

CFTC Releases Cross-Border Swaps Guidance

On June 29, 2012, the U.S. Commodity Futures Trading Commission ("**CFTC**") released its long-awaited draft interpretive guidance (the "**Release**") on the "Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act". The Release provides important clarification on the CFTC's proposals for regulating swap transactions involving U.S. and non-U.S. counterparties. Simultaneously with the Release, the CFTC released a proposed exemptive order (the "**Order**") to provide temporary relief from compliance with certain regulatory requirements regarding swaps activity. The Order allows certain swap dealers and major swap participants to delay compliance with some of the otherwise mandatory requirements relating to swaps activity with non-U.S. counterparties.

U.S. Persons and Requirements for Non-U.S. Swap Dealers and Major Swap Participants

In the Release, the CFTC proposes guidance to determine whether a non-U.S. person's swap dealing activities with U.S. counterparties would be sufficient to require registration as a "swap dealer" ("**SD**") or a "major swap participant" ("**MSP**") as well as the treatment for the SD and MSP registration purposes of non-U.S. branches, agencies, affiliates and subsidiaries of U.S. branches of non-U.S. swap dealers.

Who is a U.S. person?

In connection with determining the applicability of the SD and MSP registration requirements applicable to non-U.S. persons, the CFTC has proposed the term "U.S. person" to include, but not be limited to, the following (a "**U.S. Person**"):

- (i) a natural person who is a resident of the United States;
- (ii) a legal entity that:
 - (a) is organized or incorporated under the laws of the United States;
 - (b) has a principal place of business in the United States; **or**

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- (c) is directly or indirectly owned by one or more U.S. Persons that are also responsible for such entity's liabilities;
- (iii) a commodity pool, pooled account, or collective investment vehicle:
 - (a) of which a majority ownership is held, directly or indirectly, by any U.S. Person (irrespective of whether such owners are also responsible for the vehicle's liabilities); **or**
 - (b) which is operated by a commodity pool operator registered (or required to be registered) in such capacity with the CFTC (irrespective of whether direct or indirect owners of the vehicle are U.S. Persons);
- (iv) an individual account (discretionary or not) where the beneficial owner is a U.S. Person;
- (v) a pension plan for the employees, officers, or principals of a legal entity with principal place of business in the United States; and
- (vi) an estate or a trust, the income of which is subject to United States income tax regardless of source.

Non-U.S. Branch or Agency of a U.S. Person Is Also a U.S. Person.

The CFTC states in the Release that it does not view branches and agencies as entities having a separate legal existence, but rather as corporate extensions of a principal entity. As such, under the proposed interpretation of a "U.S. person", a non-U.S. branch or agency of a U.S. Person would also be a U.S. Person, and the CFTC would apply the SD and MSP registration requirements to a U.S. Person and its non-U.S. branches and entities on an entity-wide basis. Under the proposed treatment of non-U.S. branches and agencies of a U.S. Person, the CFTC would require the principal entity to register as an SD, and the principal entity would remain responsible for compliance with all applicable requirements under Dodd-Frank.

Non-U.S. Affiliates or Subsidiaries of a U.S. Person.

The CFTC states in the Release that under the proposed interpretation of the term "U.S. person," a non-U.S. affiliate or a subsidiary of a U.S. Person would be considered to be a non-U.S. Person, even if all of such affiliate's or subsidiary's swaps are guaranteed by the U.S. Person. However, the definition of U.S. Person includes a foreign entity that is owned by a U.S. Person if the U.S. owner is responsible for the foreign person's liabilities. Presumably the CFTC's intent is that a non-U.S. affiliate will not be a U.S. Person if only its swap obligations are guaranteed by a U.S. parent but would be a U.S. Person if, for example, it was a non-U.S. partnership in which U.S. partners had unlimited liability for the partnership. The CFTC has raised a concern regarding risks associated with a U.S. Person providing a guarantee to its non-U.S. affiliates and has requested comments on whether the term "U.S. person" should, in fact, include a non-U.S. affiliate or subsidiary guaranteed by a U.S. Person. In addition, the CFTC is seeking comments on whether the term "U.S. person" should also include any non-U.S. persons controlled by or under common control with a U.S. Person. The inclusion of any such concept of control would effectively bring any non-U.S. affiliates and subsidiaries of any U.S. parent entity under the definition of a U.S. Person.

Use of a "Central Booking Entity."

In the event an entity operates a "central booking system" where swaps may be booked into a single legal entity, whether or not such entity is a counterparty to the swap, the CFTC has proposed that the entity that books the swaps would be subject to any applicable SD registration requirements, irrespective of whether such entity is a U.S. Person and whether or not the booking entity is a counterparty to a swap (has booked the swap directly) or has booked a swap indirectly by way of a back-to-back swap or other arrangement with its affiliate or subsidiary. The CFTC noted that a non-U.S. affiliate or subsidiary may also be required to register as an SD if it independently meets the definition of an SD.

When is a non-U.S. Person Required to Register as a Swap Dealer?

As a general matter, the CFTC proposes that non-U.S. Persons who engage in more than a *de minimis* level of swap dealing with U.S. Persons (as set out under the relevant CFTC rule further defining the term "swap dealer") (a "**Non-U.S. Dealer**") would be required to register as SDs.

However, in calculating whether a Non-U.S. Dealer meets the *de minimis* threshold of swap dealing activities, the CFTC proposes to exclude from the threshold calculation the notional value of any swaps between such Non-U.S. Dealer (or any of its non-U.S. affiliates under common control) and:

- (i) any non-U.S. branches of registered U.S. SDs; or
- (ii) another non-U.S. Person, *provided that* the obligations of the Non-U.S. Dealer are not guaranteed by any U.S. Person.

In determining whether a Non-U.S. Dealer is engaged in more than a *de minimis* level of swap dealing, the CFTC proposes to include the notional value of any swap transactions (i) between such Non-U.S. Dealer (or any of its non-U.S. affiliates under common control) and a U.S. Person, other than non-U.S. branches of registered U.S. SDs, and (ii) where the Non-U.S. Dealer's obligations are guaranteed by a U.S. Person. The CFTC is seeking comment on whether to exclude any swaps entered into by a non-U.S. affiliate of a Non-U.S. Dealer that is itself registered as an SD.

"Regular Business" Determination.

The CFTC proposes that a non-U.S. Person without a guarantee from a U.S. Person should not be required to register as an SD if it does not engage in swap dealing as part of "a regular business" with U.S. Persons, even if the non-U.S. Person engages in dealing with other non-U.S. persons. As a result, a non-U.S. Person without a guarantee from a U.S. Person would not be required to apply the *de minimis* test or to register as an SD in connection with any swaps with U.S. Persons if such non-U.S. Person does not engage in swap dealing with U.S. Persons as part of its "regular business."

When is a non-U.S. Person Required to Register as a Major Swap Participant?

The CFTC proposes that if a non-U.S. Person holds swap positions above the thresholds identified in the final CFTC rule defining the term "major swap participant" ("**Non-U.S. Swap Participant**"), such Non-U.S. Swap Participant would be required to register as an MSP.

In calculating whether a Non-U.S. Swap Participant meets the applicable threshold, the CFTC proposes to include the notional value of:

- (i) any swaps entered into between such Non-U.S. Swap Participant and a U.S. Person, *provided that* if the Non-U.S. Swaps Participant's swaps are guaranteed by a U.S. Person, then such swaps will be attributed to the guarantor and not the Non-U.S. Swap Participant; and
- (ii) any swaps between a U.S. Person and a non-U.S. person if the non-U.S. Person is guaranteed by the Non-U.S. Swap Participant.

The CFTC has noted the difference in its approach to excluding a swap entered into by a Non-U.S. Swap Participant whereby the obligations of such Non-U.S. Swap Participant are guaranteed by another U.S. Person. As discussed above, if a Non-U.S. Swap Participant's obligations under a swap with a non-U.S. Person are guaranteed by a U.S. Person, such swap will be included in the calculation of the notional amount, while guaranteed swaps entered into with U.S. Persons would be excluded.

In addition, the CFTC has not expressly excluded any swaps entered into with non-U.S. branches of U.S. SDs from the calculation of the relevant MSP thresholds and is seeking comment as to whether the notional value of such swaps should be expressly included.

Cross-border Application of the Swaps Rules

A non-U.S. person who meets or exceeds the *de minimis* threshold for SDs or the position threshold for MSPs would be required to register as an SD or MSP and comply with all of the requirements applicable to SDs/MSPs for all of their swaps. However, with respect to non-U.S. SDs/MSPs and cross-border activities, the CFTC has proposed relief with respect to complying with certain of these requirements, as described below. For purposes of the proposal, the CFTC has divided the swaps requirements

into two categories: (i) entity-level requirements (which apply to each firm as a whole), and (ii) transaction-level requirements (which apply to an individual swap transaction).

Entity-level vs. Transaction-level requirements

The entity-level requirements include provisions regarding (i) the risks of a firm as a whole (including rules on capital adequacy, chief compliance officers, risk management and swap data recordkeeping) and (ii) market surveillance (including rules regarding reporting of swap data to a swap data repository, or SDR, and rules on physical commodity swaps reporting). The entity-level requirements apply to SDs/MSPs across all of their swaps, regardless of the counterparty or location of the swap transaction. The transaction-level requirements include provisions regarding (i) risk mitigation and market transparency (including rules on mandatory clearing and swap processing, margining and segregation for uncleared swaps, mandatory trade execution, swap trading relationship documentation, portfolio reconciliation and compression, real-time public reporting, trade confirmation, and daily trading records) and (ii) external business conduct standards.

Substituted compliance

Under the proposal, a non-U.S. SD/MSP, once registered, would be permitted to comply with certain of the Dodd-Frank swap requirements by substituted compliance: complying with regulations in its home country, if the CFTC finds that such regulations are comparable with requirements under the Commodity Exchange Act ("**CEA**") and CFTC regulations. The CFTC would make comparability determinations for each individual requirement, rather than of the non-U.S. regime as a whole, so that a non-U.S. SD/MSP could comply with regulations in its home jurisdiction to the extent that the comparability standard is met, but also may be required to comply with certain Dodd-Frank requirements where the comparability standard has not been met.

Application to Non-U.S. SDs/MSPs

Entity level requirements

As described above, under the proposal, non-U.S. SDs/MSPs would be required to comply with all of the entity-level requirements, but may do so through substituted compliance. With respect to the requirement to report swap transactions to an SDR, substituted compliance would be permitted for swaps by non-U.S. SDs/MSPs with non-U.S. counterparties (whether or not the non-U.S. SD/MSP is guaranteed by a U.S. person) so long as the CFTC has direct access to the swap data for such transactions that is stored at a non-U.S. trade repository.

Transaction-level requirements

Under the proposal, non-U.S. SDs/MSPs would be required to comply with the transaction-level requirements for all of their swaps with U.S. persons, other than non-U.S. branches of U.S. persons. For swaps between non-U.S. SDs/MSPs and non-U.S. counterparties, the non-U.S. SD/MSP would be required to comply with the transaction-level requirements (other than the external business conduct standards) if the non-U.S. counterparty's performance is guaranteed or supported by a U.S. person, but would not be required to comply with transaction-level requirements if the non-U.S. counterparty is not guaranteed by a U.S. person. In addition, the CFTC expressed concerns about transactions with affiliate conduits, so the transaction-level requirements would apply to swaps in which (i) a non-U.S. counterparty is majority-owned, directly or indirectly, by a U.S. person, (ii) the non-U.S. counterparty regularly enters into swaps with U.S. affiliates or subsidiaries of the U.S. person, and (iii) the financials of the non-U.S. counterparty are included in the consolidated financial statements of the U.S. person. Non-U.S. SDs/MSPs would not be required to comply with the external business conduct standards with respect to swaps transactions with a non-U.S. counterparty, whether or not the counterparty is guaranteed by a U.S. person.

Substituted compliance would be permitted for these transaction-level requirements with respect to transactions between a non-U.S. SD/MSP and a non-U.S. counterparty whose obligations are guaranteed by a U.S. person if the non-U.S. SD/MSP is subject to comparable regulation in its home jurisdiction. Non-U.S. SDs/MSPs would generally not be permitted to comply by substituted compliance with respect to the transaction-level requirements for swaps with a U.S. person.

Application to non-U.S. branches, agencies, affiliates, and subsidiaries of U.S. SDs

Non-U.S. branches or agencies of U.S. SDs

Under the proposal, non-U.S. branches and agencies of a U.S. person would be considered part of the U.S. person, and thus the U.S. person would be legally responsible for complying with the applicable entity-level and transaction-level requirements, regardless of whether its counterparty is a U.S. or non-U.S. person. For transaction-level compliance, substituted compliance would be permitted for swaps between a non-U.S. branch of a U.S. person and certain non-U.S. person counterparties.

The CFTC would permit non-U.S. branches or agencies of a U.S. SD that are located in "emerging market" countries to comply with the transaction-level requirements of their home jurisdictions rather than the requirements that would otherwise be applicable to U.S. persons, even where non-U.S. regulations are not deemed comparable by the CFTC, as long as the aggregate notional value of the swaps of all non-U.S. branches or agencies in an emerging market country does not exceed 5% of the aggregate notional value of all of the swaps of the U.S. SD. However, the U.S. person relying on the "emerging market" exception would be required to maintain supporting records to verify its eligibility for the exception and address any significant risks that may arise from non-application of the transaction-level requirements.

Non-U.S. affiliates or subsidiaries of U.S. SDs

With respect to non-U.S. affiliates or subsidiaries of U.S. SDs, the requirements that would apply to the affiliate or subsidiary would depend on where the swaps are booked and whether the affiliate or subsidiary engages in activities sufficient to trigger the requirement to register as an SD. If the non-U.S. affiliate or subsidiary facing the counterparty is acting solely as a disclosed agent for the SD and does not itself meet the definition of an SD, the Dodd-Frank requirements applicable to SDs would not be applicable to the affiliate or subsidiary, as long as the agency relationship is properly documented and the principal remains primarily responsible for the actions of the affiliate. However, if the affiliate or subsidiary facing the counterparty independently met the SD definition, it would be required to register and fulfill the Dodd-Frank requirements applicable to SDs. Under the proposal, substituted compliance by the non-U.S. affiliate or subsidiary would be permitted.

Where non-U.S. affiliates or subsidiaries enter into swaps that are not directly booked in a U.S. person, the non-U.S. affiliate or subsidiary may be required to register as an SD if the affiliate or subsidiary meets the definition of an SD. With respect to SDR reporting, non-U.S. affiliates or subsidiaries of U.S. SDs would be required to comply with the SDR reporting requirements, but would be permitted to comply by substituted compliance if the CFTC has direct access to the swap data for such swaps that is stored at the non-U.S. trade repository.

Substituted compliance

A key element of the Release is the Commission's willingness to recognize domestic regulations with respect to the compliance of non-U.S. entities with the entity level requirements. The Commission has proposed building on its experience under the existing process for recognizing non-U.S. regulations for purposes of CFTC Rule 30.10, adjusting its approach to meet the "heightened requirements and expectations" under the Dodd-Frank Act. The review would be "outcomes-based", with a focus on whether the foreign requirements are designed for the same purpose. The Commission would retain broad discretion to determine whether the requirements of a program are met by a foreign jurisdiction's regulations, and where the non-U.S. regulations are determined to be appropriate, persons based in that jurisdiction may comply with its domestic regulations in lieu of the comparable Dodd-Frank Act regulations.

Where the foreign regime does not achieve the objectives of the Dodd-Frank Act, the Commission proposes to recognize substituted compliance only to the extent that the foreign regulations are determined to be comparable and sufficiently comprehensive. In making its determination, the Commission would look to all relevant factors including, among other things:

- the scope and objectives of the non-U.S. regulations;

- the comprehensiveness of requirements of the non-U.S. regulations;
- the comprehensiveness of the non-U.S. regulator's supervisory program; and
- the authority of the non-U.S. regulator to support and enforce its oversight of the non-U.S. swap dealer or non-U.S. MSP applicant.

Process

A non-U.S. person, or a group of non-U.S. persons on such person's behalf, may request permission to comply with its home jurisdiction's requirements in lieu of the requirements under the Dodd-Frank Act. The application would be made in connection with a person's application to register as a swap dealer or MSP, and they would be required to state the factual basis on which their request is made, including a description of all applicable legislation, rules and policies, with updates as to any material changes to the facts and circumstances. Substituted compliance arrangements would likely take the form of a memorandum of understanding between the Commission and the foreign regulator.

The Commission expects that it may rely on prior comparability determinations with respect to a particular jurisdiction, with adjustments made as necessary where regulatory changes affect the basis upon which the previous finding of comparability was made. Swap dealer and MSPs that rely on substituted compliance will be required under the proposed interpretation to notify the CFTC of any changes to the relevant regulatory regime.

Clearing

The Commission, in response to a number of inquiries, stated that with respect to swaps covered by a Commission-issued clearing requirement, the Commission would likely find comparability with non-U.S. regulatory regimes where (a) the swap is subject to a governmental mandate comparable to the Commission's mandate, and (b) the swap is cleared through a DCO that is exempted from registration under the CEA.

Application to non-U.S. entities that are not Swap Dealers or MSPs.

The Release provides that clearing, trade execution, real-time public reporting, large trader reporting, swap data repository reporting and swap data recordkeeping requirements will apply to a swap if one of the parties is a U.S. Person or a non-U.S. person that is required to register as a Swap Dealer or MSP. The CFTC makes clear, however, that the swap provisions will not apply where neither party is a U.S. Person or an SD or MSP, including non-U.S. affiliates or subsidiaries of a U.S. Person. The CFTC is considering further interpretive guidance to prevent avoidance of any of the Dodd-Frank rules by use of a non-U.S. affiliate or subsidiary.

Where either party is a U.S. Person, even if neither party is an SD or an MSP, the CFTC will require compliance with the clearing, trade execution, real-time public reporting and large trader reporting requirements of the CEA regardless of the parties' compliance with any applicable non-U.S. regulatory regime. Substituted compliance will not be permitted. However, in the same circumstances, the CFTC will permit the parties to comply with swap data repository reporting and swap data recordkeeping requirements by complying with a foreign regulatory regime, as long as the CFTC has "direct access" to the data stored at the foreign swap repository.

The CFTC states in the release that it recognizes that parties to a swap conducted outside the United States may be subject to non-U.S. regulations that may conflict or duplicate the U.S. requirements. The CFTC has stated that it will attempt to address these conflicts with domestic regulators.

CFTC Proposed Exemptive Order Regarding Compliance with Certain Swap Regulations

Summary

Simultaneously with the Release, the CFTC released a proposed exemptive order (the "**Order**") to provide temporary relief from compliance with certain regulatory requirements regarding swaps activity under the CEA. The Order allows Non-U.S. SDs and Non-U.S. MSPs to delay compliance with certain entity and transaction requirements with respect to swaps activity with non-U.S. counterparties. In addition, the Order provides temporary relief for U.S. swap dealers from compliance with certain entity requirements until January 1, 2013.

Non-U.S. SDs and MSPs

Entity-Level Requirements

For swaps with a non-U.S. counterparty, the Order proposes that the Non-U.S. SD/MSP may delay compliance with the capital adequacy; chief compliance officer; risk management; and swap data recordkeeping requirements for up to 12 months after the Order is published in the Federal Register. Similar relief is available for swap data reporting and physical commodity swaps reporting (large trader reporting) only if the entity is not an affiliate or subsidiary of a U.S. SD.

However, in order for a Non-U.S. SD/MSP to use this relief, the entity must: (1) file an application to register as an SD/MSP with the National Futures Association (the "NFA") by the date on which compliance is required; and (2) file a compliance plan with the NFA. The plan must describe whether the entity will comply with the requirements or will otherwise seek to rely on substituted compliance. Further, the plan must describe the extent to which the entity would comply with home jurisdiction requirements, with a description of the applicable requirements.

For swaps with a U.S. counterparty, the Order proposes to provide similar relief for capital adequacy; chief compliance officer; risk management; and swap data recordkeeping requirements. However, no relief from swap data reporting and physical commodity swaps reporting (large trader reporting) requirements is proposed.

Transaction-Level Requirements

Swaps with a non-U.S. counterparty: The entity may comply with transaction-level requirements only as required by the entity's home jurisdiction for the proposed period of exemptive relief. Under the proposed Order, exemptive relief would be effective as of the compliance date or registration of SDs/MSPs and would expire 12 months after publication of the Order in the Federal Register.

Swaps with a U.S. counterparty: The Order offers no exemptive relief for any transaction-level requirements.

Swaps where neither party is an SD or an MS: The Order does not provide relief from transaction-level requirements for swaps between a non-U.S. Person and a U.S. Person where neither party is an SD or an MSP.

U.S. SDs and MSPs

Entity-Level Requirements

For swaps with a non-U.S. counterparty or a U.S. counterparty, the Order proposes that the entity may delay compliance with capital adequacy, chief compliance officer and risk management requirements until January 1, 2013. The Order does not provide exemption from compliance with swap data recordkeeping, swap data reporting and physical commodity swaps reporting (i.e., large trader reporting) requirements.

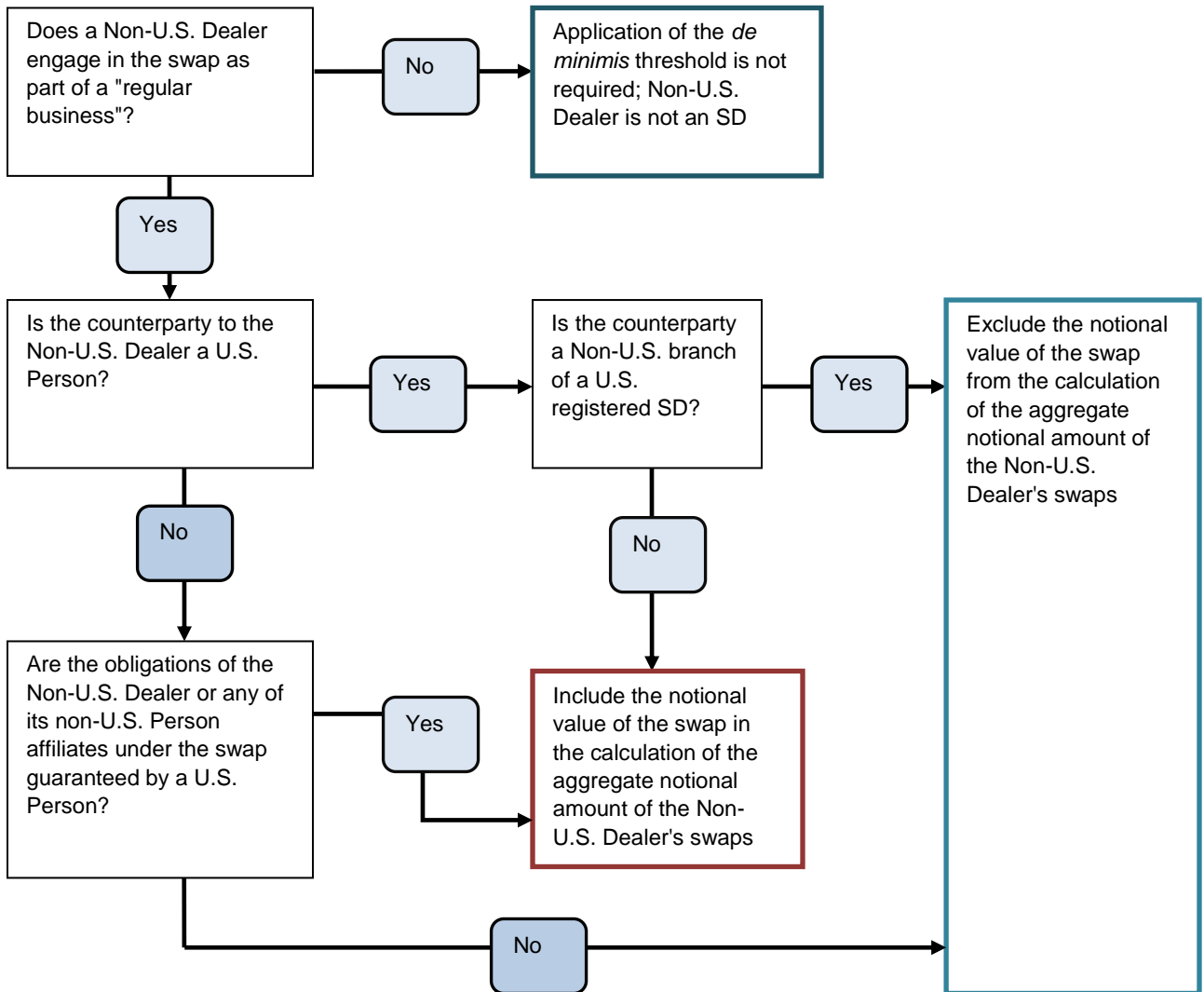
Transaction-Level Requirements

Swaps with a non-U.S. counterparty: If the entity is a non-U.S. branch of a U.S. SD or MSP, the entity may comply with transaction-level requirements only as required by the branch's home jurisdiction. However, if such relief is sought, the entity must apply for registration as an SD/MSP by the standard compliance date and file a plan for compliance with all applicable transaction-level requirements after expiration of the temporary relief. No other relief is proposed for U.S. SDs or MSPs.

Swaps with a U.S. counterparty: The Order offers no exemptive relief for any transaction-level requirements.

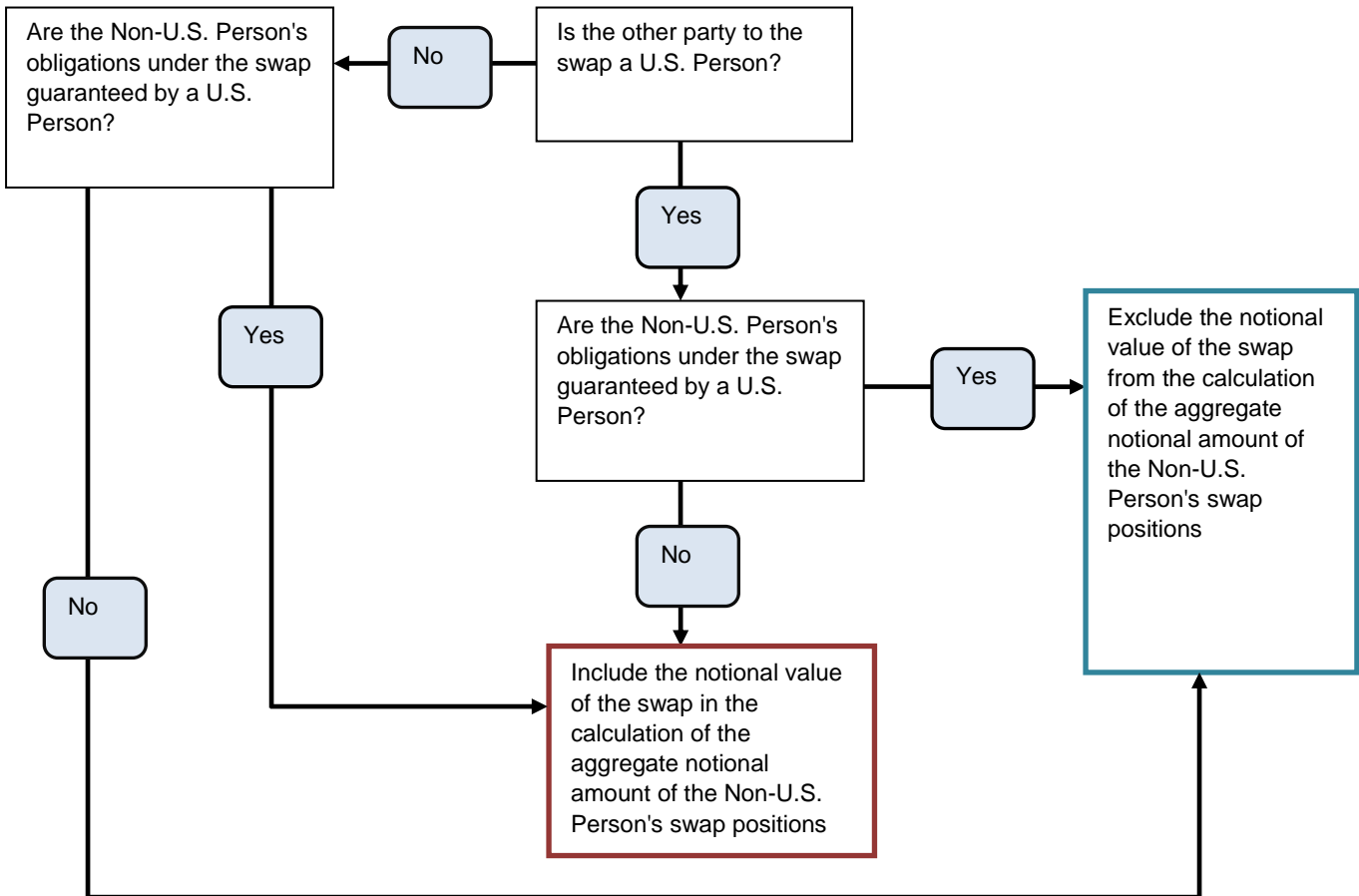
Flow Chart: Non-U.S. Swap Dealer Determination

The following chart summarizes the CFTC proposed guidance with respect to calculating the *de minimis* levels of swap dealing by a Non-U.S. Dealer and any of its non-U.S. Person affiliates under common control for the purposes of determining whether such Non-U.S. Dealer would be required to register as an SD:



Flow Chart: Non-U.S. MSP Determination

The following chart summarizes the CFTC proposed guidance with respect to calculating the *de minimis* levels of swap positions held by a Non-U.S. Person for the purposes of determining whether such Non-U.S. Person would be required to register as an MSP:



This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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