



The CFTC's Approach to Cross-Border Trading: Understanding the July 13 Exemptive Order And Its Impact on Swap Dealers

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Outline

- US Person – Expanded Definition
- Swap Dealer Registration – Counting Foreign Swaps
- Substituted Compliance:
 - Non-US Swap Dealers and Major Swap Participants
 - Branches
 - Guaranteed and Conduit Affiliates
 - Transaction-Level Requirements
 - Entity Level Requirements
- US-EU Path Forward
- Questions and Answers



How We Got Here – Timeline

- July 12, 2012: CFTC published Proposed Cross-Border – 1) Interpretive Guidance; and 2) Exemptive Order
- October 12, 2012: DSIO issued No-Action Letter No. 12-22 -- addressed swap dealer *de minimis* and MSP calculations in cross-border context
- January 7, 2013: CFTC published Final Cross-Border Exemptive Order (the “January Order”) – expired July 12, 2013
 - CFTC also published Further Proposed Interpretive Guidance
- July 11, 2013: CFTC and European Commission published “A Path Forward”

- On July 12, 2013 (expiration of the January Order), CFTC adopted by 3-1 votes:
 - 1) Final Cross-Border Interpretive Guidance (“Final Guidance”); and
 - 2) A Second Cross-Border Exemptive Order (“Final Exemptive Order”)
- Final Exemptive Order effective on July 13, 2013, but published on July 22, 2013
 - 30-day comment period (due August 21, 2013)
 - Expires December 21, 2013 (earlier, in some respects)
- Final Guidance published and effective on July 26, 2013



Issues Addressed By CFTC

Final Guidance Primarily Addresses:

- Interpretation of “US Person”
- Swap Dealer (“SD”) and Major Swap Participant (“MSP”) Registration Calculations (Including Aggregation and Attribution)
- Entity-Level and Transaction-Level Requirements
- General Framework for Substituted Compliance

“Path Forward” Addresses:

- Implementation of some agreements underway by CFTC
- Others still to come

Under Final Guidance, “US Person” includes but is not limited to:

1. Natural person who is a resident of US
2. Estate of decedent resident of US at the time of death
3. Corporation, partnership, business, etc., organized or incorporated in US or having its principal place of business in US (under January Order, principal place of business element did not apply to funds);
4. Pension plan for entity in #3 (unless primarily for foreign employees);
5. Trust governed by laws in US, if a court in US is able to exercise primary supervision over its administration; and
6. Individual or joint account (discretionary or not) where beneficial owner (or one beneficial owner if joint account) is a US Person



US Person

Three New Categories that Will Become “US Persons” on October 10, 2013:

1. Fund having its principal place of business in the US;
2. Commodity pool, pooled account, investment fund, or other collective investment vehicle that is not organized or incorporated in the US and does not have its principal place of business in US, but that is majority-owned by US Persons (exception for publicly-offered funds); and
3. Other legal entities that are directly or indirectly majority-owned by one or more US Persons and in which such US Person(s) bears unlimited responsibility for the obligations and liabilities of the entity

Final Exemptive Order provides relief from “US Person” interpretation for these new categories of “US Persons” until October 10, 2013 (75 days after publication of Final Guidance)

Impact of Being a “US Person”:

1. Subject to all Dodd-Frank requirements (e.g., mandatory clearing for certain interest rate and credit default swaps);
2. Count all swaps with US and non-US counterparties in SD and MSP registration threshold calculations; and
3. Swaps with non-US counterparties count in the registration threshold calculations of the non-US counterparty



Terminology: Branches

Foreign Branches

- A foreign branch of a US Person is itself a “US Person”
- A foreign branch of a US SD or MSP is any “foreign branch” (as defined in applicable banking regulation) of a US bank that:
 1. Is subject to Regulation K of the Federal Reserve Board or FDIC International Banking Regulation;
 2. Maintains accounts independently of the home office and of the accounts of other foreign branches, with the profit or loss accrued at each branch determined as a separate item for each foreign branch; and
 3. Is subject to substantive regulation in banking or financing in the jurisdiction where it is located

(Other relevant facts and circumstances may be considered)



Terminology: Branches

When all the following factors are present, a swap should be considered to be with a foreign branch of a US bank:

1. The non-clerical employees negotiating and agreeing to the swap (or, if swap is executed electronically, managing execution of the swap) are located in the foreign branch or another foreign branch of the US bank;
2. The foreign branch (or another foreign branch) is the office through which the US bank makes and receives payments and deliveries under the swap on behalf of the foreign branch pursuant to a master netting or similar trading agreement, and swap documentation specifies that the office for the US bank is such foreign branch;
3. The swap is entered into by the foreign branch in its normal course of business;
4. The swap is treated as a swap of the foreign branch for tax purposes; and
5. The swap is reflected in the local accounts of the foreign branch.



Terminology: Guaranteed & Conduit Affiliates

- “Guaranteed Affiliate”: Refers to a non-US person whose swap obligations are guaranteed by a US Person or a conduit affiliate
 1. For MSP purposes, swaps of guaranteed affiliates generally (but not always) are attributed to the guarantor
- “Conduit Affiliate”: Relevant factors include—
 1. A non-US Person that is a majority-owned affiliate of a US Person;
 2. The non-US Person is controlling, controlled by, or under common control with the US Person;
 3. The financial results of the non-US Person are included in the consolidated financial statements of the US Person; and
 4. The non-US Person, in regular course of business, enters into swaps with non-US third parties to hedge risks faced by (or take positions on behalf of) its US affiliate(s), and enters into arrangements with its US affiliate(s) to transfer the risks/benefits of such third-party swaps to its US affiliates



Registration Calculations

- Joint CFTC-SEC “Entity Definitions” rules established:
 1. Phase-in *de minimis* threshold for SD registration requirement of \$8 billion over a 12-month period (lower for swaps with “special entities”);
 2. Various thresholds for MSP registration requirement
- US Persons count swaps with US and non-US counterparties in SD *de minimis* and MSP threshold calculations
- Under January Order, a non-US Person (whether or not guaranteed by a US Person) did not count any swap where the counterparty is:
 1. A non-US Person; or
 2. A foreign branch of a US Person that is registered as an SD
- Under Final Exemptive Order, until October 10, 2013 (75 days after publication of Final Guidance), foregoing provisions in January Order re. SD *de minimis* and MSP threshold calculations continue to apply



Registration Calculations

For SD *de minimis* threshold calculations, under Final Guidance, beginning October 10, 2013:

- Non-US guaranteed affiliates and conduit affiliates count “dealing swaps” with US and non-US counterparties
- Non-US Person that is not a guaranteed or conduit affiliate counts “dealing swaps” with US Persons and guaranteed affiliates, but not with:
 1. A foreign branch of a US SD;
 2. A conduit affiliate; or
 3. A guaranteed affiliate that is: (i) an SD; (ii) not an SD and is below *de minimis*, but is affiliated with an SD; or (iii) guaranteed by a non-financial entity



Registration Calculations

For MSP threshold calculations, under Final Guidance, beginning October 10, 2013:

- Non-US guaranteed affiliates and conduit affiliates count:
 - (i) all swaps with US and non-US counterparties; and
 - (ii) any swaps between another person and a US Person or guaranteed affiliate if the potential non-US MSP guarantees the obligations of the other person (“guaranteed swaps”)
- Non-US Person that is not a guaranteed affiliate counts swaps with US Persons, swaps with guaranteed affiliates, and guaranteed swaps
- But: (see next slide)



Registration Calculations

For MSP threshold calculations, under Final Guidance, beginning October 10, 2013:

- Non-US Person that is not a guaranteed affiliate need not count swaps with a foreign branch of a US SD or a guaranteed affiliate that is an SD if:
 - The Non-US Person is not a financial entity; or
 - The Non-US Person is a financial entity and: (i) the swap is cleared; and (ii) the documentation of the swap requires the foreign branch or guaranteed affiliate to collect daily variation margin, with no threshold, on its swaps with the non-US Person



Registration Calculations

Under Final Guidance: Where a non-US Person that is not a guaranteed or conduit affiliate:

1. Enters into a swap anonymously on a registered designated contract market (“DCM”), swap execution facility (“SEF”), or foreign board of trade (“FBOT”), and that swap is cleared, the swap does not count in SD *de minimis* threshold calculation
2. Clears a swap through a registered derivatives clearing organization, the resulting novated swap does not count in SD *de minimis* or MSP threshold calculations



Aggregation – SD De Minimis

Under Final Exemptive Order, until October 10, 2013 (75 days after publication of Final Guidance), provisions in January Order re. aggregation among affiliates “under common control” for SD *de minimis* calculation continue to apply

Accordingly, until October 10, 2013, a non-US Person (whether or not guaranteed by a US Person) need not count:

1. Dealing swaps of: (i) US affiliates; and (ii) non-US affiliates with other non-US Persons; or
2. If it is an affiliate of a registered SD, dealing swaps of non-US affiliates that either: (i) were engaged in dealing activities with US Persons as of December 21, 2012; or (ii) were registered as an SD



Aggregation – SD De Minimis

Under Final Guidance, beginning October 10, 2013:

- All US and non-US Persons will count all dealing swaps of all US and non-US affiliates under common control -- except dealing swaps of a US or non-US affiliate that is a registered SD
- CFTC explanation:
 - Both US Persons and non-US Persons in an affiliated group may engage in swap dealing activity up to the *de minimis* threshold;
 - When the affiliated group meets the *de minimis* threshold in the aggregate, one or more affiliates(s) (inside or outside the US) would generally have to register as an SD(s) so that the relevant swap dealing activity of the unregistered affiliates remains below the *de minimis* threshold



SD Registration Timing

- A non-US Person that was exempt from SD registration under the January Order, but that must register as an SD due to the provisions of the Final Guidance re: (i) the interpretation of “US Person;” (ii) SD *de minimis* calculations; or (iii) aggregation for purposes of SD *de minimis* calculation:
 - Need not register as an SD until 2 months after the end of the month in which it exceeds the SD *de minimis* threshold
- So, if that occurs when the 75-day period of exemptive relief provided by the Final Exemptive Order expires on October 10, 2013, SD registration required by: December 31, 2013



Substituted Compliance

What is “Substituted Compliance”?

- CFTC may determine certain laws and regulations of a foreign jurisdiction are comparable to and as comprehensive as the US laws and regulations
- 14 categories for evaluation
- If comparable and comprehensive finding, rely on foreign rules
- If not comparable in one category, must comply with US rules in that category
- 6 jurisdictions have submitted applications for substituted compliance



Substituted Compliance

When Does It Apply?

- If a US SD, no substituted compliance, no relief
- If a non-US SD facing a non-US person (not a guaranteed or conduit affiliate), transaction-level rules do not apply
- If a non-US SD facing a US person (not a foreign branch), transaction-level rules apply, no relief
- If a non-US SD, substituted compliance available for **entity-level rules**
- If a non-US SD facing a guaranteed affiliate, conduit affiliate or foreign branch, substituted compliance available for **transaction-level rules**



Entity-Level Requirements

Entity-Level Requirements

- Capital adequacy (not final)
- Chief compliance officer
- Risk management
- Swap data recordkeeping
- Swap data repository reporting
- Large Trader Reporting **



Entity-Level Requirements

Entity-Level Requirements - LTR

- No substituted compliance nor relief for large trader reporting
- LTR requires reports for significant positions in swaps that are linked, directly or indirectly, to a prescribed list of US listed physical commodity futures contracts.
- Any non-US clearing member must comply, even if not registered with the CFTC and even if between two non-registrants



Substituted Compliance

Entity-Level Requirements

- Relief until December 21 or 30 days following substituted compliance determination
- Applies to Non-US SDs and Non-US MSPs located in Australia, Canada, the EU, Hong Kong, Japan and Switzerland
- Regarding SDR Reporting, substituted compliance only available where counterparty is non-US person
- Regarding swap data recordkeeping relating to complaints and marketing and sales materials substituted compliance only available where counterparty is non-US person



Substituted Compliance

Entity-Level Requirements - SDR Reporting (part 45 & 46)

Additional conditions to obtain substituted compliance:

- Non-US SDs and MSPs, not part of an affiliated group with ultimate US parent
- CFTC must have direct electronic access to relevant swap data in a foreign repository
- In order to obtain relief, such non-US SDs and non-US MSPs must be in compliance with swap data recordkeeping and reporting requirements of the home jurisdiction; OR where none exist, they must comply with CFTC's recordkeeping requirements



Transaction-Level Requirements

Category A

- Clearing and swap processing
- Margin and segregation for uncleared swaps (not final)
- Trade execution
- Swap trading relationship documentation
- Portfolio reconciliation and compression
- Real-time public reporting
- Trade confirmation
- Daily trading records



Transaction-Level Requirements

Category B

- External Business Conduct (such as: verifying eligibility to trade, providing disclosures, and daily mid-market mark for uncleared swaps)
- For non US SDs and MSPs, only applies when dealing with US persons (not including foreign branches of US SDs or MSPs)
- In the case of a foreign branch of a US bank, external business conduct only applies when the counterparty is a US person (other than another foreign branch)



Substituted Compliance

Transaction-Level Requirements - Non-US SDs and MSPs

- Relief until December 21 or 30 days following the issuance of a substituted compliance determination
- Non-US SD or MSP located in Australia, Canada, the EU, Hong Kong, Japan and Switzerland or country where CFTC expects to soon receive a request for substituted compliance.
- Counterparty is 1) a non-US person that is guaranteed by a US person, 2) an affiliate conduit of a US person, or 3) foreign branch of US SD or MSP
- Timelines are different for the clearing requirement, trade execution requirement, and real-time reporting requirement for swaps with guaranteed affiliates



Substituted Compliance

Clearing Requirement - Non-US SDs and MSPs

- Relief until October 10, 2013
- Counterparty is a foreign branch, guaranteed affiliate or conduit affiliate of a US SD or MSP
- Note: new US person definition applies on October 10 (so includes transactions with CFTC defined US fund)
- Currently the CFTC's clearing requirement applies to certain interest rate swaps and credit default index swaps



Substituted Compliance

Real-time Reporting

- Relief until September 30, 2013
- Non-US SD or MSP established in Australia, Canada, the EU, Hong Kong, Japan or Switzerland
- Counterparty is a guaranteed affiliate of a US Person



Substituted Compliance

Trade Execution

- No relief provided
- Regulations adopted for determining when a swap is “available to trade”
- To date, no swap has been determined as being made “available to trade”



Substituted Compliance

Transaction-Level Requirements - Non-US SDs and MSPs in Other Jurisdictions

- Relief until October 10, 2013
- Non-US SDs and MSPs established outside of Australia, Canada, EU, Hong Kong, Japan or Switzerland
- Counterparty is:
 - a non-US person that is guaranteed by a US person,
 - an affiliate conduit of a US person, or
 - foreign branch of US SD or MSP



Substituted Compliance

Transaction-Level Requirements - Branches

- Relief until December 21 or 30 days following substituted compliance determination
- Foreign branch of registered SD or MSP
- Located in Australia, Canada, the EU, Hong Kong, Japan and Switzerland or CFTC expects to soon receive a request for substituted compliance.
- Timelines are different for mandatory clearing, trade execution, and real time reporting for swaps with guaranteed affiliates of US persons.



Substituted Compliance

Clearing Requirement - Foreign Branches

- Relief until October 10, 2013
- Foreign branch of registered US SD or MSP
- Counterparty is another foreign branch of US SD or MSP or non-US person.



Substituted Compliance

Real-time Reporting - Foreign Branches

- Relief until September 30, 2013
- Branch established in Australia, Canada, the EU, Hong Kong, Japan or Switzerland
- Counterparty is a guaranteed affiliate of a US Person



Substituted Compliance

Transaction-Level Requirements - Foreign Branches

- Relief until October 10, 2013
- Foreign branch of registered SD or MSP
- Branch is NOT located in Australia, Canada, the EU, Hong Kong, Japan and Switzerland
- Counterparty is another foreign branch of a US SD or MSP or non-US person



Substituted Compliance

Branches of non-US SDs and MSPs (footnote 513)

- No relief
- US branches of registered non-US SDs or MSPs
- Subject to transaction-level requirements without substituted compliance available.
- Strong supervisory interest in regulating dealing activities within the US, irrespective of the counterparty



Non-Registrants

Some Transaction-Level Requirements - Guaranteed or Conduit Affiliates

- Relief until October 10, 2013
- Guaranteed or Conduit Affiliate of a US person not registered as a SD or MSP
- Counterparty is another guaranteed or conduit affiliate of a US person not registered as a SD or MSP
- Applies to swap clearing, trade execution, real-time reporting
- Does not include relief for SDR reporting and swap data recordkeeping and LTR



“Path Forward” Underway

1. Certain risk mitigation rules of CFTC and EMIR are “essentially identical”
 - CFTC staff no-action relief re. certain Transaction-Level Requirements such as confirmation and portfolio reconciliation/compression; SD/MSP compliance with EMIR also will satisfy CFTC rules
2. Where a swap is executed on an anonymous and cleared basis on a US DCM or SEF or an FBOT (equivalent to a DCM), counterparties deemed to have met Transaction-Level Requirements
 - CFTC staff no-action letter permitting all FBOTs that allow US participants to enter trades directly in FBOT’s trade matching system to list swaps for trading by direct access
3. CFTC and EC will endeavor to ensure that clearinghouses not yet recognised or registered will be permitted to continue their business operations
 - CFTC staff no-action letters to Eurex Clearing AG and LCH.Clearnet SA



“Path Forward” Still To Do

4. CFTC will extend time-limited no-action relief to certain multilateral trading facilities regulated in EU in the event that the CFTC’s trade execution requirement is triggered before March 15, 2014;
 - CFTC and EC will consult re. extending relief to trading platforms subject to regulatory requirements comparable to those for SEFs
5. Substituted compliance appropriate for margin on uncleared swaps rules
6. “Stricter rule applies” to differences in exceptions to mandatory clearing
7. CFTC and EU will work together:
 - On similar approaches to straight-through processing;
 - To reduce prudential concerns and arbitrage opportunities from different approaches to initial margin coverage relating to clearinghouses;
 - To resolve remaining issues relating to trade reporting and repositories, (consistent data fields, access to data, and privacy/blocking/secretcy laws) 42



Q&A

Please use the chat window to send in questions.

If your question is not answered in this session, please email:

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