

Conforming Version (To Conform to Release Published in the Federal Register)

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR PARTS 230, 240 and 260**

**Release Nos. 33-9063; 34-60663; 39-2467; File No. S7-02-09**

**RIN 3235-AK26**

**EXTENSION OF TEMPORARY EXEMPTIONS FOR ELIGIBLE CREDIT DEFAULT SWAPS TO FACILITATE OPERATION OF CENTRAL COUNTERPARTIES TO CLEAR AND SETTLE CREDIT DEFAULT SWAPS**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Interim final temporary rules; extension.

**SUMMARY:** We are adopting amendments to the expiration dates in our interim final temporary rules that provide exemptions under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939 for certain credit default swaps in order to facilitate the operation of one or more central counterparties for those credit default swaps. Under the amendments, the expiration dates of the interim final temporary rules will be extended to November 30, 2010.

**DATES:** Effective Date: This rule is effective September 17, 2009, and the expiration dates for the interim final temporary rules and amendments published January 22, 2009 (74 FR 3967) is extended from September 25, 2009 to November 30, 2010.

**FOR FURTHER INFORMATION CONTACT:** Amy M. Starr, Senior Special Counsel, or Sebastian Gomez Abero, Attorney, Office of Chief Counsel, Division of Corporation Finance, at (202) 551-3500, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

**SUPPLEMENTARY INFORMATION:** We are adopting amendments to the following rules: interim final temporary Rule 239T and Rule 146 under the Securities Act of 1933 (“Securities Act”),<sup>1</sup> interim final temporary Rule 12a-10T and Rule 12h-1(h)T under the Securities Exchange Act of 1934 (“Exchange Act”),<sup>2</sup> and interim final temporary Rule 4d-11T under the Trust Indenture Act of 1939 (“Trust Indenture Act”).<sup>3</sup>

## **I. BACKGROUND**

In January 2009, we adopted interim final temporary Rule 239T and a temporary amendment to Rule 146 under the Securities Act, interim final temporary Rules 12a-10T and 12h-1(h)T under the Exchange Act, and interim final temporary Rule 4d-11T under the Trust Indenture Act (collectively, the “Interim Final Temporary Rules”).<sup>4</sup> We adopted these rules in connection with temporary exemptive orders we issued to a clearing agency acting as a central counterparty (“CCP”), which exempted the CCP from the requirement to register as a clearing agency under Section 17A of the Exchange Act<sup>5</sup> solely to perform the functions of a clearing agency for certain credit default swap (“CDS”) transactions. The exemptive orders also exempted certain eligible contract participants<sup>6</sup> and others from certain Exchange Act requirements with respect to certain CDS.<sup>7</sup> Also at that time, we temporarily exempted any exchange that effects transactions in certain CDS from the requirements under Sections 5 and 6 of the Exchange Act<sup>8</sup> to register as a national securities exchange, and any broker or dealer that

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<sup>1</sup> 15 U.S.C. 77a et. seq.

<sup>2</sup> 15 U.S.C. 78a et. seq.

<sup>3</sup> 15 U.S.C. 77aaa et. seq.

<sup>4</sup> See Exchange Act Release No. 59246 (Jan. 14, 2009).

<sup>5</sup> 15 U.S.C. 78q-1.

<sup>6</sup> See 7 U.S.C. 1a(12).

<sup>7</sup> See Exchange Act Release Nos. 59164 and 59165 (Dec. 24, 2008).

<sup>8</sup> 15 U.S.C. 78e and 78f.

effects transactions on an exchange in certain CDS from the requirements of Section 5 of the Exchange Act.

The Interim Final Temporary Rules, and the temporary exemptive orders we provided under the Exchange Act, were intended to facilitate the operation of one or more CCPs that clear and settle CDS transactions while enabling us to provide oversight to the CDS market.<sup>9</sup> Since the adoption of the interim final rules, only one CCP, ICE U.S. Trust LLC (“ICE Trust”), has been actively engaged as a CCP in clearing CDS transactions in the U.S. in accordance with our exemptions.<sup>10</sup> As of August 28, 2009, ICE Trust had cleared more than 22,800 CDS transactions with a notional value of \$1.9 trillion.<sup>11</sup> We believe that the clearing of CDS transactions by ICE Trust has contributed and we anticipate will continue to contribute to increased transparency<sup>12</sup> and the reduction of systemic risk in the CDS market.<sup>13</sup>

We also granted exemptive orders to four other CCPs to clear CDS, two of which were approved in July 2009.<sup>14</sup> The Chicago Mercantile Exchange, to whom we granted an exemptive

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<sup>9</sup> For a discussion of concerns related to the market in CDS, and the development of the exemptive orders and interim temporary rules, see Exchange Act Release No. 59246 (Jan. 14, 2009).

<sup>10</sup> See Exchange Act Release No. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009) (temporary exemption for ICE U.S. Trust LLC).

<sup>11</sup> See Historical Daily Volume Report – ICE Trust U.S., available at <https://www.theice.com/marketdata/reports/ReportCenter.shtml?reportId=26>.

<sup>12</sup> See Testimony of Mark Lenczowski, Managing Director and Assistant General Counsel at JPMorgan Chase & Co., to the Senate Agriculture Committee (June 4, 2009) (In his testimony, Mr. Lenczowski indicated, in the context of CDS clearing by ICE Trust, that “[c]learing is a highly transparent process....”).

<sup>13</sup> As of June 30, 2009, ICE Trust had reduced the notional amount of CDS open interest, or net exposure, from over \$1.3 trillion to \$168.5 billion by clearing trades and netting positions. See, Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 (filed on August 5, 2009). ICE Trust also has a guarantee fund that provides additional protection in the event of a clearing participant default. See Exchange Act Release No. 59527, supra Note 10.

<sup>14</sup> See Exchange Act Release No. 60373 (July 23, 2009) (temporary exemption for Eurex Clearing AG); Exchange Act Release No. 60372 (July 23, 2009) (temporary exemption for ICE Clear Europe Limited); Exchange Act Release No. 59578 (Mar. 13, 2009) (temporary exemption for Chicago Mercantile Exchange Inc.); and Exchange Act Release No. 59164 (Dec. 24, 2008) (temporary exemption for LIFFE A&M and LCH.Clearnet Ltd.). LIFFE A&M and LCH Clearnet Ltd., to whom we granted exemptive orders in December 2008, indicated that they will suspend their plans to clear CDS. See, Alastair Marsh, NYSE

order in March 2009, has indicated that it continues to work with buy and sell participants in the CDS market to promote its CCP.<sup>15</sup> ICE Clear Europe Limited (“ICE Europe”) and Eurex Clearing AG (“Eurex”) have begun clearing CDS transactions in Europe.<sup>16</sup>

Since the adoption of the Interim Final Temporary Rules, a number of legislative initiatives relating to the regulation of derivatives, including CDS, have been introduced by members of Congress and recommended by the United States Department of the Treasury (“Treasury”).<sup>17</sup> Congress has not yet taken definitive action with respect to any of the legislative initiatives or the Treasury proposals. Separately, in July 2009, the Committee on Payment and Settlement Systems (“CPSS”) and the Technical Committee of the International Organization of Securities Commissions (“IOSCO”) established a working group to review the application of the CPSS-IOSCO Recommendations for Central Counterparties (“Recommendations”) with respect to OTC derivatives.<sup>18</sup> The Recommendations set out standards for risk management of CCPs.

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Liffe and LCH.Clearnet close CDS clearing service (Aug. 12, 2009), available at <http://www.risk.net/public/showPage.html?page=867491>.

<sup>15</sup> See Christine Birkner, CDS Clearing Battle (Buy Side vs. Sell Side), Futures (July 1, 2009) (“A spokesperson for CME Group says, ‘We continue to work with buy and sell participants to demonstrate the value of our offering.’”).

<sup>16</sup> See Press Release, IntercontinentalExchange, ICE Clear Europe Clears Euro 51 Billion in Third Week of European CDS Processing; Announces New CDS Clearing Member (Aug. 17, 2009), available at <http://ir.theice.com/releasedetail.cfm?ReleaseID=403509>. See also, Press Release, Eurex Clearing AG, Eurex Credit Clear Clears First Single Name CDS Worldwide (Aug. 28, 2009), available at [http://www.eurexclearing.com/about/press/press\\_647\\_en.html](http://www.eurexclearing.com/about/press/press_647_en.html).

<sup>17</sup> See, e.g., Derivatives Trading Integrity Act of 2009 (S. 272) (introduced by Senator Tom Harkin in January 2009); The Derivatives Markets Transparency and Accountability Act (H.R. 977) (introduced by Representative Collin Peterson in February 2009); Authorizing the Regulation of Swaps Act (S. 961) (introduced by Senator Carl Levin and Senator Susan Collins in May 2009); Treasury’s framework for regulatory reform (released in June 2009); Derivative Trading Accountability and Disclosure Act (H.R. 3300) (introduced by Representative Michael McMahon in July 2009); Description of Principles for OTC Derivatives Legislation (announced by Representative Barney Frank and Representative Collin Peterson in July 2009); Senator Charles Schumer’s announcement that he is drafting a bill establishing central trade repositories for OTC derivatives markets (August 2009); and Over-the-Counter Derivatives Markets Act of 2009 (prepared by Treasury and sent to Congress in August 2009).

<sup>18</sup> See Press Release, Bank for International Settlements, CPSS-IOSCO working group on the review of the “Recommendations for Central Counterparties” (July 20, 2009), available at <http://www.bis.org/press/p090720.htm>.

The working group plans to identify key issues that can arise when a CCP provides central clearing services for OTC derivatives transactions.<sup>19</sup>

At the time of adoption of the Interim Final Temporary Rules, we requested comment on various aspects of the rule provisions. We received a total of 15 letters, only two of which commented specifically on the interim temporary final rules. Those two letters generally supported allowing CCPs to clear and settle CDS transactions in accordance with the terms of the Interim Final Temporary Rules; but neither of the commenters specifically addressed the duration of the Interim Final Temporary Rules and temporary amendments.<sup>20</sup> The other commenters raised issues not directly related to this rulemaking.<sup>21</sup>

The Interim Final Temporary Rules expire on September 25, 2009. We have determined that it is necessary and appropriate to extend the expiration date of the Interim Final Temporary Rules to November 30, 2010.<sup>22</sup>

## **II. DISCUSSION OF THE FINAL TEMPORARY RULES**

We are adopting amendments to the Interim Final Temporary Rules to extend the expiration date of each of the rules to November 30, 2010. We are not making any other changes to the Interim Final Temporary Rules.

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<sup>19</sup> “Where necessary, the working group will propose guidance on how CCPs for OTC derivatives may meet the standards set out by the recommendations and will identify any areas in which the recommendations might be strengthened or expanded to better address risks associated with the central clearing of OTC derivatives. Participants in the working group include representatives of the central banks that are members of the CPSS, representatives of the securities regulators that are members of the IOSCO Technical Committee, and representatives of the International Monetary Fund and the World Bank.” *Id.*

<sup>20</sup> *See* letters from the Yale Law School Capital Markets and Financial Instruments Clinic (March 23, 2009) and from IDX Capital (March 23, 2009).

<sup>21</sup> The public comments we received are available for inspection in the Commission’s Public Reference Room at 100 F St. N.E., Washington, DC 20549 in File No. S7-02-09. They are also available online at <http://www.sec.gov/comments/s7-02-09/s70209.shtml>.

<sup>22</sup> *See* Section III, *infra*, for a discussion of why the extension of time is necessary.

**A. Securities Act Rule 239T and Rule 146.**

Securities Act Rule 239T exempts from all provisions of the Securities Act, except the anti-fraud provisions of Section 17(a), certain CDS (“eligible CDS”)<sup>23</sup> that are offered and sold only to “eligible contract participants,”<sup>24</sup> and that are being or will be issued or cleared by a CCP satisfying the conditions set forth in the CCP exemptions, or registered as a clearing agency under Section 17A of the Exchange Act (“Registered or Exempt CCP”). Hence, under Securities Act Rule 239T, the offer and sale of eligible CDS are exempt from the registration requirements of the Securities Act if the eligible CDS is or will be issued or cleared by a Registered or Exempt CCP, and offered and sold only to an eligible contract participant. Communications used in connection with such offers and sales are not subject to Section 12(a)(2) liability under the Securities Act. Securities Act Rule 239T assures the availability of information to buyers and sellers of CDS due to certain information conditions in the CCP exemptive orders.<sup>25</sup>

As we noted in January 2009, absent this exemption, the Securities Act may require registration of the offer and sale of eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP. Without also exempting the offers and sales of the eligible CDS by

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<sup>23</sup> See 17 CFR 230.239T(d).

<sup>24</sup> For purposes of Securities Act Rule 239T, “eligible contract participant” has the same meaning as in Section 1a(12) of the Commodity Exchange Act (the “CEA”), as in effect on the date of adoption of Rule 239T, except that the term does not include a person who is an “eligible contract participant” pursuant to Section 1a(12)(C) of the CEA. 17 CFR 230.239T(a)(2).

<sup>25</sup> We note that among the conditions of the exemptions, or representations in the exemptive requests on which we are relying, from clearing registration are that: (1) information is available about the terms of the CDS, the creditworthiness of the CCP or any guarantor, and the clearing and settlement process for the CDS; and (2) the reference entity, the issuer of the reference security, or the reference security is one of the following: an entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available; a foreign private issuer that has securities listed outside the United States and has its principal trading market outside the United States; a foreign sovereign debt security; an asset-backed security, as defined in Regulation AB [17 CFR 229.1100], issued in a registered transaction with publicly available distribution reports; an asset-backed security issued or guaranteed by Fannie Mae, Freddie Mac or the Government National Mortgage Association; or indexes in which 80 percent or more of the index’s weight is comprised of these reference entities or reference securities. See, e.g., Exchange Act Release No. 59527, supra Note 10.

a Registered or Exempt CCP from the registration requirements of the Securities Act and the Exchange Act and the provisions of the Trust Indenture Act, we believe that the CCPs would not be able to operate in the manner contemplated by the Exchange Act exemptive orders. In addition, the Securities Act, Exchange Act and Trust Indenture Act exemptions are intended to encourage market participants to clear their CDS through the CCPs.

Securities Act Rule 239T also provides that any offer or sale of an eligible CDS that is or will be issued or cleared by a Registered or Exempt CCP by or on behalf of the issuer of a security, an affiliate of such issuer, or an underwriter, if such security is delivered in settlement or whose value is used to determine the amount of the settlement obligation, will constitute a “contract for sale of,” “sale of,” “offer for sale,” or “offer to sell” such security under Section 2(a)(3) of the Securities Act.<sup>26</sup> This provision is intended to ensure that an eligible CDS that is or will be issued or cleared by a Registered or Exempt CCP cannot be used by an issuer, affiliate of an issuer or underwriter to circumvent the registration requirements of Section 5 with respect to an issuer’s security for such eligible CDS.<sup>27</sup> As a result, a transaction by such persons in an eligible CDS that is or will be issued or cleared by a Registered or Exempt CCP having such securities of the issuer also is a transaction in the issuer’s securities that must be registered under the Securities Act, unless an exemption from registration is available.

We also adopted on an interim final temporary basis an amendment to Securities Act Rule 146. Under the temporary amendment to Rule 146, eligible contract participants that are sold eligible CDS in reliance on interim final temporary Securities Act Rule 239T are defined as “qualified purchasers” under Section 18(b)(3) of the Securities Act and thereby such eligible

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<sup>26</sup> 17 CFR 230.239T(c).

<sup>27</sup> This provision is similar to the condition in the Securities Act exemption in Rule 238 for standardized options [17 CFR 230.238] and in Securities Act Section 2(a)(3) [15 U.S.C. 77b(a)(3)] relating to security futures products.

CDS that are or will be issued or cleared by a Registered or Exempt CCP are considered “covered securities” under Section 18 of the Securities Act and exempt from state blue sky laws.<sup>28</sup>

**B. Exchange Act Rule 12a-10T and Rule 12h-1(h)T**

In January 2009, we also adopted two Interim Final Temporary Rules relating to Exchange Act registration of eligible CDS that are or have been issued or cleared by a Registered or Exempt CCP. Exchange Act Rule 12a-10T exempts eligible CDS that are or have been issued or cleared by a Registered or Exempt CCP from the provisions of Section 12(a) of the Exchange Act under certain conditions.<sup>29</sup> Exchange Act Rule 12h-1(h)T exempts eligible CDS that are or have been issued or cleared by a Registered or Exempt CCP from the provisions of Section 12(g) of the Exchange Act under certain conditions.<sup>30</sup>

**C. Trust Indenture Act Rule 4d-11T**

We also adopted a rule under Section 304(d) of the Trust Indenture Act that exempts any eligible CDS, as defined in Securities Act Rule 239T and offered and sold in reliance on Securities Act Rule 239T, from having to comply with the provisions of the Trust Indenture Act.<sup>31</sup>

**III. AMENDMENT OF EXPIRATION DATE OF INTERIM FINAL TEMPORARY RULES**

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<sup>28</sup> 17 CFR 230.146(c)T. State securities regulation of covered securities generally is limited under Section 18(b). Under Section 18(b)(3), covered securities are securities offered and sold to qualified purchasers, as defined by the Commission.

<sup>29</sup> 15 U.S.C. 78l(a).

<sup>30</sup> 17 CFR 240.12h-1(h)T; 15 U.S.C. 78l(g).

<sup>31</sup> Rule 4d-11T. The Trust Indenture Act applies to debt securities sold through the use of the mails or interstate commerce. Section 304 of the Trust Indenture Act exempts from the Act a number of securities and transactions. Section 304(a) of the Trust Indenture Act exempts securities that are exempt under Securities Act Section 3(a), but does not exempt from the Trust Indenture Act securities that are exempt by Commission rule. Accordingly, while Securities Act Rule 239T exempts the offer and sale of eligible CDS satisfying certain conditions from all the provisions of the Securities Act (other than Section 17(a)), the Trust Indenture Act would continue to apply.

In January 2009, we adopted the interim final rules on a temporary basis until September 25, 2009 because we anticipated that this date would provide us with adequate time to evaluate the availability of the exemptions applicable to CDS CCPs and non-excluded CDS, and whether any conditions or provisions of such exemptions should be modified. At the time we adopted the Interim Final Temporary Rules, we indicated that we could act to extend the expiration date of such rules.<sup>32</sup>

We have now determined that it is necessary to extend the expiration date of the Interim Final Temporary Rules for the following reasons. First, we adopted the interim final rules to foster the development of CCPs by providing exemptions from certain regulatory provisions that might otherwise prevent them from engaging in such activities in the manner contemplated by the exemptive orders. To date, there has been only one CCP (ICE Trust) that has begun to clear and settle CDS transactions in the U.S. and two CCPs (ICE Europe and Eurex) that have begun to clear and settle CDS transactions in Europe. Extending the expiration date of our Interim Final Temporary Rules would not only allow ICE Trust, ICE Europe and Eurex to continue to clear and settle CDS transactions, it would also enable other CCPs to start clearing and settling CDS transactions in the manner contemplated by the exemptive orders. Competition among CCPs clearing CDS transactions could give participants more choice for their trading needs and may reduce clearing fees.<sup>33</sup> In addition, the extension would give us more time to evaluate the

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<sup>32</sup> See Section III of Exchange Act Release No. 59246 (Jan. 14, 2009).

<sup>33</sup> See Harrington and Leising, *supra* note 15 (quoting Theo Lubke, an official with the Federal Reserve Bank of New York responsible for the central bank's efforts to curb risk in the CDS market, as stating that "A competitive [CCP clearing] environment, at least in the short run, is beneficial. We don't want the first mover to be the winner just because they're the first mover. We would like to see real choice in the market for a period of time to determine which is the better mousetrap."). See also, Financial Services: Cost of Trading Going Down, Survey Finds, Europolitics (July 17, 2009) (citing European Commissioner Charlie McCreevy, "I particularly welcome the [European Commission] study's findings concerning the decreases in costs for trading and clearing and to some extent also for settlement services since 2006. This confirms

rule and assess its effect on the CDS market and the market participants. As reflected in the CPSS-IOSCO Recommendations, our fellow regulators around the world are also thinking about how to address the risks associated with the central clearing of OTC derivatives, and this remains an open and current topic of discussion for all securities regulators. Finally, Treasury has delivered financial regulatory reform proposals to Congress, and several bills to regulate derivatives and the derivatives markets have been introduced in Congress.

Absent an exemption, the offer and sale of eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP may have to be registered under the Securities Act, the eligible CDS that have been so issued or cleared may have to be registered as a class under the Exchange Act, and the provisions of the Trust Indenture Act may need to be complied with. We believe that the Interim Final Temporary Rules have facilitated and anticipate that they will continue to facilitate the use by eligible contract participants of CDS CCPs. Absent an extension of the expiration date of the interim final rules, we believe that the CCPs would not be able to operate in the manner contemplated by the exemptive orders. We note that the expiration dates of certain of these exemptive orders currently extend until April 23, 2010. We are, therefore, adopting amendments to each of the interim final rules to extend the expiration date of the rules to November 30, 2010. Extending the expiration dates for this length of time will allow us to continue to monitor the development and operation of CCPs in the CDS market under the current, evolving regulatory and legislative environment.

#### **IV. CERTAIN ADMINISTRATIVE LAW MATTERS**

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the positive impact on competition of the Markets in Financial Instruments Directive and the code of conduct on clearing and settlement.”).

Section 553(b) of the Administrative Procedure Act (“APA”)<sup>34</sup> generally requires an agency to publish notice of a proposed rule making in the Federal Register. This requirement does not apply, however, if the agency “for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.”<sup>35</sup> The Commission finds good cause to act immediately to extend the expiration date of the Interim Final Temporary Rules. When we adopted the rules in January of this year, we sought sufficient time to evaluate the appropriateness of the exemptions and the role of CCPs in the CDS market. Since that time, we have granted orders to four additional CDS CCPs exempting them from the requirement to register as a clearing agency under Section 17A of the Exchange Act. Two of these orders were granted as recently as July 2009, and one CCP has started to clear CDS transactions in the U.S. and two have begun clearing CDS in Europe. In addition, there have been a number of recent and still developing legislative and regulatory initiatives relating to the regulation of derivatives, including CDS. Finally, we note that commenters had an opportunity to comment on the length of the temporary rules in January of this year and that this extension is of a limited duration. Therefore, we believe there is good cause to extend the exemption until November 30, 2010 and find that notice and solicitation of comment on the extension to be impracticable, unnecessary, or contrary to the public interest.<sup>36</sup>

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<sup>34</sup> 5 U.S.C. 553(b).

<sup>35</sup> 5 U.S.C. 553(b)(B).

<sup>36</sup> This finding also satisfies the requirements of 5 U.S.C. 808(2), allowing the rule amendment to become effective notwithstanding the requirement of 5 U.S.C. 801 (if a federal agency finds that notice and public comment are “impractical, unnecessary or contrary to the public interest,” a rule “shall take effect at such time as the federal agency promulgating the rule determines”).

The APA also generally requires that an agency publish an adopted rule in the Federal Register 30 days before it becomes effective.<sup>37</sup> However, this requirement does not apply if the agency finds good cause not to delay the effective date.<sup>38</sup> For similar reasons to those explained above, the Commission finds good cause not to delay the effective date.

## **V. PAPERWORK REDUCTION ACT**

The Interim Final Temporary Rules do not impose any new “collections of information” within the meaning of the Paperwork Reduction Act of 1995 (“PRA”),<sup>39</sup> nor do they create any new filing, reporting, recordkeeping, or disclosure reporting requirements for a CCP that is or will be issuing or clearing eligible CDS. Accordingly, we did not submit the Interim Final Temporary Rules to the Office of Management and Budget for review in accordance with the PRA.<sup>40</sup> We requested comment on whether our conclusion that there are no collections of information is correct, and we did not receive any comment. The extension of the expiration dates does not change our analysis.

## **VI. COST-BENEFIT ANALYSIS**

In January 2009, we adopted the Interim Final Temporary Rules under the Securities Act, the Exchange Act and the Trust Indenture Act that exempt eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP and offered and sold only to eligible contract participants from all provisions of the Securities Act, other than the Section 17(a) anti-fraud provision, as well as from the registration requirements under Section 12 of the Exchange Act and from the provisions of the Trust Indenture Act. The Interim Final Temporary Rules were

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<sup>37</sup> 5 U.S.C. 553(d).

<sup>38</sup> 5 U.S.C. 553(d)(3).

<sup>39</sup> 44 U.S.C. 3501 *et seq.*

<sup>40</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

intended to facilitate the operation of one or more CCPs to act as a clearing agency in the CDS market to reduce some of the risks in the CDS market. Today, we are adopting amendments to such rules to extend their expiration date to November 30, 2010.

Since the adoption of the Interim Final Temporary Rules, one CCP (ICE Trust) has been actively engaged as a CCP in clearing CDS transactions in the U.S. in accordance with terms of the exemptive orders, and two other CCPs (ICE Europe and Eurex) have begun clearing CDS transactions in Europe. In addition, a number of legislative initiatives relating to the regulation of derivatives, including CDS, have been introduced by members of Congress and recommended by the United States Department of the Treasury.<sup>41</sup> Extending the expiration dates of the Interim Final Temporary Rules for this length of time will allow us to continue to monitor the development and operation of CCPs in the CDS market under the current, evolving regulatory and legislative environment.

A CDS is a bilateral contract between two parties, known as counterparties. The value of this financial contract is based on underlying obligations of a single entity, or on a particular security or other debt obligation, or an index of several such entities, securities, or obligations. The obligation of a seller to make payment under a CDS contract is triggered by a default or other credit event as to such entity or entities or such security or securities. Investors may use CDS for a variety of reasons, including to offset or insure against risk in their fixed-income portfolios, to take synthetic positions in bonds or in segments of the debt market as represented by an index, or to capitalize on the volatility in credit spreads during times of economic uncertainty. In recent years, CDS market volumes have rapidly increased.<sup>42</sup> This growth has

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<sup>41</sup> See Section I, *supra*, for additional discussion of developments in this area since the adoption of the Interim Final Temporary Rules.

<sup>42</sup> See Semiannual OTC derivatives statistics at end-December 2008, Bank for International Settlements (“BIS”), available at <http://www.bis.org/statistics/otcder/dt1920a.pdf>.

coincided with a significant rise in the types and number of entities participating in the CDS market.<sup>43</sup>

In a CCP arrangement, both parties entering a CDS novate their trades to the CCP, and the CCP stands in as the counterparty to all parties of the CDS it clears. Through this novation process, the counterparty risk of a CDS is effectively concentrated in the CCP.

#### **A. Benefits**

We are extending the termination date of the Interim Final Temporary Rules that provide exemptions from certain provisions of the Securities Act, the Exchange Act and the Trust Indenture Act, subject to certain conditions described in the CCP exemptive orders and in the exemptions themselves to further facilitate the operation of CCPs in the CDS market. The conditions and representations in the CCP exemptive orders and exemptions require that information be available about the terms of the CDS, the creditworthiness of the CCP or any guarantor, and the clearing and settlement process for the CDS. Additionally, the conditions require that financial information about the reference entity, the issuer of the reference security, or the reference security be publicly available. We believe that the Interim Final Temporary Rules and the exemptions under the Exchange Act, have facilitated and we anticipate will continue to facilitate the operation of CCPs<sup>44</sup> while enabling us to provide oversight to the non-excluded CDS market.<sup>45</sup> We believe that the operation of at least one CCP over the last six

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<sup>43</sup> CDSs were initially created to meet the demand of banking institutions looking to hedge and diversify the credit risk attendant with their lending activities. However, other financial institutions such as insurance companies, pension funds, securities firms and hedge funds have entered the CDS market.

<sup>44</sup> See Karen Brettell, Banks to submit 95 pct of eligible CDS for clearing (Sep. 1, 2009), available at <http://www.reuters.com/article/euRegulatoryNews/idUSN0150814420090901?pageNumber=1&virtualBrandChannel=10522>.

<sup>45</sup> See e.g., Exchange Act Release No. 59527, supra Note 10 (our exemptions require that the CCPs provide us with, among other things, access to conduct on-site inspections of facilities, records and personnel).

months in accordance with our exemptions has increased transparency,<sup>46</sup> increased available information about exposures to particular reference entities or reference securities,<sup>47</sup> and reduced risks to participants in the market for CCP-cleared CDS.<sup>48</sup> Not extending the termination date could cause significant disruptions in this market. Therefore, we believe this extension provides important benefits.

Absent an exemption, the offer and sale of eligible CDS that are and will be issued or cleared by a Registered or Exempt CCP would have to be registered under the Securities Act, the eligible CDS that are or have been issued or cleared by a Registered or Exempt CCP would have to be registered as a class under the Exchange Act, and the provisions of the Trust Indenture Act would apply. We believe that the Interim Final Temporary Rules exempting the registration of eligible CDS issued or cleared by a Registered or Exempt CCP under certain conditions have facilitated and we anticipate will continue to facilitate the use by eligible contract participants of CDS CCPs. Without also exempting the offers and sales of eligible CDS issued or cleared by a Registered or Exempt CCP from the registration requirements of the Securities Act and the Exchange Act and the provisions of the Trust Indenture Act, we believe that the CCPs would not be able to operate in the manner contemplated by the exemptive orders.

The interim final temporary exemptions treat eligible CDS issued or cleared by a Registered or Exempt CCP under the Securities Act and the Exchange Act in the same manner as certain other types of derivative contracts, such as security futures products and standardized

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<sup>46</sup> See Testimony of Mark Lenczowski, supra Note 12.

<sup>47</sup> See e.g., Exchange Act Release No. 59527, supra Note 26.

<sup>48</sup> See IntercontinentalExchange, supra Note 13.

options.<sup>49</sup> A Registered or Exempt CCP issuing or clearing eligible CDS benefits from the temporary exemptions because it does not have to file registration statements with us covering the offer and sale of the eligible CDS. The registration form most applicable to a CCP is a Form S-20, which is the form that is used by options clearing houses that do not qualify for our exemption in Securities Act Rule 238<sup>50</sup> from registering the offer and sale of standardized options. If a CCP is not required to register the offer and sale of eligible CDS (on Form S-20, for example), it would not have to incur the costs of such registration, including legal and accounting costs. Some of these costs, of course, such as the costs of obtaining audited financial statements, may still be incurred as a result of the operations of the entity as a CCP and the regulatory oversight of the central counterparty operations. In addition, if any of the CCPs are entities that are subject to the periodic reporting requirements of the Exchange Act, the cost of filing a registration statement covering the eligible CDS would be lessened further as the information regarding the CCP already would be prepared. The availability of exemptions under the Securities Act, the Exchange Act, and the Trust Indenture Act also would mean that CCPs would not incur the costs of preparing disclosure documents describing eligible CDS and from preparing indentures and arranging for the services of a trustee.

## **B. Costs**

The Interim Final Temporary Rules exempting offers and sales of eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP have facilitated and we anticipate will continue to facilitate the use by eligible contract participants of CDS CCPs that are the subject of exemptive orders at some costs to the CCP or investors.

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<sup>49</sup> See, e.g., Securities Act Section 3(a)(14) [15 U.S.C. 77c(a)(14)], Securities Act Rule 238 [17 CFR 230.238]; Exchange Act Section 12(a) [15 U.S.C. 78j], and Exchange Act Rule 12h-1(d) and (e) [17 CFR 240.12h-1(d) and (e)].

<sup>50</sup> 17 CFR 230.238.

Absent an exemption, a CCP may have to file a registration statement covering the offer and sale of the eligible CDS, may have to satisfy the applicable provisions of the Trust Indenture Act, and may have to register the class of eligible CDS that it has issued or cleared under the Exchange Act, which would provide investors with civil remedies in addition to antifraud remedies. While a CCP registration statement covering eligible CDS (or the offer and sale of such eligible CDS) may provide certain information about the CCP, CDS contract terms, and the identification of reference entities or reference securities, it would not necessarily provide the type of information necessary to assess the credit risk of the reference entity or reference security. Further, while a CCP registration statement would provide information to the CDS market participants, as well as to the market as a whole, a condition of the clearing agency exemption in the exemptive orders is that the CCPs make their audited financial statements and other information about themselves publicly available.

We recognize that a consequence of the exemptions has been and will continue to be the unavailability of certain remedies under the Securities Act and the Exchange Act and certain protections under the Trust Indenture Act. While an investor would be able to pursue an antifraud action in connection with the purchase and sale of eligible CDS under Exchange Act Section 10(b),<sup>51</sup> it would not be able to pursue civil remedies under Sections 11 or 12 of the Securities Act.<sup>52</sup> We could still pursue an antifraud action in the offer and sale of eligible CDS issued or cleared by a CCP.<sup>53</sup> We believe that the incremental costs from the extension of the expiration date of the Interim Final Temporary Rules will be minimal because the amendments are merely an extension of such Interim Final Temporary Rules and such extension will not

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<sup>51</sup> 15 U.S.C. 78j(b).

<sup>52</sup> 15 U.S.C. 77k and 77l.

<sup>53</sup> See 15 U.S.C. 77q and 15 U.S.C. 78j(b).

affect the information and remedies available to investors as a result of the Interim Final Temporary Rules.

## **VII. CONSIDERATION OF IMPACT ON THE ECONOMY, BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION**

Section 23(a)(2) of the Exchange Act<sup>54</sup> requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition.

Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. In addition, Section 2(b)<sup>55</sup> of the Securities Act and Section 3(f)<sup>56</sup> of the Exchange Act require us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to also consider whether the action will promote efficiency, competition, and capital formation.

The Interim Final Temporary Rules we are extending today exempt eligible CDS issued or cleared by a Registered or Exempt CCP from all provisions of the Securities Act, other than the Section 17(a) antifraud provision, as well as from the registration requirements under Section 12 of the Exchange Act and the provisions of the Trust Indenture Act. Because these interim final temporary exemptions are available to any Registered or Exempt CCP offering and selling eligible CDS, we do not believe that the exemptions impose a burden on competition. Although only one CCP is currently clearing and settling CDS in the U.S., we believe the extension will increase the opportunity for other CCPs to compete in the marketplace. We also believe that the ability to settle CDS through CCPs has improved and we anticipate will continue to improve the

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<sup>54</sup> 15 U.S.C. 78w(a)(2).

<sup>55</sup> 15 U.S.C. 77b(b).

<sup>56</sup> 15 U.S.C. 78c(f).

transparency of the CDS market and provide greater assurance to participants as to the capacity of the eligible CDS counterparty to perform its obligations under the eligible CDS. ICE Trust, for example, makes available on its website information about open interests, or net exposure, volume and pricing of CDS transactions. We believe that increased transparency in the CDS market could help to decrease further market turmoil and thereby facilitate the capital formation process.

### **VIII. REGULATORY FLEXIBILITY ACT CERTIFICATION**

The Commission certified pursuant to 5 U.S.C. 605(b) that the Interim Final Temporary Rules would not have a significant economic impact on a substantial number of small entities. The Interim Final Temporary Rules exempt eligible CDS that are or will be issued or cleared by a Registered or Exempt CCP. None of the entities that are eligible to meet the requirements of the exemption from registration under Section 17A is a small entity. We received no comments on the certification.

### **IX. STATUTORY AUTHORITY AND TEXT OF THE RULES AND AMENDMENTS**

The amendments described in this release are being adopted under the authority set forth in Sections 18, 19 and 28 of the Securities Act; Sections 12(h), 23(a) and 36 of the Exchange Act; and Section 304(d) of the Trust Indenture Act.

#### **List of Subjects**

17 CFR Parts 230, 240 and 260

Reporting and recordkeeping requirements, Securities.

## TEXT OF THE RULES AND AMENDMENTS

Accordingly, we are temporarily amending 17 CFR parts 230, 240, and 260 as follows and the expiration date for the interim final temporary rules published January 22, 2009 (74 FR 3967) is extended from September 25, 2009, to November 30, 2010.

### **PART 230 - GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933**

1. The authority citation for Part 230 continues to read, in part, as follows:

Authority: 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

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#### **§§ 230.146 and 230.239 [Amended]**

2. In § 230.146(c)T, in the last sentence, remove the words “September 25, 2009” and add, in their place, the words “November 30, 2010”.
3. In § 230.239T(e), remove the words “September 25, 2009” and add, in their place, the words “November 30, 2010”.

### **PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

4. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

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**§§ 240.12a-10T and 240.12h-1 [Amended]**

5. In § 240.12a-10T(b), remove the words “September 25, 2009” and add, in their place, the words “November 30, 2010”.

6. In § 240.12h-1(h)T, in the last sentence, remove the words “September 25, 2009” and add, in their place, the words “November 30, 2010”.

**PART 260 - GENERAL RULES AND REGULATIONS, TRUST INDENTURE ACT OF 1939**

7. The authority citation for Part 260 continues to read as follows:

Authority: 15 U.S.C. 77eee, 77ggg, 77nnn, 77sss, 78ll(d), 80b-3, 80b-4, and 80b-11.

**§ 260.4d-11T [Amended]**

8. Section 260.4d-11T is amended by removing the words “September 25, 2009” and adding, in their place, the words “November 30, 2010” in the last sentence.

By the Commission.

Elizabeth M. Murphy  
Secretary

September 14, 2009