement, system safeguards, reporting, recordkeeping, disclosure, information sharing, antitrust considerations, governance arrangements, conflict of interest mitigation, board composition, and legal risk. This subsection also requires a derivatives clearing organization to provide the CFTC with all information necessary for the CFTC to perform its responsibilities.

Lastly, this subsection provides authority to the CFTC to adapt DCO standards to meet evolving US or international standards

**Subsection (c). Legal Certainty for Identified Banking Products**

This subsection clarifies that identified banking products will continue to be regulated by federal banking agencies and not the CFTC or SEC. However, identified banking products can be brought under CFTC or SEC regulation if the federal banking agency, in consultation with the CFTC and SEC, determines that the product would either meet the definition of a swap or security-based swap, or has been structured to evade regulation as a swap or security-based swap.

**Public Reporting of Aggregate Swap Data- Sec. 114**

This section directs the CFTC (or a designated derivatives clearing organization or swap repository) to make available to the public aggregate data on swap trading volumes and positions.

**Swap Repositories- Sec. 115**

This section requires swap repositories to register with the CFTC, outlines the duties of a swap repository and directs the CFTC to prescribe standards regarding those duties. Additionally, an entity required to be registered as a swap repository, must register with CFTC regardless of whether they are registered with SEC as a security-based swap repository. However, the CFTC may exempt such a swap repository from registration, if it finds that the repository is subject to comparable regulation from the SEC, a Prudential Regulator, or relevant foreign authority.

This section also requires that the SEC and CFTC jointly adopt uniform rules and regulations governing repositories for swaps and security-based swaps.

**Reporting and Recordkeeping- Sec. 116**

This section requires reporting and recordkeeping by any person who enters into a swap that is not cleared through a registered derivatives clearing organization or reported to a swap repository.

**Registration and Regulation of Swap Dealers and Major Swap Participants- Sec. 117**

This section requires swap dealers and major swap participants to register with the CFTC. Dual registration is required in applicable cases. Additionally, the CFTC and SEC are directed to jointly prescribe uniform rules for entities that register with the CFTC as swap dealers or major swap participants and entities that register with the SEC as security-based swap dealers or major security-based swap participants.

This section also requires a registered swap dealer or major swap participant to meet such minimum capital and margin requirements as the prudential regulators (for banks) or CFTC and SEC (for nonbanks) shall prescribe. The capital and margin requirements set by the CFTC and SEC are to be as strict as or stricter than the requirements set by the

prudential regulators. Brokers-dealers, futures commission merchants, or introducing brokers shall maintain sufficient capital to comply with the stricter of the requirements to which it is subject. Additionally, the margin requirements set by the CFTC and SEC shall provide for the use of non-cash assets as collateral.

Finally, this section requires that registered swap dealers or major swap participants meet reporting and recordkeeping requirements; conform with business conduct standards; conform with documentation and back office standards; and comply with requirements relating to position limits, disclosure, conflicts of interest, and antitrust considerations. Further, the CFTC, in consultation with other regulators, shall adopt rules exempting foreign financial institutions from the requirements of this Act if the CFTC finds they are subject to comparable regulation in their home country.

#### **Segregation of Assets Held as Collateral in Swap Transactions- Sec. 118**

This section requires the margin or collateral posted in a cleared swap to be segregated, maintained and used for the benefit of the counterparty, in accordance with rules and regulations prescribed by the CFTC or Prudential Regulator.

Additionally, this section stipulates that, at the request of a counterparty, the margin or collateral posted in a non-cleared Over-the-Counter swap shall be segregated and maintained by the swap dealer in an account carried by a third-party custodian, in accordance with rules and regulations prescribed by the CFTC or Prudential Regulator.

#### **Conflicts of Interest- Sec. 119**

This section directs the CFTC to require futures commission merchants and introducing brokers to implement conflict-of-interest systems and procedures relating to research activities and trading.

#### **Swap Execution Facilities- Sec. 120**

This section requires a facility for the trading of swaps to register with the CFTC as a swap execution facility (SEF), subject to certain criteria relating to deterrence of abuses, trading procedures, and financial integrity of transactions. This section also establishes core regulatory principles for SEFs relating to enforcement, anti-manipulation, monitoring, information collection and disclosure, emergency powers, recordkeeping and reporting, antitrust considerations, and conflicts of interest. This section directs the CFTC and SEC to jointly prescribe rules governing the regulation of swap execution facilities, and authorizes the CFTC to exempt from registration under this section a swap execution facility that is subject to comparable, comprehensive supervision and regulation by another regulator.

#### **Derivatives Transaction Execution Facilities and Exempt Boards of Trade- Sec. 121**

This section repeals the existing provisions of the Commodity Exchange Act relating to derivatives transaction execution facilities and exempt boards of trade.

#### **Designated Contract Markets- Sec. 122**

This section requires a board of trade, in order to maintain designation as a contract market, to demonstrate that it provides a competitive, open, and efficient market for trading; has adequate financial, operational, and managerial resources; and has established robust system safeguards to help ensure resiliency.

#### **Margin- Sec. 123**

This section authorizes the CFTC to set margin levels for registered entities.

#### **Position Limits- Sec. 124**

This section authorizes the CFTC to establish aggregate position limits across commodity contracts listed by designated contract markets, commodity contracts traded on a foreign board of trade that provides participants located in the United States with direct access to its electronic trading and order matching system, and swap contracts that perform or affect a significant price discovery function with respect to regulated markets. The CFTC is to take several factors into account when determining whether a swap performs a significant price discovery function, including price linkage, arbitrage, material price references, material liquidity and any other material factors the CFTC deems relevant. However, the CFTC has the authority to exempt any swap or transaction from position limit requirements it imposes.

#### **Enhanced Authority over Registered Entities- Sec. 125**

This section enhances the CFTC's authority to establish mechanisms for complying with regulatory principles and to review and approve new contracts and rules for registered entities.

#### **Foreign Boards of Trade- Sec. 126**

This section authorizes the CFTC to adopt rules and regulations requiring registration by a foreign board of trade that provides members or other participants located in the United States direct access to the foreign board of trade's electronic trading and order matching system. This section also prohibits foreign boards of trade from providing members or other participants located in the United States with direct access to the electronic trading and order matching systems of the foreign board of trade with respect to a contract that settles against the price of a contract listed for trading on a CFTC-registered entity unless the foreign board of trade meets certain standards of comparability to the requirements applicable to U.S. boards of trade. This section also provides legal certainty for certain contracts traded on or through a foreign board of trade.

#### **Legal Certainty for Swaps- Sec. 127**

This section clarifies that no hybrid instrument and no transaction between eligible contract participants shall be void based solely on the failure of the instrument or transaction to comply with statutory or regulatory terms, conditions, or definitions.

#### **Multilateral Clearing Organizations- Sec. 128**

This section makes conforming amendments to the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) to reflect that the definition of "over-

the-counter derivative instrument” under FDICIA no longer includes swaps or security-based swaps as defined in the discussion draft.

#### **Primary Enforcement Authority- Sec. 129**

This section clarifies that the CFTC shall have primary enforcement authority for all provisions of Subtitle A of this Act, other than the new Section 4s(e) of the Commodity Exchange Act, relating to capital and margin requirements for swap dealers and major swap participants, for which the prudential regulators shall have exclusive enforcement authority with respect to banks and branches or agencies of foreign banks that are swap dealers or major swap participants. This section also provides the prudential regulators with backstop enforcement authority with respect to the nonprudential requirements of Section 4s, relating to registration and regulation of swap dealers and major swap participants, if the CFTC does not initiate an enforcement proceeding within 90 days of a written recommendation.

#### **Enforcement- Sec. 130**

This section clarifies the enforcement authority of the CFTC and the prudential authorities.

#### **Retail Commodity Transactions- Sec. 131**

This section clarifies CFTC jurisdiction with respect to certain retail commodity transactions. Specifically, subject to certain restrictions, the CFTC has authority over any transaction in any commodity if a participant is not an eligible contract participant or an eligible commercial entity.

#### **Large Swap Trader Reporting- Sec. 132**

This section requires reporting and recordkeeping with respect to large swap positions that perform or affect a significant price discovery function with respect to regulated markets.

#### **Authority to Ban Abusive Swaps- Sec. 133**

This section gives the SEC and CFTC authority to jointly prescribe rules prohibiting the trading of any swap (security-based or otherwise) that they determine would adversely affect the financial system.

#### **International Harmonization- Sec. 134**

This section directs the SEC, the CFTC, the prudential regulators, the financial stability regulators and the Office of Derivatives Supervision to coordinate with foreign regulatory authorities regarding consistent international standards with respect to regulating swaps.

#### **Authority to Ban Access to the United States Financial System- Sec. 135**

This section gives the Secretary of the Treasury the authority to bar a foreign entity from the US financial system, if the entity’s home country regulates swaps in a way that would adversely affect the financial system.

#### **Other Authority- Sec. 136**

This section clarifies that this title does not divest any appropriate federal banking agency, the CFTC, the SEC, or other federal or state agency of any authority derived from any other applicable law.

**Antitrust- Sec. 137**

This section clarifies that nothing in this title shall be construed to modify, impair, or supersede antitrust law.

**Effective Date- Sec. 138**

This section specifies that this title shall become effective 180 days after the date of enactment.

**Subtitle B — Regulation of Security-Based Swap Markets**

**Definitions under the Securities Exchange Act of 1934- Sec. 151**

This section adds and amends definitions under the Securities Exchange Act of 1934. Terms inserted include, “security-based swap,” “security-based swap dealer,” “major security-based swap dealer,” “swap dealer,” “major swap participant,” “major security-based swap participant,” and “eligible contract participant”—as defined in title A of this Act.

**Repeal of Prohibition on Regulation of Security-Based Swaps- Sec. 152**

This section repeals provisions that prohibited the SEC from regulating security-based swaps.

**Amendments to the Securities Exchange Act of 1934- Sec. 153**

**Subsection (a). Clearing for Security-Based Swaps**

This subsection directs the SEC to identify specific security swap contracts that it determines should be cleared, based on specific criteria; requires the SEC to issue rules or regulations defining the scope of clearing functions necessary to clear identified security swap contracts; and authorizes the CFTC and SEC jointly to prescribe rules or issue interpretations as necessary to prevent evasions.

Security-based swaps not accepted for clearing are to be reported to a security-based swap repository or the SEC. The counterparties may designate which one will report the transaction or, if only one of the counterparties is a swap dealer, the swap dealer will report the transaction.

Additionally, this subsection clarifies that the clearing requirement shall not apply to a swap if a registered clearing agency does not accept the swap or one of the counterparties is not a security-based swap dealer or major security-based swap participant.

Finally, this subsection provides for voluntary registration of clearing agencies and dual CFTC-SEC registration in applicable cases.

Subsection (b). Regulations for Security-Based Swap Clearing Agencies

This subsection requires the SEC and CFTC to jointly issue rules for registered clearing agencies that clear security-based swaps.

Registered clearing agencies must meet such minimum capital and margin requirements as the prudential regulators (for banks) or CFTC and SEC (for nonbanks) shall prescribe. Additionally, registered clearing agencies are required to meet reporting and recordkeeping requirements; conform with business conduct standards; conform with documentation and back office standards; and comply with requirements relating to data maintenance, information provision, and conflicts of interest.

The SEC shall have primary enforcement authority for the provisions subsection, excepting the exclusive enforcement authority the prudential regulators shall have with respect to banks and branches or agencies of foreign banks that are clearing agencies that clear security-based swaps. This section also provides the prudential regulators with backstop enforcement authority with respect to the nonprudential requirements of this subsection, if the SEC does not initiate an enforcement proceeding within 90 days of a written recommendation.

Subsection (c). Execution of Security-Based Swaps

This subsection requires that transactions in standardized swaps between swap dealers and major swap participants be executed on a registered national securities exchange, a registered swap execution facility or a regulated foreign swap execution facility. If the trade is not made on one of those platforms the transacting entity must comply with any recordkeeping or end-of-day transaction reporting requirements that are stipulated by the appropriate regulator. Furthermore, the SEC is to work towards eliminating unnecessary impediments to exchange trading.

Subsection (d). Swap Execution Facilities

This subsection requires facilities for the trading of security-based swaps to register with the SEC as Swap Execution Facilities (SEFs), subject to certain criteria relating to the deterrence of abuses, trading procedures, and financial integrity of transactions. This subsection also establishes core regulatory principles for SEFs relating to enforcement, anti-manipulation, monitoring, information collection and disclosure, emergency powers, recordkeeping and reporting, antitrust considerations, and conflicts of interest. The SEC and CFTC are to jointly prescribe rules governing the regulation of alternative swap execution facilities, and the SEC is authorized to exempt from registration a SEF that is subject to comparable, comprehensive supervision and regulation by another regulator.

Subsection (e). Segregation of Assets Held as Collateral in Swap Transactions

This section requires the margin or collateral posted to a clearinghouse in a security-based swap transaction to be segregated, maintained and used for the benefit of the counterparty, in accordance with rules and regulations prescribed by the SEC or Prudential Regulator.

Additionally, at the request of the counterparty in a non-cleared Over-the-Counter security-based swap, the margin or collateral posted by that counterparty to a swap dealer shall be segregated and maintained in an account carried by a third-party custodian, in accordance with rules and regulations prescribed by the SEC or Prudential Regulator.

Subsection (f). Trading in Security-Based Swap Agreements

This subsection prohibits parties who are not eligible contract participants from effecting security-based swap transactions off of a registered national securities exchange.

Subsection (g). Additions of Security-Based Swaps to Certain Enforcement Provisions

This subsection adds security-based swaps to the Exchange Act's list of financial instruments that a person may not use to manipulate security prices.

Subsection (h). Rulemaking Authority to Prevent Fraud, Manipulation, and Deceptive Conduct in Security-Based Swaps

This subsection prohibits fraudulent, manipulative, and deceptive acts involving security-based swaps, and directs the SEC to prescribe rules and regulations to define and prevent such conduct.

Subsection (i). Position Limits and Position Accountability for Security-Based Swaps and Large Trader Reporting

As a means to prevent fraud and manipulation, this subsection authorizes the SEC to (1) establish limits on the size of positions in any security-based swap and, in establishing such limits, require any person to aggregate positions in any security-based swap or (2) exempt from such limits any person, class of persons, transaction, or class of transactions; and (3) direct a self-regulatory organization to adopt rules relating to position limits for security-based swaps. This subsection also requires reporting and recordkeeping with respect to large security-based swap positions as the SEC may prescribe.

Subsection (j). Public Reporting and Repositories for Security-Based Swap Agreements

This subsection requires the SEC or its designee to make available to the public, aggregate data on security-based swap trading volumes and positions. This subsection also describes the duties of a security-based swap repository as accepting and maintaining security based swap data as prescribed by the SEC, requires security-based swap repositories to register with the SEC, and subjects

registered security-based swap repositories to SEC inspection and examination. This subsection directs the SEC and CFTC to jointly adopt uniform rules governing entities that register with the SEC as security-based swap repositories and entities that register with the CFTC as swap repositories and authorizes the SEC to exempt from registration any security-based swap repository subject to comparable, comprehensive supervision or regulation by another regulator.

#### **Registration and Regulation of Swap Dealers and Major Swap Participants- Sec. 154**

This section requires security-based swap dealers and major security-based swap participants to register with the SEC. Dual registration is required in applicable cases. Additionally, the CFTC and SEC are directed to jointly prescribe uniform rules for entities that register with the CFTC as swap dealers or major swap participants and entities that register with the SEC as security-based swap dealers or major security-based swap participants.

This section also requires a registered security-based swap dealer or major security-based swap participant to meet such minimum capital and margin requirements as the prudential regulators (for banks) or CFTC and SEC (for nonbanks) shall prescribe. The capital and margin requirements set by the CFTC and SEC are to be as strict as or stricter than the requirements set by the prudential regulators. The margin requirements set by the CFTC and SEC shall provide for the use of non-cash assets as collateral. Additionally, registered security-based swap dealers and major security-based swap participants are to meet standards jointly prescribed by the SEC and CFTC relating to reporting, recordkeeping, business conduct, documentation and back office standards, position limits, disclosure, conflicts of interest, and antitrust.

This subsection clarifies that the SEC shall have primary enforcement authority for the provisions of the amendments made by Subtitle B, excepting the exclusive enforcement authority the prudential regulators shall have with respect to banks and branches or agencies of foreign banks that are security-based swap dealer or major security based swap-participants. This section also provides the prudential regulators with backstop enforcement authority with respect to the nonprudential requirements of this subsection, if the SEC does not initiate an enforcement proceeding within 90 days of a written recommendation. Further, the SEC, in consultation with other regulators, shall adopt rules exempting foreign financial institutions from the requirements of this Act if the SEC finds they are subject to comparable regulation in their home country.

#### **Reporting and Recordkeeping- Sec. 155**

This section requires reporting and recordkeeping by any person who enters into a security-based swap that is not cleared or reported to a security-based swap repository. This section also includes security-based swaps within the scope of certain reporting requirements under Sections 13 and 16 of the Exchange Act.

#### **State Gaming and Bucket Shop Laws-Sec. 156**

This section clarifies the applicability of certain state laws to security-based swaps.

**Amendments to the Securities Act of 1933; Treatment of Security-Based Swaps- Sec. 157**

This section amends the Securities Act to include security-based swaps within the definition of “security.” This section also amends Section 5 of the Securities Act to prohibit offers to sell or purchase a security-based swap without an effective registration statement to any person other than an eligible contract participant.

**Other Authority- Sec. 158**

This section clarifies that this title does not divest any appropriate federal banking agency, the SEC, the CFTC, or other federal or state agency of any authority derived from any other applicable law.

**Jurisdiction- Sec. 159**

This section clarifies that the SEC shall not have authority to grant exemptions from the provisions of this Act, except as expressly authorized by this Act.

**Effective Date- Sec. 160**

This section specifies that this title shall become effective 180 days after the date of enactment.