

US Commodity Futures Trading Commission's Division of Market Oversight Issues No-Action Relief Granting Time-Limited, Exemptive Relief to Reporting Swap Dealers

On December 7, 2012, the US Commodity Futures Trading Commission's Division of Market Oversight (the "CFTC") issued a time-limited, no-action letter relating to certain Dodd-Frank reporting requirements.¹ Under CFTC regulations, swap dealers must soon begin reporting the details of their trades to "swap data repositories". These reporting requirements² raise certain privacy and confidentiality concerns where parties to the trades are located in a number of jurisdictions outside of the United States. In response to these concerns, the CFTC issued a no-action letter under which swap dealers may report trades on a redacted basis with counterparty identity anonymized. The relief, however, is only temporary and subject to significant limitations.

Privacy-Law Concerns Outside of the United States

The no-action letter was, in part, prompted by comment letters submitted by the International Swaps and Derivatives Association, Inc. ("ISDA") on behalf of the swaps industry.³ These letters address the industry's concerns that swap dealers could not comply with the new reporting requirements without being in possible breach of privacy laws in non-US jurisdictions. Surveys of privacy law outside of the United States indicated that some countries would not recognize the requirements of a foreign regulator (e.g., the CFTC) as constituting an exemption to local data privacy protections and restrictions.

¹ A copy of the letter is available at: <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/12-46.pdf>.

² Pursuant to Parts 20, 45 and 46 of the CFTC regulations.

³ A copy of these letters is available at: <http://www2.isda.org/dodd-frank/>.

In some jurisdictions, obtaining counterparty consent to disclosure is an effective way to override privacy law concerns. To streamline the process to obtain consent, ISDA proposed to include standard consent language in an ISDA protocol to which swap market participants would accede and thereby deliver their respective consents to all of their counterparties. However, as a practical matter, swap dealers cannot compel their counterparties to accede to the ISDA protocol.

In other jurisdictions, however, a counterparty's consent is not sufficient to authorize disclosure by a swap dealer. For these jurisdictions, there is no obvious solution beyond changing or clarifying local laws or a statement from local regulators requiring or authorizing swap dealers to make necessary disclosures. Swap dealers could make representations to non-US authorities where privacy and confidentiality concerns arise, but US regulatory authorities, including the CFTC, may be in the best position to resolve these issues with their non-US counterparts.

For now, the no-action relief issued by the CFTC takes a "bottom-up" approach that puts the burden on individual swap dealers to substantiate their position for each jurisdiction where they propose to submit information on a redacted basis.

No-Action Relief

The no-action letter offers swap dealers temporary relief from the CFTC's swap-reporting requirement. Recognizing that certain non-US privacy laws may expose swap dealers to liability for reporting information required by the CFTC's regulations, the letter stated that the CFTC would not pursue enforcement action against swap dealers as long as:

- the swap dealer has formed a "reasonable belief" based on the "written opinion" of outside legal counsel that either (i) non-US statutory or regulatory prohibitions restrict such reporting of identifying information or (ii) non-US common law could (A) expose the swap dealer to criminal or civil liability and (B) there is a "material risk" that the relevant counterparty or non-US regulator would initiate litigation for such reporting of identifying information;
- the swap dealer has not obtained consent from the counterparty or authorization from the non-US regulator, as applicable, to disclose the identifying information; and
- the swap dealer has made "reasonable and demonstrable efforts" to obtain the necessary consents and/or regulatory authorization to disclose such identifying information.

The letter did not provide further details on what constitutes "reasonable belief" or "reasonable and demonstrable efforts".

The relief expires on the earlier of any of the following: (i) the swap dealer obtains the consent of the counterparty or the authorization of the non-US regulator, as applicable, to report any identifying information; (ii) the date the swap dealer no longer holds a "reasonable belief" that non-US privacy laws prevent its reporting of identifying information; and, in any event, (iii) June 30, 2013.

Swap dealers may not, however, simply begin reporting on a redacted basis. To avail themselves of this relief, swap dealers relying on this no-action relief must first satisfy all of the following conditions:

- the swap dealer must maintain written evidence of its "reasonable and demonstrable efforts" to obtain authorization from non-US regulators and/or consent from their counterparties (as applicable);
- the swap dealer must retain a copy of the "written opinion" of outside legal counsel on which it based its reasonable belief regarding issues arising under non-US privacy laws;
- the swap dealer, when reporting information on a redacted basis, must include a general "Privacy Law Identifier" ("PLI") as a placeholder for each counterparty's identifying information; and
- the swap dealer must, upon the expiration of relief (again, no later than June 30, 2013), amend all of its reports to replace the general PLI with the counterparty's identifying information.

Implications of No-Action Relief for Swap Dealers

The relief provided was more limited in scope than the relief requested by the industry: it is both temporary and requires swap dealers to obtain "written opinions" from external legal counsel. Industry representatives, including several swap dealers, are seeking clarification from the CFTC as to whether less formal memoranda may suffice to satisfy the "written opinion" requirement.

When the G-20 met in late 2009 in the aftermath of the global financial crisis, the group enthusiastically adopted initiatives to improve clearing and transparency in the swaps market. But privacy issues remain significant hurdles in many jurisdictions where breaches of local privacy and secrecy laws can carry stiff penalties. This issue will need to be a priority for swap dealers and regulators alike to reach an effective, global resolution so that the market may function as intended.

We intend to circulate further information about the CFTC's reporting requirements, and any changes thereto, as it becomes available. Should you have any questions about the above, or any other regulatory matter, please do not hesitate to contact us.

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