

special accommodations to take part because of a disability should notify a contact person listed below. The public is invited to submit written statements to the Committee.

The agenda for the meeting includes: (i) Remarks by Dan Ariely, behavioral economist, on investor reaction to disclosure; (ii) update on recommendations previously adopted by the Committee; (iii) briefing on the Investor as Owner Subcommittee's environmental, social, and governance disclosure workplan; (iv) update on certain issues involved in financial reform legislation; (v) discussion of fiduciary duty, in the context of investment advisers and registered broker-dealers, including a presentation by SEC staff; (vi) discussion with an expert panel on mandatory arbitration; (vii) discussion of money market funds and the issue of net asset value ("NAV"), including a presentation by SEC staff; (viii) recommendation by Investor Education Subcommittee of an investor education campaign; (ix) reports from Subcommittees on other activities; and (x) discussion of next steps and closing comments.

**DATES:** Written statements should be received on or before May 10, 2010.

**ADDRESSES:** Written statements may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission's Internet submission form (<http://www.sec.gov/rules/other.shtml>); or
- Send an e-mail message to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number 265-25-04 on the subject line.

#### *Paper Comments*

- Send paper statements in triplicate to Elizabeth M. Murphy, Federal Advisory Committee Management Officer, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.
- All submissions should refer to File No. 265-25-04. This file number should be included on the subject line if e-mail is used. To help us process and review your statements more efficiently, please use only one method. The Commission staff will post all statements on the Advisory Committee's Web site (<http://www.sec.gov/spotlight/investoradvisorycommittee.shtml>). Statements also will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All statements received will be posted

without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

#### **FOR FURTHER INFORMATION CONTACT:**

Kayla J. Gillan, Deputy Chief of Staff, Office of the Chairman, at (202) 551-2100, or Owen Donley, Chief Counsel, Office of Investor Education and Advocacy, at (202) 551-6322, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-6561.

**SUPPLEMENTARY INFORMATION:** In accordance with Section 10(a) of the Federal Advisory Committee Act, 5 U.S.C. App. 1, § 10(a), Kayla J. Gillan, Designated Federal Officer of the Committee, has approved publication of this notice.

Dated: April 26, 2010.

**Elizabeth M. Murphy,**  
*Committee Management Officer.*

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## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-61975; File No. S7-17-09]

### **Order Extending and Modifying Temporary Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection With Request on Behalf of Eurex Clearing AG Related to Central Clearing of Credit Default Swaps, and Request for Comment**

April 23, 2010.

#### **I. Introduction**

Over the past year, the Securities and Exchange Commission ("Commission") has taken multiple actions to protect investors and ensure the integrity of the nation's securities markets, including actions<sup>1</sup> designed to address concerns

<sup>1</sup> See generally Securities Exchange Act Release No. 60372 (Jul. 23, 2009), 74 FR 37748 (Jul. 29, 2009) and Securities Exchange Act Release No. 61973 (Apr. 23, 2010) (temporary exemptions in connection with CDS clearing by ICE Clear Europe Limited); Securities Exchange Act Release No. 60373 (Jul. 23, 2009), 74 FR 37740 (Jul. 29, 2009) (temporary exemptions in connection with CDS clearing by Eurex Clearing AG) (hereinafter, the "July Eurex Order"); Securities Exchange Act Release No. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), Securities Exchange Act Release No. 61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009) and Securities Exchange Act Release No. 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010) (temporary exemptions in connection with CDS clearing by Chicago Mercantile Exchange Inc.); Securities Exchange Act Release No. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009), Securities Exchange Act Release No. 61119 (Dec. 4, 2009), 74 FR 65554 (Dec. 10, 2009) and Securities Exchange Act Release No. 61662 (Mar. 5, 2010), 75 FR 11589

related to the market in credit default swaps ("CDS").<sup>2</sup> The over-the-counter ("OTC") market for CDS has been a source of particular concern to us and other financial regulators, and we have recognized that facilitating the establishment of central counterparties ("CCPs") for CDS can play an important role in reducing the counterparty risks inherent in the CDS market, and thus can help mitigate potential systemic impact. We have therefore found that taking action to help foster the prompt development of CCPs, including granting temporary conditional exemptions from certain provisions of the federal securities laws, is in the public interest.<sup>3</sup>

The Commission's authority over the OTC market for CDS is limited. Specifically, Section 3A of the Securities Exchange Act of 1934 ("Exchange Act") limits the Commission's authority over swap

(Mar. 11, 2010) (temporary exemptions in connection with CDS clearing by ICE Trust U.S. LLC); Securities Exchange Act Release No. 59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009) (temporary exemptions in connection with CDS clearing by LIFFE A&M and LCH.Clearnet Ltd.) and other Commission actions discussed in several of these orders.

In addition, we have issued interim final temporary rules that provide exemptions under the Securities Act of 1933 and the Securities Exchange Act of 1934 for CDS to facilitate the operation of one or more central counterparties for the CDS market. See Securities Act Release No. 8999 (Jan. 14, 2009), 74 FR 3967 (Jan. 22, 2009) (initial approval); Securities Exchange Act Release No. 9063 (Sep. 14, 2009), 74 FR 47719 (Sep. 17, 2009) (extension until Nov. 30, 2010).

Further, the Commission provided temporary exemptions in connection with Sections 5 and 6 of the Securities Exchange Act of 1934 for transactions in CDS; these exemptions expired on March 24, 2010. See Securities Exchange Act Release No. 59165 (Dec. 24, 2008), 74 FR 133 (Jan. 2, 2009) (initial exemption); Securities Exchange Act Release No. 60718 (Sep. 25, 2009), 74 FR 50862 (Oct. 1, 2009) (extension until Mar. 24, 2010).

<sup>2</sup> 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 ("reference 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 payments 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 positions in bonds or in segments of the debt market as represented by an index, or to take positions on the volatility in credit spreads during times of economic uncertainty.

Growth in the CDS market has coincided with a significant rise in the types and number of entities participating in the CDS market. CDS were initially created to meet the demand of banking institutions looking to hedge and diversify the credit risk attendant to their lending activities. However, financial institutions such as insurance companies, pension funds, securities firms, and hedge funds have entered the CDS market.

<sup>3</sup> See generally actions referenced in note 1, *supra*.

agreements, as defined in Section 206A of the Gramm-Leach-Bliley Act.<sup>4</sup> For those CDS that are swap agreements, the exclusion from the definition of security in Section 3A of the Exchange Act, and related provisions, will continue to apply. The Commission's action today does not affect these CDS, and this Order does not apply to them. For those CDS that are not swap agreements ("non-excluded CDS"), the Commission's action today provides temporary conditional exemptions from certain requirements of the Exchange Act.

The Commission believes that using well-regulated CCPs to clear transactions in CDS provides a number of benefits, by helping to promote efficiency and reduce risk in the CDS market and among its participants, contributing generally to the goal of market stability, and by requiring maintenance of records of CDS transactions that would aid the Commission's efforts to prevent and detect fraud and other abusive market practices.<sup>5</sup>

Earlier this year, the Commission granted temporary conditional exemptions to Eurex Clearing AG ("Eurex") and certain related parties to permit Eurex to clear and settle CDS transactions.<sup>6</sup> Those exemptions are

<sup>4</sup> 15 U.S.C. 78c-1. Section 3A excludes both a non-security-based and a security-based swap agreement from the definition of "security" under Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10). Section 206A of the Gramm-Leach-Bliley Act defines a "swap agreement" as "any agreement, contract, or transaction between eligible contract participants (as defined in section 1a(12) of the Commodity Exchange Act \* \* \*) \* \* \* the material terms of which (other than price and quantity) are subject to individual negotiation." 15 U.S.C. 78c note.

<sup>5</sup> See generally actions referenced in note 1, *supra*.

<sup>6</sup> For purposes of this Order, "Cleared CDS" means a credit default swap that is submitted (or offered, purchased, or sold on terms providing for submission) to Eurex, that is offered only to, purchased only by, and sold only to eligible contract participants (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), and in which: (i) The reference entity, the issuer of the reference security, or the reference security is one of the following: (A) An entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available; (B) a foreign private issuer whose securities are listed outside the United States and that has its principal trading market outside the United States; (C) a foreign sovereign debt security; (D) an asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; or (E) an asset-backed security issued or guaranteed by the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac") or the Government National Mortgage Association ("Ginnie Mae"); or (ii) the reference index is an index in which 80

scheduled to expire on April 23, 2010. Eurex has requested that the Commission extend the temporary conditional exemptions and expand them to address activities in connection with: (a) Eurex requiring its clearing members to execute certain transactions associated with Eurex's process for determining daily settlement prices used in marking positions to market, and (b) Eurex clearing CDS transactions of its members' customers (in addition to clearing CDS transactions of members and their affiliates, as permitted by the current exemption).<sup>7</sup>

Based on the facts presented and the representations made on behalf of Eurex,<sup>8</sup> and for the reasons discussed in this Order, and subject to certain conditions, the Commission is extending the existing temporary conditional exemptions. In addition, the Commission is expanding the existing temporary conditional exemptions to accommodate those required trading processes and customer clearing. Specifically, this Order conditionally exempts Eurex and certain clearing members of Eurex, on a temporary basis, from the registration requirements of Sections 5 and 6 of the Exchange Act solely in connection with the calculation of mark-to-market prices for non-excluded CDS cleared by Eurex. This Order also conditionally exempts Eurex clearing members from broker-dealer registration requirements and related requirements in connection with using Eurex to clear CDS transactions of their customers. This Order also makes certain related changes to the temporary exemption of eligible contract participants and others from certain Exchange Act requirements with respect to non-excluded CDS cleared by Eurex.

percent or more of the index's weighting is comprised of the entities or securities described in subparagraph (i). See definition in paragraph III.(f)(1) of this Order. As discussed above, the Commission's action today does not affect CDS that are swap agreements under Section 206A of the Gramm-Leach-Bliley Act. See text at note 4, *supra*.

<sup>7</sup> See Letter from Paul Architzel, Alston & Bird, to Elizabeth Murphy, Secretary, Commission, Apr. 23, 2010 ("April 2010 request").

<sup>8</sup> See *id.* The exemptions we are granting today are based on all of the representations made in the April 2010 request on behalf of Eurex, which incorporate representations made on behalf of Eurex as part of the request that preceded our earlier relief in connection with CDS clearing by Eurex. We recognize, however, that there could be legal uncertainty in the event that one or more of the underlying representations were to become inaccurate. Accordingly, if any of these exemptions were to become unavailable by reason of an underlying representation no longer being materially accurate, the legal status of existing open positions in non-excluded CDS that previously had been cleared pursuant to the exemptions would remain unchanged, but no new positions could be established pursuant to the exemptions until all of the underlying representations were again accurate.

The other exemptions connected with CDS clearing by Eurex—granted to Eurex in connection with clearing agency registration requirements, as well as granted to registered broker-dealers—are largely unchanged. The Commission is extending the exemptive relief provided in connection with CDS clearing by Eurex through November 30, 2010.

## II. Discussion

### A. Description of Eurex's Activities to Date and Proposed Expansion of Activities

Eurex's request for an extension of its current temporary exemptions and their expansion to accommodate clearing of CDS transactions by its clearing members' customers and to accommodate an auction process for determining CDS settlement prices describes how Eurex has cleared CDS to date and how the proposed arrangements for central clearing of customer CDS transactions would operate.<sup>9</sup> The request also makes representations about the safeguards associated with those arrangements, as described below.<sup>10</sup>

#### 1. Eurex Proposed Use of Settlement Price Auction Process

Eurex proposes to alter its procedures for determining daily settlement prices that will be used in marking positions to market, by calculating a daily mark-to-market price based on end of day prices submitted by participating members. Under these procedures, Eurex will rank the bid and ask prices submitted by members, and then pair any locking or crossing bid/ask prices to reveal the first non-crossed, non-locked bid/offer pair and determine the point in that range at which the most trade volume will occur. If the ranking does not result in any crossed orders or locked interests, the mark-to-market price will be the midpoint of the range.

To ensure the reliability of the process, Eurex will randomly require clearing members whose prices lock or cross to execute transactions at the locked or crossed prices farthest from the mark-to-market price. This trading will be required on a limited basis, with no more than three such trades in any 30-day period and limited to no more

<sup>9</sup> See April 2010 request, *supra* note 7. The description in this Order of Eurex's proposed activities also is based on the provisions of Eurex's rules ("clearing conditions").

<sup>10</sup> Eurex's April 2010 request incorporates by reference the representations of its earlier letter, supplementing those representations with respect to customer clearing, segregation and requiring trading in connection with settlement price calculation. See April 2010 request, *supra* note 7.

than ten percent of a dealer's quote participation.

## 2. Proposed Activity Clearing CDS Transactions of Members' Customers

Eurex requests an exemption for customer access to CDS clearing it provides, similar to its existing exemptions for clearing members' proprietary CDS transactions. Eurex requests an exemption to accommodate two types of customers: "Registered Customers" and other customers.

Registered Customers are customers that will enter into a tri-party agreement with Eurex and the clearing member, in which the clearing member agrees to guarantee the Registered Customer's position and the Registered Customer agrees to be bound by Eurex's Clearing Conditions. Registered Customers' positions are carried in Eurex's systems on a fully disclosed basis. Clearing members will retain, with Eurex, separate accounts for each Registered Customer, with positions being separately booked and margined and separately disclosed on Eurex reports (which can be directly provided to the Registered Customers). Other customers, in contrast, do not enter into separate agreements with Eurex, and their positions will be comingled in a clearing member's customer omnibus clearing account with Eurex.

Customer clearing by Eurex will accommodate CDS transactions that Registered Customers enter directly into with the Eurex members that clear those customers' CDS transactions, as well as Registered Customers' CDS transactions with other counterparties. For transactions that a Registered Customer enters into with its clearing member, novation will result in two CDS positions between that clearing member and Eurex (one trade being booked to the clearing member's agent account for the benefit of customers ("Agent account") at Eurex, and one booked to its proprietary account), in addition to the original CDS position between that clearing member and the Registered Customer. For transactions that a Registered Customer enters into with a clearing member counterparty other than the firm that clears transactions for the Registered Customer, novation will result in the original trade being replaced with three trades, one between that clearing member counterparty and Eurex (in that counterparty's proprietary account at Eurex), another between the Registered Customer's clearing member and Eurex (in that member's agent account), and another trade between the Registered Customer and its clearing

member.<sup>11</sup> Registered Customers also may enter into CDS transactions with a counterparty that is not a Eurex clearing member, in which case the transaction will be cleared through the Registered Customer's and the counterparty's respective clearing members.

For customers that are not Registered Customers, the clearing mechanics will differ in that the customer position between the clearing member and Eurex will be in an omnibus account (rather than being reflected in Eurex's system as for a Registered Customer). The clearing member's internal recordkeeping system will identify the contracts with particular customers, and Eurex will rely on the clearing member's records if it is necessary to identify the beneficial owners of those positions.

Under Eurex customer clearing, the clearing relationship and Eurex's guarantee extends only between Eurex and the clearing member. Eurex states that clearing of CDS transactions will benefit customers, among other reasons, by protecting customer collateral in case of default by the customer's clearing member, and by offering customers the ability to transfer positions in the event of clearing member default.

The customer relationship would be governed by an agreement between the customer and the clearing member, and clearing members and their customers generally will have in place International Swaps and Derivatives Association ("ISDA") Master Agreements governing their transactions prior to submission for clearing. These agreements would address, among other issues, procedures whereby an executing dealer may "give up" a contract to the customer's clearing member, and the treatment of CDS transactions that are not accepted for clearing by Eurex.<sup>12</sup>

Eurex has no rule requiring an executing broker to be a clearing member. Eurex expects that transactions will be submitted to Eurex through one or more "third party confirmation platform providers" that will facilitate the matching and confirmation of the trade terms by the parties, as well as the electronic submission of the affirmed trade to Eurex for clearing.<sup>13</sup> Eurex also

expects that the platform will submit, to the relevant parties, notice of Eurex's acceptance or rejection of the trade. Third party confirmation platform providers may provide additional back-office or similar services to clearing members or clients. Eurex is currently in negotiations to enable it to accept transactions from one or more third party confirmation platform providers.<sup>14</sup>

## 3. Framework for Collection and Protection of Customer Margin

### a. Margin Requirements for Clearing Members and Customers

Eurex's clearing conditions will require clearing members to collect, from their customers, collateral that is no less than the amount required to meet the margin calculated by Eurex. Clearing members may require customers to post additional margin above the Eurex requirements.

Margin is separately calculated for each clearing member with respect to its different proprietary and agent accounts. As noted above, clearing members will have separate accounts at Eurex for each of their Registered Customers. Each clearing member will use omnibus accounts to hold collateral posted by the clearing member's other customers. The margin requirement for Registered Customers is additive with respect to each Registered Customer, and does not net across the positions of multiple Registered Customers. For other customers, in contrast, the margin required by Eurex to collateralize the clearing member's positions is calculated on a net basis among all of those customers' positions.

### b. Treatment of Customer Margin

Eurex states that its framework for segregation of customer margin will be available to all customers, and will be required for cleared CDS transactions of all customers of Eurex's U.S. clearing members and for all U.S. customers of other Eurex clearing members. Eurex will offer buy-side customers individual segregation of positions and collateral

<sup>11</sup> This process is designed to ensure that Eurex maintains a matched book of offsetting CDS contracts.

<sup>12</sup> A transaction may not be accepted for clearing by Eurex, for example, if sufficient initial margin is not posted.

<sup>13</sup> Under this approach, for example, when a Registered Customer and executing broker agree to terms of the transaction (including that the transaction should be submitted to Eurex for clearing), the executing broker will submit the trade terms to the third party confirmation platform provider, which will forward those terms to the

Registered Customer for affirmation. Once the Registered Customer has affirmed the trade, the platform will forward those terms to the clearing member designated by the Registered Customer for affirmation. Once all three parties have affirmed the transaction, it will be submitted to Eurex for clearing. Eurex will determine whether to accept or reject the submitted trade in accordance with its risk management policies and procedures.

<sup>14</sup> Eurex Clearing Conditions permits any execution venue or trade confirmation platform that meets the technical requirements to participate in its clearance and settlement architecture. Eurex represents that it is committed to work with reasonably qualified execution venues and trade processing platforms to facilitate functionality for submission of trades by non-member dealers if there is interest in such functionality.

for Registered Customers, and will offer segregation of positions and collateral of other customers using customer omnibus accounts.<sup>15</sup>

#### i. Individual Segregation for Registered Customers

Eurex's procedures for protecting collateral posted by Registered Customers in connection with Cleared CDS will distinguish between collateral that is posted by customers as required by Eurex to margin a customer's position, and additional collateral that clearing members may choose to collect from those customers.

In the case of securities collateral that a Registered Customer posts to satisfy Eurex's margin requirement, a tri-party agreement among Eurex, the clearing member and the customer will provide that the customer will directly transfer the collateral to Eurex, to be maintained in a separate "RC Margin Collateral Account" specific to that Registered Customer.<sup>16</sup> Eurex will give the Registered Customer a pledge for the return of an amount equivalent to the net value of the securities (after the customer's obligations have been satisfied) in the event of the clearing member's insolvency.

Cash collateral posted by a Registered Customer to satisfy the Eurex-required margin obligation will be deposited by the customer into a dedicated trust account of the clearing member at a third-party bank; this cash will immediately be forwarded to Eurex, to be separately booked and recorded in Eurex's accounts as customer funds and held in a depository.<sup>17</sup> This cash would be subject to a pledge back from Eurex to the Registered Customer.<sup>18</sup>

<sup>15</sup> Eurex states that it expects that its clearing members may also include futures commission merchants ("FCMs") registered with the Commodity Futures Trading Commission ("CFTC"). As discussed below, such FCM clearing members may rely on this Order's exemption from certain broker-dealer related requirements to the extent those clearing members comply with the conditions of the exemption, including conditions related to the segregation of customer collateral. See note 38, *infra*.

<sup>16</sup> Securities collateral pledged to Eurex for the purpose of margining CDS positions will be deposited with Clearstream Banking Frankfurt and Sega Intersettle.

<sup>17</sup> Cash collateral in the form of euros will be deposited by Eurex in the Deutsche Bundesbank; cash collateral in the form of Swiss Francs will be deposited by Eurex in the Swiss National Bank; cash collateral in the form of other currencies, such as U.S. dollars or pounds sterling, will be deposited by Eurex in a commercial bank. These amounts will be held for the benefit of customers.

<sup>18</sup> Eurex may invest cash collateral only in certain "approved instruments" described in Part 2.2 of the Eurex Organizational Manual under the Eurex investment guidelines. In particular, Part 2.2.1 addresses "secured money market investments," and provides that, as a general principle,

A clearing member may require a Registered Customer to deposit collateral in excess of the amount of collateral required by Eurex in connection with that customer's position. Unless Eurex provides otherwise, this "Excess Customer Collateral" will be deposited with Eurex (to be held in the RC Margin Collateral Account specific to that Registered Customer in the case of collateral in the form of securities, or with a depository in the case of collateral in the form of cash).<sup>19</sup> Alternatively, in response to market demand, Eurex may provide that clearing members and Registered Customers can agree that a clearing member will deposit the customer's Excess Customer Collateral with an independent third-party custodian that provides a written acknowledgement that it will hold the funds separately from other assets explicitly for the benefit of each of the clearing member's individual customers, and that has over \$1 billion in regulatory capital.<sup>20</sup>

#### ii. Segregation of Collateral Posted by Customers That Are Not Registered Customers

Eurex will protect the collateral posted by customers that are not Registered Customers in a way that differs from the procedures used with respect to Registered Customers. In contrast to Registered Customers, each clearing member will only need to post with Eurex sufficient collateral to satisfy the net CDS position associated with that clearing member's non-Registered

placements would be made on a secured basis to the largest possible extent, using reverse repurchase agreements as the preferred instrument. It further provides that securities accepted as collateral should be issued or guaranteed by central or regional governments, agencies, multilateral development banks, the International Monetary Fund, the European Community or the Bank for International Settlements; if, however, there is not a sufficient volume of such securities, certain covered bonds or bank bonds may be used. Eligible securities need to meet certain credit rating criteria. Part 2.2.2 provides that certain unsecured money market placements are allowed in certain situations where part 2.2.1 is not available. Eurex states that these approved instruments are similarly conservative to those instruments in which customer funds may be invested under CFTC Rule 1.25, with the distinction that Rule 1.25 is focused on investments available in the U.S. domestic market.

<sup>19</sup> Eurex would exercise its primary lien over only so much of the deposited collateral as is required to satisfy Eurex's margin requirement.

<sup>20</sup> The Commission notes that this Order's exemption for Eurex clearing members in connection with certain Exchange Act broker-dealer related requirements includes conditions that impose additional requirements for the holding of customer collateral. Clearing members must comply with those additional requirements to rely on that broker-dealer related exemption.

customers.<sup>21</sup> Also, in contrast to Registered Customers, Eurex will not separately record non-Registered customers' collateral that is posted with Eurex.

#### A. Initial Framework

Initially, Eurex will provide that clearing members may only post cash as collateral to satisfy the margin requirement of customers that are not Registered Customers. The customers will transfer, to the clearing member, title to collateral posted to satisfy this requirement; the clearing member then will immediately deposit, with Eurex, an amount of cash necessary to address the net margin requirement associated with these customers' positions. Eurex will hold a primary pledge with respect to the deposited cash.<sup>22</sup>

The collateral that a clearing member will be required to collect from these customers will exceed the amount of net margin (reflecting the net exposure associated with those customers' positions) that the clearing member must forward to Eurex. Clearing members also may collect from these customers additional amounts of collateral in excess of the Eurex-required margin. This excess collateral will not be held at Eurex; instead, clearing members must post this collateral as soon as possible to a third-party custodian, consistent with the use of third-party custodians discussed above in the context of Registered Customers.<sup>23</sup> Clearing members must grant back, to these customers (such as through the use of an independent collateral agent) a *pro rata* security interest in the customer collateral on deposit with the third-party custodian.

#### B. Future Framework

Eurex anticipates that in the near future it will make changes to the segregation framework for non-Registered customers. Under the revised framework, these customers will transfer cash or securities collateral

<sup>21</sup> In other words, the amount the clearing member is required to post to Eurex in connection with these customers is determined by reference to all of the positions of those customers. For Registered Customers, in contrast, clearing members must post with Eurex at least all of the collateral that the clearing member collects pursuant to Eurex requirements; this amount does not account for netting across the positions of different Registered Customers.

<sup>22</sup> The clearing member would grant back to an independent collateral agent for the benefit of these customers an interest in any collateral returned to the third-party custodian (as described below) by Eurex in the event of the clearing member's insolvency or default.

<sup>23</sup> As noted above, this Order's broker-dealer related exemptions include conditions that impose additional requirements as to the use of third-party depositories. See note 20, *supra*.

required by the clearing member into one of two trust accounts at a third-party custodian, consistent with the use of third-party custodians discussed above. The Omnibus Customer Margin Account at this custodian will secure the clearing member's net obligation in respect of these customers; the clearing member will grant a first priority pledge in favor of Eurex over this account, and will notify the third-party custodian of that pledge.<sup>24</sup> The Segregated Customer Custody Account at this custodian will hold additional collateral that the clearing member collects from these customers (as required by Eurex, or in addition to the Eurex-required collateral). The clearing member would be required to take steps, such as through the use of granting a security interest to an independent collateral agent, to enable these non-Registered customers to segregate this collateral away from the clearing member's insolvency estate.

#### *C. Risk of Customer Loss in Connection with Default*

If a default by a customer other than a Registered Customer results in a shortfall, Eurex may, after first exhausting the clearing member's available assets, use the net margin as necessary to satisfy that shortfall. As a result, under both Eurex's initial framework and its future framework regarding the collateral posted by these non-Registered customers, the customers whose collateral is commingled (at Eurex or at a third-party depository) are subject to the risk of loss resulting from the default of another non-Registered customer of that clearing member, up to the amount of the net margin associated with the positions of that clearing members' non-Registered customers.

#### *c. Treatment of Variation Margin*

Eurex states that losses and gains caused by the relative change in the value of contracts are reflected in mark-to-market margin that is calculated daily. Such variation margin would be calculated as a debit against deposited collateral or as a credit to the customer's collateral account. Eurex anticipates, however, that in the future it will enhance this framework by providing for cash flows of these amounts.

Eurex states that its rules require clearing members to segregate all funds

accruing from their customer's positions, in addition to funds received from their customers to margin those positions. In other words, the rules require that clearing members segregate all mark-to-market margin that accrues to customers, as well as any funds paid to the clearing member on behalf of the clearing member's customers.<sup>25</sup>

#### *4. Default and Portability Rules*

##### *a. Portability of Positions and Collateral*

Prior to clearing member default, Registered Customers and other customers would be able to instruct that positions and collateral be moved to another clearing member. This would be subject to: (i) The approval of all involved parties, (ii) a release by the clearing member with respect to any outstanding obligations of the customer to the clearing member, and (iii) a release by Eurex.

In the case of Registered Customers, following clearing member default but prior to the filing of formal insolvency proceedings the security agreements would provide that the collateral would be returned to the Registered Customer, facilitating the transfer of the collateral to a new clearing member. In the case of customer omnibus accounts, Eurex would be able to ascertain the beneficial owners of positions with the clearing member's cooperation, allowing the collateral to be transferred with the agreement of the affected entities.

##### *b. Shortfalls and Liquidation Procedures*

If a clearing member were to become insolvent as the result of a Registered Customer, Eurex would have the right to use the collateral in that Registered Customer's account to satisfy the shortfall. In that event, Eurex would not be able to use the collateral posted by other customers to make up the shortfall. If a clearing member became insolvent due to a shortfall associated with a customer other than a Registered Customer, as noted above Eurex could use collateral in the account up to the amount of net omnibus position, causing loss to non-defaulting customers.<sup>26</sup>

In the event of a clearing member's default, the clearing member would be required to close its cleared CDS transactions; otherwise Eurex could close the positions on behalf of the clearing members.<sup>27</sup> If Eurex cannot

close those transactions within a reasonable period, it may use a voluntary auction process to liquidate the position in whole or in part, and assign the remaining positions among non-defaulting clearing members *pro rata*.

#### *5. Other Clearing Member Requirements Related to Customer Clearing*

Eurex states that before offering CDS clearance and settlement services to U.S. customers of non-U.S. clearing members, it will adopt a requirement that the clearing member be regulated by: (i) A signatory to the International Organization of Securities Commissions ("IOSCO") Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, (ii) a signatory to a bilateral arrangement with the Commission for enforcement cooperation, or (iii) a financial regulatory authority in Ireland or Sweden.

#### *B. Temporary Conditional Exemption from Exchange Registration Requirements*

Eurex represents that, in connection with its clearing and risk management process, it will calculate an end-of-day settlement price for each Cleared CDS in which a Eurex clearing member has a cleared position, based on prices submitted by Eurex clearing members. As part of this mark-to-market process, Eurex will periodically require Eurex clearing members that submit quotes that lock or cross to execute certain CDS trades. Requiring Eurex clearing members to trade CDS periodically in this manner is designed to help ensure that such submitted prices reflect each Eurex clearing member's best assessment of the value of each of its open positions in Cleared CDS on a daily basis, thereby reducing risk by allowing Eurex to impose appropriate margin requirements.

Section 5 of the Exchange Act states that "[i]t shall be unlawful for any broker, dealer, or exchange, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce for the purpose of using any facility of an exchange \* \* \* to effect any transaction in a security, or to report any such transactions, unless such exchange (1) is registered as a national securities exchange under section 6 of [the Exchange Act], or (2) is exempted from such registration \* \* \* by reason of the limited volume of transactions effected on such

<sup>24</sup> Interest or distributions on this account will be paid to the clearing member; the party that benefits from those amounts will be determined by agreement between the clearing member and the customer (as also is the case for the initial framework with regard to interest earned on cash posted with the third-party custodian).

<sup>25</sup> Sections 1.83 through 1.8.6 of Eurex's rules.

<sup>26</sup> Eurex states that the individually segregated collateral of Registered Customers will never be used to cover any shortfall caused by any other customer.

<sup>27</sup> These procedures may be subject to the action of the receiver of the clearing member, such as the

Federal Deposit Insurance Corp. in the case of a U.S. bank clearing member.

exchange \* \* \*.”<sup>28</sup> Section 6 of the Exchange Act sets forth a procedure whereby an exchange<sup>29</sup> may register as a national securities exchange.<sup>30</sup> To facilitate the establishment of Eurex’s end-of-day settlement price process, including the periodically required trading described above, the Commission is exercising its authority under Section 36 of the Exchange Act to temporarily exempt Eurex and Eurex clearing members, through November 30, 2010, from Sections 5 and 6 of the Exchange Act and the rules and regulations thereunder in connection with Eurex’s calculation of mark-to-market prices for open positions in Cleared CDS. This temporary exemption is subject to the following conditions:

First, Eurex must report the following information with respect to the calculation of mark-to-market prices for Cleared CDS to the Commission within 30 days of the end of each quarter, and preserve such reports during the life of the enterprise and of any successor enterprise:

- The total volume of transactions, expressed in the currency of the underlying instrument, executed during the quarter, broken down by reference entity, security, or index; and
- The total unit volume and/or notional amount executed during the quarter, broken down by reference entity, security, or index.

Second, Eurex must establish and maintain adequate safeguards and procedures to protect members’ confidential trading information. Such safeguards and procedures shall include: (a) limiting access to the confidential trading information of members to those employees of Eurex who are operating the system or responsible for its compliance with this exemption or any other applicable rules; and (b) establishing and maintaining standards controlling employees of Eurex trading for their own accounts. Eurex must establish and maintain adequate oversight procedures to ensure that the safeguards and procedures established pursuant to this condition are followed.

Third, Eurex must comply with the conditions to the temporary exemption from to the temporary exemption from registration as a clearing agency

extended by this Order,<sup>31</sup> given that this exemption is granted in the context of our goal of continuing to facilitate Eurex’s ability to act as a CCP for non-excluded CDS, and given Eurex’s representation that it must require periodic trading of Cleared CDS positions by Eurex clearing members whose submitted end-of-day prices lock or cross, to enhance the reliability of end-of-day settlement prices submitted as part of the daily mark-to-market process.

The Commission is also temporarily exempting each Eurex clearing member, through November 30, 2010, from the prohibition in Section 5 of the Exchange Act to the extent that such Eurex clearing member uses any facility of Eurex to effect any transaction in Cleared CDS, or to report any such transaction, in connection with Eurex’s calculation of mark-to-market prices for open positions in Cleared CDS. Absent an exemption, Section 5 would prohibit any Eurex clearing member that is a broker or dealer from effecting transactions in Cleared CDS on Eurex, which will rely on this Order for an exemption from exchange registration. The Commission believes that temporarily exempting Eurex clearing members from the restriction in Section 5 is necessary and appropriate in the public interest and is consistent with the protection of investors because it will facilitate their use of Eurex’s CCP for Cleared CDS, which for the reasons set forth in this Order the Commission believes to be beneficial. Without also temporarily exempting Eurex clearing members from this Section 5 requirement, the Commission’s temporary exemption of Eurex from Sections 5 and 6 of the Exchange Act would be ineffective, because Eurex clearing members that are brokers or dealers would not be permitted to effect transactions on Eurex in connection with the end-of-day settlement price process.

### *C. Temporary Conditional Exemption From Broker-Dealer Related Requirements for Certain Clearing Members of Eurex and Others*

The July Eurex Order did not address clearing of customer transactions by Eurex, and that order thus did not provide Eurex clearing members that hold customer collateral in connection with cleared CDS transactions with an exemption from broker-dealer requirements under the Exchange Act. Absent an exception or exemption, persons that effect transactions in non-excluded CDS that are securities may be

required to register as broker-dealers pursuant to Section 15(a)(1) of the Exchange Act.<sup>32</sup> Moreover, certain other requirements of the Exchange Act could apply to such persons, as broker-dealers, regardless of whether they are registered with the Commission.

It is consistent with our investor protection mandate to require securities intermediaries that receive or hold funds and securities on behalf of others to comply with standards that safeguard the interests of their customers. For example, a registered broker-dealer is required to segregate assets held on behalf of customers from proprietary assets because segregation will assist customers in recovering assets in the event the broker-dealer fails. To the extent that funds and securities are not segregated, they could be used by an intermediary to fund its own business and could be attached to satisfy debts of the intermediary if it were to fail. Moreover, the maintenance of adequate capital and liquidity protects customers, CCPs and other market participants. Adequate books and records (including both transactional and position records) are necessary to facilitate day to day operations as well as to help resolve situations in which an intermediary fails and either a regulatory authority, receiver, trustee or other entity is forced to liquidate the firm. Appropriate records also are necessary to allow examiners to review for improper activities, such as insider trading or other fraud.

At the same time, requiring intermediaries that receive or hold funds and securities on behalf of customers in connection with transactions in non-excluded CDS to register as broker-dealers may deter the use of CCPs in customer CDS transactions, which would cause customers to lose the counterparty risk benefits of central clearing, and would

<sup>32</sup> Section 15(a)(1) generally provides that, absent an exception or exemption, a broker or dealer that uses the mails or any means of interstate commerce to effect transactions in, or to induce or attempt to induce the purchase or sale of, any security must register with the Commission.

Section 3(a)(4) of the Exchange Act generally defines a “broker” as “any person engaged in the business of effecting transactions in securities for the account of others,” but excludes certain bank securities activities. 15 U.S.C. 78c(a)(4). Section 3(a)(5) of the Exchange Act generally defines a “dealer” as “any person engaged in the business of buying and selling securities for his own account,” but includes exceptions for certain bank activities. 15 U.S.C. 78c(a)(5). Exchange Act Section 3(a)(6) defines a “bank” as a bank or savings association that is directly supervised and examined by state or federal banking authorities (with certain additional requirements for banks and savings associations that are not chartered by a federal authority or a member of the Federal Reserve System). 15 U.S.C. 78c(a)(6).

<sup>28</sup> 15 U.S.C. 78e.

<sup>29</sup> Section 3(a)(1) of the Exchange Act, 15 U.S.C. 78c(a)(1), defines “exchange.” Rule 3b-16 under the Exchange Act, 17 CFR 240.3b-16, defines certain terms used in the statutory definition of exchange. See Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998) (adopting Rule 3b-16 in addition to Regulation ATS).

<sup>30</sup> 15 U.S.C. 78f. Section 6 of the Exchange Act also sets forth various requirements to which a national securities exchange is subject.

<sup>31</sup> See Part II.E, *infra*.

lessen the systemic risk reduction benefits associated with central clearing.

Those factors argue in favor of flexibility in applying the requirements of the Exchange Act to these intermediaries, conditioned on requiring the intermediaries to take reasonable steps to help increase the likelihood that their customers would be protected in the event the intermediary became insolvent, even if those safeguards are as not as strong as those required of registered broker-dealers. This requires us to balance the goals of promoting the central clearing of customer CDS transactions against the goal of protecting customers, and to be mindful that these conditions cannot provide legal certainty that customer collateral in fact would be protected in the event an Eurex clearing member were to become insolvent.

In granting the temporary exemption, we also are relying on Eurex's representation that before offering the Non-Member Framework, it will adopt a requirement that non-U.S. clearing members subject to the framework are regulated by: (i) A signatory to the International Organization of Securities Commissions ("IOSCO") Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, (ii) a signatory to a bilateral arrangement with the Commission for enforcement cooperation, or (iii) a financial regulatory authority in Ireland or Sweden.<sup>33</sup>

Accordingly, pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to grant a conditional exemption through November 30, 2010, with respect to certain Exchange Act requirements related to broker-dealers. This exemption is available to Eurex clearing members other than registered broker-dealers. This exemption also is available to any eligible contract participant, other than a registered broker-dealer, that does not receive or hold funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other

persons.<sup>34</sup> Solely with respect to Cleared CDS, those persons temporarily will be exempt from the broker-dealer registration requirements of Section 15(a)(1), and the other requirements of the Exchange Act (other than paragraphs (4) and (6) of Section 15(b)<sup>35</sup>) and the rules and regulations thereunder that apply to a broker or dealer that is not registered with the Commission.

For all Eurex clearing members—regardless of whether they receive or hold customer collateral in connection with Cleared CDS—this temporary exemption is conditioned on the clearing member being in material compliance with Eurex's rules, as well as on the clearing member being in compliance with applicable laws and regulations relating to capital, liquidity, and segregation of customers' funds and securities (and related books and records provisions) with respect to Cleared CDS.

For Eurex clearing members that receive or hold funds or securities of U.S. persons (or who receive or hold funds or securities of any person in the case of a U.S. clearing member)—other than for an affiliate that controls, is

<sup>34</sup> In some circumstances, an eligible contract participant that does not hold customer funds or securities nonetheless may act as a dealer in securities transactions, or as a broker (such as an inter-dealer broker).

Solely for purposes of this requirement, an eligible contract participant would not be viewed as receiving or holding funds or securities for purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons, if the other persons involved in the transaction would not be considered "customers" of the eligible contract participant under the analysis used for determining whether certain persons would be considered "customers" of a broker-dealer under Exchange Act Rule 15c3-3(a)(1). For these purposes, and for the purpose of the definition of "Cleared CDS," the terms "purchasing" and "selling" mean the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing the rights or obligations under, a Cleared CDS, as the context may require. This is consistent with the meaning of the terms "purchase" or "sale" under the Exchange Act in the context of security-based swap agreements. See Exchange Act Section 3A(b)(4).

<sup>35</sup> Exchange Act Sections 15(b)(4) and 15(b)(6) grant the Commission authority to take action against broker-dealers and associated persons in certain situations. Accordingly, while this exemption from broker-dealer requirements generally extends to persons that act as broker-dealers in the market for Cleared CDS (potentially including inter-dealer brokers that do not hold funds or securities for others), such persons may be subject to actions under Sections 15(b)(4) and (b)(6) of the Exchange Act.

In addition, such persons may be subject to actions under Exchange Act Section 15(c)(1), 15 U.S.C. 78o(c)(1), which prohibits brokers and dealers from using manipulative or deceptive devices. As noted above, Section 15(c)(1) explicitly applies to security-based swap agreements. Sections 15(b)(4), 15(b)(6) and 15(c)(1), of course, would not apply to persons subject to this exemption who do not act as broker-dealers or associated persons of broker-dealers.

controlled by, or is under common control with the clearing member—in connection with Cleared CDS, this temporary exemption further is conditioned on the customer not being a natural person, and on the clearing member providing certain risk disclosures to the customer.<sup>36</sup>

Also, those clearing members that receive or hold such customer funds or securities must transfer those funds and securities, as promptly as practicable after receipt, to either the appropriate customer account at Eurex<sup>37</sup> or an account held by a third-party custodian, as described below.<sup>38</sup>

Collateral that is held at a third-party custodian, moreover, must either be held: (1) In the name of the customer, subject to an agreement in which the customer, the clearing member and the custodian are parties, acknowledging that the assets held therein are customer assets used to collateralize obligations of the customer to the clearing member, and that the assets held in the account may not otherwise be pledged or rehypothecated by the clearing member or the custodian; or (2) in an omnibus account for which the clearing member maintains daily records as to the amount owing to each customer, and which is subject to an agreement between the clearing member and the custodian specifying: (i) That all account assets are held for the exclusive benefit of the clearing member's customers and are being kept separate from any other accounts that the clearing member maintains with the

<sup>36</sup> The clearing member must disclose that it is not regulated by the Commission and that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply, that the insolvency law of the applicable jurisdiction may affect the customer's ability to recover funds and securities or the speed of any such recovery, and (if applicable) that non-U.S. members may be subject to an insolvency regime that is materially different from that applicable to U.S. persons.

<sup>37</sup> Cash collateral transferred to Eurex may be invested in certain "approved instruments," as discussed above. See note 18, *supra*.

<sup>38</sup> Eurex anticipates that registered FCMs may become clearing members of Eurex; Eurex thus may apply to the CFTC for an order, under Section 4d of the Commodity Exchange Act ("CEA"), to allow FCM clearing members to segregate the collateral posted by customers as margin for Cleared CDS transactions and positions in an account established in accordance with Section 4d and underlying rules.

This Order does not preclude Eurex clearing members that are FCMs (and that are not registered broker-dealers) from relying on this exemption from broker-dealer related requirements under the Exchange Act, provided such members comply with the conditions of this exemption, including conditions related to segregation of customer collateral. The Commission intends to monitor developments that may form the basis for alternative segregation conditions for FCM members of Eurex.

<sup>33</sup> Non-U.S. clearing members that do not meet these criteria would not be eligible to rely on this exemption.

The Commission has established informal relationships with securities authorities in Ireland and Sweden and cooperates with them on an *ad hoc* basis. Also, the securities regulators in both Ireland and Sweden have applied to become signatories to the IOSCO Multilateral Memorandum of Understanding for Consultation, Cooperation and the Exchange of Information.



custodian; (ii) that the account assets may not be used as security for a loan to the clearing member by the custodian, and shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the custodian or any person claiming through the custodian; and (iii) that the assets may not otherwise be pledged or rehypothecated by the clearing member or the custodian.<sup>39</sup> Under either approach, the third-party custodian cannot be affiliated with the clearing member.<sup>40</sup> Moreover, if the third-party custodian is a U.S. entity, it must be a bank (as that term is defined in Section 3(a)(6) of the Exchange Act), have total regulatory capital of at least \$1 billion,<sup>41</sup> and have been approved to engage in a trust business by its appropriate regulatory agency. A custodian that is not a U.S. entity must have regulatory capital of at least \$1 billion,<sup>42</sup> and must provide the clearing member, the customer and Eurex with a legal opinion<sup>43</sup> providing that the account

<sup>39</sup> We do not contemplate that either of these approaches involving the use of a third-party custodian would interfere with the ability of a clearing member and its customer to agree as to how any return or losses earned on those assets would be distributed between the clearing member and its customer.

Also, the restriction in both approaches on the clearing member's and the custodian's ability to rehypothecate these customer funds and securities does not preclude that collateral from being transferred to Eurex as necessary to satisfy variation margin requirements in connection with the customer's CDS position.

<sup>40</sup> For purposes of the Order, an "affiliated person" of a clearing member mean any person who directly or indirectly controls a clearing member or any person who is directly or indirectly controlled by or under common control with a clearing member; ownership of 10 percent or more of an entity's common stock will be deemed *prima facie* control of that entity. See definition in paragraph III.(f)(2) of this Order. This standard is analogous to the standard used to identify affiliated persons of broker-dealers under Exchange Act Rule 15c3-3(a)(13), 17 CFR 240.15c3-3(a)(13).

<sup>41</sup> In particular, custodians that are U.S. entities must have total capital, as calculated to meet the applicable requirements imposed by the entity's appropriate regulatory agency of at least \$1 billion. The term "appropriate regulatory agency" is defined in Section 3(a)(34) of the Exchange Act, 15 U.S.C. 78c(a)(34)).

<sup>42</sup> Custodians that are non-U.S. entities must have total capital, as calculated to meet the applicable requirements imposed by the foreign financial regulatory authority of at least \$1 billion. The term "foreign financial regulatory authority" is defined in Section 3(a)(52) of the Exchange Act, 15 U.S.C. 78c(a)(52)).

<sup>43</sup> This condition requiring that Eurex receive a legal opinion as a repository for regulators, and other conditions of this Order that require clearing members to convey information (e.g., an audit report related to the clearing member's compliance with exemptive conditions) to Eurex, does not impose upon Eurex any independent duty to audit or otherwise review such information. These conditions also do not impose on Eurex any independent fiduciary or other obligation to any customer of a clearing member.

assets are subject to regulatory requirements in the custodian's home jurisdiction designed to protect, and provide for the prompt return of, custodial assets in the event of the custodian's insolvency, and that the assets held in that account reasonably could be expected to be legally separate from the clearing member's assets in the event of the clearing member's insolvency. Also, cash collateral posted with the third-party custodian may be invested in other assets that constitute "approved instruments" pursuant to part 2.2 under the Eurex Organizational Manual.<sup>44</sup> Finally, a clearing member that uses a third-party custodian to hold customer collateral must notify Eurex of that use.

To the extent there is any delay in the clearing member transferring such funds and securities to Eurex or a third-party custodian,<sup>45</sup> the clearing member must effectively segregate the collateral in a way that, pursuant to applicable law, could reasonably be expected to effectively protect the collateral from the clearing member's creditors. The clearing member may not permit such persons to "opt out" of such segregation even if applicable regulations or laws otherwise would permit such "opt out."

To facilitate compliance with the segregation practices that are required as a condition to this temporary exemption, the clearing member also must annually provide Eurex with a self-assessment that it is in compliance with the requirements, along with a report by the clearing member's independent third-party auditor that attests to that assessment. The report must be dated the same date as the clearing member's annual audit report (but may be separate from it), and must be produced in accordance with the standards that the auditor follows in auditing the clearing member's financial statements.<sup>46</sup>

Finally, to support these segregation practices and enhance the ability to detect and deter circumstances in which clearing members fail to segregate customer collateral consistent with the exemption, this temporary exemption is conditioned on the clearing member agreeing to provide the Commission with access to information related to Cleared CDS transactions.<sup>47</sup> In

<sup>44</sup> See note 18, *supra*.

<sup>45</sup> This provision is intended to address short-term technology or operational issues.

<sup>46</sup> As the self-assessment is intended to serve as the basis for the third-party auditor's report, we expect the self-assessment to be generally contemporaneous with that report.

<sup>47</sup> This requirement for clearing members to make information available to the Commission is consistent with a requirement in Exchange Act Rule

particular, the clearing member would provide the Commission (upon request and subject to agreements reached between the Commission or the U.S. Government and an appropriate foreign securities authority<sup>48</sup>) with information or documents within the clearing member's possession, custody, or control, as well as testimony of clearing member personnel and assistance in taking the evidence of other persons, that relates to Cleared CDS transactions. If, after the clearing member has exercised its best efforts to provide this information (including requesting the appropriate governmental body and, if legally necessary, its customers), the clearing member nonetheless is prohibited from providing the information by applicable foreign law or regulations, this temporary conditional exemption would no longer be available to the clearing member.<sup>49</sup>

We recognize that requiring clearing members that receive or hold customer collateral to satisfy these conditions will not guarantee that a customer would receive the return of its collateral in the event of a clearing member's insolvency, particularly in light of the fact-specific nature of the insolvency process and the multiplicity of insolvency regimes that may apply to Eurex's members clearing for U.S. customers. We believe, however, that these are reasonable steps for increasing the likelihood that customers would be able to access collateral in such an insolvency event. We also recognize that these customers generally may be expected to be sophisticated market participants that should be able to weigh the risks associated with entering into arrangements with intermediaries that are not registered broker-dealers, particularly in light of the disclosure required as a condition to this temporary exemption.

15a-6(a)(3)(i)(B), which exempts certain foreign broker-dealers from registering with the Commission. See Exchange Act Rule 15a-6(a)(3)(i)(B).

<sup>48</sup> The term "foreign securities authority" is defined in Section 3(a)(50) of the Exchange Act, 15 U.S.C. 78c(a)(50).

<sup>49</sup> Consistent with the discussion above as to the loss of an exemption due to an underlying representation no longer being accurate, see note 8, *supra*, if a clearing member were to lose the benefit of this exemption due to the failure to provide information to the Commission as the result of a prohibition by an applicable foreign law or regulation, the legal status of existing open positions in non-excluded CDS associated with those clearing members and its customers would remain unchanged, but the clearing member could not establish new CDS positions pursuant to the exemption.



### *D. Modified and Extended Temporary Conditional General Exemption for Eurex and Certain Eligible Contract Participants*

The existing order on behalf of Eurex temporarily exempted Eurex, and certain members and eligible contract participants from a number of Exchange Act requirements, subject to certain conditions, recognizing that applying the full panoply of Exchange Act requirements to participants in transactions in non-excluded CDS likely would deter some participants from using CCPs to clear CDS transactions. That temporary conditional exemption, however, did not extend to the antifraud provisions of the Exchange Act, in light of the importance of continuing to apply those antifraud provisions to transactions in non-excluded CDS.<sup>50</sup>

We are modifying the existing temporary conditional exemption to accommodate customer CDS clearing by Eurex. As revised, this temporary conditional exemption applies to Eurex and to any eligible contract participants<sup>51</sup>—including any Eurex clearing member<sup>52</sup>—other than eligible

contract participants that are self-regulatory organizations, or eligible contract participants that are registered brokers or dealers.<sup>53</sup>

In light of the temporary conditional exemption that we are granting from certain Exchange Act requirements related to broker-dealers, we also are modifying this temporary conditional exemption by excluding from its scope the broker-dealer registration requirements of Section 15(a)(1),<sup>54</sup> and the other requirements of the Exchange Act, including paragraphs (4) and (6) of Section 15(b), and the rules and regulations thereunder that apply to a broker or dealer that is not registered with the Commission.<sup>55</sup>

Eurex clearing members relying on this temporary conditional exemption must be in material compliance with Eurex rules. Moreover, to help promote compliance with the temporary conditional exemption that we are granting from certain Exchange Act requirements specifically related to broker-dealers, any Eurex clearing member relying on this exemption that participates in the clearing of Cleared CDS transactions on behalf of other persons must annually provide a certification to Eurex that attests to whether the clearing member is relying on the temporary exemption from broker-dealer related requirements described below.<sup>56</sup>

As before, this temporary conditional exemption, solely with respect to Cleared CDS, generally addresses the provisions of the Exchange Act and the rules and regulations thereunder that do not apply to security-based swap agreements. Thus, persons relying on the exemption would still be subject to those Exchange Act requirements that explicitly are applicable in connection

no longer are limiting the exemption in that way, and are not using those definitions.

<sup>53</sup> The current exemption also excludes persons that hold funds and securities for others. This restriction no longer is necessary in light of the exemption from broker-dealer related requirements.

Also, a separate temporary exemption addresses the Cleared CDS activities of registered broker-dealers. See Part II.E, *infra*. Solely for purposes of this Order, a “registered broker-dealer,” or a “broker or dealer registered under Section 15(b) of the Exchange Act,” does not refer to someone that would otherwise be required to register as a broker or dealer solely as a result of activities in Cleared CDS in compliance with this Order.

<sup>54</sup> 15 U.S.C. 78o(a)(1).

<sup>55</sup> Currently, this exemption only excludes paragraphs (4) and (6) of Section 15(b) from its scope.

<sup>56</sup> We expect the clearing member to initially provide this certification to Eurex around the time it commences relying on this exemption. To the extent we extend this temporary conditional exemption and include the same type of certification requirement, the clearing member then would annually renew the certification.

with security-based swap agreements.<sup>57</sup> Also, as before, this temporary conditional exemption does not extend to: the exchange registration requirements of Exchange Act Sections 5 and 6;<sup>58</sup> the clearing agency registration requirements of Exchange Act Section 17A; the requirements of Exchange Act Sections 12, 13, 14, 15(d), and 16;<sup>59</sup> or certain provisions related to government securities.<sup>60</sup> This revised temporary exemption will be in effect through November 30, 2010.

### *E. Extension of Other Temporary Exemptions Associated With CDS Clearing by Eurex*

The order we previously granted to facilitate CDS clearing by Eurex conditionally exempts Eurex, until April 23, 2010, from the clearing agency registration requirements of Section 17A of the Exchange Act in connection with Cleared CDS. Subject to the conditions in that exemption, Eurex is permitted to act as a CCP for Cleared CDS without having to register with the Commission as a clearing agency. In granting that exemption, the Commission recognized the need to ensure the prompt establishment of Eurex as a CCP for CDS

<sup>57</sup> See note 50, *supra*. In addition, all provisions of the Exchange Act related to the Commission’s enforcement authority in connection with violations or potential violations of such provisions would remain applicable. Thus, for example, the Commission retains the ability to investigate potential violations and bring enforcement actions in the federal courts as well as in administrative proceedings, and to seek the full panoply of remedies available in such cases.

<sup>58</sup> These are subject to a separate temporary class exemption. See note 1, *supra*. A national securities exchange that effects transactions in Cleared CDS would continue to be required to comply with all requirements under the Exchange Act applicable to such transactions. A national securities exchange could form subsidiaries or affiliates that operate exchanges exempt under that order. Any subsidiary or affiliate of a registered exchange could not integrate, or otherwise link, the exempt CDS exchange with the registered exchange including the premises or property of such exchange for effecting or reporting a transaction without being considered a “facility of the exchange.” See Section 3(a)(2), 15 U.S.C. 78c(a)(2).

The revised exemptions connected with CDS clearing by Eurex also includes a separate temporary exemption from Sections 5 and 6 in connection with the mark-to-market process of Eurex.

<sup>59</sup> 15 U.S.C. 78l, 78m, 78n, 78o(d), 78p. Eligible contract participants and other persons instead should refer to the interim final temporary rules issued by the Commission. See note 1, *supra*.

<sup>60</sup> This exemption specifically does not extend to the Exchange Act provisions applicable to government securities, as set forth in Section 15C, 15 U.S.C. 78o–5, and its underlying rules and regulations. The exemption also does not extend to related definitions found at paragraphs (42) through (45) of Section 3(a), 15 U.S.C. 78c(a). The Commission does not have authority under Section 36 to issue exemptions in connection with those provisions. See Exchange Act Section 36(b), 15 U.S.C. 78mm(b).

<sup>50</sup> OTC transactions subject to individual negotiation that qualify as security-based swap agreements are subject to those provisions. While Section 3A of the Exchange Act excludes “swap agreements” from the definition of “security,” certain antifraud and insider trading provisions under the Exchange Act explicitly apply to security-based swap agreements. See (a) paragraphs (2) through (5) of Section 9(a), 15 U.S.C. 78i(a), prohibiting the manipulation of security prices; (b) Section 10(b), 15 U.S.C. 78j(b), and underlying rules prohibiting fraud, manipulation or insider trading (but not prophylactic reporting or recordkeeping requirements); (c) Section 15(c)(1), 15 U.S.C. 78o(c)(1), which prohibits brokers and dealers from using manipulative or deceptive devices; (d) Sections 16(a) and (b), 15 U.S.C. 78p(a) and (b), which address disclosure by directors, officers and principal stockholders, and short-swing trading by those persons, and rules with respect to reporting requirements under Section 16(a); (e) Section 20(d), 15 U.S.C. 78t(d), providing for antifraud liability in connection with certain derivative transactions; and (f) Section 21A(a)(1), 15 U.S.C. 78u–1(a)(1), related to the Commission’s authority to impose civil penalties for insider trading violations.

“Security-based swap agreement” is defined in Section 206B of the Gramm-Leach-Bliley Act as a swap agreement in which a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein.

<sup>51</sup> This exemption in general applies to eligible contract participants, as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order, other than persons that are eligible contract participants under paragraph (C) of that section.

<sup>52</sup> The current exemption specifically applies to any “Eurex U.S. Clearing Member” and “Eurex Non-U.S. Clearing Members.” These terms were defined to exclude U.S. members that submitted customer CDS trades for clearing, and to exclude non-U.S. members that submitted customer CDS trades for clearing for the account of any other person except a U.S. person. In light of our expansion of the Eurex exemptions to accommodate customer clearing, we

transactions, while also ensuring that important elements of Section 17A of the Exchange Act, which sets forth the framework for the regulation and operation of the U.S. clearance and settlement system for securities, apply to the non-excluded CDS market. The temporary exemption is subject to a number of conditions designed to enable Commission staff to monitor Eurex's clearance and settlement of CDS transactions.<sup>61</sup> The temporary exemption, moreover, in part is based on Eurex's representation that it met the standards set forth in the Committee on Payment and Settlement Systems ("CPSS") and IOSCO report entitled: *Recommendation for Central Counterparties* ("RCCP").<sup>62</sup> The exemption expires on April 23, 2010. For consistency with the other exemptions we are granting in connection with CDS clearing by Eurex, and consistent with our earlier findings, we find pursuant to Section 36 of the Exchange Act that it is necessary and appropriate in the public interest and is consistent with the protection of investors for the Commission to extend, through November 30, 2010, the conditional relief provided from the clearing agency registration requirements of Section 17A we previously granted to Eurex.

Finally, the earlier order also exempts registered broker-dealers, until April 23, 2010, from certain Exchange Act requirements in connection with their activities involving Cleared CDS. In crafting these temporary exemptions, we balanced the need to avoid creating disincentives to the prompt use of CCPs against the critical role that certain broker-dealers play in promoting market integrity and protecting customers (including broker-dealer customers that are not involved with CDS transactions). Accordingly, we exempted registered broker-dealers from provisions of the Exchange Act and the rules and regulations thereunder that do not apply to security-based swap agreements,

subject to certain exceptions.<sup>63</sup> For consistency with the other exemptions we are granting in connection with CDS clearing by Eurex, and consistent with our earlier findings, we find pursuant to Section 36 of the Exchange Act that it is necessary and appropriate in the public interest and is consistent with the protection of investors for the Commission to extend, through November 30, 2010, the conditional relief previously provided to registered broker-dealers in connection with Cleared CDS.

#### *F. Solicitation of Comments*

When we granted our initial temporary conditional exemptions in connection with CDS clearing by Eurex, we solicited comment on all aspects of the exemptions, and specifically requested comment as to the duration of the temporary exemptions, the appropriateness of the exemptive conditions, and whether Eurex should be required to register as a clearing agency under the Exchange Act. We received no comments in response to this request.

In connection with this Order extending the temporary conditional exemptions granted in connection with CDS clearing by Eurex, and expanding that relief to accommodate central clearing of customer CDS transactions, we reiterate our request for comments on all aspects of the exemptions. We particularly request comments as to the relief we are granting in connection with customer clearing, including whether Eurex members that clear customer CDS transactions should be required to register as broker-dealers, whether the conditions that we have placed on the relief adequately protect customer funds and securities from the threat posed by clearing member insolvency, whether additional conditions or requirements are appropriate to promote compliance with the requirements of the exemptions, and what, if any, additional conditions would be appropriate.

We also particularly request comment as to whether the segregation conditions of this Order should extend to certain transfers of variation margin associated with Cleared CDS, as well as whether CDS customers are able to easily access mark-to-market profits associated with Cleared CDS. Do any practices (such as, for example, negotiated "thresholds" in credit support annexes between clearing members and customers) impede customers from demanding and receiving the timely return of such mark-to-market profits? Should the

Commission condition any future exemptions on segregating the mark-to-market profits associated with Cleared CDS if they are not returned to customers within a certain amount of time following demand (subject to provisions regarding reasonable minimum transfer amounts, and provisions permitting offset against amounts owing from the customer directly to the clearing member)? Would such a condition impose significant operational or other costs that may deter the clearing of customer CDS transactions? Are there other factors (e.g., costs, benefits, market conditions, economic considerations, or availability of credit hedges) that may reduce the significance of any customer protection benefits provided by requiring segregation of such mark-to-market profits? We also invite comment on whether differences among CDS CCPs regarding protection of mark-to-market profits may have competitive impacts.

In addition, we request comment on how clearing members intend to comply with this Order's condition requiring the segregation of all margin posted by customers connected with purchasing, selling, clearing, settling or holding Cleared CDS positions—not only the gross margin required by Eurex rules. To what extent would clearing firms typically require certain customers to post such "excess" margin above the Eurex requirements in connection with Cleared CDS transactions?

Finally, to what extent do clearing members and customers seek to include Cleared CDS positions within portfolio margining calculations that include other instruments (e.g., non-cleared CDS, other OTC derivatives or securities)? If portfolio margining is used, how do clearing members allocate the total collateral required by a clearing member from a customer between the portion posted in connection with Cleared CDS (and hence subject to this Order's segregation conditions) and the portion attributable to other derivatives transactions involving that clearing member and customer? To the extent a clearing member's portfolio margin calculations include a customer's Cleared CDS positions, is it reasonable to conclude that any portion of the customer margin is not connected with Cleared CDS, and thus does not need to be segregated? Would a dealer's inclusion of Cleared CDS positions in its portfolio margin calculation interfere with the customer protection benefits of CDS clearing in the event of a dealer's insolvency? In other words, would the dealer's cleared CDS customer positions be portable to another dealer if collateralized solely by the Eurex-

<sup>61</sup> See July Eurex order.

<sup>62</sup> The RCCP was drafted by a joint task force ("Task Force") composed of representative members of IOSCO and CPSS and published in November 2004. The Task Force consisted of securities regulators and central bankers from 19 countries and the European Union. The U.S. representatives on the Task Force included staff from the Commission, the Federal Reserve Board, and the Commodity Futures Trading Commission.

The RCCP establishes a framework that requires a CCP to have (i) the ability to facilitate the prompt and accurate clearance and settlement of CDS transactions and to safeguard its users' assets; and (ii) sound risk management, including the ability to appropriately determine and collect clearing fund and monitor its users' trading. This framework is generally consistent with the requirements of Section 17A of the Exchange Act.

<sup>63</sup> See July Eurex order.

required margin, or would the dealer's cleared CDS customers be placed at a disadvantage in an insolvency situation because of this practice? Should the Commission provide firms with further guidance regarding the inclusion of Cleared CDS in portfolio margin calculations?

Comments may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/other.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-17-09 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov/>). Follow the instructions for submitting comments.

#### *Paper Comments*

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090. All submissions should refer to File Number S7-17-09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. We will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/other.shtml>). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

### **III. Conclusion**

*It is hereby ordered*, pursuant to Section 36(a) of the Exchange Act, that, through November 30, 2010:

(a) Exemption from Section 17A of the Exchange Act.

Eurex Clearing AG ("Eurex") shall be exempt from Section 17A of the Exchange Act solely to perform the functions of a clearing agency for Cleared CDS (as defined in paragraph (f)(1) of this Order), subject to the following conditions:

(1) Eurex shall make available on its Web site its annual audited financial statements.

(2) Eurex shall keep and preserve at least one copy of all documents, including all correspondence,

memoranda, papers, books, notices, accounts and other such records as shall be made or received by it relating to its Cleared CDS clearance and settlement services. These records shall be kept for at least five years and for the first two years shall be held in an easily accessible place.

(3) Eurex shall supply information and periodic reports relating to its Cleared CDS clearance and settlement services as may be reasonably requested by the Commission, and shall provide access to the Commission to conduct on-site inspections of all facilities (including automated systems and systems environment), records, and personnel related to Eurex's Cleared CDS clearance and settlement services.

(4) Eurex shall notify the Commission, on a monthly basis, of any material disciplinary actions taken against any of its members using its Cleared CDS clearance and settlement services, including the denial of services, fines, or penalties. Eurex shall notify the Commission promptly when it terminates on an involuntary basis the membership of an entity that is using Eurex's Cleared CDS clearance and settlement services. Both notifications shall describe the facts and circumstances that led to Eurex's disciplinary action.

(5) Eurex shall notify the Commission of all changes to its rules, procedures, and any other material events affecting its Cleared CDS clearance and settlement services, including its fee schedule and changes to risk management practices, not less than one day prior to effectiveness or implementation of such changes or, in exigent circumstances, as promptly as reasonably practicable under the circumstances. All such rule changes will be posted on Eurex's Web site. Such notifications will not be deemed rule filings that require Commission approval.

(6) Eurex shall provide the Commission with reports prepared by independent audit personnel concerning its Cleared CDS clearance and settlement services that are generated in accordance with risk assessment of the areas set forth in the Commission's Automation Review Policy Statements. Eurex shall provide the Commission with annual audited financial statements for Eurex prepared by independent audit personnel.

(7) Eurex shall report all significant systems outages to the Commission. If it appears that the outage may extend for 30 minutes or longer, Eurex shall report the systems outage immediately. If it appears that the outage will be resolved in fewer than 30 minutes, Eurex shall

report the systems outage within a reasonable time after the outage has been resolved.

(8) Eurex, directly or indirectly, shall make available to the public on terms that are fair and reasonable and not unreasonably discriminatory: (i) All end-of-day settlement prices and any other prices with respect to Cleared CDS that Eurex may establish to calculate mark-to-market margin requirements for Eurex clearing members; and (ii) any other pricing or valuation information with respect to Cleared CDS as is published or distributed by Eurex.

(b) Exemption From Sections 5 and 6 of the Exchange Act

(1) Eurex shall be exempt from the requirements of Sections 5 and 6 of the Exchange Act and the rules and regulations thereunder in connection with its calculation of mark-to-market prices for open positions in Cleared CDS, subject to the following conditions:

(i) Eurex shall report the following information with respect to the calculation of mark-to-market prices for Cleared CDS to the Commission within 30 days of the end of each quarter, and preserve such reports during the life of the enterprise and of any successor enterprise:

(A) The total volume of transactions, expressed in the currency of the underlying instrument, executed during the quarter, broken down by reference entity, security, or index; and

(B) The total unit volume and/or notional amount executed during the quarter, broken down by reference entity, security, or index;

(ii) Eurex shall establish and maintain adequate safeguards and procedures to protect clearing members' confidential trading information. Such safeguards and procedures shall include: (A) Limiting access to the confidential trading information of clearing members to those employees of Eurex who are operating the system or responsible for its compliance with this exemption or any other applicable rules; and (B) establishing and maintaining standards controlling employees of Eurex trading for their own accounts. Eurex must establish and maintain adequate oversight procedures to ensure that the safeguards and procedures established pursuant to this condition are followed; and

(iii) Eurex shall satisfy the conditions of the temporary exemption from Section 17A of the Exchange Act set forth in paragraphs (a)(1)–(8) of this Order.

(2) Any Eurex clearing member shall be exempt from the requirements of

Section 5 of the Exchange Act to the extent such Eurex clearing member uses any facility of Eurex to effect any transaction in Cleared CDS, or to report any such transaction, in connection with Eurex's clearance and risk management process for Cleared CDS.

(c) Exemption for Eurex, Eurex clearing members, and certain eligible contract participants.

(1) Persons eligible. The exemption in paragraph (c)(2) is available to:

(i) Eurex; and

(ii) Any eligible contract participant (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), including any Eurex clearing member, other than:

(A) an eligible contract participant that is a self-regulatory organization, as that term is defined in Section 3(a)(26) of the Exchange Act; or

(B) a broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof).

(2) Scope of exemption.

(i) In general. Subject to the conditions specified in paragraph (c)(3) of this subsection, such persons generally shall, solely with respect to Cleared CDS, be exempt from the provisions of the Exchange Act and the rules and regulations thereunder that do not apply in connection with security-based swap agreements. Accordingly, under this exemption, those persons remain subject to those Exchange Act requirements that explicitly are applicable in connection with security-based swap agreements (*i.e.*, paragraphs (2) through (5) of Section 9(a), Section 10(b), Section 15(c)(1), paragraphs (a) and (b) of Section 16, Section 20(d) and Section 21A(a)(1) and the rules thereunder that explicitly are applicable to security-based swap agreements). All provisions of the Exchange Act related to the Commission's enforcement authority in connection with violations or potential violations of such provisions also remain applicable.

(ii) Exclusions from exemption. The exemption in paragraph (c)(2)(i), however, does not extend to the following provisions under the Exchange Act:

(A) Paragraphs (42), (43), (44), and (45) of Section 3(a);

(B) Section 5;

(C) Section 6;

(D) Section 12 and the rules and regulations thereunder;

(E) Section 13 and the rules and regulations thereunder;

(F) Section 14 and the rules and regulations thereunder;

(G) The broker-dealer registration requirements of Section 15(a)(1), and the other requirements of the Exchange Act (including paragraphs (4) and (6) of Section 15(b)) and the rules and regulations thereunder that apply to a broker or dealer that is not registered with the Commission;

(H) Section 15(d) and the rules and regulations thereunder;

(I) Section 15C and the rules and regulations thereunder;

(J) Section 16 and the rules and regulations thereunder; and

(K) Section 17A (other than as provided in paragraph (a)).

(3) Conditions for Eurex clearing members.

(i) Any Eurex clearing member relying on this exemption must be in material compliance with the rules of Eurex.

(ii) Any Eurex clearing member relying on this exemption that participates in the clearing of Cleared CDS transactions on behalf of other persons must annually provide a certification to Eurex that attests to whether the clearing member is relying on the exemption from broker-dealer related requirements set forth in paragraph (d) of this Order.

(d) Exemption from broker-dealer related requirements for Eurex clearing members and certain eligible contract participants.

(1) Persons eligible. The exemption in paragraph (d)(2) is available to:

(i) Any Eurex clearing member (other than one that is registered as a broker or dealer under Section 15(b) of the Exchange Act (other than paragraph (11) thereof)); and

(ii) Any eligible contract participant that does not receive or hold funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons (other than one that is registered as a broker or dealer under Section 15(b) of the Exchange Act (other than paragraph (11) thereof)).

(2) Scope of exemption. The persons described in paragraph (d)(1) shall, solely with respect to Cleared CDS, be exempt from the broker-dealer registration requirements of Section 15(a)(1) and the other requirements of the Exchange Act (other than Sections 15(b)(4) and 15(b)(6)) and the rules and regulations thereunder that apply to a broker or dealer that is not registered with the Commission, subject to the conditions set forth in paragraph (d)(3) with respect to Eurex clearing members.

(3) Conditions for Eurex clearing members.

(i) General condition for Eurex clearing members. A Eurex clearing member relying on this exemption must

be in material compliance with the rules of Eurex, and also must be in material compliance with applicable laws and regulations relating to capital, liquidity, and segregation of customers' funds and securities (and related books and records provisions) with respect to Cleared CDS.

(ii) Additional conditions for Eurex clearing members that receive or hold customer funds or securities. Any Eurex clearing member that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for U.S. persons (or for any person if the clearing member is a U.S. clearing member)—other than for an affiliate that controls, is controlled by, or is under common control with the clearing member—also shall comply with the following conditions with respect to such activities:

(A) The U.S. person (or any person if the clearing member is a U.S. clearing member) for whom the clearing member receives or holds such funds or securities shall not be natural persons;

(B) The clearing member shall disclose to such U.S. person (or to any such person if the clearing member is a U.S. clearing member) that the clearing member is not regulated by the Commission and that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to any funds or securities held by the clearing member, that the insolvency law of the applicable jurisdiction may affect such persons' ability to recover funds and securities, or the speed of any such recovery, in an insolvency proceeding, and, if applicable, that non-U.S. clearing members may be subject to an insolvency regime that is materially different from that applicable to U.S. persons;

(C) As promptly as practicable after receipt, the clearing member shall transfer such funds and securities (other than those promptly returned to such other person) to:

(I) The appropriate customer margin account at Eurex; or

(II) an account held by a third-party custodian, subject to the following requirements:

(a) the funds and securities must be held either:

(1) In the name of a customer, subject to an agreement to which the customer, the clearing member and the custodian are parties, acknowledging that the assets held therein are customer assets used to collateralize obligations of the customer to the clearing member, and that the assets held in that account may not otherwise be pledged or

rehypothecated by the clearing member or the custodian; or

(2) in an omnibus account for which the clearing member maintains a daily record as to the amount held in the account that is owed to each customer, and which is subject to an agreement between the clearing member and the custodian specifying that:

(i) All assets in that account are held for the exclusive benefit of the clearing member's customers and are being kept separate from any other accounts maintained by the clearing member with the custodian;

(ii) the assets held in that account shall at no time be used directly or indirectly as security for a loan to the clearing member by the custodian and shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the custodian or any person claiming through the custodian; and

(iii) the assets held in that account may not otherwise be pledged or rehypothecated by the clearing member or the custodian;

(b) the custodian may not be an affiliated person of the clearing member (as defined at paragraph (f)(2)); and

(1) if the custodian is a U.S. entity, it must be a bank (as that term is defined in section 3(a)(6) of the Exchange Act), have total capital, as calculated to meet the applicable requirements imposed by the entity's appropriate regulatory agency (as defined in section 3(a)(34) of the Exchange Act), of at least \$1 billion, and have been approved to engage in a trust business by its appropriate regulatory agency;

(2) if the custodian is not a U.S. entity, it must have total capital, as calculated to meet the applicable requirements imposed by the foreign financial regulatory authority (as defined in section 3(a)(52) of the Exchange Act) responsible for setting capital requirements for the entity, equating to at least \$1 billion, and provide the clearing member, the customer and Eurex with a legal opinion providing that the assets held in the account are subject to regulatory requirements in the custodian's home jurisdiction designed to protect, and provide for the prompt return of, custodial assets in the event of the insolvency of the custodian, and that the assets held in that account reasonably could be expected to be legally separate from the clearing member's assets in the event of the clearing member's insolvency;

(c) such funds may be invested in investments that constitute "approved instruments" pursuant to part 2.2 under the Eurex Organizational Manual; and

(d) the clearing member must provide notice to Eurex that it is using the third-party custodian to hold customer collateral.

(D) To the extent there is any delay in transferring such funds and securities to the third-parties identified in paragraph (C), the clearing member shall effectively segregate the collateral in a way that, pursuant to applicable law, is reasonably expected to effectively protect such funds and securities from the clearing member's creditors. The clearing member shall not permit such persons to "opt out" of such segregation even if regulations or laws otherwise would permit such "opt out."

(E) The clearing member annually must provide Eurex with:

(I) An assessment by the clearing member that it is in compliance with all the provisions of paragraphs (d)(3)(ii)(A) through (D) in connection with such activities, and

(II) a report by the clearing member's independent third-party auditor that attests to, and reports on, the clearing member's assessment described in paragraph (d)(3)(ii)(E)(I) and that is

(a) dated as of the same date as, but which may be separate and distinct from, the clearing member's annual audit report;

(b) produced in accordance with the auditing standards followed by the independent third party auditor in its audit of the clearing member's financial statements.

(F) The clearing member shall provide the Commission (upon request or pursuant to agreements reached between the Commission or the U.S. Government and any foreign securities authority (as defined in Section 3(a)(50) of the Exchange Act)) with any information or documents within the possession, custody, or control of the clearing member, any testimony of personnel of the clearing member, and any assistance in taking the evidence of other persons, wherever located, that the Commission requests and that relates to Cleared CDS transactions, except that if, after the clearing member has exercised its best efforts to provide the information, documents, testimony, or assistance, including requesting the appropriate governmental body and, if legally necessary, its customers (with respect to customer information) to permit the clearing member to provide the information, documents, testimony, or assistance to the Commission, the clearing member is prohibited from providing this information, documents, testimony, or assistance by applicable foreign law or regulations, then this exemption shall not longer be available to the clearing member.

(e) Exemption for certain registered broker-dealers.

A broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof) shall be exempt from the provisions of the Exchange Act and the rules and regulations thereunder specified in paragraph (c)(2), solely with respect to Cleared CDS, except:

- (1) Section 7(c);
- (2) Section 15(c)(3);
- (3) Section 17(a);
- (4) Section 17(b);
- (5) Regulation T, 12 CFR 200.1 *et seq.*;
- (6) Rule 15c3-1;
- (7) Rule 15c3-3;
- (8) Rule 17a-3;
- (9) Rule 17a-4;
- (10) Rule 17a-5; and
- (11) Rule 17a-13.

(f) Definitions.

For purposes of this Order:

(1) "Cleared CDS" shall mean a credit default swap that is submitted (or offered, purchased, or sold on terms providing for submission) to Eurex, that is offered only to, purchased only by, and sold only to eligible contract participants (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), and in which:

(i) The reference entity, the issuer of the reference security, or the reference security is one of the following:

(A) An entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available;

(B) A foreign private issuer whose securities are listed outside the United States and that has its principal trading market outside the United States;

(C) A foreign sovereign debt security;

(D) An asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; or

(E) An asset-backed security issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae; or

(ii) The reference index is an index in which 80 percent or more of the index's weighting is comprised of the entities or securities described in subparagraph (i).

(2) For purposes of this Order, the term "Affiliated Person of the Clearing Member" shall mean any person who directly or indirectly controls a clearing member or any person who is directly or indirectly controlled by or under common control with the clearing member. Ownership of 10 percent or more of the common stock of the relevant entity will be deemed *prima facie* control of that entity.

#### IV. Paperwork Reduction Act

Certain provisions of this Order contain "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995.<sup>64</sup> The Commission has submitted the proposed amendments to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

##### A. Collection of Information

As discussed above, the Commission has found it to be necessary or appropriate in the public interest and consistent with the protection of investors to grant the temporary conditional exemptions discussed in this Order through November 30, 2010. Among other things, the Order would require a Eurex clearing member that receives or holds customers' funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions to: (i) provide Eurex with certain certifications/notifications, (ii) make certain disclosures to Cleared CDS customers, (iii) enter into certain agreements to protect customer assets, (iv) maintain a record of each customer's share of assets maintained in an omnibus account, and (v) obtain a separate report, as part of its annual audit report, as to its compliance with the conditions of the Order regarding protection of customer assets.

##### B. Proposed Use of Information

These collection of information requirements are designed to, among other things, inform Cleared CDS customers that their ability to recover assets placed with the clearing member are dependent on the applicable insolvency regime, provide Commission staff with access to information regarding whether clearing members are complying with the conditions of this Order, and provide documentation helpful for the protection of Cleared CDS customers' funds and securities.

##### C. Respondents

Based on conversations with industry participants, the Commission understands that approximately 12 firms may be presently engaged as CDS dealers and thus may seek to be a clearing member of Eurex. In addition, 8 more firms may enter into this business. Consequently, the Commission estimates that Eurex, like

the other CCPs that clear CDS transactions, may have up to 20 clearing members.

##### D. Total Annual Reporting and Recordkeeping Burden

Paragraph III.(c)(3)(ii) of the Order requires any Eurex clearing member relying on the exemptive relief specified in paragraph (c) that participates in the clearing of Cleared CDS transactions on behalf of other persons to annually provide a certification to Eurex that attests to whether the clearing member is relying on the exemption from broker-dealer related requirements set forth in paragraph (d) of this Order. The Commission estimates that it would take a clearing member approximately one half hour each year to complete the certification and provide it to Eurex, resulting in an aggregate burden of 10 hours per year for all 20 clearing members to comply with this requirement on an annual basis.<sup>65</sup>

Paragraph III.(d)(3)(ii)(C)(II)(d) of the Order requires that a clearing member notify Eurex if it is using a third-party custodian to hold customer collateral. The Commission estimates that it would take a clearing member approximately one half hour each year to draft a notification and provide it to Eurex, which would result in an aggregate burden of 10 hours per year for all 20 clearing members to comply with this requirement on an annual basis.<sup>66</sup>

Paragraph III.(d)(3)(ii)(B) of the Order requires an Eurex clearing member to disclose to its U.S. customers<sup>67</sup> that it is not regulated by the Commission and that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to any funds or securities it holds, that the insolvency law of the applicable jurisdiction may affect the customers' ability to recover funds and securities, or the speed of any such recovery, in an insolvency proceeding, and, if it is not a U.S. entity, that it may be subject to an insolvency regime that is materially different from that applicable to U.S. persons. The Commission believes that clearing members could use the language in the Order that describes the disclosure that

must be made as a template to draft the disclosure. Consequently the Commission estimates, based on staff experience, that it would take a clearing member approximately one hour to draft the disclosure. Further, the Commission believes clearing members will include this disclosure with other documents or agreements provided to cleared CDS customers and a clearing member may take approximately one half hour to determine how the disclosure should be integrated into those other documents or agreements, resulting in a one-time aggregate burden of 30 hours for all 20 clearing members to comply with this requirement.<sup>68</sup>

Paragraph III.(d)(3)(ii)(C)(II)(a)(1) of the Order requires that, if an Eurex clearing member chooses to segregate each of its customers' funds and securities in a separate account, it must obtain a tri-party agreement for each such account acknowledging that the assets held in the account are customer assets used to collateralize obligations of the customer to the clearing member, and that the assets held in the account may not otherwise be pledged or re-hypothecated by the clearing member or the custodian. Paragraph III.(d)(ii)(C)(II)(a)(2) of the Order requires that, if an Eurex clearing member chooses to segregate its customers' funds and securities on an omnibus basis, it must obtain an agreement with the custodian with respect to the omnibus account acknowledging that the assets held in the account (i) are customer assets and are being kept separate from any other accounts maintained by the clearing member with the custodian, (ii) may at no time be used directly or indirectly as security for a loan to the clearing member by the custodian and shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the custodian or any person claiming through the custodian, and (iii) may not otherwise be pledged or re-hypothecated by the clearing member or the custodian. Opening a bank account generally includes discussions regarding the purpose for the account and a determination as to the terms and conditions applicable to such an account. We understand that most banks presently maintain omnibus and other similar types of accounts that are designed to recognize legally that the assets in the account may not be attached to cover debts of the account

<sup>65</sup> 10 hours = (20 clearing members × ½ hour per clearing member). This estimate is based on burden estimates published with respect to other Commission actions that contained similar certification requirements (see e.g., Exchange Act Release No. 41661 (Jul 27, 1999), 64 FR 42012 (Aug. 3, 1999), and the burden associated with the Year 2000 Operational Capability Requirements, including notification and certifications required by Rule 15b7-3T(e)).

<sup>66</sup> *Id.*

<sup>67</sup> If the clearing member is a U.S. entity, it must make this disclosure to all of its customers.

<sup>68</sup> 30 hours = (1 hour per clearing member to draft the disclosure + ½ hour per clearing member to determine how the disclosure should be integrated into those other documents or agreements) × 20 clearing members.

<sup>64</sup> 44 U.S.C. 3501 *et seq.*

holder. Thus the standard agreement for this type of account used by banks should contain the representations and disclosures required by the proposed amendment. However, a small percentage of clearing members may need to work with a bank to modify its standard agreement. We estimate that 5% of the 20 clearing members, or 1 firm, may use a bank with a standard agreement that does not contain the required language.<sup>69</sup> We further estimate each clearing member that uses a bank with a standard agreement that does not contain the required language would spend approximately 20 hours of employee resources working with the bank to update its standard agreement template.<sup>70</sup> Therefore, we estimate that the total one-time burden to the industry as a result of this proposed requirement would be approximately 20 hours.<sup>71</sup>

Paragraph III.(d)(3)(ii)(C)(II)(a)(2) of the Order further requires that the clearing member maintain a daily record as to the amount held in the omnibus account that is owed to each customer. The Commission included this requirement in the Order to stress the importance of such a record. However it believes that a prudent clearing member likely would create and maintain such a record for business purposes. Consequently, the Commission believes this requirement would not create any additional paperwork burden.

Paragraph III.(d)(3)(ii)(E) of the Order requires Eurex clearing members that receive or hold customers' funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions annually to provide Eurex with an assessment that it is in compliance with all the provisions of paragraphs III.(d)(3)(ii)(A) through (D) of the Order in connection with such activities, and a report by the clearing member's independent third-party auditor, as of the same date as the firm's annual audit report,<sup>72</sup> that attests to, and reports on, the clearing member's assessment. The Commission estimates that it will take each clearing

member approximately five hours each year to assess its compliance with the requirements of the order relating to segregation of customer assets and attest that it is in compliance with those requirements.<sup>73</sup> Further, the Commission estimates that it will cost each clearing member approximately \$200,000 more each year to have its auditor prepare this special report as part of its audit of the clearing member.<sup>74</sup> Consequently, the Commission estimates that compliance with this requirement will result in an aggregate annual burden of 100 hours for all 20 clearing members, and that the total additional cost of this requirement will be approximately \$4,000,000 each year.<sup>75</sup>

In sum, the Commission estimates that the total additional burden associated with all of the conditions contained in the exemptive order would be approximately 170 hours,<sup>76</sup> and that

<sup>73</sup> This estimate is based on burden estimates published with respect to other Commission actions that contained similar certification requirements (see e.g., Securities Act Release No. 8138 (Oct. 9, 2002) (67 FR 66208 (Oct. 30, 2002)), and the burden associated with the Disclosure Required by the Sarbanes-Oxley Act of 2002, including requirements relating to internal control reports).

<sup>74</sup> This estimate is based on staff conversations with an audit firm. That firm suggested that the cost of such an audit report could range from \$10,000 to \$1 million, depending on the size of the clearing member, the complexity of its systems, and whether the work included a review of other systems already being reviewed as part of audit work the firms is already providing to the clearing member. The staff understands that it would be less costly to perform this type of audit if the clearing member chooses to forward all customer collateral to Eurex (an option allowed by the order) and does not use any third party. Finally, the staff understands that most Eurex clearing members are large dealers whose audits likely include internal control reviews and SAS 70 reports regarding custody of customer assets, which would require a review of the same or similar systems used to comply with the audit report requirement in this order.

<sup>75</sup> 100 hours = (5 hours for each clearing member to assess its compliance with the requirements of the order relating to segregation of customer assets and attest that it is in compliance with those requirements × 20 clearing members). \$4 million = \$200,000 per clearing member × 20 clearing members.

<sup>76</sup> 170 hours = (10 hours per year to complete the certification and provide it to Eurex + 10 hours per year to prepare the notification + 30 hours to draft the disclosure and determine how the disclosure should be integrated into those other documents or agreements + 20 hours to work with the bank to update its standard account agreement template to include the necessary language + 100 hours per year to assess its compliance with the requirements of the order relating to segregation of customer assets and attest that it is in compliance with those requirements). This total burden includes one-time burdens of 50 hours (= 30 hours to draft the disclosure and determine how the disclosure should be integrated into those other documents or agreements + 20 hours to work with the bank to update its standard account agreement template to include the necessary language) and annual burdens of 120 hours (= 10 hours per year to complete the certification and provide it to Eurex

the total additional cost associated with compliance with the exemptive order would be approximately \$4 million.<sup>77</sup>

#### *E. Collection of Information Is Mandatory*

The collections of information contained in the conditions to the Order are mandatory for any entity wishing to rely on the exemptions granted by the Order.

#### *F. Confidentiality*

Certain of the conditions of this Order that address collections of information require Eurex clearing members to make disclosures to their customers, or to provide other information to Eurex (and in some cases also to customers). Apart from those requirements, the provisions of this Order that address collections of information do not address or restrict the confidentiality of the documentation prepared by Eurex clearing members under the exemptive conditions. Accordingly, Eurex clearing members would have to make the applicable information available to regulatory authorities or other persons to the extent otherwise provided by law.

#### *G. Request for Comment on Paperwork Reduction Act*

The Commission requests, pursuant to 44 U.S.C. 3506(c)(2)(B), comment on the collections of information contained in the Order to:

(i) Evaluate whether the collections of information are necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility;

(ii) evaluate the accuracy of the Commission's estimates of the burden of the collections of information;

(iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and

(iv) evaluate whether there are ways to minimize the burden of the collections of information on those required to respond, including through the use of automated collection techniques or other forms of information technology.

Persons who desire to submit comments on the collection of information requirements should direct their comments to the OMB, Attention: Desk Officer for the Securities and

+ 10 hours per year to prepare the notification + 100 hours per year to assess its compliance with the requirements of the order relating to segregation of customer assets and attest that it is in compliance with those requirements).

<sup>77</sup> The estimated cost of the additional audit report. See footnote 75 and accompanying text.

<sup>69</sup> This estimate is based on burden estimates published with respect to other Commission actions that contained similar certification requirements (see e.g., Exchange Act Release No. 55431 (Mar. 9, 2007), 72 FR 12862 (Mar. 19, 2007), and the burden associated with the amendments to the financial responsibility rules, including language required in securities lending agreements).

<sup>70</sup> *Id.*

<sup>71</sup> 20 hours = (20 clearing members × 5%) × 20 hours to work with a bank to update its standard agreement template to include the necessary language.

<sup>72</sup> The Commission intends for this requirement to be performed in conjunction with the firm's annual audit report.



Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090, and refer to File No. S7–17–09. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this document in the **Federal Register**; therefore, comments to OMB are best assured of having full effect if OMB receives them within 30 days of this publication. The Commission has submitted the proposed collections of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–17–09, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE., Washington, DC 20549–0213.

By the Commission.  
**Elizabeth M. Murphy**,  
*Secretary.*

[FR Doc. 2010–9931 Filed 4–28–10; 8:45 am]

**BILLING CODE 8011–01–P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–61973; File No. S7–16–09]

### Order Extending Temporary Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection With Request on Behalf of ICE Clear Europe, Limited Related to Central Clearing of Credit Default Swaps, and Request for Comments

April 23, 2010.

#### I. Introduction

The Securities and Exchange Commission (“Commission”) has taken multiple actions<sup>1</sup> designed to address

<sup>1</sup> See generally Securities Exchange Act Release No. 60372 (Jul. 23, 2009), 74 FR 37748 (Jul. 29, 2009) (temporary exemptions in connection with CDS clearing by ICE Clear Europe Limited) (“2009 ICE Clear Europe order”); Securities Exchange Act Release No. 60373 (Jul. 23, 2009), 74 FR 37740 (Jul. 29, 2009) and Securities Exchange Act Release No. 61975 (Apr. 23, 2010) (temporary exemptions in connection with CDS clearing by Eurex Clearing AG); Securities Exchange Act Release No. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), Securities Exchange Act Release No. 61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009) and Securities Exchange Act Release No. 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010) (temporary exemptions in connection with CDS clearing by Chicago Mercantile Exchange Inc.); Securities Exchange Act Release No. 59527 (Mar. 6, 2009), 74

concerns related to the market in credit default swaps (“CDS”).<sup>2</sup> The over-the-counter (“OTC”) market for CDS has been a source of particular concern to us and other financial regulators, and we have recognized that facilitating the establishment of central counterparties (“CCPs”) for CDS can play an important role in reducing the counterparty risks inherent in the CDS market, and thus can help mitigate potential systemic impact. We have therefore found that taking action to help foster the prompt development of CCPs, including granting temporary conditional exemptions from certain provisions of the Federal securities laws, is in the public interest.<sup>3</sup>

The Commission’s authority over the OTC market for CDS is limited. Specifically, section 3A of the Securities

FR 10791 (Mar. 12, 2009), Securities Exchange Act Release No. 61119 (Dec. 4, 2009), 74 FR 65554 (Dec. 10, 2009) and Securities Exchange Act Release No. 61662 (Mar. 5, 2010), 75 FR 11589 (Mar. 11, 2010) (temporary exemptions in connection with CDS clearing by ICE Trust US LLC); Securities Exchange Act Release No. 59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009) (temporary exemptions in connection with CDS clearing by LIFFE A&M and LCH.Clearnet Ltd.) and other Commission actions discussed in several of these orders.

In addition, we have issued interim final temporary rules that provide exemptions under the Securities Act of 1933 and the Securities Exchange Act of 1934 for CDS to facilitate the operation of one or more central counterparties for the CDS market. See Securities Act Release No. 8999 (Jan. 14, 2009), 74 FR 3967 (Jan. 22, 2009) (initial approval); Securities Act Release No. 9063 (Sep. 14, 2009), 74 FR 47719 (Sep. 17, 2009) (extension until Nov. 30, 2010).

Further, the Commission provided temporary exemptions in connection with Sections 5 and 6 of the Securities Exchange Act of 1934 for transactions in CDS; these exemptions expired on March 24, 2010. See Securities Exchange Act Release No. 59165 (Dec. 24, 2008), 74 FR 133 (Jan. 2, 2009) (initial exemption); Securities Exchange Act Release No. 60718 (Sep. 25, 2009), 74 FR 50862 (Oct. 1, 2009) (extension until Mar. 24, 2010).

<sup>2</sup> 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 (“reference 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 payments 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 positions in bonds or in segments of the debt market as represented by an index, or to take positions on the volatility in credit spreads during times of economic uncertainty.

Growth in the CDS market has coincided with a significant rise in the types and number of entities participating in the CDS market. CDS were initially created to meet the demand of banking institutions looking to hedge and diversify the credit risk attendant to their lending activities. However, financial institutions such as insurance companies, pension funds, securities firms, and hedge funds have entered the CDS market.

<sup>3</sup> See generally actions referenced in note 1, *supra*.

Exchange Act of 1934 (“Exchange Act”) limits the Commission’s authority over swap agreements, as defined in section 206A of the Gramm-Leach-Bliley Act.<sup>4</sup> For those CDS that are swap agreements, the exclusion from the definition of security in section 3A of the Exchange Act, and related provisions, will continue to apply. The Commission’s action today does not affect these CDS, and this Order does not apply to them. For those CDS that are not swap agreements (“non-excluded CDS”), the Commission’s action today provides temporary conditional exemptions from certain requirements of the Exchange Act.

The Commission believes that using well-regulated CCPs to clear transactions in CDS provides a number of benefits by helping to promote efficiency and reduce risk in the CDS market, by contributing to the goal of market stability, and by requiring maintenance of records of CDS transactions that would aid the Commission’s efforts to prevent and detect fraud and other abusive market practices.<sup>5</sup>

In the 2009 ICE Clear Europe Order, the Commission provided temporary conditional exemptions to ICE Clear Europe, Limited (“ICE Clear Europe”) and certain other parties to permit ICE Clear Europe to clear and settle CDS transactions.<sup>6</sup> The current exemptions

<sup>4</sup> 15 U.S.C. 78c–1. Section 3A excludes both a non-security-based and a security-based swap agreement from the definition of “security” under Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10). Section 206A of the Gramm-Leach-Bliley Act defines a “swap agreement” as “any agreement, contract, or transaction between eligible contract participants (as defined in section 1a(12) of the Commodity Exchange Act \* \* \*) \* \* \* the material terms of which (other than price and quantity) are subject to individual negotiation.” 15 U.S.C. 78c note.

<sup>5</sup> See generally actions referenced in note 1, *supra*.

<sup>6</sup> For purposes of this Order, “Cleared CDS” means a credit default swap that is submitted (or offered, purchased, or sold on terms providing for submission) to ICE Clear Europe, that is offered only to, purchased only by, and sold only to eligible contract participants (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), and in which: (i) The reference entity, the issuer of the reference security, or the reference security is one of the following: (A) An entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available; (B) a foreign private issuer whose securities are listed outside the United States and that has its principal trading market outside the United States; (C) a foreign sovereign debt security; (D) an asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; or (E) an asset-backed security issued or guaranteed by the Federal National Mortgage Association (“Fannie Mae”), the Federal Home Loan Mortgage