

Client Alert

Latham & Watkins
Corporate Department

CFTC Issues Proposals on the Extraterritorial Application of US Swaps Regulations

On June 29, 2012, the Commodity Futures Trading Commission (the CFTC) with a 5-0 vote proposed the much-anticipated interpretive guidance on how Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act)¹ will apply extraterritorially (the Cross-Border Release),² together with a companion proposal delaying compliance with its rules for non-US persons and, in some cases, for US persons (the Exemptive Release; and together with the Cross-Border Release, referred to as the Releases).³

The extraterritorial application of Title VII is a particularly important aspect of the Dodd-Frank Act because the swaps market is international in scope, and transactions between swaps market participants frequently take place across national borders. A swap entered into between two non-US counterparties outside the United States may nonetheless have a US connection through back-to-back transactions, agency relationships, affiliate relationships or guarantees; entities that are prudentially regulated outside the United States may transact with US counterparties and US swap dealers may transact with non-US parties. Essentially, the proposed interpretive guidance revolves around whether a swap transaction and the parties to that transaction fall within the scope of US regulations. The Releases are the CFTC's first attempt to address these important issues.

Overview

Section 722(d) of the Dodd-Frank Act states that the amendments to the Commodity Exchange Act (CEA) effected by the Dodd-Frank Act will not apply to activities outside of the US unless, among other things, those activities have a direct and significant connection with activities in, or effect on, commerce of the United States.⁴ In the Cross-Border Release, the CFTC has attempted to define when swaps-related activities outside the US and/or by non-US persons have such an impact on US commerce, and to establish the scope of compliance to be required in connection with those activities. The interpretative structure of the Cross-Border Release is quite complicated and many issues remain to be addressed. We suggest that market participants carefully analyze the impact of the Releases on their business and avail themselves of the comment periods.⁵ Although the Releases are complex, with exceptions even to fairly narrow interpretations and much that remains unclear, the broad parameters of the Cross-Border Release can be summarized as follows:

"The Releases set forth a complex and intertwined set of rules regarding registration requirements, designation and compliance obligations."

US persons transacting with non-US counterparties

- US persons, as defined in the Cross-Border Release,⁶ must comply with the CFTC's swaps regulations even when transacting with non-US counterparties.

Identifying non-US persons and transactions that are extraterritorial or cross-border

- Foreign branches and agencies of US persons are considered to be US persons for most purposes, but non-US persons do not need to count transactions with them for purposes of determining the availability of the *de minimis* exception from registration⁷ as a swap dealer.
- A foreign affiliate or subsidiary of a US person is not a US person, even when its obligations are guaranteed by a US person.

Non-US persons determining whether registration as a swap dealer or major swap participant (MSP) is required

- Non-US persons must calculate the availability of the *de minimis* exception to the swap dealer definition by counting:
 - their and their non-US affiliates' swaps dealing activity with US persons,
 - their swaps dealing activity with non-US persons if a US person guaranteed their obligations, and the swaps dealing activity of their non-US affiliates with non-US persons, if a US person guaranteed the obligations of the non-US affiliate,
but excluding
 - the swaps dealing activity of their US affiliates.
- For purposes of determining whether a non-US person is engaged in dealing activities as part of a "regular business," the non-US person need not consider whether it is engaged in a "regular business" of dealing with non-US persons as long as it is not so engaged with US persons.
- For organizations in which aspects of booking swaps may occur across multiple affiliated entities in multiple jurisdictions, more complicated rules apply (as discussed below).
- Non-US persons determine whether they are required to register as MSPs by counting all swap positions where the non-US person's counterparty is a US person, other than those positions where the non-US person's obligations are guaranteed by a US person.⁸

Applicability of CFTC regulations to non-US persons registered as swap dealers and MSPs

- Obligations are generally characterized as Entity-Level Requirements or Transaction-Level Requirements;
 - **Entity-Level Requirements** include those related to: (i) capital requirements, (ii) chief compliance officers, (iii) risk management, (iv) swap data recordkeeping, (v) regulatory reporting and (vi) large trader reporting.
 - **Transaction-Level Requirements** include: (i) clearing and swap processing, (ii) margining and segregation for uncleared swaps, (iii) trade execution, (iv) swap trading relationship documentation, (v) portfolio reconciliation and compression, (vi) real-time reporting, (vii) trade confirmation, (viii) daily trading records and (ix) external business conduct standards.
- The CFTC will generally permit "substituted compliance" for Entity-Level Requirements but will only permit substituted compliance for reporting obligations if it has direct access to the relevant data;
- The CFTC generally requires full compliance with Transaction-Level

Requirements where the counterparty is a US person;

- The CFTC will generally permit “substituted compliance” for Transaction-Level Requirements in connection with swaps with non-US counterparties guaranteed by US persons, but will not require any compliance with its external business conduct rules — relating to disclosures to and relationships with counterparties — for such swaps.
- The CFTC generally will not require compliance with Transaction-Level Requirements in connection with swaps with non-US counterparties where the obligations of the counterparty are not guaranteed by a US person.

Criteria for substituted compliance

- The CFTC has broad discretion to determine whether a foreign compliance regime meets the objective of the program elements of the CFTC’s regulations.
- If the foreign regulatory regime does not achieve the objectives of the Dodd-Frank Act, the CFTC will only allow substituted compliance for those aspects that are “comparable and comprehensive to” the CEA and the CFTC’s regulations.
- Applicants and foreign regulators can each request a determination of the availability of substituted compliance, but registered entities must then keep the CFTC informed of regulatory changes that are inconsistent with the initial determination.

All of these aspects of the Cross-Border Release work together in complex ways, and market participants should analyze the impact of the release on their specific circumstances.

Which persons and entities are US persons?

The Cross-Border Release provides a list of persons and entities that would qualify as a “US person.”⁹ This list includes:

- any natural person who is a resident of the United States;
- 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 is either
 - organized or incorporated under the laws of the United States or having its principal place of business in the United States or
 - an entity in which the direct or indirect owners are responsible for the liabilities of such entity and one or more of such owners is a US person;
- any individual account (discretionary or not) where the beneficial owner is a US person;
- any commodity pool,¹⁰ pooled account, or collective investment vehicle (whether or not it is organized or incorporated in the United States) of which a majority ownership is held, directly or indirectly, by a US person or US persons;
- 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;
- a pension plan for the employees, officers, or principals of a legal entity with its principal place of business inside the United States; and
- an estate or trust, the income of which is subject to United States income tax regardless of source.¹¹

Additionally, the CFTC proposed to include branches and agencies of US persons within the definition of a US person, but explicitly proposed to exclude affiliates and subsidiaries of US persons even if their obligations are guaranteed by a US person.¹² Although non-US affiliates and subsidiaries whose swap obligations are guaranteed by a US entity are not included in the definition of a US person, a US guarantee of a non-US affiliate or subsidiary has significant effects under the proposed interpretation.¹³

Swap Dealer and MSP Registration for Non-US Persons¹⁴

Before determining the specific CFTC requirements that are applicable, non-US persons involved in the swaps market should first determine whether they need to register with the CFTC as a swap dealer or MSP. Most — though not all — of the requirements under the CFTC's regulations implementing Title VII of the Dodd-Frank Act apply only to swap dealers and MSPs.

In the Entity Definitions Rule, the CFTC finalized requirements for persons to register as swap dealers if their "swap dealing activities" in any given 12-month period of time exceed a *de minimis* threshold of US\$8 billion notional value (or US\$25 million for swap dealing activity with "special entities" such as pension plans).¹⁵ The Entity Definitions Rule also requires persons to register as MSPs if their uncollateralized exposure under their swaps positions exceeds certain thresholds such that they "significantly impact the financial system of the United States."¹⁶ The Cross-Border Release proposes applying the tests for swap dealers or MSPs to non-US persons in a manner similar to their application to US persons, with the same *de minimis* exception from swap dealer registration and the same substantial position thresholds for MSP registration, but with additional limits on the activities that count toward each of these determinations.

Determining swap dealer status for non-US persons. In the Entity Definitions Rule, the CFTC and SEC established a set of quantitative and qualitative criteria, as well as various exemptions and exclusions, to be considered by parties evaluating whether they need to register as swap dealers.¹⁷ As discussed above, entities are permitted to conduct a *de minimis* amount of activity that satisfies the qualitative tests for swap dealing and that is not otherwise excluded. Affiliated entities must share the *de minimis* exception to prevent companies from avoiding registration by subdividing substantial swap dealing business among multiple entities.

The Cross-Border Release does not change the core analysis for non-US entities. Instead, it addresses which types of swap dealing activity must be considered in measuring the availability of the *de minimis* exception and which affiliates must be aggregated for the calculation. A non-US entity is permitted to calculate the availability of the CFTC's *de minimis* exception by considering only activities that constitute swap dealing and are: (i) with US persons and (ii) with non-US persons if the obligations of the non-US entity performing the calculation are guaranteed or otherwise supported by a US person,¹⁸ and then aggregating the amount so determined with the corresponding amount calculated by each of its non-US affiliates that meet the control standard.¹⁹ The swap dealing activity of US affiliates need not be counted. In addition, for purposes of this determination, the non-US person making the determination need not count the foreign branches of US entities that are registered US swap dealers as US persons.

Table 1: Swap dealing activity included in swap dealer *de minimis* calculations for non-US persons²⁰

	Party A: Non-US person Party B: US persons	Party A: Non-US person Party B: Foreign branch of a registered US swap dealer	Party A: Non-US person guaranteed or supported by a US entity Party B: Any counterparty	Party A: US affiliate of a non-US person (Entity Z) Party B: Any counterparty	Party A: Non-US affiliate of a non- US person (Entity Z) Party B: Any US person other than a foreign branch of a US swap dealer	Party A: Non-US affiliate of a non-US person (Entity Z) if Party A is guaranteed or supported by US entity Party B: Any counterparty
Swap dealer <i>de minimis</i> calculation	Included for Party A	Excluded for Party A	Included for Party A	Excluded for Entity Z	Included for Entity Z	Included for Entity Z

Determining MSP status for non-US persons. MSP status is determined under the Entity Definitions Release by making certain calculations as to the swaps exposure of the entity and determining whether it exceeds certain thresholds. The Cross-Border Release does not propose altering the means by which exposure under a particular swap would be calculated or changing the relevant thresholds. Instead, it eliminates certain swaps from the calculation entirely. A non-US person may exclude all swaps with non-US persons and may further exclude swaps with US persons if its obligations are guaranteed by a US person (in which case the U.S. person providing the guarantee must count them).²¹

Treatment of Branches, Agencies and Affiliates for Swap Dealer and MSP Determinations

Many argued that the Entity Definitions Rule created uncertainty as to (i) which entity or entities within an integrated corporate group that conducts swap activity across multiple entities in the group should register as a swap dealer or MSP and (ii) whether that registration would cover branches, agencies or affiliates. The Cross-Border Release provides some answers to these questions, but continues to leave many of them unanswered.

US Entities with Foreign Branches. The CFTC observes that a US entity and its foreign branches are a single legal entity, and is applying the swaps regulations across the entity in most instances. Accordingly, if a US entity is required to register as a swap dealer or MSP and it has branches outside the US, the swap dealer's or MSP's non-US branches need not separately register, but they must comply with all CFTC regulations to the same extent as the US registrant.²² The US registrant would be ultimately responsible for the compliance of its non-US branches.

Non-US Entities with US Branches. The treatment of US branches of non-US entities under the Cross Border Release, however, is far less clear. For example, in looking at central booking arrangements, whether accomplished through agency arrangements, principal arrangements or back-to-back transactions, the CFTC is generally taking the position that the entity that books the swap so that it ends up with the ultimate exposure, whether directly or indirectly through back-to-back arrangements, needs to count the swaps activity for purposes of its *de minimis* test. Significantly, the CFTC states that "even if the US branch, agency, affiliate, or subsidiary of a non-US person engages in solicitation or negotiation in connection

with the swap entered into by the non-US person, the Commission proposes to interpret section 2(i) of the CEA such that the Dodd-Frank Act requirements, including the registration requirement, applicable to swap dealers also apply to the non-US person."²³

The CFTC may have originally intended to address the treatment of US branches of non-US entities in greater detail but appears to have opted against it. In footnote 54, for example, the Cross-Border Release implies that a description of how US branches of non-US entities will be treated under the CFTC's guidance is included later in the release, but the section referred to is not to be found.²⁴ Based on informal conversations with the staff of the CFTC, this ambiguity was not unintentional and they welcome comments on the subject.

Foreign affiliates or subsidiaries of US entities. Unlike the treatment of foreign branches, the CFTC proposes to treat foreign affiliates and subsidiaries of US entities as non-US persons for purposes of the registration requirements. Thus, these non-US affiliates or subsidiaries would only need to register if their activities or positions, determined in accordance with the standards we discuss under "Swap Dealer and MSP Registration for Non-US Persons" above, would require such registration.

Dodd-Frank Act Requirements Applicable to Non-US Swap Dealers and MSPs

As stated above, the Cross-Border Release generally divides the Dodd-Frank Act requirements into two categories — Entity Level and Transaction-Level Requirements — and these requirements will apply in different combinations under different circumstances.

Entity-Level Requirements include those related to: (i) capital requirements, (ii) chief compliance officers, (iii) risk management, (iv) swap data recordkeeping, (v) regulatory reporting and (vi) large trader reporting.

Transaction-Level Requirements include: (i) clearing and swap processing, (ii) margining and segregation for uncleared swaps, (iii) trade execution, (iv) swap trading relationship documentation, (v) portfolio reconciliation and compression, (vi) real-time reporting, (vii) trade confirmation, (viii) daily trading records and (ix) external business conduct standards.

Non-US persons that are registered as swap dealers or MSPs must comply with all Entity-Level Requirements, but the release permits these entities to satisfy these obligations by complying with their domestic regulatory requirements instead of the CFTC's if their domestic requirements are comparable to those of the CFTC and, in the case of reporting obligations, the CFTC has direct access to the relevant data. The release refers to this as "substituted compliance."²⁵ See below for more information on substituted compliance.

Whether Transaction-Level Requirements will apply is somewhat more complex, and varies depending on the type of counterparties involved, whether the parties are guaranteed by a US entity, whether the swap is booked in a US entity, and whether one of the counterparties is a "conduit."

General rules for Transaction-Level Requirements. All Transaction-Level Requirements, other than external business conduct requirements, will apply to swaps between a non-US swap dealer or MSP and US persons, and the CFTC will not permit substituted compliance. However, Transaction-Level Requirements

will *not* apply to swaps between the same non-US swap dealer or MSP and a non-US branch of a US person.²⁶ Although this treatment is inconsistent with the general treatment of non-US branches of US persons, which are considered to be US persons under the proposed interpretation, the CFTC has indicated that it is taking this approach as an accommodation to parties outside the US who are not transacting with US persons other than the non-US branches of US registered swap dealers.. Additionally, all Transaction-Level Requirements other than external business conduct standards will apply to swaps between a non-US swap dealer or MSP and a non-US counterparty whose obligations are guaranteed by a US person. In the latter instance, the CFTC would permit substituted compliance for these Transaction-Level Requirements.

External business conduct standards will only apply to non-US swap dealers or MSPs if the counterparty is a US person. These standards will not apply to transactions with non-US counterparties even where the transaction is guaranteed by a US person. The only exception to this is that a swap between a non-US branch of a US swap dealer or MSP with a non-US counterparty would not be subject to external business conduct standards even though the branch is technically a US person.²⁷

Rules for "conduits." The Cross-Border Release, consistent with the long-standing CFTC policy on "looking through" foreign entities may be used to evade regulation, has proposed to apply the Transaction-Level Requirements (other than external business conduct standards)²⁸ to all swaps entered into by a non-US swap dealer or MSP with a non-US entity that is effectively acting as a "conduit" for the swap activities of one or more of its US affiliates. A conduit is a non-US entity that: (i) is majority-owned, directly or indirectly, by a US person; (ii) regularly enters into swaps with one or more US affiliates or subsidiaries of the US person; and (iii) is consolidated by the US person into the US person's financial statements.²⁹ This means that a transaction between a non-US swap dealer or MSP and a conduit is treated as if it were a swap with a non-US person that was guaranteed by a US person. The CFTC will permit substituted compliance for these transactions.

The CFTC has not made the conduit entity subject to special rules by virtue of its status as such, though it leaves open the possibility that it would do so.³⁰ However, to the extent that the conduit independently engages in swap dealing activity or maintains swap exposures that would cause it to have to register as a swap dealer or MSP, nothing in the proposal would exempt it from such registration.

Rules for branches and agencies of US swap dealers and MSPs. Transaction-Level Requirements are generally applicable to a non-US branch of a US swap dealer or MSP in the same way they would be applicable to the US entity.³¹ The CFTC will permit substituted compliance for swaps between non-US branches of a US person and non-US persons, however. The CFTC requested comment on whether it should permit substituted compliance for a transaction between a non-US branch of a US swap dealer or MSP and another non-US branch of a US entity.³²

The release also provides an exemption from Transaction-Level Requirements in certain circumstances without substituted compliance. Specifically, branches of US swap dealers³³ in emerging markets would be exempt from all Transaction-Level Requirements (*i.e.*, without substituted compliance) if they engage in a limited amount of swaps in such emerging markets. Specifically, if the US swap dealer limits the notional value of its swaps in emerging markets to 5 percent of the aggregate notional value of all swaps of the US swap dealer, its branches engaging in those swaps need not comply with Transaction-Level Requirements even absent any comparable regulations.³⁴

Rules for central booking arrangements involving non-US affiliates of a US swap dealer. Similar to the rules applicable to the scope of a swap dealer or MSP's designation, the Cross-Border Release bases the application of Entity-Level and Transaction-Level Requirements to non-US affiliates of a US swap dealer based on whether or not a swap is booked in the US and the nature of the activities in which the non-US affiliate engages:

If the non-US person is required to register as a swap dealer, it must comply with the Entity-Level Requirements and the Transaction-Level Requirements for any swaps booked in its US swap dealer affiliate (but substituted compliance is permitted). The US swap-dealer affiliate will also be liable for compliance with the Transaction-Level Requirements (although only one entity must fulfill the obligations).³⁵

If a non-US affiliate or subsidiary of a US person is required to register as a swap dealer and enters into a swap which is *not* booked in the US person, the release would treat the non-US entity as any other non-US swap dealer. Therefore, Transaction-Level Requirements other than external business conduct standards would apply to swaps between the non-US swap dealer and US persons or non-US persons whose obligations are guaranteed by a US person, but substituted compliance would be permitted for those guaranteed swaps.³⁶

Below is a table setting forth an entity's responsibilities to comply with Transaction-Level Requirements (other than external business conduct standards) as well as areas of remaining uncertainty.

Table 2: Transaction-Level Requirements (excluding external business conduct standards)

Counterparties	US person	Non-US branch of US person	Conduit of a US person	Non-US person <u>guaranteed</u> by a US person	Non-US person <u>not</u> guaranteed by a US person
US-based SD or MSP	Apply	Apply	Apply	Apply	Apply
Non-US branch of a US SD or MSP	Apply	<i>Apply — request for comment whether substituted compliance should be permitted³⁷</i>	<i>Apply — unclear if substituted compliance is permitted</i>	Substituted compliance	Substituted compliance
Non-US affiliate (unregistered) of US SD – swap booked in US SD affiliate	Apply to US SD	Apply to US SD	Apply to US SD	Apply to US SD	Apply to US SD
Non-US SD where swap is booked in US SD affiliate	Apply to non-US SD and US SD	<i>Unclear</i>	<i>Unclear</i>	<i>Unclear</i>	<i>Unclear</i>
Non-US SD where swap is <u>not</u> booked in a US SD affiliate	Apply	Do not apply	Substituted compliance	Substituted compliance	Do not apply
Non-US SD (without US affiliates)	Apply	Do not apply	Substituted compliance	Substituted compliance	Do not apply

Substituted Compliance and Comparability Determinations

In order to avail itself of substituted compliance, a non-US swap dealer or MSP would have to demonstrate that its domestic regulator has regulatory requirements comparable to the applicable requirements under the CEA and CFTC regulations. Comparability must be established on an individual requirement basis (*i.e.*, for each of the Entity-Level and Transaction-Level Requirements).³⁸ Therefore, the CFTC will not determine whether a regulator's regime as a whole is comparable, but only that individual requirements are comparable.

The CFTC has made determinations regarding comparability of a non-US regulator's regulations in the past — most notably under Part 30 of the CFTC's regulations. Under Part 30, the CFTC can and has exempted non-US persons from certain requirements (associated with soliciting or accepting orders from US persons for foreign futures or foreign options contracts) if the CFTC determines that the non-US person is subject to comparable regulation.³⁹ In the Cross-Border Release, the CFTC proposes to use its experience under Part 30 in order to make comparability findings, but states that prior determinations of comparability will not be determinative for purposes of substituted compliance.⁴⁰

In determining whether a non-US regulator has a comparable regulatory regime, the CFTC proposed to examine: (i) the scope and objectives of the regulatory requirement(s), (ii) the comprehensiveness of such requirements, (iii) the comprehensiveness of the foreign regulator's supervisory compliance program, and (iv) the foreign regulator's authority to support and enforce its oversight of the non-US swap dealer or non-US major swap participant.⁴¹ The CFTC envisions a process in which it would enter into a memorandum of understanding with foreign supervisors to provide for information sharing and cooperation in supervision.

Importantly, the CFTC proposed to permit non-US persons to petition the CFTC for a comparability determination in a variety of ways. Specifically, the petitions may be submitted by a person, a group of persons, or a foreign regulator (on behalf of non-US persons).⁴² The CFTC is proposing to require registered entities relying on substituted compliance to notify it of material changes in law that would affect the comparability determination. Also, the CFTC stated that it may request a legal opinion regarding comparability of regulations but that these will not be necessary unless requested.⁴³

Cross-Border Application for Non-Swap Dealer/MSPs

Certain Dodd-Frank requirements apply to swap market participants regardless of whether or not they are registered as a swap dealer or MSP — *i.e.*, to "nons." Specifically, these requirements include: (i) clearing, (ii) trade execution, (iii) real-time public reporting, (iv) large trader reporting, (v) swap data reporting and (vi) recordkeeping requirements.⁴⁴ The Cross-Border Release proposes to require non-swap dealer/MSPs located outside the US to comply with these requirements under the following circumstances:

Clearing, trade execution and real-time reporting: Any swap where at least one counterparty is a US person must satisfy the CFTC's clearing, trade execution and real-time reporting requirements. No substituted compliance would be permitted.

Large trader reporting: Non-US clearing members must report all positions that are reportable under Part 20 of the CFTC's regulations and comply with applicable recordkeeping requirements under Part 20. No substituted compliance would be permitted.

Regulatory reporting and recordkeeping. So long as the CFTC has direct access to swap data reported to a non-US trade repository, substituted compliance will be permitted for regulatory reporting and recordkeeping purposes for transactions between US and non-US persons.⁴⁵

Exemptive Release

The CFTC also proposed the Exemptive Release (styled as a proposed order), which would exempt US and non-US persons from certain Entity-Level and Transaction-Level Requirements under certain circumstances, on the same day as it issued the Cross-Border Release for comment.⁴⁶ This proposed order does not provide any relief from swap dealer or MSP registration requirements, but provides certain temporary exemptions from Entity-Level and Transaction-Level Requirements for US and non-US entities. Note that this Exemptive Release does not have any effect on regulations that are *not* included in the list of Entity-Level or Transaction-Level Requirements. Also of note, and much like the Cross-Border Release, the Exemptive Release does not specifically address how US branches, agencies, affiliates or subsidiaries of non-US entities would be treated.

Exemptions for US Persons. The Exemptive Release provides a general exemption from all Entity-Level Requirements other than swap data recordkeeping, regulatory reporting, and large trader reporting for US persons that are registered as swap dealers or MSPs, until January 1, 2013.⁴⁷ Therefore, US-registered swap dealers and MSPs need not comply with any otherwise-applicable regulations regarding: (i) capital requirements, (ii) chief compliance officers, or (iii) risk management procedures until January 1, 2013.

Additionally, regarding Transaction-Level Requirements, the Exemptive Release permits non-US branches of US swap dealers or MSPs when transacting with non-US persons to comply only with the regulations of jurisdiction of the location of the branch for 12 months following the date that the Exemptive Release is published in the Federal Register.

Exemptions for Non-US Persons. The order also provides temporary relief to non-US persons from certain Entity-Level and Transaction-Level Requirements, which will be available for 12 months after the date that the Exemptive Release is published in the Federal Register. Note that this date appears to be tied to the publication of the proposed order, not the final order.

First, during the exemption period, the Exemptive Release exempts non-US swap dealers and MSPs from all Entity-Level Requirements other than regulatory reporting and large trader reporting⁴⁸ when transacting with US counterparties. When transacting with non-US persons, the order provides that the non-US swap dealer or MSP will be exempt from all Entity-Level Requirements, including such reporting requirements, so long as it is not an affiliate or subsidiary of a US swap dealer.⁴⁹

Second, during the exemption period, the Exemptive Release provides that all Transaction-Level Requirements will apply to non-US swap dealers and MSPs when transacting with US persons. However, the order permits non-US swap dealers and MSPs to comply only with any regulations that are applicable in the non-US swap dealer's or MSP's home jurisdiction when transacting with *non-US* persons.⁵⁰ Foreign branches of US swap dealers and MSPs would only have to comply with the regulations then imposed by the regulations in the foreign location of the branch. This relief may be further extended if the CFTC determines that it is appropriate to do so. Note that the relief proposed to be granted is not "substituted compliance"

and requires no finding of comparability. Rather, it would function as a stopgap pending further development of foreign regulatory systems in this area.

Conditions of Relief. In order to rely on the relief provided in the Exemptive Release, US and non-US persons must file a compliance plan with the NFA within 60 days of filing their swap dealer or MSP applications. This compliance plan must provide certain information about the swap dealer or MSP's ability and plans to comply with Entity Level and Transaction-Level Requirements and to seek substituted compliance, if applicable.

Conclusion

The Releases set forth a complex and intertwined set of rules regarding registration requirements, designation and compliance obligations. In many areas, market participants may have difficulty determining the applicable compliance obligations due to the complexity of the interpretations or simply because they are silent on the issue. We urge market participants to submit comments to the CFTC to the extent they remain unsure of, or disagree with, the application of these seminal proposals.

Endnotes

- ¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).
- ² See Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, RIN 3038-AD57 (not yet published in the Federal Register). Although the voting record indicates that the issuance of the proposal was approved unanimously, at least one Commissioner has indicated that he would not support a final interpretation that does not significantly modify the proposal. See Scott D. O'Malia, Commissioner, CFTC, *Statement of Concurrence: (1) Proposed Interpretive Guidance and Policy Statement Regarding Section 2(i) of the CEA; and (2) Notice of Proposed Exemptive Order*, June 29, 2012.
- ³ The Cross-Border Release is designed as a proposed interpretation rather than a proposed rule, which has certain legal implications. Notably, the CFTC does not have to provide a cost-benefit analysis for an interpretation (and did not provide one in the Cross-Border Release) and can revise or amend the interpretation at any time without going through the entire process mandated by the Administrative Procedures Act, which requires notice and an opportunity to comment.
- ⁴ See 7 USC. § 2(i).
- ⁵ The Cross-Border Release will be open for comment for 45 days following its publication in the Federal Register and the Exemptive Release will be open for comment for 30 days after publication in the Federal Register.
- ⁶ The CFTC generally has not defined the term "US person" elsewhere in its rules. CFTC rule 4.7(a)(1)(iv) defines the term, "non-United States person," see 17 C.F.R. § 4.7(a)(1)(iv), but the CFTC had not defined the inverse: what a United States person is. The new US person definition and that in rule 4.7(a)(1)(iv) are similar but have important distinctions.
- ⁷ Under the *de minimis* exception from the swap dealer definition, even if an entity is engaged in swap dealing activity, such entity does not need to register as long as the entity's dealing activity remains below the applicable *de minimis* threshold. In general, this threshold will be set at a temporary level of US\$8 billion, but is significantly lower, at US\$25 million, for entities that engage in dealing activities with special entities. See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant", 77 Fed. Reg. 30596, 30744 (to be codified at 17 C.F.R. § 1.3(ggg)(4)) (May 23, 2012) (the *Entity Definitions Rule*); see also Latham & Watkins *Client Alert, Are You a Swap Dealer? The CFTC and SEC Finalize Swap Entity Definitions* (June 20, 2012).
- ⁸ In this circumstance, the guaranteed swaps are counted toward the determination of whether the guaranteeing US person is an MSP, but are not counted toward that determination for the non-US person.
- ⁹ As explained above, the CFTC previously had a definition for "non-United States person" but not "United States person." See 17 C.F.R. § 4.7(a)(1)(iv). Notably, the CFTC also requested comment on whether it should adopt the SEC's definition of a US person in Reg S (SEC Release No. 33-6863). See Cross-Border Release, p. 17.
- ¹⁰ See Latham & Watkins *Client Alert, Final CFTC Rules Maintain Limited Trading Exemptions But May Require Many More Investment Advisers to Investment Funds to Register as CPOs and CTAs* (March 2, 2012).
- ¹¹ See Cross-Border Release, p. 16.
- ¹² See *id.*
- ¹³ For example, if a non-US entity (*parent*) has a non-US subsidiary ("*subsidiary*") whose obligations are guaranteed by a US person, any swaps that the subsidiary enters into with any counterparty (*i.e.*, US person or not) that constitute swap dealing activity must be aggregated with the parent's US-facing swap dealing activity when the parent is determining whether or not it must register as a swap dealer. Also, the subsidiary must include these in making its own determination of whether it must register as a swap dealer. See Cross-Border Release, pp. 21-22. This is explained further below.
- ¹⁴ When a US person enters into swaps, *all* of those swaps count toward that person's *de minimis* threshold, including swaps with non-US persons. See *generally*, Cross-Border Release, pp. 19-20.
- ¹⁵ See Entity Definitions Rule, 77 Fed. Reg. at 30744 (to be codified at 17 C.F.R. § 1.3(ggg)(4)); see also Latham & Watkins *Client Alert, Are You a Swap Dealer? The CFTC and SEC Finalize Swap Entity Definitions* (June 20, 2012).
- ¹⁶ See *id.* at 30661.
- ¹⁷ See *id.* at 30744-46 (to be codified at 17 C.F.R. § 1.3(ggg)).

- ¹⁸ See Cross-Border Release, p. 26.
- ¹⁹ See *id.* at 21. For aggregation purposes under the Entity Definitions Rule, affiliates are entities that control, are controlled by or are under common control with each other.
- ²⁰ All swaps in Table 1 are presumed to be entered into in connection with swap dealing activity.
- ²¹ See Cross-Border Release, p. 27.
- ²² See *id.* at 28.
- ²³ *Id.* at 30.
- ²⁴ See *id.* at 30, n.54. Footnote 54 states that, “[a]s further described below (in Subsection E), a number of commenters urge the Commission to treat a branch of a non-U.S. bank as a separate legal entity.” However, there is no Subsection E in the release nor is there any section that directly addresses branches of non-US entities.
- ²⁵ See *id.* at 49-51.
- ²⁶ See *id.* at 52.
- ²⁷ See *id.* at 60-61 & n.116.
- ²⁸ See *id.* at 55.
- ²⁹ See *id.* at 55.
- ³⁰ See *id.* at 75 (“The Commission is considering whether to propose measures to address this situation. However, at this time, the Commission makes clear that such non-US affiliate or subsidiary would not be subject to the Dodd-Frank swap provisions, except pursuant to specific Dodd-Frank Act provisions (or Commission regulation adopted thereunder) or Commission orders.”)
- ³¹ Responsibility for these Transaction-Level Requirements resides with the U.S. SD or MSP and not the non-US branch, however. Nonetheless, the US entity may task the branch with fulfilling its regulatory obligations. See *id.* at 62.
- ³² See Exemptive Release, p. 8 n.19.
- ³³ The release does not mention branches of US MSPs in emerging markets, so they may not be covered by the exemption.
- ³⁴ See Cross-Border Release, pp. 61-62.
- ³⁵ See *id.* at 63-64.
- ³⁶ See *id.* at 64.
- ³⁷ See Exemptive Release, p. 8 n.19.
- ³⁸ See Cross-Border Release, p. 69.
- ³⁹ See 17 C.F.R. pt. 30 app. A.
- ⁴⁰ See Cross-Border Release, pp. 68, 72 & n.129.
- ⁴¹ See *id.* at 69-70.
- ⁴² See *id.* at 70.
- ⁴³ See *id.* at 71 n.126.
- ⁴⁴ See *id.* at 74.
- ⁴⁵ See *id.* at 76-78.
- ⁴⁶ See Exemptive Order Regarding Compliance with Certain Swap Regulations, RIN 3038-AD85 (not yet published in the Federal Register).
- ⁴⁷ See *id.* at 34. We note that such requirements may not have a compliance date earlier than January 1, 2013 even without the exemptive order, but the proposed exemption provides additional clarity with respect to timing.
- ⁴⁸ Note that the Exemptive Order does not require non-US persons to comply with recordkeeping requirements (as it does for US persons). See Exemptive Order, p. 33.
- ⁴⁹ See *id.* at 33. Note that this special rule only applies to affiliates or subsidiaries of US-based SDs, not MSPs.
- ⁵⁰ See *id.*

If you have any questions about this *Client Alert*, please contact one of the authors listed below or the Latham attorney with whom you normally consult:

Ellen L. Marks
+1.312.876.7626
ellen.marks@lw.com
Chicago

Stephen P. Wink
+1.212.906.1229
stephen.wink@lw.com
New York

Alan Avery
+1.212.906.1301
alan.avery@lw.com
New York

Courtenay Myers Lima
+1.212.906.1691
courtenay.myerslima@lw.com
New York

Peter Y. Malyshev
+1.202.637.1087
peter.malyshev@lw.com
Washington, D.C.

Jonathan T. Ammons
+1.202.637.1088
jonathan.ammons@lw.com
Washington, D.C.

Client Alert is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the attorney with whom you normally consult. A complete list of our *Client Alerts* can be found on our website at www.lw.com.

If you wish to update your contact details or customize the information you receive from Latham & Watkins, visit <http://events.lw.com/reaction/subscriptionpage.html> to subscribe to our global client mailings program.

Abu Dhabi	Houston	Paris
Barcelona	London	Riyadh*
Beijing	Los Angeles	Rome
Boston	Madrid	San Diego
Brussels	Milan	San Francisco
Chicago	Moscow	Shanghai
Doha	Munich	Silicon Valley
Dubai	New Jersey	Singapore
Frankfurt	New York	Tokyo
Hamburg	Orange County	Washington, D.C.
Hong Kong		

* In association with the Law Office of Mohammed A. Al-Sheikh