

MEMO# 26291

July 12, 2012

CFTC Proposes Interpretive Guidance on the Cross-Border Application of Certain Swaps Provisions; Conference Call to Discuss Comments Scheduled for August 7

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 21-12
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 30-12
INTERNATIONAL COMMITTEE No. 22-12
SEC RULES COMMITTEE No. 43-12 RE: CFTC PROPOSES INTERPRETIVE GUIDANCE ON THE CROSS-BORDER APPLICATION OF CERTAIN SWAPS PROVISIONS; CONFERENCE CALL TO DISCUSS COMMENTS SCHEDULED FOR AUGUST 7

Recently, the Commodity Futures Trading Commission ("CFTC") issued proposed interpretive guidance regarding the cross-border application of the swaps provisions of the Commodity Exchange Act ("CEA") that were enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). [\[1\]](#) The CFTC has issued the Proposed Guidance in recognition that many swaps businesses are conducted across multiple jurisdictions and in response to numerous comments on the application of Title VII of the Dodd-Frank Act to the cross-border activities of non-U.S. and U.S. market participants. [\[2\]](#)

In the Proposed Guidance, the CFTC sets forth the manner in which it will consider: (1) whether a non-U.S. person's swap dealing activities are sufficient to require registration as an SD; (2) whether a non-U.S. person's swap positions are sufficient to require registration as a MSP; (3) the treatment of foreign branches, agencies, affiliates and subsidiaries of U.S. SDs and of U.S. branches of non-U.S. SDs; (4) the application of the requirements under Title VII of the Dodd-Frank Act to swaps and activities of non-U.S. SDs, non-U.S. MSPs, and foreign branches, agencies, affiliates, and subsidiaries of U.S. SDs, including permitting a non-U.S. SD or non-U.S. MSP to comply with comparable foreign regulatory requirements; and (5) the application of its rules on clearing, trading and certain reporting under the Dodd-Frank Act with respect to swaps between counterparties that are not SDs or MSPs. A

summary of the Proposed Guidance is provided below.

Comments on the Proposed Guidance are due by August 27, 2012. We will hold a conference call on Tuesday, August 7 at 12:00 pm ET to discuss the Proposed Guidance and possible ICI comments. The dial-in numbers are 877-891-6973 in the United States and + 1-517-319-9311 from outside the United States. The passcode is 15656. If you plan to participate, please RSVP to Jennifer Odom via email (jodom@ici.org).

U.S. Person

For purposes of the Proposed Guidance, the CFTC proposes to interpret the term “U.S. person” by reference to the extent to which swap activities or transactions involving one or more such persons have the relevant effect on U.S. commerce. The CFTC proposes to include within the term: (1) any natural person who is a resident of the United States; (2) any corporation, partnership, limited liability company, business or other trust, association, joint-stock company, fund or any form of enterprise similar to any of the foregoing, in each case, that either (i) is organized or incorporated under the laws of the United States or having its principal place of business in the United States or (ii) in which the direct or indirect owners are responsible for the liabilities of such entity and one or more of such owners is a U.S. person; (3) any individual account (discretionary or not) where the beneficial owner is a U.S. person; (4) any commodity pool, pooled account, or collective investment vehicle (regardless of where it is incorporated) of which a majority ownership is held by a U.S. person(s); (5) any commodity pool, pooled account, or collective investment vehicle the operator of which would be required to register as a commodity pool operator under the CEA; (6) a pension plan for the employees, officers, or principals of a legal entity with its principal place of business inside the United States; and (7) an estate or trust, the income of which is subject to United States income tax regardless of source.

Under the Proposed Guidance, a “U.S. person” generally would include a foreign branch or agency of a U.S. person, but a foreign affiliate or subsidiary of a U.S. person would not be considered a U.S. person. Although the CFTC does not propose to adopt the definition of “U.S. person” in the Securities and Exchange Commission’s Regulation S, the CFTC does request comment on whether it should interpret the term in a similar manner “notwithstanding that Regulation S has a different focus.”

SD and MSP Registration Thresholds

According to the CFTC, the statutory definitions of SD and MSP do not contain geographic limitations and do not distinguish between U.S. and non-U.S. SDs and U.S. and non-U.S. MSPs. Therefore, the CFTC proposes that non-U.S. persons who engage in more than a de minimis level of swap dealing with U.S. persons would be required to register as swap dealers. Under the Proposed Guidance, in the case of an affiliated group of non-U.S. persons under common control, the CFTC would require that all of the affiliated non-U.S. persons should aggregate the notional value of their swap dealing transactions with U.S. persons (and their swap dealing transactions with non-U.S. persons in which such person’s obligations are guaranteed by U.S. persons) to determine the level of swap dealing activities. In addition, a non-U.S. person without a guarantee from a U.S. person would not need to apply the de minimis test if it is not engaged in swap dealing as part of its “regular business” with respect to U.S. persons as counterparties.

With respect to MSPs, the Proposed Guidance would require a non-U.S. person who holds

swap positions where a U.S. person is a counterparty above the specified MSP threshold to register as an MSP. Unlike for SDs, the CFTC proposes to require non-U.S. persons to register as MSPs when their swaps with U.S. persons, disregarding any such positions where their obligations thereunder are guaranteed by U.S. persons, exceed a relevant MSP threshold. [\[3\]](#)

Foreign Branches, Agencies, Affiliates, and Subsidiaries of U.S. SDs and U.S. Branches, Agencies, Affiliates, and Subsidiaries of Non-U.S. SDs

The CFTC proposes to apply the Dodd-Frank Act registration requirements to a U.S. person and its foreign branches and agencies on an entity-wide basis. The CFTC also proposes to require the U.S. person who books the swaps to register as an SD, regardless of whether the swaps were directly booked by the U.S. person (by such person becoming a party to the swap) or indirectly transferred to the U.S. person (by way of a back-to-back swap or other arrangement). An affiliate would be required to register as an SD if it independently meets the definition of an SD. When a non-U.S. person is the booking entity (i.e., the legal counterparty) to swaps, even if the U.S. branch, agency, affiliate or subsidiary of a non-U.S. person engages in solicitation or negotiation in connection with the swap entered into by the non-U.S. person, the CFTC would apply the Dodd-Frank requirements to the non-U.S. person.

Application of Swap Provisions to Non-U.S. SDs and Non-U.S. MSPs

The CFTC proposes to divide the Dodd-Frank swap provisions into two categories – Entity-Level Requirements (which apply to an SD or MSP on a firm-wide basis) [\[4\]](#) and Transactional-Level Requirements (which apply to the individual swaps). [\[5\]](#)

The Entity-Level Requirements apply to registered SDs and MSPs across all their swaps without distinctions as to the counterparty or the location of the swap. The CFTC proposes to require registered non-U.S. SDs and non-U.S. MSPs to comply with the Entity-Level Requirements but would permit “substituted compliance” with foreign regulations under certain circumstances. [\[6\]](#) For SDR Reporting and the Large Trader Reporting requirements, the CFTC proposes to require non-U.S. SDs and non-U.S. MSPs to report all of their swaps to a registered SDR and to comply with the Large Trader Reporting requirements but to permit substituted compliance with respect to swaps by non-U.S. SDs and non-U.S. MSPs with non-U.S. counterparties.

For Transaction-Level Requirements, the CFTC proposes to require non-U.S. SDs and non-U.S. MSPs to comply with these requirements for all of their swaps with U.S. persons, other than foreign branches of U.S. persons, as counterparties. The CFTC does not intend to permit substituted compliance for the Transaction-Level Requirements for swaps between non-U.S. SDs or non-U.S. MSPs and U.S. persons. The CFTC proposes to require non-U.S. SDs and non-U.S. MSPs to comply with the clearing, swap processing, margin (and segregation), portfolio reconciliation and compression, trade confirmation, swap trading relationship documentation, and daily trading records requirements for swaps where the non-U.S. counterparty’s performance is guaranteed by (or otherwise supported by) a U.S. person and for swaps with non-U.S. affiliate “conduits.” [\[7\]](#) The CFTC does not propose to

require non-U.S. SDs and non-U.S. MSPs to comply with the external business conduct standards in transactions with a non-U.S. counterparty (whether or not guaranteed by a U.S. person).

With respect to clearing, the CFTC notes that it expects to find comparability with foreign regulatory regimes when the swap is subject to a mandate issued by appropriate government authorities in the home countries of the counterparties to the swap (provided that the foreign mandate is comparable to the CFTC's mandate) and the swap is cleared through a derivatives clearing organization that is exempt from registration under the CEA.

Cross-Border Application of Swap Provisions to Transactions Involving Other Market Participants

The CFTC proposes to require the Dodd-Frank Act requirements related to clearing, trade-execution, real-time reporting, Large Trader Reporting, SDR Reporting, and recordkeeping to apply to swaps where one or both of the counterparties to the swap is a U.S. person. Because the clearing, trade execution, and real-time public reporting requirements serve an important role in protecting U.S. market participants and the general market against financial losses, the CFTC proposes to apply these requirements where one of the counterparties is a U.S. person (irrespective of the location of the transaction) without permitting substituted compliance with a foreign regulatory regime. With respect to transactions that are subject to SDR Reporting and swap data recordkeeping requirements, the CFTC proposes to permit substituted compliance provided that the CFTC has direct access to the swap data for these transactions that is stored at the foreign trade repository.

Moreover, the CFTC proposes to require non-U.S. clearing members with reportable positions to comply with the Large Trader Reporting requirements and traders with reportable positions to comply with the recordkeeping requirements without permitting substituted compliance. Transactions between non-U.S. persons that are not SDs or MSPs are not subject to the Title VII requirements (except the Large Trader Reporting requirements as described).

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endnotes

[1] Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 FR 41214, available at <http://www.gpo.gov/fdsys/pkg/FR-2012-07-12/pdf/2012-16496.pdf> (July 12, 2012) (“Proposed Guidance”).

[2] In a companion release, the CFTC proposed to provide temporary exemptive relief to allow non-U.S. swap dealers (“SDs”) and non-U.S. major swap participants (“MSPs”) to delay compliance with specific entity-level requirements subject to certain conditions and to allow non-U.S. SDs and non-U.S. MSPs to comply only with transactional-level requirements as may be required in the home jurisdiction for swaps with non-U.S. counterparties (“Proposed Exemptive Order”). The Proposed Exemptive Order also would

permit U.S. SDs and U.S. MSPs to delay compliance with certain entity-level requirements until January 1, 2013. Exemptive Order Regarding Compliance with Certain Swap Regulations, 77 FR 41110, available at <http://www.gpo.gov/fdsys/pkg/FR-2012-07-12/pdf/2012-16498.pdf> (July 12, 2012). Comments on the Proposed Exemptive Order are due by August 13, 2012.

[3] A non-U.S. person also would be required to aggregate any swap between another non-U.S. person and a U.S. person if it guarantees the obligation of the non-U.S. person thereunder.

[4] The Entity-Level Requirements relate to (1) capital adequacy; (2) chief compliance officer; (3) risk management; (4) swap data recordkeeping; (5) swap data reporting (“SDR Reporting”); (6) physical commodity swaps reporting (“Large Trader Reporting”).

[5] The Transaction-Level Requirements include: (1) clearing and swap processing; (2) margining and segregation for uncleared swaps; (3) trade execution; (4) swap trading relationship documentation; (5) portfolio reconciliation and compression; (6) real-time public reporting; (7) trade confirmation; (8) daily trading records; and (9) external business conduct standards.

[6] Substituted compliance means that a non-U.S. SD or non-U.S. MSP is permitted to conduct business by complying with its home regulations without additional requirements under the CEA if the CFTC finds that such requirements are comparable to requirements under the CEA and CFTC regulations. A non-U.S. person may request the CFTC’s permission to comply with comparable requirements of its home jurisdiction or a group of non-U.S. persons from the same jurisdiction or a foreign regulator may submit an application for substitute compliance on behalf of non-U.S. persons subject to a foreign supervisory regime.

[7] The Transaction-Level Requirements would apply to swaps in which: (1) a non-U.S. counterparty is majority-owned by a U.S. person; (2) the non-U.S. counterparty regularly enters into swaps with one or more other U.S. affiliates or subsidiaries of the U.S. person; and (3) the financials of such non-U.S. counterparty are included in the consolidated financial statements of the U.S. person. The CFTC proposes to permit substituted compliance for these Transaction-Level Requirements with respect to swaps between a non-U.S. SD or non-U.S. MSP with a non-U.S. person guaranteed by a U.S. person or with non-U.S. affiliate conduits.